

Behaviour of Equity Investors towards Investment in the Banking Sector in the Context of Bank Frauds in India

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ABSTRACT

Banking sector is the engine of growth of all modern economies. A sound banking sector is therefore, essential to build up of investors' confidence in the stock market. The governance of bank based on the principle of prudential norms is an indicator of sound economy. Indian banking sector has witnessed drastic changes since the inception of Liberalisation, Privatisation and Globalisation policies in the year 1991. But when viewed from the perspective of ethical practices, financial distress and corporate governance, today the banking sector suffers from its own set of challenges. Banking frauds has risen to Rs.18170 crore during the financial year 2017, which is considered to be one of the major hurdles the banking sector in India now faces. Top lenders in banking sector such as SBI, PNB and Canara Bank are already piled up with frauds. It is imperative that banks take this rising graph of bank frauds as a serious threat to this sector and ensure that steps are taken to reduce the same. As a result of this there has been constant volatility in the value of the shares of these banks. The objective of investor is to minimize the risk involved in investment and maximize the return from investment. This has been the main drive behind the volatility of share price. This paper aims to analyse the extent, pattern & reasons of stock price volatility of the selected shares of the banking industry. The paper also intends to analyse the impact of frauds on the share prices of the shares of the banking industry.

Keywords: Retail Investor, Investor Behaviour, Banking Sector, Finance, Liberalisation, Privatisation, Globalisation, corporate governance, bank frauds.

INTRODUCTION:

Banks are the engines that fuels prosperity in the financial sector, there by leading to the growth of the economy as a whole. Indian banking industry had an exponential growth in the banking sector since the last few decades. Unfortunately, there was an isolated cases of bank frauds since nationalisation but got momentum since liberalisation of Indian economy. The spread of branch network, growth and diversification in related business areas, large-scale computerization and networking and so on have collectively triggered the operational risks faced by the banks. Technology actually acts as a double edged sword; for both detecting frauds as well as for the purpose of preventing them. "The Institute of Internal Auditors International Professional Practices Framework (2009) defines fraud as, "Any illegal act characterized by deceit, concealment, or violation of trust. Frauds are perpetuated by parties to obtain money, property or services; to avoid payment, or loss of services; or to secure personal or business advantage." According to Deloitte India Banking Fraud Survey Report (Edition II, 2015), "Common causes of frauds in banking include diversion & siphoning of funds, whereas fraudulent documentation and absence, or overvaluation of collaterals were the main reasons for fraud in retail banking." And among the frauds that have occurred in India, most number of them have been reported from the public sector banks. The Financial Stability Report of RBI (June 2018) reported that the State-run lenders accounted

for a staggering 85 per cent of nearly 6,500 fraud cases, amounting to more than Rs 30,000 crore . The unhealthy development and the rise of such banking frauds will definitely create loss of credibility of the banks. This study attempts to analyse the changes in the behaviour of the customers after the occurrence of the banking frauds. To analyse whether the occurrence of frauds have made any changes in the behaviour of the investors is done using the volatility of the share prices, by comparing the adjusted daily closing price of the NSE shares of the 4 selected public sector banks (State Bank of India, Punjab National Bank, Andhra Bank and Canara Bank) banks 3 months before and after the frauds have occurred.

STATEMENT OF PROBLEM:

The Financial Stability Report of RBI for the year 2018 reported that the top 10 banking frauds in 2018 is from the Public Sector Banks and alone lead to a financial loss of Rs 10,000 crore. Banks had reported nearly 5,000 frauds amounting to Rs 20,000 crore in the fiscal year 2017. Moreover as per DNA (2012) report, “PSBs have a 75% market share, but the number of funds by private banks is 5 times of PSBs.” Thus the spread of branches, computerisation of banks, growth and diversification in business have led to these frauds. The present study therefore attempts to analyse the behaviour of the investors of the selected public sector banks before and after the occurrence of frauds.

