The Impact of Fraud in the Banking Industry:  
A Case of Standard Chartered Bank

BY

YEGO, KIPROTICH JOHN

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STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: __________________________  Date: __________________________

Yego, Kiprotich John (ID 625641)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: __________________________  Date: __________________________

Mr. Kepha Oyaro

Signed: __________________________  Date: __________________________

Dean, School of Business
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ABSTRACT

Fraud has become a worldwide problem that is not set to abate in the near future. It’s eroding the profitability of businesses with disturbing effects on firm solvency. This research aims to contribute to the knowledge of fraud in a foreign bank with a focus on Standard Chartered Bank. The research uses a sample of fraud, audit, security and other managers involved in fraud prevention to conduct a mixture of quantitative and qualitative study based on a survey of sixty respondents.

The introduction to this research, lays out the background of the study and the objectives, aims and research questions of the research at hand. This chapter also introduces the scope, rationale and importance of this research. The research objectives of this study are three: What are the Causes of Bank Fraud? What are the Risks of Bank Fraud? Which Strategies Should be used to Combat Bank Fraud?

The literature on fraud, the internal and external environments that affect fraud, the banking environment in Africa and other related aspects of fraud are also discussed here to get a feel of what is happening around the world on this topic.

Research Methodology, describes the various methods that were considered appropriate in conducting this research. The research philosophy as well as the practical considerations that was relevant to the research. The topic discusses the three research questions which are: The Causes of fraud; Risks of Fraud and Strategies Used to Curb Bank Fraud. The research design in this study was a descriptive research design. Discussion of the quantitative survey is primarily descriptive and exploratory in nature. However, a few hypotheses are formulated in order to shed further light on possible relationships existing in regard and size of the bank as determinants of the size of loss to fraud.

The research found that fraud is considered to be a major problem within the bank, even though the relative size of frauds conducted was unsophisticated and relatively small. Fraud prevention and detection methods used in the bank were standard and no different from global standards. The fraud triangle worked effectively to predict the patterns of fraud described by respondents. However from this study it is argued that the Fraud Triangle is not
as effective in illuminating the collusive and predatory nature of the Kenyan bank fraudster. Internal and external factors involved in fraud in Kenya are also identified, including low or non-existent fraud budgets for detecting and preventing fraud, ineffective justice systems, weak industry co-operation, inadequately trained police and prosecutors, weak government regulatory frameworks, among others. Unlike previous research and theories that have mainly focused on either the individual or environmental factors, this research suggests an integrated theoretical and conceptual approach to fraud.

Recommendations for the bank have been generated from the results and findings. A set of policy changes for the bank for policymakers to look at. In addition, policy implications for the Kenyan Legal System, as well as the KBA to improve conditions in the banking institution.

In conclusion, the overall loss to the banks was primarily from low-volume and technically uncomplicated frauds. However, the banking industry does appear to be very aware of fraud and its potential for significant growth thus the need to have fraud budget.

The research will be of immense help to the policy formulators in Standard Chartered Bank, in matters relating to the crime of fraud. It will equip staff and more so the senior policymakers to make the right decisions in the area of fraud detection and prevention going forward.
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DEDICATION

To my beloved dad.
# TABLE OF CONTENTS

DECLARATION.........................................................................................................................ii
COPYRIGHT............................................................................................................................iii
ABSTRACT..............................................................................................................................iv
ACKNOWLEDGEMENT..........................................................................................................vi
DEDICATION..........................................................................................................................vii
TABLE OF CONTENTS.................................................................................................viii

CHAPTER ONE.........................................................................................................................1
1.0 INTRODUCTION...............................................................................................................1
1.1 Background of the Problem.........................................................................................1
1.2 Problem Statement.....................................................................................................3
1.3 Purpose of Study.........................................................................................................3
1.4 Research Questions....................................................................................................3
1.5 Importance of the Study............................................................................................3
1.6 Scope of the Study.....................................................................................................4
1.7 Definitions of Terms..................................................................................................5
1.8 Chapter Summary.....................................................................................................5

CHAPTER TWO.......................................................................................................................7
2.0 LITERATURE REVIEW....................................................................................................7
2.1 Introduction..................................................................................................................7
2.2 Causes of Bank Fraud...............................................................................................7
2.3 Risks of Bank Fraud..................................................................................................12
2.4 Strategies used to Combat Bank Fraud.................................................................15
2.5 Chapter Summary.....................................................................................................20
## CHAPTER THREE

**3.0 RESEARCH METHODOLOGY**

- 3.1 Introduction ........................................................................................................ 21
- 3.2 Research Design ................................................................................................ 21
- 3.3 Population and Sampling Design ..................................................................... 22
- 3.4 Data Collection Methods .................................................................................. 23
- 3.5 Research Procedures ......................................................................................... 24
- 3.6 Data Analysis ..................................................................................................... 24
- 3.7 Chapter Summary ............................................................................................... 24

## CHAPTER FOUR

**4.0 STUDY RESULTS AND FINDINGS**

- 4.1 Introduction ........................................................................................................ 25
- 4.2 Demographic Data .............................................................................................. 25
- 4.3 Causes of Bank Fraud ....................................................................................... 29
- 4.4 Risks of Bank Fraud ........................................................................................... 35
- 4.5 Strategies Used to Combat Bank Fraud .............................................................. 40
- 4.6 Summary of Findings ......................................................................................... 43

## CHAPTER FIVE

**5.0 DISCUSSION, CONCLUSION AND RECOMMENDATION**

- 5.1 Introduction ........................................................................................................ 45
- 5.2 Summary ............................................................................................................. 45
- 5.3 Discussion .......................................................................................................... 46
- 5.4 Conclusion ......................................................................................................... 50
- 5.5 Recommendations ............................................................................................ 52
REFERENCES..........................................................................................................................56

APPENDICES..................................................................................................................................62

Appendix 1: Introductory Letter...................................................................................................62
Appendix 2: Corruption Perception Index, 2012............................................................................63
Appendix 3: Ownership Structures of Banks...............................................................................63
Appendix 4: Mergers within the Banking Industry......................................................................64
Appendix 5: Questionnaire...........................................................................................................65

LIST OF TABLES
Table 4.1: Role of the respondent in the organization.................................................................27
Table 4.2: Nature of the fraud.......................................................................................................34
Table 4.3: Motivating factors for fraud........................................................................................34
Table 4.4: Investigating parties in reported frauds.......................................................................39
Table 4.5: Ranked importance of organizational measures.........................................................40

LIST OF FIGURES
Figure 4.1 Gender of the respondents..........................................................................................28
Figure 4.2: Number of years the respondent has worked in the bank........................................29
Figure 4.3: Classification of fraud problem by respondents..........................................................30
Figure 4.4: Trends of fraud...........................................................................................................31
Figure 4.5: Main perpetrator(s) of fraud.......................................................................................32
Figure 4.6: Types of fraud.............................................................................................................33
Figure 4.7: Estimated overall loss as a per cent of projected annual revenues............................36
Figure 4.8: Responses on whether the fraud had a significant damage to the business............37
Figure 4.9: Type of damage caused by the fraud.........................................................................38
Figure 4.10: Ways in which fraud was detected...........................................................................38
Figure 4.11: How often the bank reviews fraud prevention methods..........................42
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

‘A way of making money is to stop losing it.’

Despite the size and area of business that organizations operate in, they are constantly exposed to bank fraud risk. Bank fraud is the loss resulting from inadequate or failed internal processes, people and systems, or from external events. It is also the widest category of risk, bounded only by subjects such as Murphy’s Law which states that “anything that can go wrong will go wrong”, the imagination of fraudsters, and external events completely beyond management’s control. Bank fraud is therefore the first type of risk that any institution takes on. Managing and mitigating the bank fraud of an organization is a significant challenge for senior managers. (Adam 2011). A vast amount of resources, time and energy are used up in developing Corporate Governance Policies, implementing internal control systems, risk management strategies and training employees to adhere to these measures. Yet, some dishonest, intelligent people, commonly referred to as fraudsters, still manage to find ways to override systems or dupe honest people in to gaining access to organizations’ resources and assets.

