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1. Impact of Bank Frauds on Shareholders' Wealth - A Case Study of Punjab National Bank

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Abstract

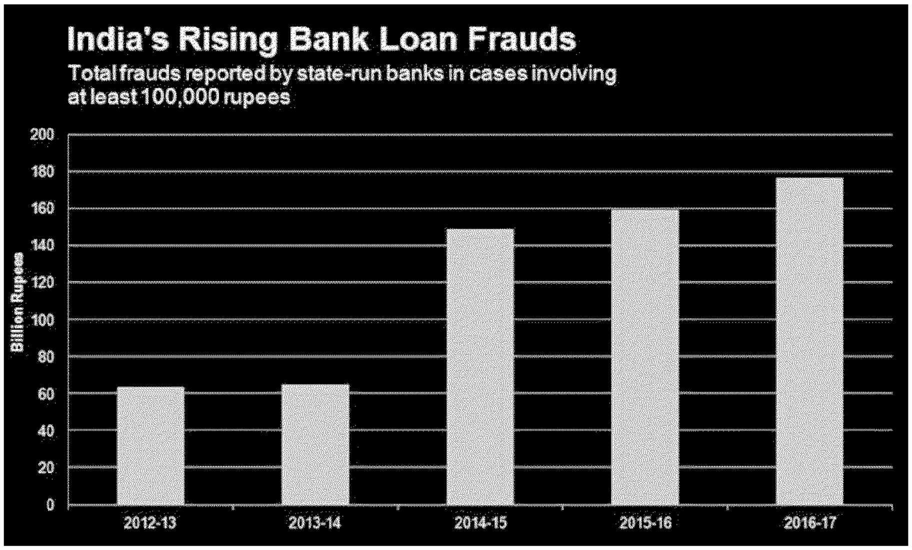
Banking paradox of any nation is believed to be another name for trust. The banking industry helps in maintaining healthy credit line to industrial sector as well as overall economy. Bank stocks have been considered to be must haves especially due to their inevitable social importance. However, outbreak of scams or frauds like the recent INR 11,400 Crore PNB scam lead to gigantic economic losses including fall in stocks of PNB by 41% and its reach outspread to other bank stocks as well as overall stock market performance. This makes it important to judge the wealth creation from viewpoint of investors who invest for short term and/or long term gains. Therefore, the present study applies event study methodology for the purpose of analysing the impact of PNB fraud on its shareholder's wealth.

Key words: PNB, Fraud, Event study, Market Index, Cumulative Abnormal Returns.

Introduction

Banking Frauds constitute a considerable percentage of white-collar offences being probed by the police. Frauds are not like the ordinary thefts and robberies, the amount misused in these crimes runs into lakhs and crore of rupees.

Figure 1. India's Rising Bank Loan Frauds



Source : **(Shah and Tripathy, 2018)**

The above chart shows the increasing trend of bank frauds in India over a period of time. In the year 2012-13 and 2013-14, the frauds were slightly lower. There was a sudden increase of frauds in 2014-15. This can be reasoned by lack of accountability and standards in the public banking system. The bank's technology was being misused, as the same continued for the next few years, giving rise to more bank frauds in the country in the year 2016-17.

Punjab National Bank Fraud

The second largest PSU, Punjab National Bank Fraud case was one of the biggest scam in the country. On 14th February 2018, Punjab National Bank (PNB) disclosed a Rs. 11,300 crore fraud by one of the country's richest man, diamantaire Nirav Modi. PNB scam lead to gigantic economic losses including fall in stocks of PNB by 41%. The value of PNBs fraudulent transactions was nearly fifty times its net profits of Rs. 230.11 crores for Q3FY18. The impact widespread to other banks including UCO Bank, Allahabad Bank, SBI, etc.

Literature Review

(Gayathri and Mangaiyarkarasi, 2018) stated how the PNB scam came as a huge blow to the entire banking sector. The study identified and analyzed the factors that led to this massive scam and also summarized the impact of scam on various banks and the economy as whole. **(Sanusi, Rameli, and Isa, 2015)** examined the effects of frauds on different stockholders, including the shareholders, the depositors, the borrowers, the staff as well as the banking institution itself. The study concluded that the banking activities require full compliance of the standards and best practices in risk management and internal controls. **(Barber and Lyon, 1997)** used market index as a reference portfolio in event study designed to detect long run (one to five year) abnormal stock returns. Study concluded existence of significant biases in test statistics when long-run abnormal returns are calculated using a reference portfolio, long run CAR and associated test statistics are generally positively biased and long run BHAR and associated test statistics are generally negatively biased. **(Shah and Arora, 2014)** examined a sample of 37 M&A announcements in the Asia-Pacific region during the time period of May 2013 – September 2013 to identify the post-facto effect of M&A announcements on the stock prices of the target and the bidding firms. The study used the technique of event study and concluded that the M&A announcement didn't create any abnormal returns for the bidder firms. **(Adnan and Hossain, 2016)** concluded that CAAR equally increased prior to announcement for both target and acquiring companies but in the post merger announcement period the CAAR for acquiring companies observed a sudden fall.

