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BEHIND THE VEIL: PSYCHOLOGICAL AND SOCIO-ECONOMIC DRIVERS OF CORPORATE FRAUD

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Abstract

The increasing frequency of corporate fraud, evidenced by cases like Jet Airways, Fortis-Religare, and Infosys, raises concerns about the ethical integrity of accounting managers and auditors. Unscrupulous management often manipulates these professionals to falsify financial records, deceiving investors and the public. Fraud, a complex and multifaceted problem, is influenced by psychological factors such as greed, ego, rationalisation and socioeconomic factors like financial stress and opportunity. Corporate frauds in India, including financial misstatements, asset misappropriation, and corruption, are driven by pressures and opportunities that facilitate unethical behaviour. Organisations should implement targeted fraud awareness training to mitigate these issues, and individuals must commit to ethical decision-making, as we all share a responsibility to prevent corporate fraud.

Keywords- Corporate fraud, awareness, ethical decision-making, vigilance, prevention.

Introduction

The increasing number of financial scams in the business world has prompted concerns about accounting managers' professional and personal honesty. Accounting managers and auditors have been reported as working as puppets for unscrupulous management rather than acting as watchdogs for transparent and honest financial reporting. Such deceptive techniques draw attention to the unethical behaviour of those responsible for exposing businesses to fraud. From the Jet Airways disaster, the Fortis–Religare fraud, the suicide of Café Coffee Day's founder, the Punjab and Maharashtra Cooperative (PMC) Bank fraud, to the most recent ones in the shape of Crompton Greaves power and Infosys fraud, India has been gripped by corporate downfalls in 2019.¹ All of these incidents highlight the unethical tactics used by senior management, particularly chief financial officers (CFOs), directors, and other company executives, to falsify the firm's book of accounts to deceive investors, shareholders, and the general public. Another

¹ K.Sayal, *What Role Does Human Behaviour Play in Corporate Frauds?*, Economic and Political Weekly (2021),

example of unethical practices by senior management is the Infosys fraud case. It has been accused of telling its employees that visa expenses should not be recorded in the books. It has also been claimed that management put pressure on staff to keep critical information about significant acquisitions from the board of directors and auditors and that they were asked to change the investment philosophy and create incorrect assumptions to demonstrate accounting margins.² However, with vigilance and a strong ethical compass, we can empower ourselves to prevent such corporate frauds.

What is Fraud?

Fraud is an intentional act of crime, legal or illegal, done during employment. It is a general conception that when a person engages in fraudulent activity, he will try to process it as an ethical act. Fraud is a multidimensional problem that necessitates refocusing our efforts to include human behaviour as a significant fraud risk factor. This is because human behaviour is flexible and dynamic rather than a fixed quality that distinguishes individuals. We believe that a better understanding of the underlying behavioural dynamics of fraud perpetrators in terms of psychological and socio-economic factors, as well as the forces that lead individuals to cross ethical boundaries, consciously or unconsciously, can provide a new perspective on fraud detection and help us figure out why people try to rationalise fraudulent behaviour.

Psychological Factors Behind Corporate Fraud

A psychological basis for fraud appears easy at first glance—greed and dishonesty. However, such an explanation is extremely simplistic. Many people in society are aggressively acquisitive, yet they normally follow the law. Furthermore, not all dishonest people defraud others. Behavioural scientists have yet to discover a psychological feature that can be used as a legitimate and accurate predictor of a person's likelihood to commit fraud. Nonetheless, there are several examples of attempts to distinguish between those who would commit fraud (or who are likely to commit fraud given the correct circumstances) and those who would not. These efforts include "honesty" or "integrity" testing to assess potential employees' trustworthiness.³ When considering the variables that contribute to fraud in general and specific types of fraud, remember that psychological factors might serve as a marker for fraud but not as a complete explanation.

² Ramamoorti, *The Psychology and Sociology of Fraud: Integrating the Behavioral Sciences Component into Fraud and Forensic Accounting Curricula*, 23 *Issues in Accounting Education* p 521–33 (2008).

³ Sackett, *Honesty testing for personnel selection: A review and critique*, 37 *Personnel Psychology* p. 221–245 (1984).