For example, the China’s banking sector has around 20 billion Yuan ($3.2bn, £1.8bn, €2.4bn) of exposure to the companies at the centre a massive fraud probe in the eastern port city of Qingdao. In Nigeria, The Central Bank of Nigeria (CBN) reported that cases of attempted fraud and forgery in banks, as at half-year 2012 exceeded what was recorded in the whole of 2011. For instance, the CBN half-year report for 2007, disclosed that a total of 741 cases of attempted fraud and forgery, involving N5.4 billion (US $34.8 million), were reported as at June, 2012. Whereas in 2006, the entire cases of fraud reported were 1,193, involving the sum of N4.8 billion (US $30.97). Fraudsters stole at least $9.4 million from commercial
banks in the first half of the year in schemes that exploited gaps in online banking solutions and involved collusion with bank staff.

Data from the Banking Fraud Investigations Department (BFID), a division of the Central Bank of Kenya, shows that 525 cases of fraud were leading to a loss of $8.5 million by various financial institutions in the first quarter of 2014.

Research shows that there is not a single financial organization that is immune to fraud, and that the typical organization loses 5-7% of its annual revenues to fraud. (Samociuk, Iyer&Doody 2010, 11). Developing preventative measures against fraud, identifying the methods through which fraud is or can be committed, establishing effective control measures and putting in

Although fraud is one of the focuses of the Kenya Bankers Association (KBA), information is still only thinly available. This research seeks to fill that gap by examining fraud in the Kenyan banking industry and identifying ways in which the industry could improve its fraud handling.

The Kenyan banking industry is regulated by the Central Bank of Kenya (CBK), which manages bank supervision and monetary policy in line with key economic objectives within Kenya (Central Bank of Kenya, 2011). The Central Bank of Kenya was established following independence in 1966, and was re-established in 1997 with a higher 2 level of autonomy to set monetary and fiscal policy; however, the bank is not as yet fully independent. The bank’s core mandate for supervision includes review and revision of laws and policies related to banking as well as licensing and oversight of financial services and banking agencies operating within Kenya, including commercial and retail banks, microfinance agencies, mortgage agencies, insurance companies, and other companies (Bank Supervision Report, 2008). As of Dec 2010 the total number of banks registered in Kenya included 43 commercial banks, 126 foreign exchange bureaus, two representative offices of foreign banks, two microfinance institutions, and one mortgage finance company (Bank Supervision Report, 2010).
Fraud in the banking industry is not formally tracked by the Central Bank, and thus there is no information regarding how this affects bank profitability and operational capacity. Although fraud is one of the focuses of the Kenya Bankers Association (KBA), information is still only thinly available. This research seeks to fill that gap by examining fraud in the Kenyan banking industry and identifying ways in which the industry could improve its fraud handling.

The research covers Standard Chartered Bank. This is because it has a heavy and long time presence in Kenya. Hence they will make a good reference and will represent other foreign banks to an extent.

1.2 Problem Statement
A vast amount of resources, time and energy are used up in developing Corporate Governance Policies, implementing internal control systems, risk management strategies and training employees to adhere to these measures. Yet, some dishonest, intelligent people, commonly referred to as fraudsters, still manage to find ways to override systems or dupe honest people in to gaining access to organizations’ resources and assets.

The unfortunate truth is that a majority of organizations that fall victim to fraud do not take the time to fully understand the actual risks involved in fraud and therefore do not make efforts to detect and prevent fraud before it actually occurs.

Developing preventative measures against fraud, identifying the methods through which fraud is or can be committed, establishing effective control measures and putting in place fraud resolution guidelines not only helps organizations prevent the loss of revenue and assets, but also improves the quality of their business processes and their overall reputation in the business environment.

1.3 Purpose of Study
This study seeks to establish the impact of bank fraud in the case of Standard Chartered Bank Kenya.

1.4 Research Questions
1.4.1 What are the causes of bank in the foreign banks in Kenya?
1.4.2 What are the risks of bank fraud?

1.4.3 What strategies should be used to combat bank fraud?

1.5 Importance of the Study

1.5.1 Importance to Policy Makers

The government will need this information to put in place regulations to either protect customers or control the banking sector by ensuring strict buffer. Banking is one of the major supports of most economies and as such when the field is changing so do the rules that govern this sector to keep up with the changes. The banking crises of 2000s have only made it imperative for greater control measures to be put in place and this research will help in this. The management of the banks can also use this research to come up with policy that mitigate against fraud.

1.5.2 Importance to banking industry

As the main research participants the information will help in understanding the causes, risks and the strategies that can be used to combat fraud. The banks will be able to see the how this affects their overall profitability and can use this information in regards to any new regulations that might be required in banking as a result of technology and innovation.

1.5.3 Importance to Potential Investors

This research will shed light on the possible types of bank frauds and will help them in understanding and therefore enlighten them on how to avoid falling victim. This will ensure that they do not face huge losses

1.6 Scope of Study

The research will be focused on the top two foreign banks in Kenya with their headquarters in Nairobi, and will involve the senior employees at the banks in the risks and operational department or any other senior employee with responsibility of handling related information. The total number of respondents will be 200. The research is to be carried out in July of 2015.
The challenges foreseen are in getting sincere and informed responses from respondents as the current situation in bank fraud is sensitive, and in this respect the researcher anticipates overcoming the problem by assuring respondents that the information they give in the study would purely be for academic purposes and used in confidence.

1.7 Definition of Terms

1.7.1 Bank fraud

Activities undertaken by an individual or company that are done in a dishonest or illegal manner, and are designed to give an advantage to the perpetrating individual or company (Chapman, 2012).

1.7.2 Foreign banks


1.7.3 Strategy

A plan of action or policy designed to achieve a major or overall aim (Kottler & Keller, 2011).

1.7.4 Policy makers

Individuals (usually members of the board of directors) who have the authority to set the policy framework of an organization (Chapman, 2012).

1.8 Chapter summary

Chapter One was an introduction to this study, laying out the background of the study and the aims, objectives and research questions of the research at hand. This chapter also introduces the scope, rationale and significance of this study.

In Chapter Two, the literature on fraud talks about the external and internal environments that affect fraud levels. In Chapter Three, the Research Methodology chapter describes the mixed methods approach that was considered appropriate in conducting the primary research of this study. Chapter Four mainly discusses the results and findings. Finally in Chapter Five,
Conclusions and Recommendations, the main issues that emerge from the study are discussed.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This literature review constructs a theoretical framework regarding banking fraud and provides a discussion focused on the research questions. The goal of the literature review is multi-fold. First, in Section 2.2 it presents the background information required to understand the causes of fraud in the banking industry in a real-world context. It defines fraud in the context of this study and outlines the different types of fraud that are the main focus of this study. Section 2.3 presents the theoretical underpinnings of the risks of fraud that will be used for analysis and examination. It discusses the main risks of fraud used in this study as well as other types of fraud. The discussion about the fraud theories leads into a discussion on the external and internal environmental factors that affect the levels of fraud. Various strategies that should be used to combat fraud are considered in Section 2.4 while Section 2.5 is the chapter summary of what has been discussed and what will be covered in chapter three.

2.2 Causes of Bank Fraud

2.2.1. Financial problems

“Trusted persons become trust violators when they conceive of themselves as having a financial problem which is non-shareable, are aware that this problem can be secretly resolved by violation of the position of financial trust, and are able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property.” (Cressey, 2013, p30)

The first factor, pressure on the employee, occurs due to “non-shareable” financial problems. Cressey (2013) identified fraud as being the outcome of problems that the individual perceived as being in some way non-sharable. He identified six types of non-sharable problems that were seen to lead to the potential for fraud within the individual. Figure 2.4 shows these types of problems. Cressey (2013) viewed the term “non-shareable” as being
relative, varying from person to person. Thus, what is non-shareable to one person may not be non-shareable to another. However, he concluded that non-shareable problems were concerned with status-seeking or status-maintaining activities. The six categories of non-shareable problems include violations of obligations, personal failures, business reversals, isolation from friends and associates, status gaining demands, and problems in the employer-employee relationship (Cressey, 2013).

