Science Arena Publications
Specialty Journal of Accounting and Economics
Available online at www.sciarena.com
2016, Vol, 2 (3): 75-81

# Effect of Securities and Financial Scams on Investors' Perception

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**Abstract:** *Scams have been occurring in stock markets across the world at regular intervals and these have resulted in people losing their huge capitals invested in various types of securities. Stock market scams are also called as securities scams as different types of securities are traded in the stock market. Stock market scams are result of various types of manipulations and other processes carried out by investors and traders at various levels. The investors' perception is greatly affected by the securities and financial scams. The thinking and attitude of the investors towards stock market is greatly influenced by the scams. Therefore, the objective of this paper was to study the effect of securities and financial scams on investor perception. This study is exploratory in nature. It focused on the securities and financial scams on the investor's perception. Consequently, the quantitative analysis of data is done. The data is collected through the structured questionnaire method. The Paired Samples T-test and regression analysis is used with the help of SPSS software for the analysis of data.*

## Introduction

Financial scam refers to any disclosure that is omitted or improperly reported on any of the four financial statement components (balance sheet, income statement, cash flow statement and shareholder's equity). Scams have been occurring in stock markets across the world at regular intervals and these have resulted in people losing their huge capitals invested in various types of securities. Stock market scams are also called as securities scams as different types of securities are traded in the stock market. Stock market scams are result of various types of manipulations and other processes carried out by investors and traders at various levels. The American Institute of Certified Public Accountants (AICPA, 1997), in its Statement of Auditing Standards (SAS) No. 82, refers to financial statement fraud as intentional misstatements or omissions in financial statements. Financial statement fraud is defined by the Association of Certified Fraud Examiners (ACFE) as: "The intentional, deliberate, misstatement or omission of material facts, or accounting data which is misleading and, when considered with all the information made available, would cause the reader to change or alter his or her judgment or decision".
The broadly accepted definition of financial statement fraud, is articulated by the National Commission on Fraudulent Reporting as "intentional or reckless conduct, whether act or omission, that results in materially misleading financial statements". The common theme among these definitions is that fraud, particularly financial statement fraud, is deliberate deception with the intent to cause harm, injury, or damage. The terms financial statement fraud and management fraud have been used interchangeably, primarily because (1) management is responsible for producing reliable financial reports, and (2) the fair presentation, integrity, and quality of the financial reporting process is the responsibility of management.

## REVIEW OF LITERATURE

There are various studies that were conducted by previous researchers to know various aspects of the securities and financial scams. The Studies that are directly and indirectly related to the research are reviewed as under:
**Sliter (1994)** stated that the junior capital markets are rampant with fraud. RCMP investigators are frustrated with their lack of success in protecting the integrity of the public market place. This paper outlines some of the reasons for this ineffectiveness and provides some concrete suggestions for improvement. Comments are supported by quotations from numerous past RCMP stock fraud investigators.

**Karpoff et al. (1998)** stated that the Press reports of military procurement fraud investigations, indictments, and suspensions are associated with significantly negative average abnormal returns in the stocks of affected firms. Abnormal stock returns are significantly less negative, however, for firms ranking among the top 100 defence contractors than for unranked contractors, even after controlling for firm size, the fraud's characteristics, and the firm's recidivism. Unranked contractors are penalized heavily for procurement frauds, experiencing both a decline in market value and a subsequent loss in government-derived revenues. Furthermore, these losses are related to the percentage of the firm's revenues that derive from government contracts. Influential contractors, in contrast, are penalized lightly, experiencing negligible changes in share value and government contract revenue.

**Parekh (2003)** explored that the discovery of massive frauds in the Indian and International capital markets, regulators and legislatures have increasingly turned towards making corporate governance standards mandatory and have attached penalties to violation of these 'corporate governance' 'guidelines'. This questions the necessity for associating corporate governance in the insider trading context with penal provisions in India. It makes suggestions for the removal of these penalties and instead let the markets decide whether to penalize companies which do not have these process oriented safeguards in place. It also recommends introduction of certain substantive and procedural regulations/standards for reduction of the incidence of insider trading in companies.

**Wang (2004)** discussed the regulation of foreign investment in China's stock market. It starts with the development of financial markets in China, followed by a detailed introduction to the evolution of China's stock market and the regulatory regime. It then introduces the forms of foreign participation in China's stock market. It critically analyses the legal traps faced by foreign investors in the Chinese stock market, including the burdensome and ambiguous regulatory culture, market frauds associated with the SOE reform, poor corporate governance, and the absence of effective judicial protection. It finally puts forward some reform recommendations.

**Bose (2005)** examined the regulatory infrastructure of the Indian securities market and see whether there exist well formulated laws with well-defined scope and powers of the regulator, capable of presenting all investors in the Indian market with a level playing field. he summarize some of the regulatory provisions that have evolved for tackling market misconduct and try to see what comes in the way of regulatory action aimed at investor protection in India, as compared with the US which is perceived as the world's most safe and liquid capital market. He also discusses the roles of the stock exchanges and electronic databases in aiding the regulator in prevention, detection and conviction of securities frauds. One tends to conclude that the scope of Indian securities laws, which have gradually evolved over time, is now quite pervasive and the problem lies mostly in enforcing compliance particularly for crimes such as price manipulation and illegal insider trading.