Almost every sort of fraudulent action includes explanations based on financial hardship. This could be due to imprudence, bad luck, or a mix of the two. Of course, financial stress is a highly personal experience. Even persons with above-average wealth may feel financially deprived compared to what they consider the relevant standard. This is due to a desire to own things one cannot afford, even if genuine financial hardship does not exist. There is an element of ego at work here since there is a tendency to compare oneself to others better situated in terms of lifestyle, comfort, and financial things. Financial hardship can also be caused by the possibility of losing what you already own. High-flying entrepreneurs, for example, may face adverse business conditions that put them in *a position* of severe financial vulnerability and jeopardise their empires. The prospect of losing monetary money, power, position, and pride is present. To others, fraud may appear to be a quick fix. Lifestyle choices, the most notable of which is compulsive gambling, can also cause financial stress. In today's society, the high cost and addictive nature of illicit drugs may cause financial strain for those who use them. Relationship breakdowns can lead to a lot of financial and emotional hardship, especially when it comes to pricey divorce settlements and custody or maintenance battles. A quick and drastic drop in an individual's living level and a sense of impotence and bitterness can occur when a marriage breaks down. This set of circumstances reflects the traditional detectives' explanation of what drives a person to commit fraud: sexual relationships, substance misuse, and risk-taking or gambling.⁴ Ego/power is another facet of motivation that might apply to any or all types of deception. This can refer to having power over individuals as well as situations. Regarding the former, the feeling of having power over another person or people appears to be a powerful motivator for some fraudsters, to the point where it becomes an objective. Some fraudsters appear to take a disdainful delight in manipulating their victims instead of simply the outcome. The satisfaction gained from mastery of a situation is similar to the feeling of dominance over others. This is especially true in more intricate, long-term and computer fraud, requiring specialised expertise. It also represents the confident artist's professional pride.

Stotland refers to this drive as an "ego challenge" and refers to a sense of mastery and thrill in encountering and overcoming problems. ⁵ As he points out, some fraudsters put much effort into their work and aren't looking for an "easy buck." While this is typically a beneficial trait when used in respectable endeavours, it has been tainted by fraudsters.

⁴ G. Nettler, *Lying, Cheating, Stealing*, Anderson Publishing, Cincinnati, Ohio (1982).

The process of rationalisation, which lessens the offender's inhibition, is another psychological facet of deception. "Techniques of neutralisation" have been coined to describe such potential excuses.⁵

The literature tends to conflate motive and neutralisation, but the two are distinct in significant ways. Fraud is driven by motivation, but neutralisation clears the path by removing internal moral arguments. Regardless of the sort of fraud, most perpetrators appear to be attempting to justify or rationalise their actions. They will employ "adjustment vocabulary," which will fabricate justifications and extenuating circumstances while removing the act's sense of crime.⁶ Examples of neutralisations include Viewing the victim as guilty in some way or trivialising the offence such that it becomes a "victimless crime" or that no meaningful harm is done. The easiest frauds for the fraudster to rationalise are those in which the victim freely and intentionally participates in illegal activities (such as money laundering or tax evasion). It's simple to feel that the victim deserved it in such instances. Blum (1972) discovered that many attributed their success to the victim's natural avarice in his research of confident men and their practises.⁷ Many con artists appeared to have a pessimistic view of human nature, assuming that others were just as devious and deceitful as they were. It is undeniable that cultivating hatred and a lack of regard for the victim makes it easier to abuse them. To put it another way, an honest man cannot be deceived. In this situation, the victim bears sole responsibility for the deception.

According to Stotland, "weak restrictions" diminish the inhibitions to commit white-collar crimes like fraud, in addition to positive reasons. They're pretty comparable to the neutralisations that have been mentioned previously.⁸

One of these weak restrictions is the belief that everyone does this as part of good business/financial practice. Tax fraud, insurance fraud, and padding expenditure accounts have become commonplace, and those who do not participate are considered foolish. The moral uncertainty surrounding some sorts of fraud is heightened, according to Stotland, by the typically short punishments meted out to perpetrators. The leniency of punishment in high-profile instances communicates to society that these persons are somehow different from the average criminal.

⁵ G. M. Sykes, *Techniques of neutralization: A theory of delinquency*, 22 American Sociological Review, p 664–70 (1957).

⁶ D. R. Cressey, *Why managers commit fraud*, 19 Australian and New Zealand Journal of Criminology, p195–209.

⁷ R. H. Blum, *Deceivers and Deceived: Observations on Confidence Men and their Victims, Informants and their Quarry, Political and Industrial Spies and Ordinary Citizens*, Charles C. Thomas, Springfield, Illinois, p. 44 (1972).

