

Financial Fraud: A Comparative Study of Banks Fraud and Profitability

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Abstract- *The foundation of the Indian economy is its banking system. After banking regulations were liberalized, private companies were able to enter the banking sector thanks to these changes. Which intern fuels competition in the finance industry. As a result, banking operations become more inventive, efficient, and technologically advanced. It paved the way for the introduction of brand-new financial services and products, including electronic payment systems, mobile banking, and online banking. Which opened the door for a rise in financial fraud throughout the system. So, this essay will examine the broad subject of financial fraud in banks and how it affects revenue. And fraud in banks has climbed by 159.27% in 2019-20, with advances and off-balance-sheet variables being the most significant contributors.*

Indexed Terms- *Financial fraud, Profitability, and Bank.*

I. INTRODUCTION

Indian Economy in the post-LPG period witnessed significant changes in the banking sector, leading to a transformative impact on the financial industry as a whole. During this period, there was a notable shift from state-controlled banking systems to more liberalized and competitive environments. Governments initiated reforms to liberalize banking regulations, promote private participation, and encourage foreign investment in the financial sector. This resulted in the entry of new players, increased competition, and expanded product offerings in banking. This leads to innovation, efficiency, and technological advancements in banking operations. It led to the emergence of new financial products and services, such as online banking, mobile banking, and electronic payment systems. Financial institutions also diversified their operations into areas like investment banking, insurance, and wealth management. With

increased complexity and speed in financial transactions, new avenues for fraudulent activities emerged. The expansion of digital banking and electronic payment systems created opportunities for cybercriminals to engage in identity theft, phishing scams, and unauthorized access to financial accounts. So, in this paper, we will study the categories of fraud in the banking sector and their effect on the profitability of the banks.

II. LITERATURE REVIEW

Neha Sharma & Dhiraj Sharma (2018) This study establishes a theoretical framework for understanding banking fraud in India and internationally and highlights the need for further research. It also examines the growth and trends of fraud in the Indian banking sector, including the role of employees and customers. So there is a need to give training to employees and robust technological security is needed for the banking operations.

Dr. Madan Lal Bhasin (2015) Studied the reason for increase in the financial fraud in the Indian banking sector. A survey revealed poor practices, insufficient training, and weak controls. Technology, such as forensic data analysis, can aid in combating complex fraud.

Shewangu Dzumira (2015) focused on the conceptualization of cyber-banking fraud and proposes measures to mitigate the risk. It examines key participants, such as victims, fraudsters, and banks, as well as environmental factors and fraud types. Based on a conceptual study, the paper develops a model to assist financial institutions in managing cyber fraud risks, contributing to the existing knowledge in this area.

Shewangu Dzumira (2014) Investigated electronic fraud in the banking industry and the challenges faced

in combating this risk. Through a descriptive study using content analysis, data was collected from questionnaires and interviews with informants from 22 banks. The study identifies various types of electronic fraud and highlights challenges like resource limitations, inadequate cybercrime laws, and lack of knowledge and awareness. The paper recommends collaborative efforts among stakeholders to enhance cyber security and protect technological systems from cyber-attacks.

Need for study

The growth of the financial sector of the economy is significantly influenced by the banking industry. expansion of banking product offerings, increasing competition, and the entry of new companies. The complexity and speed of financial transactions increased, opening up new opportunities for fraud. The growth of online banking and payment methods gave fraudsters more opportunities to commit identity theft, malware attacks, and unauthorized access to financial accounts. By reviewing the prior literature, we were able to determine that the majority of the studies focused on the existence of financial fraud in banks, including advances and digital fraud. However, limited study has been done regarding the impact of banking scams on the Net profit of the banks.

Objectives

The study’s primary goals are to gain an overview of banking fraud in India and its effects on the profitability of the scheduled commercial banks.

III. METHODOLOGY

The study is based on analytical and descriptive methods related to financial fraud in the banking sector. Since the study is based on secondary data, data sources are collected from the Reserve Bank of India Report, news stories, Articles, and a few reputable periodicals.