**Gopalsamy (2005)** conducted a study that revealed that the majority of retail investors have lost confidence in various agencies associated with capital markets, including the Securities and Exchange Board of India. Investors have no confidence or low confidence in company managements, auditors, stock brokers and the SEBI. Expressing concern over low investor confidence, it said, 'No vibrant corporate growth can be expected if most investors have so little confidence in corporate managements and various agencies, which are supposed to protect investors.' It said "the situation called for a strong official initiative from the government for introducing radical reforms in corporate governance". The study also reveals a significant shift of investors from equity share towards high quality bonds of domestic financial institutions. Retail investors were, however, reluctant to touch the bonds of private sector companies, it said. The study said "investors' preference for buying new issues, instead of making secondary market purchases, had completely disappeared as a result of free pricing".

**Panda et al. (2009)** focused on the securities fraud in the Indian stock markets and the manner in which the alternate dispute resolution approach is efficient in dealing with such frauds in contrast to the traditional approaches. An attempt has been made to highlight the development of arbitration as an alternative to the courts in disputes between investors and broker-dealers. Specifically, the advantages and benefits associated with arbitration as an alternate dispute settlement mechanism is also emphasized so as to evolve best practices for combating the situation.

**Trivedi (2010)** stated that in today's era corporate ethics plays a very vital role for any Company in the corporate world. Surviving for companies in such a competitive world has become difficult. So, for good governance a company needs to follow certain ethics which we can call as corporate ethics, to minimize the corporate frauds and white collar crimes.

**Need for the Study**

Previous research reveals the various aspects of the securities and financial scams. In this study, an attempt is made to investigate that how far the shareholder's perception will be influenced because of the corporate frauds. Safeguarding shareholder's interest is regarded as the underlying purpose of regulatory system. This study brings out the fact that evading this aspect can lead to a situation where the ethical, financial and the regulatory system of the economy as a whole can be disturbed. How powerful the shareholder's interest objective is to shake the economic system is not much discussed by researchers and hence, through this concept, an attempt is made to fill this gap.

## RESEARCH METHODOLOGY

The study is based on primary data in connection with outline objectives. The Primary data was collected through pre-structured questionnaire. This study is exploratory in nature. The present study focused on the securities and financial scams on the investor's perception. Consequently, the quantitative analysis of data is done. The primary data was collected through the questionnaire method. The questionnaire was designed to provide answers to our research questions. The questionnaire was first pilot tested on 10 investors and was found to be satisfactory. The data is collected through the structured questionnaire method. The Paired Samples T-test and regression analysis is used with the help of SPSS software for the analysis of data. To represent this data tables and graphs are used as per requirement.

**Objectives**

The specific objectives of the study are:-

1. To study the effect of securities and financial scams on investor perception.
2. To see the effect on the decision of investors before and after scams.

The following hypothesis has been framed for the present study:

1. There is no significant effect on the decision of investors before and after scams.
2. There is no significant effect of financial performance on the frequency of investment in securities.
3. There is no significant effect of the Management of company on the frequency of investment in securities.
4. There is no significant effect of the Dividend policy and reputation of the company on the frequency of investment in securities.

**Sample Size**

The sample for the purpose of the proposed study consists of 150 investors which have been selected randomly from Jalandhar city in Punjab, India.

**Demographic profile of the respondents**

**Table 1:** Profile of the respondent

| Profile | Frequency | Percent |
|---|---|---|
| Retired Person | 15 | 10.0 |
| High Salaried Class | 18 | 12.0 |
| Newly Employed Persons | 15 | 10.0 |
| Students | 26 | 17.3 |
| Agents | 7 | 4.7 |
| Business | 18 | 12.0 |
| Part Time Employees | 13 | 8.7 |
| Stock Brokers | 15 | 10.0 |
| Middle Class People | 23 | 15.3 |
| **Total** | **150** | **100.0** |

Table 1 shows that out of 150 respondents, 10% are retired persons, 12% of the total respondents belong to high salaried class. 10% of our respondents are newly employed and 12% belongs to high business class. However the maximum respondents are students that are 17.3%. Agents and stock brokers are 4.7% and 10% respectively.15.3% of the respondents are from middle class people which cover considerable portion of our respondents out of the total studied respondents.

## FINDINGS & SUGGESTIONS'

### 1. Impact of securities and financial scams on investor's perception

The study is based on the primary data in connection to the outline objectives. The data was collected through the structured questionnaire method. The Paired Sample T-test and regression analysis is used with the help of SPSS software for the analysis of data.

