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Dr. Suharnomo, S.E., M.Si.

Bank Jateng

Faculty of Economics
and Business
Universitas
Diponegoro

The Vulnerability of Rural Banks to Investment Frauds: A Lesson From Victims' Stories

Anis Chariri[1], Wahyu Meiranto[2]

[1]Faculty of Economics and Business, Diponegoro University, Semarang 50275, Indonesia, email: anis_chariri@live.undip.ac.id

[2]Faculty of Economics and Business, Diponegoro University, Semarang 50275, Indonesia, email: wmeiranto76@yahoo.com

Abstract

Investment frauds have emerged in recent years and resulted in the financial and social losses. A number of investors, as victims, are suffered from the frauds and this may also be faced by rural banks. This study aims to understand investment frauds from the perspective of victims and those who are concerned with the frauds, and to identify the vulnerability of rural banks to the frauds. This study employed media-based phenomenology method. Data were collected from statements of victims released in the national medias. This study revealed that investment frauds are learned behaviors that can be imitated by the fraudsters with similar ways and have four main dimensions, namely: unrealistic investment returns, aggressive offering styles, unclear investment projects, and unusual investment management. These findings imply that rural banks should be careful in evaluating investments offered by those who promise extremely high return, offer investment by fostering and rushing styles, propose unclear form of investment and strange investment management. Finally, this study suggested that financial authorities should release more proper regulations to protect rural banks from investment frauds

Keywords: *investment frauds, rural bank, phenomenology, qualitative research*

1. INTRODUCTION

Investments play important roles in modern society because investments involves activities where the funds can be placed in hopes of generating positive income, maintain or increase its value given its risk [1]. Unfortunately, in recent years, the public have witnessed a number of individuals suffering from financial losses because of investment frauds [2]–[5]. In the context of Indonesia, the public have witnessed investment frauds committed by *KSP Pandawa Group,* PT MiOne Global Indonesia, Talk Fusion, *Mirna Cempluk*. which made victims suffer from financial losses. Rural banks are also seen as vulnerable institutions to the investment frauds because these banks are commonly characterized by lack of effective internal control and fraud risk assessment [6]. The Financial Service Authority (OJK) has stopped all business suspected to investment frauds.

The growing number of frauds have also attracted scholars to investigate them from different perspectives. Studies on investment frauds are mostly associated with characteristics of Ponzi schemes [3], [11]. However, these studies have ignored the behavioral aspect of investment frauds [2]. In other words, the previous studies were unable to deeply reveal investment frauds from the perspectives of the victims and those who are concerned with the frauds to construct the dimensions of fraudulent investments from psychological point of views. Indeed, Psychological aspects are important in understanding the investment frauds (Lewis, 2012), which may provide management of rural banks with some lessons on how to avoid such frauds. Hence, this study aims to understand investment frauds from the perspective of victims and those concerning the frauds, and identify the vulnerability of rural banks to the frauds.

2. LITERATURE REVIEW

Investment fraud can be conceptually defined as types of investment characterized by offers of low or no-risk investments, guaranteed returns, overly-consistent returns, complex strategies, or unregistered securities [12], [13]. Investment fraud vary ranging from pyramid schemes, Ponzi schemes, advance fee fraud, to market manipulation fraud.

In pyramid schemes, "fraudsters claim that they can turn a small investment into large profits within a short period of time, but in reality", members earn money solely by recruiting new members into the program [12]. Meanwhile, Ponzi schemes are frauds “in which a central fraudster collects money from new investors and uses it to pay purported returns to earlier-stage investors rather than investing or managing the money as promised”[12]. Advance fee schemes demand victims to pay upfront fees in the expectation of earning much larger gains [13]. This type of investment fraud generally "starts with an offer to pay investors an attractively high price for worthless stock in their portfolio" [12]. Finally, market manipulation fraud—also well known as a “pump and dump”—is a fraud in which “a fraudster deliberately buys shares of a very low-priced stock of a small, thinly traded company and then spreads false information to drum up interest in the stock and increase its stock price” [12].

The fraudsters of investment frauds often seek to victimize empathy groups to exploit the common interests to construct trust to effectively operate the investment fraud against them [3], [12]–[14]. The fraudster’s ability to foster trust makes these schemes so successful because investment frauds can be seen as socially constructed reality. Borrowing a crime theory, investment fraud is a learned behavior [15], which is learned by imitating the motives and methods of the fraud.

3. METHODS

This study is built on a belief that investment frauds is a socially constructed reality, which can be understood from the life experience of the victims and those who are concerned with the frauds. As it is not easy to directly interview the victims, this research employed media-based phenomenology method. In other words, this research was based on the life experiences of investment fraud victims that were told in the national medias, such as *Liputan6.com, KoranSINDO, Wartakotalive.com, detikFinance, detikNews, CNN Indonesia, Tempo.co, JPNN.com, and Merdeka.com*. Thus, all data were collected from the stories of the victims released in the medias, and then were analyzed using the following steps: data reduction, data display, data interpretation, and finally, searching for meanings to draw research conclusions.