Data Analysis

Table 01- Financial Fraud in the Banks

Area of Operation	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Development Trend
Advances	672	1,162	1,055	721	1,388	1,263	2,740	3,552	6,530	8,334	17,123	17,367	20,556	22,558	64,558	1,81,865	
Card/Internet	3	6	11	15	37	35	21	25	46	54	52	40	42	119	71	528	
Deposits	28	28	48	78	68	165	563	216	221	321	421	658	903	437	148	616	
Off-balance sheet	33	25	4	8	22	370	212	373	1,527	1,988	689	112	63	5208	5538	2445	
Foreign exchange transactions	14	30	7	30	14	28	148	130	98	144	889	51	2,201	1428	695	54	
Cash	4	16	7	5	36	14	21	28	28	24	43	22	37	48	56	63	
Cheques/demand drafts, etc.	15	9	10	17	15	17	40	22	16	29	25	40	34	34	36	38	
Inter-branch accounts	6	7	1	3	5	2	1	8	3	1	0	10	6	11	0	0	
Creating all accounts	2	4	12	8	43	7	11	39	7	24	7	87	6	8	289	7	
Non-resident accounts	2	0	1	4	2	2	2	3	3	8	8	8	3	5	0	1	
Others	18	29	51	28	39	64	59	98	112	64	162	146	77	242	244	172	
Grand Total	798	1,316	1,208	917	1,669	1,997	3,822	4,497	8,665	10,093	18,698	23,928	41,167	71,503	1,85,391		

Source: RBI Annual Report

The above table 01 includes information on bank frauds committed in India from 2004–2005 to 2019–2020, divided into several areas of business and the associated amounts in crores. The total quantity of fraud has increased over time. Advances reported the largest fraud amount, totaling 1,81,865 crores in 2019–20. Off-balance sheet fraud and card/Internet fraud were both considerable, with 2019–20 totals of 129 crores and 5,538 crores, respectively. Fraudulent operations were also observed in other operational areas, including deposits, foreign currency transactions, and cash. The startling figure of 1,85,391 crores was lost to bank scams in 2019–20.

Table 02 – Comparison of Financial Fraud and Net profit of the banks.

(Amount in Crore)

Year	Fraud	Net Profits
2004-05	795	20,958
2005-06	1,316	24,582
2006-07	1,208	31,203
2007-08	917	42,726
2008-09	1,669	52,750
2009-10	1,997	57,109
2010-11	3,822	70,331
2011-12	4,497	81,700
2012-13	8,665	91,200
2013-14	10,093	80,900
2014-15	19,456	89,070
2015-16	18,698	34,100
2016-17	23,928	43,900
2017-18	41,167	-32,438
2018-19	71,503	-23,397
2019-20	1,85,391	10,911

Source: RBI Report

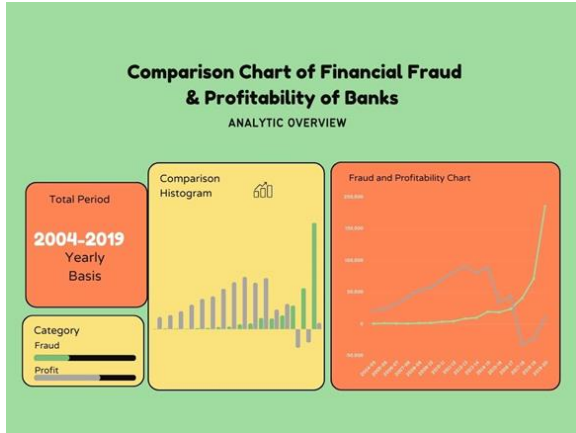


Table- 02 presents the financial fraud incidents and net profits of banks over a span of years. The number of fraud incidents varied each year, ranging from 795 in 2004-05 to a significant surge of 1,85,391 in 2019-20. Net profits also fluctuated, with the highest recorded at 91,200 crores in 2012-13. Interestingly, there appears to be an inverse relationship between financial fraud and net profits. As fraud incidents increased, net profits experienced a decline. This suggests that financial fraud can have a negative impact on the profitability of banks.

Major findings

- Study shows that financial fraud increased by 159.27% in the year 2019-20. In 2019-20 total fraud is valued at 1,85,391 crores as compared to the 2018-19 value of 71,503.
- The highest contribution factor to financial fraud is Advances by the banks and off-balance sheet factors.
- Study shows that as fraud incidents increase, net profits decline.

CONCLUSION

The liberalization of banking regulations, private participation, and foreign investment in the financial sector in India resulted in increased competition, innovation, and technological advancements. This led to the emergence of new financial products and services, such as online banking and electronic payment systems. However, this expansion also created opportunities for fraudulent activities, including identity theft and unauthorized access to financial accounts.

As a result, it was found that financial fraud increased significantly by 159.27% in 2019-20 compared to the previous year. The total value of fraud reached 1,85,391 crores in 2019-20, with advances and off-balance sheet factors being the major contributors. Hence there is a need for effective measures to mitigate fraudulent activities in the banking sector. Banks must prioritize robust security systems and risk management strategies to protect themselves and their customers from the detrimental effects of financial fraud.

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