**Effect on the Decision of Investors before and after Scams**

**Table 1 :** Paired Samples T- test

| | Paired Differences | | | | |
|---|---|---|---|---|---|
| | **Mean** | **Std. Deviation** | **t** | **df** | **P-Value** |
| Decision Before Scam & Decision After Scam | .33333 | .66218 | 6.165 | 149 | .000* |

*Significant at 5% Level

The result of paired sample T-test shows that there is significant effect on the decision of investors before and after scams. In the table 1, the P- value is highly significant at 5% level ($P<0.05$). Therefore, the null hypothesis is rejected that there is no significant effect on the decisions of investors before and after scams.

**Effect of Reputation of company, Dividend Policy, Management of Company, Financial Performance on the Frequency of Investment in Securities**

**Table 2:** Results of Regression Analysis

Coefficients[a]

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | p-value |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | -1.318 | .178 | | -7.407 | .022* |
| Reputation of company | .016 | .043 | .022 | .382 | .003* |
| Dividend Policy | .312 | .057 | .345 | 5.484 | .014* |
| Management of Company | .634 | .086 | .572 | 7.371 | .000* |
| Financial Performance | -.001 | .041 | -.002 | -.026 | .029* |

*Significant at 5% Level

a. Dependent Variable: Frequency of Investment in Securities

The table 2 shows the result that the decision to invest in securities is significantly affected by the Reputation of company, Dividend Policy, Management of Company, Financial Performance. The p- value in the above table is highly significant at 5% level. Therefore, the null hypothesis is rejected that there is no significant effect of Reputation of company, Dividend Policy, Management of Company, and Financial Performance on the Frequency of Investment in Securities (p-value<0.05).

**Major Findings regarding Impact of Corporate Frauds and Scams on Investor's Perception**

- The result of paired sample T-test shows that there is significant effect on the decision of investors before and after scams. In the table 4.3, the P- value is highly significant at 5% level (P<0.05). Therefore, the null hypothesis is rejected that there is no significant effect on the decisions of investors before and after scams.
- The results depicts that the decision to invest in securities is significantly affected by the Reputation of company, Dividend Policy, Management of Company, Financial Performance. The p-value in the above table is highly significant at 5% level. Therefore, the null hypothesis is rejected that there is no significant effect of Reputation of company, Dividend Policy, Management of Company, and Financial Performance on the Frequency of Investment in Securities (p-value<0.05).
- The results reveals that majority of the investors are the frequent traders of the stock market that counts to 63% of the total investors.
- Majority of the investors i.e. 58% gets influenced by the market reputation of a company without considering the performance of its umbrella companies while investing. These investors include students, retired people and people of middle class in majority.
- While making investment decision majority of the respondents i.e. 64.7% of the investors considers dividend policy as very important factor.
- Only 8.7% of the investors consider management of the company as very important factor while making investment decision. Most of the investors i.e. 40% of the total stock market investors consider management as important factor, since the future prospects of the company and its

growth rate depends upon the management decisions which directly affect the stock worth of the company.

- Financial performance is the most crucial aspect and 3/4$^{th}$ of the investors i.e. 72% of the Investors consider this factor important while investing in the stock market.
- The result shows that only 22% of the total investors do not immediately react to the news of occurrence of scam, rather they analyze the conditions of the stock market and studies impact of scam on their individual shareholdings before reacting. Very large percentage of the investors i.e. 78 % of the investors reacts immediately to the news of occurrence of a scam in the stock market.
- Future prospects, financial position along with the management of the company is the most important factor considered by the long term investors of the stock market, while the short term and medium term investors consider the dividend policy and reputation of the company the most.
- Majority of the investors (78%) of the investors gets involved in the trading activities immediately after the scam gets revealed. Rest 22% investors do not initiate any change since they are involved in long term investment.
- Most of the people who had good market experience out of their analytical decision do recommend other people to invest in the stock market.

## Conclusion

Various scams, scandals and stigmas have surfaced in the recent years. These may not all be attributable to the antics of politicians, but they have been facilitated largely because of the vitiated atmosphere that the politicians and the political system have created in the country. In spite of the setbacks faced by SEBI, it continued its efforts to introduce more capital market reforms in India, making the markets an attractive investment destination. Analysts felt that the major reason for SEBI's failure to protect investors against scams was lack of skilled human capital. For instance, they quoted the example of the KP scam in which KP had taken huge positions in ten stocks. In spite of SEBI possessing this information, it could not gauge KP's vested interests in acquiring these huge positions and his illegitimate plans. Most of the scams that have taken place keep featuring off and on in the media, but that doesn’t stop the next one from taking place since investigations and trials are excruciatingly prolonged. Scams and scandals have manifested themselves in large numbers over the past few years. Therefore enhancing the revelation of information and preventing the misuse of asymmetric or insider information is the most basic task of a financial regulator. Asymmetries and imperfections of information leave investors susceptible to cheating. They also cause participants to follow each other in swings that create excess volatility and externalities. So improving transparency of markets is a top regulatory priority. This will protect the interest of shareholders also.

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