2.2.2 Opportunity.

By itself the non-shareable problem will not lead an employee to commit fraud (Wells, 2014). The employee must also perceive that he/she has the opportunity to commit the crime without being caught. While the position of trust may provide an opportunity for the solution of a non-shareable financial problem, Cressey (2013) found that many trusted people did not at first see in their positions of trust the opportunities which such positions offer, and thus did not engage in fraud by using entrusted funds to solve their non-shareable problems. Making the connection between the non-shareable problem and the illegal solution is a product of the interrelated intellectual processes of knowing and rationalizing that the problem can be solved by violation of their position of trust. Rarely would a person in a position of trust not know, in a general way, that the position of trust can be violated, and therefore, that an objective opportunity for trust violation exists. With respect to general information, Wells (2014) states that the very essence of an individual’s fiduciary capacity implies that since the position is one of trust it is capable of being violated. Opportunities could present themselves in the form of poor internal controls, weak discipline policies or poor organizational ethics (Cressey, 2013; Wells, 2013).

2.2.3 Rationalization.

The act of rationalization is not an after-thought that justifies the fraud, but it is the real reason(s) which the person has for acting in a fraudulent manner. Rationalization is, therefore, part of the motivation to commit fraud and is often abandoned after the criminal act has taken place (Wells, 2014). Cressey (2013) observed that a trusted person does not invent a new rationalization for his violation of trust, but rather he applies to his own situation a verbalization which has been made available to him by virtue of his having come
in contact with a culture in which such verbalizations are present. The fraudulent individual acquires such verbalizations from other persons who have had prior experience with situations involving positions of trust and trust violation. This resonates the Differential Association theory earlier discussed (Sutherland, 2009) that suggests that an individual learns crime from their association with persons already exposed to it. Examples of such ideologies that seek to justify the crime are: “some of our most respectable citizens got their start in life by using other people’s money temporarily”; “all people steal when they get in a tight spot”; “my intent is only to use money temporarily so I am ‘borrowing’, not ‘stealing’; “I have been trying to live an honest life, but I have had nothing but troubles so ‘to hell with it” (Cressey, 2013; pgs. 102-107, 110, 118, 124)

These cultural ideologies are contradictory to the theme that honesty is expected in all situations of trust. The individual uses such ideologies to adjust contradictory personal values in regard to criminality on the one hand and integrity, honesty and morality on the other. These rationalizations form excuses for the trusted person to violate the trust but are not sufficient in escaping legal prosecution. Employees who take organization funds for their own purposes over a prolonged period of time have been known to consider themselves as borrowers rather than criminals. It is only when the rationalizations are abandoned that the trust offender sees himself for what he is, a criminal (Cressey, 2013; Wells, 2014).

Cresset’s Fraud Triangle has been used to explain the nature of fraudsters for many years. However, in concluding his research Cressey (2013) points out that the fraud triangle theory is limited in its practical use for prevention and detection of trust violation like fraud or for treatment of apprehended offenders. Wells (2014) has also echoed the same sentiment that the fraud theory triangle has had little application when it comes to fraud prevention. This theory is therefore open to revision. One obvious critique of this model is that it describes antecedents that may be present in a large number of cases that do not result in fraud. Thus, the fraud triangle cannot be said to be predictive; rather it is a descriptive model that is best used in post hoc analysis (Day, 2010). Furthermore, the elements that are posed within this model cannot always be seen to be present; one example of this is many cases of executive fraud, in which there is no discernible non-shareable problem that must be solved by the fraud (Albrecht, Albrecht, & Albrecht, 2013). This means that even if the fraud triangle is
used predictively, it cannot be used to fully model all cases, because some cases will fall outside this model. There is also a limitation in the existing research in that the majority of research is placed on issues of opportunity and putative motivation for the fraud. In contrast, elements of rationalization, cognitive capability to perform the fraud, and the incentive to commit fraud have been relatively poorly studied in the literature; thus, there are a number of assumptions that must be made about these areas (Holton, 2009). The reason for this lack of study may be due to a fundamental problem with the formulation of the rationalization construct; given that actually identifying the rationalization used by the individual at the time of the fraud is not possible and many individuals may engage in post hoc rationalization, there is no real way to identify the actual rationalization for the crime (Souse & Wright, 2012). This means that the majority of fraud research necessarily focuses on the development of opportunity and, sometimes, identification of fraud incentives, rather than rationalization.

2.2.4 Differential Association

Sutherland (2009) suggested that crime is learned, just like any other subject. He believed that criminal behaviour occurred with other persons in a process of communication and hence criminality could not occur without the help of other people. Gaylord and Gallaher (2012) observe that Sutherland in departure from economic explanations, biological and pathological perspectives attributes crime to the social context of the individual. Sutherland (2009) viewed criminal behaviour as arising when an individual is exposed more to definitions favourable to violation of law than to definitions unfavourable to violation of law; hence criminal behaviour is a consequence of conflicting values. He theorised that the learning process consisted of two areas: the techniques to commit the crime and the attitudes, drives, rationalizations and motives of the criminal mind. Thus he found that organizations that have dishonest employees will eventually ‘infect’ a portion of honest ones and generally that honest employees will eventually have an influence on some of those who are dishonest (Sutherland, 2009; Wells, 2014), and assumes all persons are equally exposed to criminal and anti-criminal behaviour patterns. In spite of criticisms brought forward against it, the Differential Association theory’s contribution is strong and several contemporary theorists in criminology and sociology have extended and expanded on Sutherlands’ theory to explain criminal behaviour (Akers, 2012; Burgess and Akers, 2013; Bandura, 2011; Glaser, 2012).
2.2.5 Job dissatisfaction

Research by Hollinger and Clarke (2011) on 12,000 employees revealed that dissatisfaction motivated employees to commit fraud. When employees perceived that their jobs or working conditions were unfair, they were more likely to justify and commit fraud (Wells, 2014). However, this theory is difficult to prove due to the relative lack of information regarding employee theft in general; while it can be studied in its particulars, it is difficult to identify in general due to lack of reliable and widespread information about employee theft (Mustaine & Tewksbury, 2012).

2.2.6 Capability of the offender

Wolfe and Hermanson (2013), argued the offender requires the capability of committing the crime, where capability may involve the technical knowledge, confidence etc. to execute and/or get away with the crime (Wolfe & Hermanson, 2013). The inclusion of cognitive capabilities and biases has helped to rectify some of the potential limitations of the fraud triangle; for example, one group of researchers uses cognitive heuristics to understand why in some cases managers may develop a rationalization to commit fraud, while others did not, based on individual cognitive biases and conditions (Anadarajan & Kleinman, 2011). Social manipulation, or the involvement of others in the fraud through subterfuge or manipulation of emotions, social status, or other factors, is also often called social engineering. This form of manipulation allows the fraud perpetrator to involve others in the fraud, in order to use their access or skills to benefit the fraud perpetrator. Thus, this type of fraud may involve others as co-conspirators who are not fully cognizant of the nature of the fraud (or who may not know about it at all), but who are rather acting out of desire to help a co-worker or other acquaintance (Omar & Mohamad Din, 2010).
2.2.7 Criminal behaviour is learned

Sutherland (2009) suggested that criminal behaviour is learned. However, it differs from the Differential Association theory in that it presupposes the existence of a specific criminal culture, which is associated with people living in a specific area or within a specific ethnic group (Costello, 2012). He assumes that criminals have been transmitted into a culture of crime by being socialized to accept specific values that condone crime. Therefore implying that fraudulent behaviour in accounting is learned. These sociological theories of crime emerged in the early 20th Century in order to explain the emergence of criminal groups in specific regions of a city, ethnic group, or class (Costello, 2012).