REVIEW OF LITERATURE:

(Dr. Madan Lal , 2015) through his study reveals that there are poor employment practices and lack of effective training; over-burdened staff, weak internal control systems, and low compliance levels on the part of Bank Managers, Offices and Clerks. (Kaveri, 2014) remarked that “while the Indian banking industry has witnessed a rapid growth in their business and profits, the amount involved in bank frauds has also been on the rise. This unhealthy development causes losses to the banks and badly affects their credibility.” (Chiezey & Onu, 2013), “fraudulent activities cause losses to banks and their customers, and also reduce money available for the development of economy.” (Gates & Jacob, 2009) have pointed out that “the misuse of technology in the banking includes use of banking access for over-payments to vendors, sharing confidential information, and misuse of technology for unauthorized activities.” (Kumar & Sriganga, 2014) stated, “By leveraging power of data analysis technology, banks can detect fraud very soon and reduce the impact of losses due to frauds. Use of new technology can prove to be very helpful to control the fraud risk in banks.” (Pasricha & Mehrotra, 2014) observed that “one of the most challenging aspects in the Indian banking sector is to make banking transactions free from electronic crime.” All the major operational areas in banking offer a good opportunity for fraudsters, especially in deposit, loan and inter-branch transactions. (Bhasin M. , 2015) concluded, “Frauds generally take place in banks when safeguards and procedural controls are inadequate, or when they are not carefully followed, thus providing ample opportunities to the fraudsters. Frauds are increasing and fraudsters are becoming more sophisticated and ingenious.” (Soni & Soni, 2013) concluded that “cyber fraud in the banking industry has emerged as a big problem and a cause of worry for this sector.”

SCOPE AND SIGNIFICANCE:

As per KPMG's India Fraud Survey 2012, “Despite having a strong regulator, the financial services sector has emerged as the most susceptible sector to frauds.” The occurrence of frauds especially among the Public Sector Banks are on the rise since the beginning of the twenty first century. The spread of branches, computerisation of banks, growth and diversification in business have led to these frauds. And these frauds caused the loss of credibility and trust of customers in many of these banks. Thus it is pertinent to study the impact of these frauds on the investors. This is analysed by comparing the value of the adjusted closing price before and after the fraud. The scope of the study is limited to four Public Sector Banks where fraud have been taken place such as State Bank of India, Punjab National Bank, Andhra Bank and Canara Bank.

OBJECTIVES:

- To determine the effect of fraud on the adjusted closing price of shares
- To compare the differences in the share prices before after the occurrences of the fraud

HYPOTHESIS:

H₀: There is no significant difference between the volatility of share prices before and after the fraud has taken place in all the four banks

H₁: There is significant difference between the volatility of share prices before and after the fraud has taken place in all the four banks

METHODOLOGY:

This study is descriptive in nature. Secondary data is used for the study. Data is collected from the Official list of NSE. The study makes use of Paired Sample t test to test whether any difference has been occurred in the share prices before and after the fraud. One sample Kolmogorov Smirnov test is used to check the normality. Since the occurrence of fraud has been more from the Public Sector Banks, four banks from this sector has been taken on the basis of the volume of frauds. So Punjab National Bank, Canara Bank, State Bank of India and Andhra Bank is selected. Adjusted closing price of three months before the occurrence of frauds and three months after the occurrence of the frauds is analysed by using the t-test. Thus two variables are used; before the study and after the study.

Sample:

The sample required for the study are selected from the banks which are reported during the period of study.

Period of the Study:

The period of the study is three months before the occurrence of frauds and three months after the occurrence of the frauds are analysed by using the t-test. Thus period of the study varies from bank to banks and is as follows for each of the banks.

Table 1: Occurrence of Frauds in Banks

Bank	Date of Occurrence of Fraud	3 months after	3 months after
PNB	14/02/2018	14/11/2018-13/02/18	15/02/18-15/05/18
SBI	21/03/2018	21/12/18-20/03/18	22/03/18-21/06/18
Canara Bank	13/03/2018	13/12/18-12/03/18	14/03/18-14/06/18
Andhra Bank	13/01/2018	13/10/18-12/01/18	14/01/18-14/04/18

ANALYSIS:

Analysis is done using paired t-test with the help of SPSS software. It is done using the three months adjusted closing price of the NSE stocks of four banks before and after the occurrence of fraud. Before that a brief detail regarding the fraud is given:

(Details are from Times of India)

Recently exposed Rs 11346 crore fraud by renowned jewellers to country's second-largest public sector bank PNB has caused a stir in banking industry. It may be the biggest banking scam till date. RBI has directed PNB to pay entire Rs 11346 crore to the lenders or it may lead to turmoil in financials of the banks. Following are some other scams which hit the news earlier:

On 14th Feb 2018, PNB noticed fraudulent transactions worth Rs 11,346 crore at one of its branches in Mumbai. Apparently the branch staff issued fake LoU (Letter of understanding) for buyer's credit to companies owned by Gitanjali Group. Companies like Gitanjali Gems, Gili India, Nakshatra etc are said to be involved in this scam.