Objective of the Study

To examine the effect of fraud on the wealth of shareholders of PNB Bank.

Methodology

The study examines that the impact of Punjab National Bank (PNB) fraud on its shareholders wealth by employing event study methodology .The fraud was disclosed and disseminated in the market on 14th February 2018 which is considered "the event" under the study.

Data used for the study includes Daily share price data of PNB bank as well as market index (Nifty 50) for a total of 20 days before event day and 20 days after the event and estimation window being 180 days prior to (t-20).

This study uses **Market Model** (most popular statistical model under event study methodology). Firstly, returns of PNB bank and corresponding return of market index is ascertained using respective daily price data.

$$\mathbf{CAR}\,(\tau_1,\tau_2) = \sum_{\tau=\tau_1}^{\tau_2} \mathbf{AR}_{i\tau}$$

Where, CAR_i is the Cumulative Abnormal Returns of the selected bank for event window (τ_1,τ_2) and AR is the abnormal returns on stock.

H0: There is no significant impact of the fraud on the returns of PNB shareholders. (CAR=0)

Hα: There is a significant impact of fraud on thereturns ofPNB shareholders. (CAR≠0)

The null hypotheses that mean **CAR** are equal to zero for sample of n firms, is tested by using t values at 1%, 5%, 10% level of significance:

$$\mathbf{t}_{CAR} = \overline{\mathbf{CAR}}_{\mathbf{i}\bar{t}}/(\boldsymbol{\sigma}(\mathbf{CAR}_{\mathbf{i}\bar{t}})\ /\sqrt{\boldsymbol{n}})$$

Analysis and Interpretation

Table no.2: Percentage Cumulative Abnormal Returns of Punjab National Bank over the different event windows

Bank	Pre- Fraud Period			Post - Fraud Period		
	-20 days	-10days	-5 days	+20 days	+10days	+5 days
Punjab National Bank	-0.2	9.73	2.87	-30.86	-32.97	-17.24
		***	***	***	***	***

*, **, *** *represents significance at 10%, 5% and 1% level respectively.*

The following trends can be inferred from the above table;

The 5 days event window is the shortest window period of the study. It shows the immediate reaction of the shareholders towards the disclosure of fraud. As the market moves towards (t+10) window period, higher negative and statistically significant CARs were observed. These abnormal returns were statistically significant at 1% level of significance This is attributable to the common notion in the market about the high risk involved. The shareholders feel a sense of scepticism about effects of fraud and probable humongous losses. It can be noted that, as the event window broadens, the negative CARs have decreased from -32.97 to -30.86 (2.11%). This signifies that the market showed signs of gradual stabilisation. During the pre-fraudperiod, as the days neared the fraud, the CAR reduced to 2.87. It is an established fact in the field of event study that pre-disclosure abnormal returns are affected due to leakage of insider information.

These trends are in similar lines with the facts and highlights gauged by news releases and previous literature. Various articles highlighted the slumped share prices of not only PNB but that of other banks and fall of BSE Sensex points. Also, **(Gayathri and Mangaiyarkarasi, 2018)** detailed that out of the 39 listed banks in India, the share prices of the 34 listed banks fell between February 12 and February 15. The sudden volatility in the prices eroded the market cap of these 34 stocks by over Rs 36,380 crore. Benchmark BSE Bankex lost 1.2 per cent. PNB eroded investor's wealth worth Rs 8,077 crore and its stock tanked 20.6 per cent between February 12 and February 15 2018.

Conclusion

PNB scam not only resulted as a mammoth to its shareholders in terms of fallen share prices, but it also exposed various other banks to credit risk. Various credit rating agencies including Moody and Fitch raised doubts about the bank's creditworthiness. Based on the results derived using Event Study Methodology and the analysis of CARs derived for shareholders of PNB, the Null hypothesis (CAR=0) is rejected across all three postfraud event windows and (t-5), (t-10) event windows in pre-fraud period. Hence, it can be concluded that there has been a significant impact of PNB fraud on the short term wealth creation of the bank's shareholders.

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