2.2.8 Misfit between values and norms

When there is a misfit between values and norms e.g. the dilemma between goals and the means to achieve it. In a bid to align the goals with the means an individual may adopt five types of solutions, including conformity, innovation (using illegitimate means to achieve success, as in accounting fraud), ritualism, retreatism, and rebellion (Durkheim, 2014; Merton, 2012; Merton, 2011). All these adaptations arise from the pressures of the society that accentuate economic success and the difficulty of achieving it. Thus the anomie theories involve the failure to match norms or values of ambition with the ability to realize the goals using illegitimate means (Durkheim, 2014; Merton, 2012; Merton, 2011).

2.3 Risks of Bank Fraud

The effect of fraud in foreign banking industry are felt by all, if not as a customer, then, as a citizen of nation. The effect of fraud has a chain reaction on the community as a whole because this industry constitutes a vital position in a community. Every part of the economy, especially the banking sector is punctuated with fraud. Thus, its, success or failure goes a long way to determine the success of the community. Fraud is a major cause of bank failure. The number of fraud that occurs in foreign banks is so alarming with the overall effect on poor bank performance. The amount of money lost to fraudsters is large; such amounts taken out of the coffers of banks do not generate any income for banks, but rather result to bank solvency and liquidity problem. Recently two officials of Skye bank Plc, was arraigned
before a chief 21 magistrate’s court on a three count charge of forgery and stealing. In Union bank Plc; eight staffs were accused on two separate charges that border on criminal conspiracy, stealing by fraudulent conversion, money laundering and fraud to the tune of about ₦ 700million. The then Oceanic Bank Managing Director was involved in fraudulent cases. Frauds lead to loss of money which belongs to either the bank or customers. This loss results in a decline of productive resources available to the bank. The following are some under listed effects of bank frauds and forgeries.

2.3.1 It destroys the bank’s reputation.

Despite the amount of money that banks put into risk management, be it operational, investment, or political risk, there is one area that banks have traditionally only mentioned in passing, that of reputational risk.

Now that is not to say that banks haven’t acknowledged reputational risk. Indeed back in 2005, the Economist Intelligence Unit found that “52 per cent consider reputation risk as a risk by itself, while 48 per cent consider it as a consequence of other risks” like operational risk – people, process, systems and external events – compliance

And yet, pre-the credit crisis, around the world banks had been feted for their strategies, while countries such as Ireland and Iceland were being cited as models for other sovereigns to aspire to in terms of regulating financial services. So it was understandable that reputational risk tended to take a back seat.

The strange thing is that reputational risk isn’t new. From Barclays and its continued trading in Apartheid South Africa to Arthur Anderson and its role in the Enron saga, financial services should have kept an eye on this risk. Indeed, Andersen is a classic case of reputational risk management.

2.3.2 The trust and understanding among staff is reduced.

Trust among co-workers, managers, and other bank team members is built, confirmed, weakened, or destroyed every day. Trust increases slowly over time through repeated interactions—but can dissolve in moments from just one bad criminal activity.
Trust is a key component in a healthy work environment. In bank facilities where trusting work relationships exist, more work gets done. Team members work together collaboratively. Job satisfaction, morale, and job retention are high. Absenteeism is low because trust buffers high stress levels.

2.3.3 Fraud reduces bank’s profitability.

Fraud leads to loss of money belonging either to the bank or customers. Such losses may be absorbed by the profits for the affected trading period and this, consequently, reduces the amount of profit which would have been available for distribution to shareholders. Losses from fraud, which are absorbed by the equity capital of the bank, impair the bank’s financial health and constrain its ability to extend loans and advances for profitable operations. In extreme cases, rampant and large incidences of fraud could lead to a bank’s failure.

Fraud can increase the operating cost of a bank because of the added cost of installing the necessary machinery for its detection, prevention and protection of assets. Moreover, devoting valuable time to safeguarding its asset from fraudulent men distracts management. This unproductive diversion of resources reduces outputs and low profits which in turn could retard the growth of the bank.

2.3.4 It places emotional and psychological burdens on the fraud victims.

There is a perception among some members of the public that fraud is a ‘victimless’ crime or has little impact (Duffield and Grabosky, 2011)

The impact of fraud can also lead to a range of health problems, both physical and mental. Spalek (2012) in a study on the victims of the Maxwell pension fraud found that ‘anger’ was a common emotional impact of the fraud. She also found they suffered stress, anxiety and fear as a result of their loss.

2.3.5 It discourages banking habit among the banking public.

Fraud as witnessed in recent times has resulted in the collapse of many banks, this raises the question of how reliable are banks to trust ones money with them, the ethics of banking profession which is honesty, reliability and competence are far fading away. It is
disheartening to note that the successful prevention of a particular fraud give rise to a more complex and sophisticated one by the perpetrators and the category of staff involved are increasingly those of higher rank. This brings a great concern to the society.

2.3.6 The bank ceases to meet up with staff welfare.

The Bank is fully committed to supporting the health and welfare of its employees. These include insurance, paid leave (both annual and sick leave), social event activities such as team building or parties. But with reduced profits through bank fraud the bank will not be able to meet the above staff welfare

Others risk of bank fraud include; lack the ability to complete favourably with its competitors, public criticisms, increased operating expenses, damage to credibility, endangered bank’s plan and strategies, reduced operational efficiency, bank’s liquidation, a decrease in foreign direct investments and foreign investors, depletion of shareholders funds and banks capital base, and bad national image.

2.4 Strategies Used to Combat Bank Fraud

Types of fraud encountered in the banking environment include internal fraud and external fraud (Black, 2014b; Greenbaum&Thakor, 2010; Mishkin, 2011; Weiss, 2013). Fraud detection and prevention is at the heart of every fraud management system. Detection of fraud is highly complex, and a large percentage of fraud cases are actually detected externally (such as by the media or external auditors) or by accident (Dyck, Morse, &Zingales, 2010). However, approaches such as lifecycle monitoring and verification can be used to reduce the incidence of fraud overall (Potter, 2012; Porter, 2010; Wilhelm, 2013;Venkatraman&Delpachitra, 2009).

According to Wilhelm (2013) the fraud management lifecycle can be used to encapsulate the process of fraud prevention. This cycle consists of eight stages, including deterrence, prevention, detection, mitigation, analysis, policy, investigation, and prosecution (Wilhelm, 2013). The deterrence stage involves activities that hinder or discourage fraud through fear of consequences (Wilhelm, 2013; Webster, 2012). On the other hand prevention activities hinder, check, keep away or stop the fraudster from committing fraudulent activities. The
detection stage uncovers existing or attempted fraud while mitigation includes activities designed to stop the continuation of the fraud e.g. blocking access to the bank account. The analysis stage seeks to determine the root cause of the fraud and the factors that led to the occurrence of the fraudulent activity. The policy stage is characterised by the creation, evaluation and communication of policies aimed at reducing fraud e.g. fixing limits to the authority to incur expenditure such as any transaction over £10,000 should be reported. The seventh stage of investigation brings together any evidence and information to curb further fraudulent activity, recover assets or secure restitution and gather evidence necessary for the successful prosecution of the fraudsters. Many known frauds are not prosecuted due to concerns about the damage such prosecution could cause to the image and reputation of the organization. The combination of internal factors (information technology, risk tolerance, fraud management philosophy etc.) and external factors (regulatory requirements, competitors, fraud methods etc.) all play a part in influencing fraud management. The complexity of fraud management increases with a dynamic and ever growing environment (Wilhem, 2013; Webster, 2012).

Specific signs of potential fraud by insider employees that Porter (2013) identified included long hours, refusal to delegate, different behavioural patterns than expected, copying data, overriding controls, and relatively low levels of documentation. This suggests identifying these factors is crucially important for detecting fraud.

The rest of this section discusses auditing as a measure of fraud management. Also discussed is how banks can prevent fraud as well as how fraud can be detected.

2.4.1 Auditing

Often a strong system of internal controls is the frontline defence that an organization can employ to prevent and detect fraud. The absence of internal controls does not always preclude the occurrence of fraud but it does leave potentially an open door for it to happen. Poor internal controls manifest themselves through: poor inventory control, lack of proper documentation and support for cash payments, lack of segregation of duties, ineffective or obsolete accounting software and the absence of independent verification (Doyle et al., 2014; Porter, 2013)
To prevent these failures, companies should conduct periodic risk assessments, lead by either internal or external auditing staff. The assessments should focus on high-risk areas, such as physical controls relating to high-dollar fixed assets, cash, marketable securities, payroll and inventory.

