



AN EXPLORATORY STUDY OF UNETHICAL PRACTICES IN FINANCIAL SERVICES IN INDIA

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ABSTRACT

The cases of unethical practices in different areas of business have been witnessed in Indian corporate history. The financial frauds and unethical practices have severely damaging effects on the people who are affected by such practices. Corporate leader Mr. Subrata Roy Sahara has spent years in jail under the investigation of case of financial irregularities in financial services firm of Sahara group. Several companies are under investigation by SEBI for unethical practices. Mis-selling by banks had made the regulators worried. The paper evaluates the reasons for such unethical practices. The exploratory research design is used for the study. The paper concludes with recommendations for checking cases of unethical practices in chit fund firms.

Keywords: Unethical Practices, Financial Services, Exploratory, Mis-Selling, Sahara, SEBI

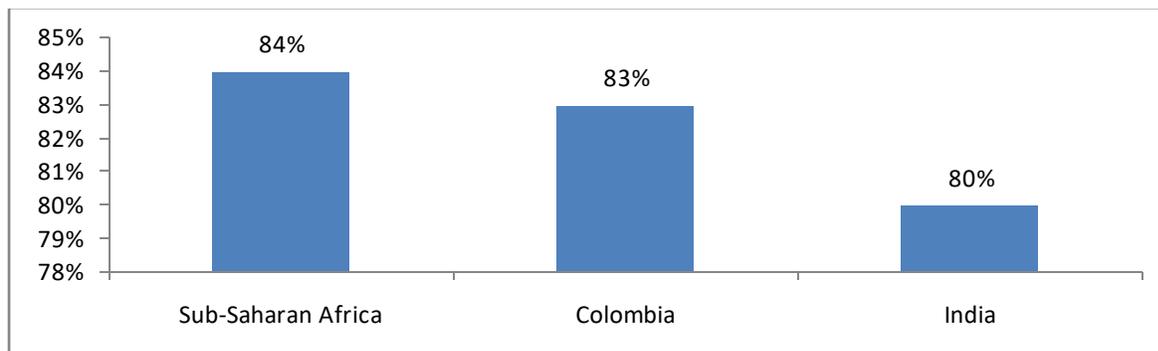
Indian Financial Services

India has a diversified financial system comprising of banks, non banking financial companies, co-operatives, insurance companies, pension funds, mutual funds, and other smaller financial entities. Commercial banks account for 64% of total assets held by the financial system (ibef, 2016). As per a report by KPMG-CII, the country is expected to become fifth largest banking sector globally by 2020 (ibef, 2016). To improve financial inclusion central government led by

Mr. Narendra Modi has launched various programmes like Prime Minister Jan Dhan Yojana among others. 217 million accounts have been opened under PMJDY and 174.6 million Rupay cards have been issued as on 30th April 2016 (ibef, 2016).

According to global fraud report 2015-16, India is the third highest ranked country/region in perceived prevalence of fraud (Vasudeva, 2016) as shown in figure 1.

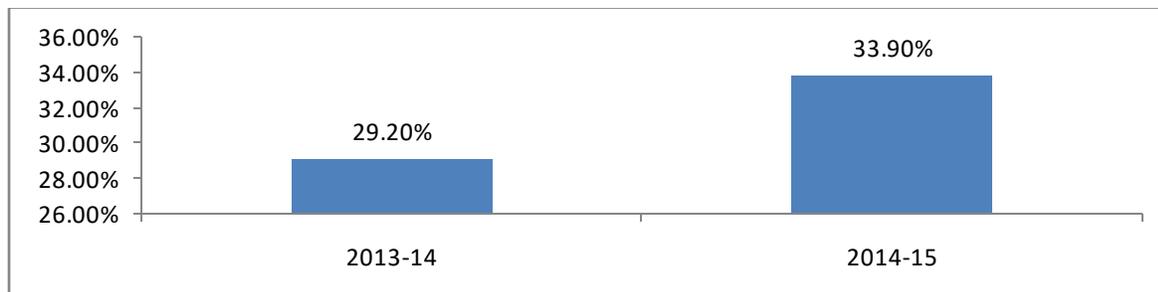
Figure 1: Perceived Prevalence of Fraud



Source: Vasudev, 2016

There has been a rise in the complaints of violation of banking codes, fair practices codes from 2013-14 (29.2%) to 2015-16 (33.9%).

