Chapter 4
The Threat of Ponzi Schemes:
An Asian Perspective

Sourya Mookerjee
Trinity College Dublin, Ireland

Varun Sardesai
Symbiosis International University (Deemed), India

ABSTRACT

A flood of corporate fraud has hit the market in the most recent decade, resuscitating attention to the impact of these incidences on corporate administration and stock market responses. Of particular relevance are Ponzi schemes that are considered practically the same as frauds. As more and more investors fall into the deep trap of Ponzi schemes, the situation is getting even more irrepressible. The reasons for a rise in the number of such swindles are mainly attributed to the breakdown in governance in different countries across the globe. This chapter dwells over the root causes of Ponzi schemes with specific focus on Asia and its developing regions. Through an in-depth study of the causes, the chapter looks to recommend possible solutions in mitigating the crisis, steps to ensure financial stability, and prevention of fraud risks.

INTRODUCTION

Ever since the 2008 global meltdown, there has been an inevitable focus on curbing financial misuse. Maintaining financial stability becomes an arduous task during times of uncertainty. Following the major events in 2016, including the Brexit vote in the United Kingdom and the Presidential Elections in the United States, the much-feared uncertainty for investors and financial authorities is back again. Such outcomes were earlier perceived to be a consequence of globalization, involving issues like immigration and trade, both of which play a pivotal role in determining the financial flows around the global economy. Thus, this makes the issue of maintaining financial stability in today's uncertain world even more pertinent. Studies conducted in recent years amplify how self-seeking aspirations and cupidity can make pioneers lose sight and validate unethical and deceitful practices (Bishop, 2013). A flood of

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corporate frauds has hit the market in the most recent decade, resuscitating attention to the impact of these incidences on stockowner value, corporate administration and stock market responses (Bonini & Boraschi-Diaz, 2013). The reasons for a rise in the number of such swindles are mainly attributed to the breakdown in governance in different countries across the globe (Rajagopalan & Zhang, 2009).

Of particular relevance are Ponzi schemes that are considered practically the same as frauds (Gabel, 2011). It is named after Charles Ponzi, the con man who masterminded it for the first time (Zuckoff, 2006; Frankel, 2012; Lewis, 2015). Lewis (2015) explains that in a Ponzi scheme, the promoter of the plan guarantees financiers/investors an appealing quantifiable yield and announces it to be safe, yet in all actuality, no genuine venture happens. Individuals are urged to place resources into the plan, and the capital accumulated by the initial patrons is utilized for disbursing preliminary returns until investors feel confident and choose to contribute more. Numerous investors then persuade their kith and kin to join, boosting the inflow of assets. In the long run, in any case, the plan goes bust in light of the fact that the promoter begins to spend the cash too rapidly; old investors pull back their funds, and the consortium of new investors flees. If the plan lives longer, more investors reinvest their proceeds and it is less likely that anybody explores its niceties, thus permitting the felon to wheedle out and squander more funds (Levmore, 2012). Nonetheless, sooner or later, when such "pyramid" schemes get too huge, the promoter can't jack up enough capital from new investors to reimburse former investors, and many individuals lose their wealth (Sec.gov, 2013). Thus, a Ponzi plan can't work for eternity as the fund is a restricted asset and will dry in the long run; the malefactor must realize that the plan will in the end crumple due to failure to pull in new investors (Tanner, 2011).

"A Ponzi scheme is an investment fraud that pays existing investors with funds collected from new investors. Ponzi scheme organizers often promise to invest their money and generate high returns with little or no risk. But, the money is not invested at all. Instead, it is used to pay those who invested earlier and keeping the rest for themselves" (U.S. Securities and Exchange Commission, 2018). Ponzi plan is oft known as "pyramid scheme" because it is made viable by a pyramidal configuration in which funds from numerous investors at the base are utilized to pay exceptional yields to few investors at the pinnacle (Cortés, Santamaría & Vargas, 2016).

A growing phenomenon that was a corollary of the 2008 recession was fraud risk arising from Ponzi schemes. These schemes, by nature, are unrealistic entities for which investors devote their money in expectation of nearly doubling their initial investments within very short periods of time and with lowest possible risks associated (Investopedia, 2017). There is a correlation between the level of Ponzi schemes unraveled and the performance of our economy. When there is an economic slowdown, there are less people likely to invest and more people wanting to withdraw their invested capital, thereby leading to a collapse of such deceptive investments (Wilber, 2009). Although these schemes first came to be known by the notorious actions of Charles Ponzi, the Bernie Madoff Investment Scandal post the 2008 crisis, could not have made it anymore infamous. The $18 billion fraud by Madoff shook the world and proved to be an inflection point. It was after this event that the issue of Ponzi schemes became one of the prime focus for financial regulators, just as terror had become one of the main challenges for all governments post 9/11 (Rhee, 2009).

Ponzi schemes are among the most notorious investments prevailing in today's times. These schemes lure investors by offering attractive returns with little or no risk. Essentially, the success of a Ponzi scheme, such as the Bernie Madoff Scandal, majorly lies on the principal of 'more money coming in than going out'.

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