Specific questions should be raised during these assessments: Is there a policy of locking doors and filing cabinets after business hours? Does the company require the use of identification numbers and passwords, which are kept, secured and rotated on a regular basis? Does the company have a policy of mandatory vacations and job rotations? Does the company have at least one back-up copy of all data and software files stored at a secure off-site storage location? Does the company run background checks on new employees?

Internal and external auditing, or oversight by independent accounting professionals of the company’s accounts and reports, is a major approach to fraud reduction (Wells, 2014). Evidence regarding auditing indicates that many companies actually desire audits even in the absence of regulation requiring it (Wallace, 2013). For example, following the 2011 relaxation of mandating auditing statements for private corporations in Canada, 73% of the companies that had previously been required to audit continued to do so even though it was no longer required (Wallace, 2013). Of the remaining 27%, many firms continued to use a review engagement rather than a formal audit (Wallace, 2013). This is consistent with agency and information theory, which indicate that auditing is an important element in reducing agency problems and providing full information to owners (and not only to regulators).

2.4.2 Whistle blowers and regulatory requirements

Whistle blowing is traditionally a voluntary practice of individuals who observe something incorrect about a given auditing or accounting situation and bring it to the attention of auditors (Schmidt, 2014). However, there has also been a movement in recent years to introduce a regulatory requirement for whistle blowers, or to induce some regulatory compensation or incentive to blow the whistle (Schmidt, 2014). Schmidt (2014) found that a variety of measures in the US, UK and Germany have been identified and intended to enforce the obligation for whistle blowing. These include the US Sarbanes-Oxley (SOX) Act of 2012, the British Public Interest Disclosure Act (PIDA) of 1998, and a variety of special-
purpose German regulations and case law (Schmidt, 2014). Although the specifics of each law vary, the ultimate intent is to influence the whistle blower to bring the irregularity to attention either through positive influence (monetary incentive) or negative influence (the potential to be prosecuted if it is found out) (Schmidt, 2014).

Whistle-blowers may face significant social pressures in African societies, however, which may mean that regardless of incentives, there may be a strong incidence of retaliation that will act as a negative incentive to engage in the disclosure activity (Domfeh&Bawole, 2011). There are also structural impediments to whistle blowing, such as elements of the African Union Convention on Preventing and Combating Corruption, which promotes a presumption of guilt that whistle-blowers must overcome (Schroth, 2014). A significant case of whistle-blowing relates to the infamous Kenyan Goldenberg Scandal (referred to in Chapter 3 Section 3.6). Another famous Kenyan whistle-blower, John Githingo, a journalist, also resigned his job and fled the country two years after unearthing evidence of corruption, fraud and graft at high levels of government in Kenya (Transparency International, 2014). These cases discourage the practice of whistle-blowing in Kenya. Even though some laws have been passed to protect the whistle-blower there is still lack of effective legal protection for whistle-blowers in Kenya (Transparency International, 2014). Thus, whistleblowing, though it is considered to be valuable in a Western context, may not be effective in the Kenyan banking environment.

2.4.3 World Bank Fraud Detection and Prevention Rules

A major factor in the modernization of the Kenyan banking system has been the imposition of World Bank rules for development lending (McGee, 2012; Muhoro& McGee, 2012). Thus, World Bank rules are likely to be highly relevant for the development of fraud detection systems in the Kenyan bank. The World Bank has its own series of rules for fraud and corruption prevention and detection in World Bank projects. They include specific anticorruption policies intended to address corruption in the bidding and loan processes in general bank operations and case studies that highlight where and when fraud may be found (Aguilar et al., 2011). The guidelines also include a specific ethical guidance for bank staff intended to address problems of ethical practice by bank employees.
2.4.4 Supervision

Bank fraud commonly emerges as a response to inadequate supervisory conditions (Evanoff & Kaufmann, 2014). Supervision at the government level is arranged in different ways depending on the jurisdiction. While the European Union has a central and single bank supervisory structure, the United States has shared bank supervision structures. This can lead to uncertainty regarding bank management, including the understanding of what would occur if the bank failed as well as who bears responsibility for losses from fraud. This can be particularly difficult in the case of international banks, where different levels of supervision and different supervisors may be present in the different countries. Thus, a bank that may be appropriately controlled in the home country may not be subject to appropriate oversight in other countries (Evanoff & Kaufmann, 2014).

2.4.5 Restriction of Business

Although banks may not detect initial fraud, they will have much stronger reactions following disclosed fraud by customers (Graham, Li, & Qiu, 2012). Specifically, companies that are forced to restate their earnings face higher spreads and interest rates and more demand for securing of loans than those that do not, as well as higher fees; those that have restated due to fraud are even further penalized. Thus, the bank can use contract terms to protect themselves from information asymmetries identified through these restatements (Graham, Li, & Qiu, 2012). However, it is uncertain how often this happens in Africa.

2.4.6 Human Resources Strategies (Recruitment and Selection)

One major individual response that banks may use in order to reduce fraud is to use recruitment and selection strategies to limit the exposure to those believed to be untrustworthy. However, this has not been very effective in the African context for a variety of reasons.

Human resources management practices, including recruitment and selection, are seen as a means of controlling for risk management (Meyer et al., 2011). However, some firms in Africa (as in Meyer et al’s study in South Africa) often have poor recruitment practices, such
as not checking CVs or references prior to the hiring of the employee. Recruitment and selection practices including not checking CVs or references can often be seen to be related to structural issues, such as not being able to rely on support from previous employers and sabotage by employees (Meyer, Roodt, & Robbins, 2011). Thus, while firms should rely on recruitment and selection practices to lessen the potential for internal theft or other risks, in practice this may not always occur (Meyer, Roodt, & Robbins, 2011). Another issue, observed in Tanzania, is that a bank may outsource or share its back office operations, and in the process lose full control of the recruitment processes used to select the employees working on its accounts (Newenham-Kawindi, 2011). Furthermore, as in the Tanzanian case, the issue of social relationships and its impact on the recruitment practices may also influence the effectiveness of recruitment for risk management (Newenham-Kawindi, 2011). While it might be presumed that the risk of recruitment would be higher for positions such as clerks or cashiers, in fact this is not true; a study of Nigerian banks revealed that between 2011 and 2014, the most frequent perpetrators of fraud were supervisors, managers, or assistants in these roles (Owojori, Akintoye, & Adidu, 2011). As such, increased skills and responsibility cannot be substituted for effective recruitment practices.

2.5 Chapter Summary

This chapter has presented the most relevant secondary information identified by the researcher in the literature for the area of research. The fraud theories provide an understanding about the nature, characteristics and behaviour of fraud and those who perpetrate fraud. A theoretical and contextual framework has been laid by identifying the economic foundations of fraud, corporate governance practices, types of banking fraud and aspects of fraud detection and prevention. The body of empirical evidence for fraud in the banking industry has been examined, presenting specific information and evidence regarding areas such as the use auditing practices for the areas of concern. From the literature presented above it is clear that most of the research and studies on fraud and fraud prevention have been carried out in very few countries, notably, the United States of America, Great Britain and Australia. This justifies and presents a strong case for more fraud research in Africa. In chapter three, the researcher will discuss the research methodology.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology and methods used in the research design of this study. A triangulated research design that combines qualitative and quantitative methods of a questionnaire and interviews in order to examine the research questions is adopted. This chapter attempts to justify the methods applied in the research. It also discusses various aspects of the research methodology including research design (Section 3.2); population and sample selection (Section 3.3); data collection methods (Sections 3.4); research procedures (Sections 3.5); and data analysis methods (Section 3.6). Section 3.7 concludes with the chapter summary field reflections of this study.