Figure 2: Growth of Complaints for Violation of Banking Codes, Fair Practices Codes



Source: Lele, 2017

Objective

To evaluate unethical practices in financial services

Research Methodology

The exploratory research design is used for the study. The inputs collected from secondary sources like newspapers have been evaluated to identify the factors responsible for such scams and remedial measures have been suggested based on analysis of inputs.

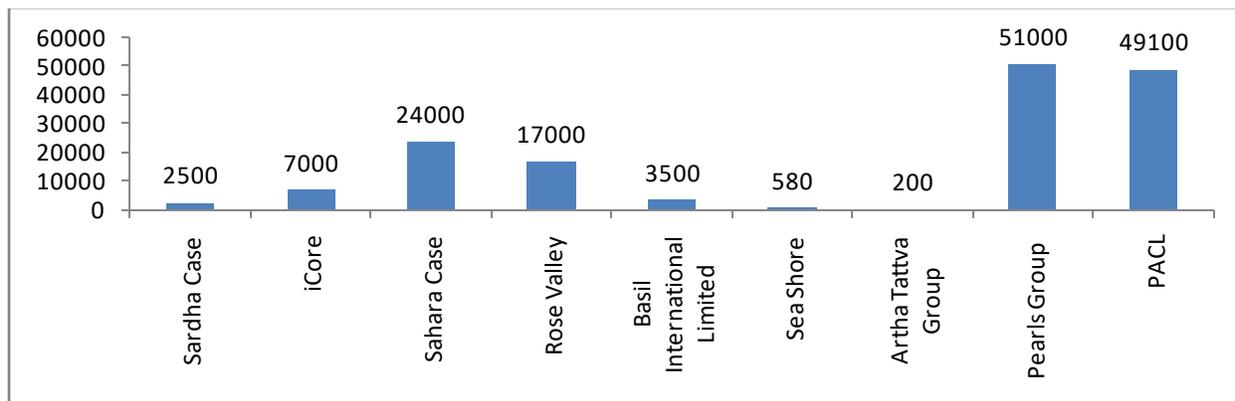
The Chit Funds Scams

The frauds committed by chit fund companies are not new in a country where 50% people are unbanked. What is new is business baron like Mr. Subrata Roy Sahara spending years in jail.

The only case of Sahara stands out as an odd one out due to judicial activism of Honorable Supreme Court to safeguard small investors. It is interesting to observe that Justice M M Das probing the chit fund scam was not able to summon 16 ponzi firms due to failure of crime branch to provide details of such firms (Times of India, 2016). If police cannot find details of fraud firms for enquiry commission than who will find it.

Due to lack of faith on formal financial system, only 3% of household saving flow into mutual funds and equity (Singh and Sharma, 2013). Only few cases like Sahara, Saradha and Pearls come to the media attention and many more such cases never come to lime light. CBI has estimated amount of chit funds scam to be about Rs 80000 crores (dnaindia, 2016). Pearls group case is estimated to be worth Rs 51000 crore. Rose Valley has been found to be involved in cheating Rs 17000 crore of innocent investors in northeast and eastern states. iCORE raised Rs 7000 crore from investors (Acharya, 2015).

Figure 3: Size of Chit Fund Scams (in Crores)



Source: Sharan, 2016, Dnaindia, 2016, Zachariah, 2015

Deducting Money without Consent

Coimbatore consumer court ordered a bank to pay compensation of Rs 14000 for deducting Rs. 12 from bank account of an individual without consent for insurance premium (Revathy, 2016). Since most of the people do not pay attention to small amounts of deductions, such unfair practices seldom come to the notice. When few consumers raise the issue the banks credit the

amount back to the account. The RBI, Central Vigilance Commission and IRDAI have already criticized banks for such practices.

Mis-Selling

Miss-selling is a becoming a preferred unfair means of banks. They have emerged as the big culprits in mis-selling (Singh, 2016). SEBI has issued show cause notice to HSBC bank in case of Suchitra Krishnamoorthi for miss-selling unsuitable mutual funds and then churning the portfolio for earning commissions. Suchitra Krishnamoorthi lost Rs 2 crores out of Rs. 4 crores wealth being managed by HSBC (Halan, 2013). The complaint was filed first to the banking ombudsman, but it was rejected. Later money life foundation emailed to all three regulators and HSBC chairperson. IRDA did nothing but passed on the statements of HSBC and Tata AIA response (Basu, 2014). SEBI also threatened the HSBC bank to stop all mutual funds from using HSBC as a distributor and ban HSBC from securities market. It was second time SEBI has ventured into the territory of RBI. If a celebrity can have such a treatment, what would be the condition of a common customer of banks? As the regulatory regime follow buyer beware concept, the buyers taken for granted, as many people have poor financial literacy.