A former director of Andhra Bank and directors of Gujarat based pharma company Sterling Biotech were arrested on 14/02/2018 in Rs 5000 crore fraud case for withdrawing cash from the bank accounts of several benami companies. Company had taken loan of Rs 5000 crore from a consortium led by Andhra Bank. Later the loan turned into non-performing assets.

On 21/03/2018, the promoter of the Kolkata-based Shree Ganesh Jewellery House was arrested in connection with loss of Rs 2,223 crore to association of 25 banks led by the State Bank of India. The Accused was using the import finance from one bank and export finance from another bank so as to escape the recovery of import finance.

On 13th March, 2018, the promoters of a mining company Abhijeet Group were arrested for being defaulters in loans payment of over Rs 11,000-15,000 crore from 20 banks and financial institutions through 132 shell companies of the group. Abhijeet group created vehicle company Jas Infrastructure to provide contract for erection, procurement and construction of a power plant at Bihar to its group company Abhijeet Projects and

misusing loan amounts worth Rs 790 crore from Canara Bank.

Table 2: Result of paired sample t test of payment indicators during 3 months pre and post frauds

	Paired Differences			t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean			
PNB	-75.08250	6.68447	.86296	-87.006	60	0.001*
SBI	-31.41271	35.58699	4.63303	-6.780	60	0.001*
Canara Bank	-69.34500	39.16205	5.05580	-13.716	60	0.001
Andhra Bank	-4.61406	6.90895	.86362	-5.343	60	0.001*

Source: Computed from secondary data

*Significant at 5% level

FINDINGS:

- In the case of PNB the paired sample t test result shows the t statistic of -87.006 with 60 degrees of freedom. The two tailed p value is 0.000, which is less than 0.05. As the p value is less than 0.05, the null hypothesis is rejected at 5% level of significance.
- The paired sample t test result of SBI shares shows the t statistic of --6.780with 60 degrees of freedom. The two tailed p value is 0.000, which is less than 0.05. As the p value is less than 0.05, the null hypothesis is rejected at 5% level of significance.
- In the case of Canara bank the p value is 0.000, which is less than 0.05. As the p value is less than 0.05, the null hypothesis is rejected at 5% level of significance.
- The two tailed p value of Andhra Bank is 0.000, which is less than 0.05. As the p value is less than 0.05, the null hypothesis is rejected at 5% level of significance.
- Thus, there is a significant difference in the adjusted closing price of the shares of the Banks three months before and after the occurrence of frauds. Hence it can be ascertained that the frauds have a negative impact on the stock price.
- Among the banks where the frauds have occurred, PNB has been affected the most, followed by Canara, S.B.I and Andhra banks.
- Thus accordingly the impact is stronger according to the volume of frauds that have occurred.

CONCLUSION AND SUGGESTIONS:

KPMG-CII report (2013), "Indian banking sector has potential to become 5th largest in the world by 2020, and 3rd largest by 2025." As the investigation and prosecution of fraudsters in India is very slow, time-consuming process, the chance of fraud always exists. From the present study it is clear that the news of the occurrence of frauds had negative impact on the wealth of the shareholders. They had lost confidence in the shares of all the banks where frauds have occurred. Thus the null hypotheses are rejected and is proved that there is significant difference between the volatility of share prices before and after the fraud has taken place in all the four banks. Although banks cannot stay cautious 100% against the frauds still it can take some preventive measures against the same. Banks should ensure that internal audit professionals plays their role of auditing in a cautious manner. Banks need to educate their customers of the various frauds that are prevailing and measures to curb them. Multiple points of scrutiny could be employed. Laws should also be applied in a stricter manner so that frauds could be minimised in a better manner.

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