3.2 Research Design

The research design employed in this study was a descriptive research design in form of a survey. According to Denzin and Lincoln (2014), research design is the plan and structure used to analyze the subject matter under study and whose purpose is to answer the research questions. The major purpose of descriptive research design is to describe the state of affairs as it is at present. Survey is concerned with particular characteristics of specific population of subjects either at a fixed point in time or varying time for comparative purposes (Evans & Dadzie, 2013).

According to Gaylord and Galliher (2012), descriptive research design has an advantage over causal research design in that it seeks to answer the ‘what’ question rather than the ‘how, when and why’. The disadvantage of descriptive research design over causal research design is that the association between cause and effect may not be as clear which could lead to wrong inferences being drawn by the researcher.
3.3 Population and Sampling Design

3.3.1 Population

According to Denzin and Lincoln (2014), the population in a study is the collection of people or elements onto which a measure is subjected in order to make inferences. The population will be focused on 60 respondents within the bank.

3.3.2 Sampling Design

The sample design is the method by which the selection of primary elements of study and analysis are determined in order to respond to the research questions (Gaylord and Galliher, 2012).

3.3.2.1 Sampling Frame

According to Cooper and Schindler (2014), the sampling frame is the list of elements representing the population from which the sample is drawn. Often times, a researcher may not get direct access to the entire population of interest thus they rely on the sampling frame to represent the entire population.

3.3.2.2 Sampling Technique

The sampling technique is the process of selecting the specific methodology to use in deciding the entities in the study (Elliot & Willingham, 2010). Simple random sampling is the key to obtaining a representative sample since every sample of a given size in the accessible population has an equal chance of being sampled. The technique will allow the researcher to get a higher response rate as respondents are easily available in the foreign banks.

3.3.2.3 Sample Size

Sample size is the number of observations in a sample (Bolton & Hand, 2012). It is commonly denoted \( n \) or \( N \). A sample size of 60 has been selected for the purpose of data collection within Nairobi City.
The following formula has been recommended by Yamane (1973):

\[ n = \frac{N}{1 + Ne^2} \]

Where:

- \( n \) is the sample required
- \( N \) is the total population
- \( e^2 \) is the probability error

This study assumes a confidence interval of 95% which means the allowed error is 5%.

3.4 Data Collection Methods

The information required for the study was collected through a structured questionnaire which had the study research questions as the basis on which the questionnaire was formed. Respondents were requested to provide specific information through the questionnaire which had both open ended and close ended questions. There was use of the likert scale, short responses, yes or no and check boxes accordingly.

There was four parts in the questionnaire: the first part was for the respondents background information, the second part was based on the first research question, the third part was based on the second research question and finally the fourth part was based on the third research question.

In order to enhance the response rate, respondents were assured of strict confidentiality of the information they share with the researcher and that the information was to be used solely for research purposes.
3.5 Research Procedures

The questionnaire was initially pre-tested to ensure the questions will be effective when data collection was being carried out. The feedback from the pre-test was to be used to analyze the quality of the questionnaire. The questionnaires were distributed through drop and pick by the researcher where he was to visit respondents at their places of work, administer the questionnaire and where possible collect them the same day.

The questionnaires were used to collect responses from the respondents as accurately as possible. Short responses, check boxes and/or Likert scale were only used.

3.6 Data Analysis

Data analysis was carried out in order to inspect, clean, transform and model data with the aim of identifying and highlighting useful information that can be used to support the decision making process (Barako 2010). Data collected was edited to ensure completeness, coded and a code book developed, then entered into Statistical Package for the Social Sciences (SPSS). Appropriate descriptive statistics such as central tendencies: mean, mode and median as well as frequencies were used for analysis. Figures, tables, graphs and charts were used to present the analysed data for ease of understanding.

3.7 Chapter Summary

This chapter has summarized the research process in the study, in order to allow for critical examination of the findings. This has included discussion of the materials in terms of the qualitative and quantitative process, as well as the integration of the various findings. The questionnaire was used as the main data collection tool. Moreover, the research design focused on respondents in Nairobi county. In addition, data was analyzed using the SPSS program. The next chapters present the findings and outcomes of the study.
CHAPTER FOUR

4.0 STUDY RESULTS AND ANALYSIS

4.1 Introduction

This chapter discusses the results and analysis of the survey that was conducted. The main aim of the survey was to collect data that would give a wider picture of the nature and characteristics of fraud in the Kenyan banking industry. The survey consisted of 18 quantitative questions, using a variety of question types including rankings and descriptive. The questions were focused in four areas, including background of the respondent, causes of fraud in the organization, risk of fraud to the organization, fraud prevention techniques in use within the organization. This survey questionnaire is attached in Appendix 5. This survey was distributed to a sample of 60 individual respondents from the organization.

Following identification of hypotheses regarding the relationship between fraud and Organizational characteristics (presented in Chapter 2), statistical analysis was performed using the statistical package SPSS. This analysis included descriptive statistics and inferential univariate and multivariate inferential statistical analysis, designed to both provide a hypothesis-testing approach and to identify any other relationships or patterns that could be seen within the data. An exploratory approach was used in order to identify any other potential relationships.

Section 4.2 presents the demographic data. Sections 4.3, 4.4 and 4.5 present the three objectives of the study with the findings in light of the research questions and the conceptual framework. Finally Section 4.6 summarizes the outcomes of the findings and analysis.

4.2 Demographic data

The results of this study focused in three areas. First, in order to understand where the responses to the study have been derived from and the overall sample used for this study, a respondent study was built using the demographic and organizational information that was
collected within the study. Second, descriptive statistics were provided that identified specific issues involved in the data set and described the distribution of variables. Third, statistical processes were used in order to identify relationships that were used to either prove or disprove the hypotheses that were stated above. The results of this research were then analyzed in terms of the existing literature on fraud in the banking industry in order to determine where there were differences and similarities, as well as new insights that have emerged from the process of this research study.

4.2.1 Respondent Profile
This study was built on a sample of 60 respondents from the organization. A profile of the respondents has been built in order to determine the organizational context in which this research has taken place. The respondent profile included organization-specific characteristics (including the description of the banking operation, the type of business organization, the number of employees, and the turnover lost to fraud over the past year) as well as respondent-specific characteristics (including the position in the organization, the number of years in this organization, the highest academic/professional qualification).

4.2.2 Respondent Characteristics
There was also analysis of the data provided by the respondents to the study themselves. The responses for this study came from a wide variety of individuals within organization, with varying degrees of responsibility within the organization itself as well as a variety of levels of experience, both within the organization and outside it. Table 4.1 shows the job titles of respondents (which have been standardized but not collapsed).
Table 4.1 Role of the respondent in the organization

<table>
<thead>
<tr>
<th>Job Title</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit and Investigations/Internal Auditor</td>
<td>18</td>
<td>30.0%</td>
</tr>
<tr>
<td>Audit Manager/Chief Internal Auditor</td>
<td>5</td>
<td>8.33%</td>
</tr>
<tr>
<td>Risk Manager</td>
<td>5</td>
<td>8.33%</td>
</tr>
<tr>
<td>Accountant</td>
<td>3</td>
<td>5.0%</td>
</tr>
<tr>
<td>Auditor (Internal)</td>
<td>3</td>
<td>5.0%</td>
</tr>
<tr>
<td>Fraud Investigation</td>
<td>3</td>
<td>5.0%</td>
</tr>
<tr>
<td>Fraud Prevention and Investigation/Operations</td>
<td>3</td>
<td>5.0%</td>
</tr>
<tr>
<td>Head of Security</td>
<td>2</td>
<td>3.33%</td>
</tr>
<tr>
<td>Internal Investigations</td>
<td>2</td>
<td>3.33%</td>
</tr>
<tr>
<td>Manager (Not further specified)</td>
<td>2</td>
<td>3.33%</td>
</tr>
<tr>
<td>Operations Manager</td>
<td>2</td>
<td>3.33%</td>
</tr>
<tr>
<td>Security/Investigations Manager</td>
<td>2</td>
<td>3.33%</td>
</tr>
<tr>
<td>Assurance Manager</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Internal Control Monitor</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Floor Services Manager</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Forensic Manager/Forensic Auditor</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Head of Accounting</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Head of Finance</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Heads Internal Control &amp; Compliance Dept</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Information System Auditor</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Systems and Process Analyst</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Validation Specialist</td>
<td>1</td>
<td>1.66%</td>
</tr>
<tr>
<td>Total</td>
<td>60</td>
<td>100%</td>
</tr>
</tbody>
</table>

Respondent-specific questions included the number of years worked in the current institution, the number of years overall experience in the accounting or auditing field, and the role of the respondent in the organization. Table 4.1 shows a wide variety of respondents, and the majority of who fall into fraud prevention and detection, security and auditing job functions. The average overall accounting experience was 10.71 years while the average number of years the respondents had worked in the current institution was 6.9 years.
4.2.3 Background of the Respondent

This section deals with section A of the questionnaire which sought to understand the background of the respondent. The first question was about how the gender of the respondent. Forty one respondents (68%) were male and nineteen respondents (32%) were female indicated as shown in Figure 4.1.