⁸ *Supra* note 7.

Again, in the eyes of the public, this "decriminalises" fraud. According to Stotland, the nature of the victim might decrease white-collar criminal restrictions, with impersonal government offices and massive organisations being ethically simpler to deceive. When you steal a little from many people, the harm isn't as personal as it would be if you were targeting a single victim or a small group. This is akin to the earlier neutralisation of one can afford it.

Socio-economic factors relating to Corporate Frauds

Crime and society are inseparable elements. Social life is always accompanied by crime at every stage. There are a lot of factors that influence the crime other than the natural factors. The economic theory of crime states that a person will commit a crime if the profit expected from the criminal activity is more than the act's legal alternative.⁹ There are a lot of factors, such as the economic growth of a country, urbanisation, industrialisation, and social structure, that can contribute to the commission of any offence. If any person has been unemployed for a long time or his income is insufficient to meet his needs, he may resort to bribery or other forms of corruption or fraud. In white-collar crimes or corporate fraud cases, unemployment or lack of finances is not the issue. It can be driven by greed.

Corporate fraud is one category of white-collar crime committed by persons with an enviable social position to secure personal or business advantage.¹⁰ Generally, corporate fraud occurs when any company willfully conceals any information or provides any false information to benefit by hiding the true information. This fraud is often committed through misinformation about prospects, audit manipulation, hiding debts in books of accounts, etc.

Types of Corporate Frauds in India

Broadly, there can be many types of corporate fraud, such as employee fraud, customer fraud, fraud of investment bankruptcy, etc. The three most common types of corporate fraud are¹¹:

1. Financial fraud—In this type of fraud, the accounting records are altered or falsified, and the financial information might be concealed or misleading.
2. Misappropriation of Assets – in this fraud, internal or external parties commit the theft of assets.

⁹ Grzegorz Pieszko, *The influence of socio - economic factors on crime*, 21 IOSR-JHSS, 18, 18-19, (2016).

¹⁰ Vikramaditya Khanna, *CEO Connectedness and Corporate Fraud*, 70 JOFI, 1203, 1212, (2015).

¹¹ KIYAMAZ H., *CORPORATE FRAUD EXPOSED* 19-38 Emerald Publishing Limited (2020).

3. Corruption is the most common form of fraud. In this, officials make or receive improper payments in return for legitimate or illegitimate work.

Corporate frauds came to the notice of the government after major scams like the Harshad Mehta scam, the Sahara fiasco, the Satyam Scam and many other cases wherein the funds were misappropriated. Under the legislation, the Companies Act 2013 focuses on the issue of fraud pertaining to the companies by providing a specific provision, i.e. Section 447, which states the punishment for fraud but does not define 'corporate fraud' per se.¹²

The 'Supply and Demand side' in corruption

To understand corruption, it is essential to understand the social and economic factors driving it. There are three main components for fraudulent behaviour on the supply side.¹³

1. Pressure—The main motive of crime is pressure. A person may have some financial constraints; he may resort to illegal means to resolve these. However, financial constraints aren't always the issue. Greed for a better lifestyle than the current one can also be an essential factor in motivating any corporate fraud or corruption. The managerial personnel and employees should be trained to understand the behavioural traits of fraudsters.
2. Opportunity – Without having an adequate opportunity to commit fraud or corruption, the commission of offence cannot occur. The person must be able to abuse the power for wrongful gains with a low risk of getting caught.
3. Rationalisation is when the offender tries to justify his act through some justification. Most of the offenders are first-time offenders. They attempt to justify their acts by stating reasons like they were borrowing money or were in dire need of it. They may justify by alleging fraud on others or that they were underpaid.

The demand side of corruption and fraud are equally essential to note. Corruption becomes a breeding ground in a state where a free press, transparent government, and civil and political rights are lacking or are not implemented properly.¹⁴ Corruption is often viewed as a moral problem, but it should rather be considered as a political and economic problem. The psychology of any crime can only be considered in isolation by considering the social and economic factors attached to it.

¹² Companies Act, 2013, § 447, No. 18, Acts of Parliament, 2013 (India).

¹³ Thomas Fox, *Socio-Economic and Cultural Risk Factors That Drive Corruption: A Focus on the 'Supply Side' of the Equation*, JDSUPRA, (Nov. 8, 2021, 9:29 PM), <https://www.jdsupra.com/legalnews/socio-economic-and-cultural-risk-factors-53692/>.