4. DISCUSSION

A. Meanings Behind the Victim Experiences: a Learned Behavior

Investment fraud can be seen as a learned behavior by imitating the similar frauds. An example of how a fraudster learned investment frauds was the case of Mrs. Julisa Cancerita (well known as *Mirna Cempluk*), who was arrested by Police in Malang Eastern Java because of her involvement in investment frauds. Her business (selling baby clothes and equipment) actually get bankrupt on June 2016. To solve her business problems, Mirna upload her business on Facebook and offered investment with 30% return. She knew very well that most

investors demand high return and believe that such return is realistic ignoring the risks from the investment. This business then got bankrupt on January 2017. Interestingly, even though her business was bankrupt, she still received money transferred by investors. She used the money to support her life and to pay her debts. One of her victim, Mrs. Leli said

> "Yes… it is true that first deposit runs smoothly [she gained a high return], but after that I cannot contact her to ask the promised return, and finally I lose my money"

Another victim, Mrs. Nurul, told her story:

> "…the investment…actually promised interesting returns in term of direct cash return…We were promised direct cash return…I have known Mirna and her investment offers…through social media [Facebook]. I also attended three meetings…in a hotel and famous places and she paid all costs…"

Similar story can be seen from Mrs. Fitria, who began investing in Mirna's investment scheme, early 2017 by transferring money of 7 million rupiahs to Mirna's account. In the next 20 days Mrs. Fitria received a refund of 8.7 million rupiahs. She said:

> "Because of the promising profits, I increased my contribution and invested more money up to 50 million rupiahs. Unfortunately, Mirna suddenly disappeared …We usually communicate through short messages or social media".

The similar case happened to Mrs. Novi, a resident of Malang City who transfer twice to Mirna Cempluk each transfer amounting to 5 million rupiahs. Of the total 10 million rupiahs, the money is returned to 13 million rupiahs. She said:

> "Because the investment is profitable, I transferred again 10 million rupiahs, but the next return is not clear…Mirna shows herself as generous and often donate to social activities. This what makes me sure to transfer money…"

PT MiOne Global Indonesia, located in Tanjung Priok, North Jakarta, is another company committed to investment frauds by using Multi-Level Marketing (MLM) scheme. A victim of this fraud said:

> "I am Nelly, from Nunukan, North Kalimantan…I feel depressed, disappointed and hurt…being tricked directly by the fraudster. I invested in the company because the director is religious, he is a preacher…I feel ashamed to my family, friends, and relatives because I invited them to invest their money to this company…"

KSP Pandawa Group is another example of investment frauds with more than 170 victims and a total loss of approximately 20 billion Rupiahs. A victim, Mrs. Dian explained;

> "I am interested in investing my money because of following my friends. The company offers us with 10 percent profit each month…But unfortunately, there is no profit payments…hundreds of others also become victims of this MLM scams"

It can be seen from the different cases that investment frauds were run by similar schemes. This implies that investment frauds can be considered as learned behaviors, by which fraudsters can imitate the frauds by creating rationalization of their motives and learning methods used in investment frauds. What have been shown by the fraudster is that criminal behavior is a learned behavior and is maintained by its consequences both in material and social [16]. Behavior is not determined by beliefs and reinforcements, or punishments, which an individual receives. However, it is also affected by the behavior of those living around us. In fact, individuals often model or imitate the behavior of others. Thus, if individuals are seen as successful in doing investment frauds, the potential fraudster can learn from them and imitate their fraudulent behavior. The new fraudsters

learn their techniques and rationalize their motives on how to commit to investment frauds. "They are able to sustain their participation in unlawful behavior by surrounding themselves with others who share their feelings about the unlawful behavior they are engaged in" [17]

B. Investment Frauds: Learning their Dimensions

Following stories told by the victims, it is interesting to consider some stories told by police and the regulator (OJK). These stories are seen as important because such stories provide us with some lessons on the types and dimensions of investment frauds. For example, fraudulent investment usually offers extremely high returns. The Criminal Investigation Unit of Malang City, Mr. Purnomo said: "they [victims] are interested in the investment offered with high profit, which is actually investment scams". A similar story said by the Chairman of OJK Task Force for Investment Alert, Mr Tobing: "They [fraudulent investments] are unlicensed, the yields are extremely high and without any risks". Moreover, the OJK Board of Commissioner for Education and Consumer Protection, Mrs Kusumaningtuti explains:

> "many people are deceived by the investment frauds because of lucrative returns. This makes people are interested in the offer. To further convince the potential victims, they [fraudsters] often use public figures to attract buyers [new investors] …

In line with the models employed in offering investment scams, it can be seen that most investment frauds are designed so as similar to multilevel marketing or pyramid schemes. For this, the Chairman of OJK Task Force for Investment Alert, Mr Tobing explains:

> "perpetrators employed various modes of investment frauds…They promised very high yields [returns] and used of MLM system. The fraudsters usually offer large commissions in a short period of time…

The Deputy Director of OJK Investment Policy, Mr. Widyana, also said:

> "investment frauds are similar to MLM schemes using Ponzi or pyramid models in recruiting members…such investment promises unreasonable interests"

Another interesting aspect of investment frauds are the legal aspect of business. Most of investment frauds come from unlicensed business. For example, in the case of The Cooperative *(KSP) Pandawa Mandiri*, the Director of Special Crime Unit, Polda Metro Jaya, Mr. Hadiningrat explained:

> The Cooperative *(KSP) Pandawa Mandiri* actually has a business license. But the fundraising activities from the investors are illegal practice because the company does not have any license to do so…"

From the stories, it can be seen that in the Indonesia context, there are three types of investment frauds, which are consistently offered by fraudsters. The first type of investment frauds is Ponzi schemes**.** This type of investment fraud usually involves paying back returns to old investors from funds invested by new investors. This scheme is characterized by offering overly consistent returns, unregistered investments, high returns with little or no risk, or secretive or complex strategies of investment [3], [12]–[14]. The second type of investment fraud is pyramid scheme. This investment fraud is similar to Ponzi schemes, but in pyramid schemes, participants receive commissions if they are able to recruit new participants into the scheme [12]. The third type of investment fraud is advance fee fraud scheme. This scheme requires the victims to pay upfront fees in the hope of achieving much greater gains [13]. The perpetrators usually fool the victims by claiming the fact that to join a lucrative investment program, they must first send funds to cover a cost, often disguised as a tax or

participation fee [12], [13]. By learning the model and the characteristics of investment frauds, the perpetrators try to attract individuals to join their fraudulent investments. Thus, based on the stories of the victims and those concerned with investment frauds, such frauds can be categorized into four dimensions as described on Table 1.

Table 1. Dimensions of Investment Frauds

Unrealistic investment returns	**Aggressive Offering Styles**	**Unclear Investment Projects**	**Unusual Investment Management**
a. lucrative return in a short period of time b. inconsistent return (both time of payment and the paid amounts). c. no risk and tax-free returns	a. offered on a personal basis b. prioritizing recruitment of new members c. recruiting members like multi-level marketing d. involving salesperson who tend to force potential investors buy the offered product immediately	a. unclear form of business (unlicensed business) b. Investment in the form of goods, but the quality of goods is not comparable with the price c. products are not clearly listed d. unclear documentation	a. unclear fund management b. unclear management ownership and business structure, and business address c. bonuses payment based on the recruitment of a new member d. complex strategies that are difficult to understand

C. Rural Banks and the Vulnerability to Investment Frauds

Mirroring to the victim stories of investment frauds, it is believed that rural banks are potential to be a victim of investment frauds. Lack of internal control, financial competence of employees and organizational culture can be seen as main factors [6], [18], [19], which make rural banks vulnerable to investment fraud. More specifically, the Director of OJK Literacy and Financial Education, Mr. Tarihoran also insisted "SMEs [including rural banks] are the most vulnerable business to investment frauds, so we need to educate them about investment frauds…"

Based on the survey results on frauds, it is also clear that private companies (37%) including rural banks are vulnerable to frauds [20]. Furthermore, private companies with less than 100 employees (30%) are the victims of frauds [20]. Interestingly, banking/financial industries (16.8%) are the most vulnerable entities to frauds including investment frauds. These figures imply that rural banks should be careful in accepting investment offers, especially investment having the above four dimensions. Borrowing red flags of fraudulent schemes, rural banks should consider the following indicators that serve as an alert [21]:

a. Management of rural banks should be suspicious if their investments constantly outperform competitors with similar investment strategies or offering returns above the legal rate or market rate. As all investments are risky, guaranteed rates of return should be investigated.
b. Management of rural banks should be careful of secrecy. If an investment is legitimate, there should be full disclosure about it.
c. Management of rural banks should not choose investments based on the irrational excitement of others.
d. Management of rural banks should have proper internal control systems
e. Management of rural banks should conduct fraud risk assessment periodically

5. CONCLUSION

This study is intended to understand investment frauds from the perspective of victims and those who are concerned with the frauds, and to identify the vulnerability of rural banks to the frauds. Based the victims' life experiences in the investment frauds, this study revealed that investment frauds are learned behaviors that can be imitated by the fraudsters with similar ways. Moreover, investment frauds can be identified from four

main dimensions, namely: unrealistic investment returns, aggressive offering styles, unclear investment projects, and unusual investment management. These findings imply that rural banks should be careful in evaluating investments offered by those who promise extremely high return, offer investment by fostering and rushing styles, propose unclear form of investment and strange investment management. Finally, this study suggested that financial authorities should release more proper regulations to protect rural banks from investment frauds.

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