![Gender Chart]

**Figure 4.1 Gender of the respondents**

The second question was about the marital status of the respondent. Fifty two respondents (86.5%) were married, seven respondents (11.5%) were single and one respondent (2%) was divorced.

The third question sought to find out the highest academic/professional level of the respondent. Thirty nine respondents (65%) had attained graduate as the highest academic profession while twenty one respondents (35%) had post graduate qualification.

The fourth question focused on the number of years the respondent has worked in the bank. Five respondents (8%) indicated they had worked in the bank for less than 5 years, twenty one respondents (35%) indicated they had worked for between 5-10 years and 34 respondents (57%) indicated they had worked in the bank for above 10 years (See Figure 4.2).
Finally, the fifth question on this section touched on the average monthly income of the respondent. No respondents indicated they were earning below Kshs. 50,000, one respondent (2%) indicated she earned an average monthly income of Kshs. 50,000 – 100,000, eight respondents (13%) indicated they were earning Kshs. 100,000 – 150,000 and 51 respondents (85%) indicated they were earning an average monthly income of above Kshs. 150,000.

4.3 Causes of Bank Fraud

This section deals with the causes of bank fraud and captures Research Question 1 on the perceived causes, characteristics of fraud and the general trend of fraud as this section highlights who the perpetrator is, their motivation and rationalization. The first question was about how the respondents classify the fraud problem. Fifty four respondents (90%) indicated that it was a major problem as shown in Figure 4.3. This high percentage could perhaps have been subjective by the nature of the respondents’ scope of work, which involves detecting and preventing fraud. These results are consistent with the broad-spectrum industry findings.
of the African Fraud and Misconduct survey (KPMG, 2011) that reported 72% of respondents indicated that fraud was a major problem.

![Classification of Fraud](image)

**Figure 4.3: Classification of fraud problem by respondents**

The second question sought to find out how likely it was that fraud would be encountered in the organization. One respondent said that it was quite unlikely, while six (10% of the sample) respondents indicated that it was likely. Twelve respondents (20%) indicated that it was quite likely, while 41 respondents (68.3%) said that it was very likely. In total 98.3% respondents indicated that fraud is likely to occur over the next 5 years in the financial institution.

The third question focused on the course of the trend in fraud. Three respondents said that it was decreasing, while seven indicated that it was remaining constant. Thirty-eight respondents indicated that it was increasing, while 12 respondents indicated that it was increasing rapidly (See Figure 4.4).
Figure 4.4: Trends of fraud

Again this finding is in tandem with findings of the African Fraud Survey (KPMG, 2011), which gave a similar view with 79% of the respondents expressing their view that the trend of fraud was on the rise.

The fourth question sought to find out who was/were the main perpetrator(s) of the fraud. This information was compiled from the opinion expressed by those working to counteract fraud in the organization and not from the fraudsters implicated in committing the fraud (See figure 4.5)
These findings agree with the KMPG (2012) report that revealed that over 75% of frauds are perpetrated by staff in Kenyan organizations and that collusion is the number one form of fraud in the organizations surveyed. If collusion between external perpetrators is included then the overall rate of collusion moves up to 88%, leaving single perpetrators in only 12% of cases. This raises a significant question as to whether previous criminology theories that emphasized the individual characteristics and situation of fraudsters may have over-simplified real situations.

The fifth question sought to demystify what type of fraud was observed. Figure 4.6 shows the relative popularity of an assortment of negotiable instruments and assets that were the target of fraudsters.
This shows that the most popular types fraud based on frequency numbers were cheques (n=60; 66.66% of respondents), cash theft (58.33% of respondents), and credit cards (23.33% of respondents) with identity theft and bribery or kickbacks being secondary. This discovery is consistent with reports appearing both in a national newspaper (Okwemba, 2015) and on the local television (KTN, 2015) revealing that cheque fraud was the most widespread type of fraud suffered by the banking business in the first quarter of 2015.

To support this set of questions asked in this chapter is to compare similar research findings as shown by table 4.2; which shows the frequency and the range types of fraud that were involved. The main kinds of fraud were theft and diversion (theft refers to the taking of money while diversion and misappropriation refer to assignment of funds to other areas). Conversion frauds are those that are used to carry out other frauds. Abuse and misuse frauds refer to frauds related with breach of bank policies for personal gain, while infringement was primarily inappropriate seizure of private customer information.
In addition to the types of fraud and the occurrence of various types of fraud, this research on the last question of this section also examined the identified motivations (pressures) and rationalizations (justifications) for the fraudulent behavior involved. It should be noted that as this information came from the bank staff rather than the fraud perpetrators, this is a third-party judgment for the reasons involved in the fraudulent doings. Table 4.3 shows the relative regularity of various motivations for the fraud. These figures exhibit that opportunity, lifestyle habits, personal financial pressure and greed were the most recurrent motivating factors in the responses. These results generally support findings of KPMG (2012) a study that researched on motivation and rationalization of fraud.

Table 4.3: Motivating factors for fraud
Outcome indicate that most perpetrators commit fraud from opportunity rather than need supports the predator concept (Kranacher et al., 2011). Under this representation, the fraudster looks for opportunities to commit fraud immediately, and do not need rationalization or pressure, but only opportunity (Dorminey et al., 2010). This is contradictory with the fraud triangle theory, in which an individual gradually gives in (Kranacher et al., 2011). However, this is only pinpointing and since feedback was not reported by the actual perpetrators (fraudsters), this could be skewed. The study findings also confirmed that non-shareable problems, including financial pressures, social pressures, greed and living outside one’s means as put by Cressey (2013) were motivators of fraud.

4.4. Risks of Bank Fraud

4.4.1 Overall Review and analysis

This section deals with the risks of bank fraud and captures Research Question 2 on the risks of bank fraud as this section highlights the monetary loss of fraud as a percentage of business turn-over, significant damage to the business, the type of damage and how the fraud was detected. The first question was about how the respondents estimated the overall monetary loss as a percentage of business income. In general loss from fraud was estimated as a percentage of the organization’s turn-over (income). Figure 4.7 shows the overall monetary loss for a usual year established downright as a percentage of the organization’s income. A majority of the organizations respondents reported a monetary loss of less than one per cent of the revenue, although a small number of respondents indicated the organization had a loss of up to 20%. This demonstrates a wide-ranging variance in the loss of funds as an overall total from the banks. This information is however restricted to known or detected fraud that has been reported.
Figure 4.7: Estimated overall loss as a per cent of projected annual revenues

This data represents the information regarding the loss to the organization in terms of the loss of a single fraud as a percentage of annual revenue. The mean overall loss reported as a percentage of revenues (N = 60) was 1.57%, with a median 1% and a standard deviation of 2.93%. The minimum was 0.10%, with the maximum being 16%.

These estimated losses are only indicative of the possible problem fraud is within the banking sector. The only similar studies relate to the ACFE (2012) report where it was reported that the average loss for organizations in the USA is 7%. Though, this considers more industries than just the banking industry considered under the current research. Closer to home the African fraud survey (KPMG, 2013) categorized 17% of the loss as ranging over USD$170,000 for all the industries surveyed in that study. A direct comparison cannot be made but it indicates that fraud losses keep on to be incurred and are likely to increase more given the broad opinion about fraud.