Sumit Bose Committee recommended that for every financial product there should be a single sheet on which all important disclosures about the product are made in clear and large font size. It should also be stated why the product is suitable for the customer based on his/her age, income and risk profile. The sheet should be signed by the seller (Singh, 2016).

Factors Responsible for Unethical Practices in Financial Services

Political Colonialism

End of British Colonialism led to a vaccum in India, which has been filled up by Political Class. Political Class became the controller of resources, and in collaboration with bureaucrats, industrialist and investigating agencies has exploited the resources and looted the hard earned money of innocent people by way of financial and other frauds. The perpetrators of crime and fraud are given the responsibility to investigate their own crime. The investigation is a cover up to show to innocent voters and citizens that a law & order and investigation machinery exists in the country. All the files get closed after some time and no conclusive results ever achieved in any major investigation. The innocent voters forget the scams after some time and the business of political colonialism (in collaboration with bureaucrats and industrialist) continues as usual.

Swarup Mitra was found to be on board of one of the group company of iCore. Mr. Swarup Mitra is the son of West Bengal transport minister Mr. Madan Mitra (Acharya, 2015). In pearls group case former union minister, MP, state minister, formal journalist and other politicians are being investigated by CBI (dnaindia, 2016)

Judicial Constraints

In India there are more than three crore pending cases in Indian judicial system (Zee News, 2016). Even if a brave innocent investors duped by fraud chit funds companies, files a complaint in a court, there is little chance that the case will come for hearing in the lifetime of the complainant. Similarly fraud chit fund operators are aware of the possibility of their case not coming up for hearing in their lifetime this motivates them to continue to indulge in such activities because of little possibility of getting punishment while alive. Judicial constraints act as an advantage for fraudulent chit fund companies and disadvantage for innocent small investors. In a country with surplus talented manpower, it is ironical that there is acute shortage of judges. The shortage is planned policy of politicians to keep the judicial system in resource constraints so that the backlog of cases can never be cleared and the politicians can rule the country in nexus with corrupt bureaucrats and unethical businessmen without any fear of being ever summoned by any court of law as their case will never come up for hearing in their lifetime due to backlog of cases, and if it appears in any court of law, the hearing will most likely never reach any conclusion. Judicial constraint is artificially created by politicians to protect their own corrupt rule from fair judicial system of country.

Cultural Barriers

The Indian culture is dominated by preference to caste, ethnic and religious sentiments over integrity and honesty of political candidates in election market. Indian voters have only one criteria to decide whom to vote and that is caste (in a broader sense including ethnic, religious belonging), even if the candidate is involved in corruption and many other anti social activities, the voters merrily votes for candidates belonging to their caste. The society accepts corruption as a legitimate way of life to satisfy greed for lavish life style and to ensure better financial future for family. The politicians are well aware of the acceptance of corrupt candidates of same caste by voters so they have no hesitation to indulge in unethical, immoral and corrupt practices to live a lavish life style and loot innocent people and national resources for personal gratification. In a country where doctors steal and sell kidney and other body parts, politicians steal files from home ministry of people suspected to be terrorist, people with fake degree become law minister

in state cabinet like Delhi, size of black money is worth Rs 30,000 crore or 20% of GDP of the country (Indiatimes, 2016), a baby dies because family could not pay Rs 20 as bribe to government hospital staff for injection (Agnihotri, 2016) the corruption and unethical practices are considered as a necessary evil to survive in an all corrupt system.

Opaque Selection Process for Top Executives of Banks

The top bosses in public sector banks are appointed on the discretion of bureaucrats and politicians. There is hardly any norm (Bandopadhyay, 2014). Public sector banks form 70% of the industry. The industrialist lobby for their preferred candidates and the selection is done. The selected top executive then starts obliging the people who were influential in the selection process and had lobbied for the candidate. The lack of transparency leads to fixing of the candidates so manipulate the appraisal process of providing loans. CMD of Syndicate Bank was caught taking bribe for extending fresh loans to Bhushan Steels, though Bhushan steel already had exposure of Rs 40,000 crore to different banks. Brokers arrange loans after charging 2% of the loan amount. One such broker who arranged loans worth Rs 50,000 crore between 2008 and 2011 was caught while bribing banker (Bandyopadhyay, 2014).

