Chapter 5
Factors Affecting Detection and Prevention of Financial Fraud in Banks:
Evidence From an Emerging Economy

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ABSTRACT

Banks globally have a dire need for a more systematic and structured fraud risk management framework. In an emerging economy like India, the number of frauds discovered over the years continues to pose challenges towards creating effective fraud mitigating strategies. The study examines factors affecting fraud detection, prevention, and response to various types of financial frauds in Indian banks. A total of seven factors were extracted out of 34 items, with respect to the bank employees' perception on fraud detection, prevention, and response. After further examination of the factors, significant difference was found in the perception of challenges faced in fraud detection, prevention, and response within varied categories. The study can prove to be a foundation for gaining insights from banking stakeholders who encounter fraudulent incidents.

INTRODUCTION

During the last decade, global media significantly covered a lot of banking frauds. Though several laws aimed at restraining fraud were enacted, the challenges pertaining to their enforcement has delayed the intended impact. Financial frauds have emerged in various forms throughout the global financial history. One example can be the deficient knowledge about a complex financial product which triggered the

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collapse of US financial markets and ultimately the domino effect overtook the global financial crisis in 2008 (Gee & Button, 2016).

A holistic global frauds report of 125 countries was published by Association of Certified Fraud Examiners, which stated that the overall losses caused by financial frauds throughout the world are more than USD7.1 billion (Ogola, K'Aol, &Linge, 2016). Also, the South Asian region including India, suffered an average loss of USD 100,000 per year. The most critical challenge for banks remains in developing exhaustive fraud risk management controls to prevent and detect frauds (Boateng, Longe & Mbarika, Avevor & Isabalija, 2010) and hence determining factors affecting prevention, detection and response to bank frauds has become vital.

Consequently, the aim of this study is to shed light on important policy questions such as the extent of actions taken to curb frauds, identification of core issues and providing new insights that might encourage regulators and stakeholders to proactively prevent and detect financial frauds. Using a sample of Indian Banks, evidence was found that the approach of bank management towards fraud detection and identification of potential red flags across, factors and different processes may be specifically helpful in case of bank frauds. Further, the analysis suggested the presence of various challenges as perceived by banking stakeholders for fraud detection as discussed in the upcoming sections.

LITERATURE REVIEW

Reurink (2018) studied the effect of misrepresentation on the exhibition of books of accounts in Nigerian banks. The authors suggested that banks in Nigeria needed to fortify their inner control frameworks to improve their operations. Zhou & Kapoor (2011); Costa & Wood (2016); Gee, J., & Button (2019); examined the financial cost of frauds, and the role of auditors and management to prevent and detect them. Bhasin (2016) studied utilization of the expertise of internal auditors to detect and prevent frauds. It was found that poor job practices, ineffective employee training and weak internal control systems were enhancing the chances of occurrence of frauds. A similar study by Enfoe, et.al. (2016) stated that administering the audit practices periodically led to revelation, deterrence, and depletion of frauds.

Swain & Pani (2016) said that frauds occurred due to inadequate supervision of senior management along with the major technological loopholes in online banking. Costa & Wood (2016) highlighted significant factors describing characteristics of the fraudsters alarming the fraudulent acts of individuals. Dantas, Costa, Niyama & Medeiros, (2014) stated that compliance of regulations was highest in developed nations. Brazil had the highest level of regulatory confirmation than the international average. Subbarao, (2009) studied the factors associating with banking frauds. Cybercrimes were found to be the most prevalent.

Khanna & Arora, (2009) concluded that lack of training, overburdened staff, aggressive competition, and poor compliance level affected bank frauds in India. Sood & Bhushan, (2020) found that unnecessary and unhealthy competition led to malicious practices in banks. Research by Kundu and Rao, (2014) highlighted that ignorance, situational pressures, and permissive attitudes caused most banking frauds. A report on bank frauds by Deloitte (Milan, 2018) identified similar factors affecting like lack of oversight by the manager on deviations from existing processes, business pressure of targets, and untrained staff as causes of bank frauds.

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