¹⁴ Daniel Kaufmann, *The Big Question: How Can Nations Break the Cycle of Crime and Corruption*, 27 WORLD POLICY JOURNAL, 3, 3-6, (2010).

Reformations to reduce corporate fraud

Targeted fraud awareness training should be mandated for employees and managers so that any fraudulent activity can be detected. 15 Anti-fraud training programs have also resulted in less fraud in corporations. The very least that should be done is for members of any organisation to be educated about fraud and its consequences. Employees who report any questionable or fraudulent activity should be rewarded in any organisation.

Furthermore, risk assessments for fraud and corruption should be conducted occasionally. A code of Conduct should be made for the members of any organisation, and it should specifically state the organisation's position on Anti-corruption. An appropriate anonymous reporting mechanism should be installed. Apart from this, proper financial auditing should be done occasionally.

Ethical decision-making is another important factor that organisations should observe. Corporate fraud or corruption is highly likely if the business environment is non-ethical. The organisation's members may attempt to justify the wrong through their organisation. Companies and organisations should strongly focus on ethical decision-making in their businesses.

Whistle-blower Policies can help identify and counter corruption and fraud practices in companies. Clause 49 of the Listing Agreement under the SEBI (Securities and Exchange Board of India) states that a whistle-blower system is required for corporate governance.

Conclusion

The prevalence of financial fraud in the business world underlines the urgent need for strict measures to ensure transparency and accountability in financial reporting. Corporate frauds in India, including the Jet Airways disaster, the Fortis-Religare scam and the Infosys scandal, highlight the unethical practices used by top management to manipulate financial statements and mislead stakeholders. A comprehensive understanding of the psychological and socioeconomic factors that lead individuals to cheat is necessary for this ongoing issue. Because it is a deliberate fraud, its perpetrators often rationalise various psychological mechanisms. Greed, financial hardship, and the desire for power and control are common motivators. Yet these justifications are frequently accompanied by an explanation process that reduces the cheater's moral hurdle. Neutralisation techniques, such as justifying the act as a victimless crime or blaming the victim, play a vital role in enabling fraud. In addition, the socio-economic environment, including unemployment, urbanisation and economic inequalities, also increases the incidence of corporate

fraud.

Corporate fraud in India takes many forms, including financial fraud, embezzlement and corruption. According to the economic theory of crime, individuals commit crimes when the expected benefits exceed legal alternatives. Factors such as greed and the ability to exploit the system with minimal risk of detection play an important role in white-collar crime. The legal framework, particularly the Companies Act 2013, addresses corporate fraud but lacks a comprehensive definition, underscoring the need for clearer legislation and stronger enforcement. Fighting corporate fraud requires a multifaceted approach. Fraud awareness training for employees and managers is necessary to detect and prevent fraud. Organisations must regularly conduct risk assessments and develop robust codes of conduct that emphasise anti-corruption initiatives. Implementing anonymous reporting mechanisms and rewarding whistleblowers can improve fraud detection and prevention. Organisations should promote ethical decision-making to create a culture of honesty and responsibility. In addition, the role of socioeconomic factors in promoting fraud must be acknowledged. Corruption often thrives in environments that lack transparency, a free press and political rights. Seeing corruption not only as a moral problem but also as a political and economic problem can help formulate effective strategies to combat it. Ensuring proper auditing, transparent management, and a strong whistleblowing policy are important steps in this direction. Developing better fraud detection mechanisms requires studying the psychological dynamics of fraudsters, including their motivations and rationales. Understanding the behavioural and psychological factors that drive people to commit fraud can provide valuable information for designing targeted interventions. For example, assessing the honesty and integrity of potential employees before hiring can help identify individuals who may threaten the organisation's integrity. India's high-profile corporate fraud cases are a wake-up call for companies and regulators. A strong regulatory framework with strong internal controls must be considered. Organisations must prioritise ethical practices and transparency to restore trust between investors, shareholders and the public. In short, it can be stated that the fight against corporate fraud requires a comprehensive approach that considers both individual and systemic factors. Organisations can significantly reduce the risk of fraud by promoting a culture of honesty, implementing effective controls and understanding fraud's psychological and socio-economic drivers. Lessons learned from past events should guide future efforts to create a more open, accountable and ethical business environment.