The sanction of Rs. 900 crore loan to Kingfisher by IDBI Bank at a time when the firm suffered from acute eligibility related inefficiencies is under investigation. Rs. 9200 crore default case of Mr. Vijay Mallya is just the tip of the iceberg. According to credit information bureau (India) Ltd, there are 5275 other willful defaulters who owe Rs. 56,521 crore to Indian banks. The amount involved in willful default is 1.5 times the budgetary allocation for agriculture and farmer welfare (Ghosh, 2016).

Multiple Regulators

Multiple regulators lead to confusion and organizations take benefit of such regulatory lacunas. Unfair practices of banks by miss-selling financial products manufactured by entities that are regulated by non banking regulators like SEBI and Insurance Regulatory and Development Authority (IRDA). Banks try to transfer the responsibility in case of any consumer complaint. The presence of multiple regulators works as an incentive for banks as they treat it as regulatory no man's land. Though there are three regulator for banks, but none seem to be effective to deal with the issue of mis-selling, as is evident in the case of Suchitra Krishnamoorthi. Since RBI is the has more influence over banks as compared to SEBI or IRDA, RBI should take the responsibility to punish top executives of banks found in mis-selling.

The Vicious Cycle

Chit Fund firms target section of people from low income to lower middle income families from tier 2, 3 towns. Such people are targeted who are outside the formal banking system and do not have access to banking and social welfare schemes.

Establishing local offices and hiring local staff is targeted to gain the confidence of investors. The lure of high returns is able to attract the investors to invest money in these schemes. False claims about group companies of chit fund companies help to put a stamp of credibility on the chit fund company. This credibility helps chit fund companies to scale up their operations.

After collecting sizable amount of funds, the chit fund company suddenly disappears. Investors raise hue and cry. Some media channels report the case. The administration gives message of setting up enquiry commission. The chit fund company tries to manage the administration by sharing a portion of the collections with the concerned people and the case goes out of memory of people.

Powerful and corrupt people involved in unethical practices flourish, but innocent people who are not vote banks for any political party, are left to fend for themselves.

The regulatory agencies are not able to come to know about such case in absence of any complaint or even if they get the complaint the investigation takes lot of time, due to shortage of manpower and resources.

Recommendations

The unbanked people are soft targets for chit fund companies. The unbanked people should be provided access to formal banking system. The regulatory framework for chit funds should be made stringent and security walls made robust enough so that it is difficult to lure innocent investors and run away with their money. The investigations should be fast forward and punishment made enough to act as a deterrent. The regulatory framework should be proactive rather than reactive.

The financial inclusion schemes should be implemented on a war footing to ensure every citizen of the country gets access to formal banking and safe investment options.

Awareness about fraudulent practices of chit fund companies and safe investment options through financial literacy can be a potent tool to empower innocent investors to safeguard themselves and do not fall prey to chit fund companies.

Simplifying procedures and easy access for investment in mutual funds and other saving schemes will attract people towards formal system of financial investments.

Judicial system should be strengthened by appointment of required number of additional judges and setting up fast track courts for economic offenses involving small investors.

The honest and dedicated youth should be motivated to enter politics so that the political colonialism can be demolished and real democracy will prevail, where honesty integrity and nationalism will be criteria for voters to elect the state and central governments. Police reforms are the need of the hour. Police should be freed from political influence and selection of police should be on professional basis as it is done for army, using services selection boards. Unless it happens the scams will continue, only the name of firm and amount involved in the scam will change. Regulatory regime should shift from buyer beware to seller beware. The onus to prove innocence should be on seller.

The honest and ethical firms and entrepreneurs should be appreciated and whistle blowers protected so that people will come forward to raise such cases before corrupt firms loot hard earned money of billions and make their life miserable.

Conclusion

Awareness, Access to banking, Alertness of investors and promptness of investigating agencies can save investors from unethical practices of financial services. Expanding the mutual funds to middle class households and financial inclusion will provide better and well regulated option to investors and strict enforcement of regulatory provisions will reduce the incidences of unfair practices in financial services.

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