The second question focused on if the respondent thought there was a significant damage. Twenty five respondents (42%) indicated there was a significant damage to the business while thirty five respondents (58%) indicated there was no significant damage (See Figure 4.8).
The third question sought to find out the type of damage caused by the actual fraud to the bank. Eighteen respondents (30% of the sample size) said that it caused loss of money to the organization, while thirty one respondents (51%) indicated that it resulted to loss of money by the customer. Five respondents (9% of sample) indicated that it lead to a reputational or goodwill loss, while six respondents (10%) indicated that it lead to customer exit. No respondents specified other type of damage from the ones indicated above (See Figure 4.9).
The last but not least question on this chapter focused on how fraud was detected. Fraud was detected in a variety of ways, with the organization using more than one method of detection. Figure 4.10 identifies the major type and frequency of the various ways in which fraud could be detected based on the data collected.

**Figure 4.9:** Illustration of the number of respondents with their respective view of type of damage caused by the fraud

**Figure 4.10:** Ways in which fraud was detected
The information indicates that a third of the incidents were exposed by accident. The use of external auditing was one of the least helpful methods of discovery of fraud, with the same number of frauds being discovered by anonymous letters or calls regarding the incidence. In contrast, whistle-blowers (23.3%), and customer complaints (12%) were commonly resorted to methods of discovering fraud. This is inconsistent with earlier study showing that rated internal controls as being the most famously used detection method followed by whistle-blowing and then by accidental detection (KPMG, 2013). The dissimilarity in outcome from all these studies imply that there is no one universal method for fraud discovery, making fraud discovery and fraud discovery methods fluid subjects.

On another similar research conducted on the banking industry as a whole and primarily focused on local Kenyan Banks. Organizations diversified widely in who investigated the fraud, and some organizations using numerous investigators in order to investigate the crime. The most common stakeholders involved in the investigation (See Table 4.4) included internal investigation by a security division, investigation by a law enforcement body, and review of a case by internal audit committee.

Table 4.4: Investigating parties in reported frauds

<table>
<thead>
<tr>
<th>Investigator Type</th>
<th>Frequency (n=60)</th>
<th>Percept (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Investigation by Security Department</td>
<td>39</td>
<td>65.0</td>
</tr>
<tr>
<td>Law enforcement body</td>
<td>28</td>
<td>46.7</td>
</tr>
<tr>
<td>Case reviewed by internal audit committee</td>
<td>17</td>
<td>28.3</td>
</tr>
<tr>
<td>Risk managers</td>
<td>8</td>
<td>13.3</td>
</tr>
<tr>
<td>Forensic Accountants</td>
<td>6</td>
<td>10.0</td>
</tr>
<tr>
<td>Private Investigators</td>
<td>5</td>
<td>8.3</td>
</tr>
<tr>
<td>Internal Investigation by Finance Department</td>
<td>4</td>
<td>6.7</td>
</tr>
<tr>
<td>Government regulatory body</td>
<td>2</td>
<td>3.3</td>
</tr>
<tr>
<td>External auditors</td>
<td>1</td>
<td>1.7</td>
</tr>
<tr>
<td>Fraud specialists</td>
<td>1</td>
<td>1.7</td>
</tr>
<tr>
<td>Operations team</td>
<td>1</td>
<td>1.7</td>
</tr>
</tbody>
</table>

There appears to be an inclination by banks in Kenya to try investigating fraud cases internally by primarily resolving them through the Audit Committees or the Security
Department. This could be an image saving approach as the banks do not have to expose their fraud troubles to external parties and risk damaging their reputation. However, there are also a considerable proportion of respondents that said that a law enforcement body was involved in fraud investigation. This could be a sign that almost half the fraud cases are reported to a law enforcing body.

4.5 Strategies Used to Combat Bank Fraud

4.5.1 Overall Analysis of Research Question Three

Research question 3 asks how the bank is approaching fraud management. This question addresses the specific organizational and technological approaches to prevention and detection. The significance and use of fraud prevention measures were examined using ranked items that asked how helpful each of the potential firm’s responses was, with 1 representing the most important and 5 representing the least important for a maximum of five responses. Table 4.5 describes the mean, median, and standard deviation of each of these measures, as well as the number of response aligned with each measure.

Table 4.5: Ranked importance of organizational measures

<table>
<thead>
<tr>
<th>Organisational Approach</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improvement or review of internal controls</td>
<td>1.55</td>
<td>1</td>
<td>0.979</td>
<td>55</td>
</tr>
<tr>
<td>Training employees on fraud prevention</td>
<td>2.75</td>
<td>3</td>
<td>1.184</td>
<td>44</td>
</tr>
<tr>
<td>Establishing fraud prevention policies</td>
<td>2.78</td>
<td>3</td>
<td>1.265</td>
<td>37</td>
</tr>
<tr>
<td>Ethical code of conduct</td>
<td>3.32</td>
<td>4</td>
<td>1.282</td>
<td>25</td>
</tr>
<tr>
<td>Implementing a fraud hotline</td>
<td>3.81</td>
<td>4</td>
<td>0.891</td>
<td>23</td>
</tr>
<tr>
<td>Screening/reference checks</td>
<td>3.19</td>
<td>3</td>
<td>1.327</td>
<td>21</td>
</tr>
<tr>
<td>Staff rotation policy</td>
<td>4.19</td>
<td>4</td>
<td>0.834</td>
<td>16</td>
</tr>
<tr>
<td>Security department</td>
<td>3.55</td>
<td>4</td>
<td>1.440</td>
<td>11</td>
</tr>
<tr>
<td>Automated fraud prevention</td>
<td>4</td>
<td>5</td>
<td>1.265</td>
<td>11</td>
</tr>
<tr>
<td>Close supervision</td>
<td>4.1</td>
<td>4.5</td>
<td>1.101</td>
<td>10</td>
</tr>
<tr>
<td>Spot checking</td>
<td>4.1</td>
<td>4</td>
<td>0.964</td>
<td>10</td>
</tr>
<tr>
<td>Limiting opportunities</td>
<td>3.29</td>
<td>3</td>
<td>1.704</td>
<td>7</td>
</tr>
<tr>
<td>Ethics training</td>
<td>3.83</td>
<td>4</td>
<td>0.933</td>
<td>6</td>
</tr>
<tr>
<td>Fraud auditing</td>
<td>4.33</td>
<td>4.5</td>
<td>0.816</td>
<td>6</td>
</tr>
</tbody>
</table>
Table 4.5 shows that the five-most commonly used measures included improvement or review of internal controls (N = 55), the use of fraud prevention and detection training (N = 44), the use of fraud prevention policies (N = 37), the use of an ethical conduct code (N = 25) and the use of a fraud hotline (N = 23). On the other hand, independent t-testing for differences in means indicates that the mean importance ranking for ethical code of conduct and fraud prevention is not in tandem with the frequency of the fraud prevention methods. This data is available in the Appendix (T-Tests).

The responses that were highly ranked, but only by a small set, may be interpreted as being highly effective responses in organizational contexts that require them, but that are not habitually used. One such example is forensic accountants, which are ranked number 3 in mean significance among users despite the relative infrequency of their use. This shows that the bank use forensic accountants and consider them to be very important, but that their actual use is uncommon.

The research has upheld the universal perceived effectiveness of the internal control and audit and its extensive use within the organization, as identified by a couple of other researchers as being an important aspect in the prevention and detection of fraud (Bostan, 2011; Greenlee et al., 2012; Hillison et al., 2010; Moeller, 2014; Adams, 2014). The use of internal auditors has been shown to be consistent with findings by other researchers. This shows that, despite any possible difference between the Anglo-American and African business models, internal controls still have the would-be to be effective in cases where they have been implemented suitably, as consistent with earlier research in this area (Black & Geletkanycz, 2009; Palmer et al. 2008).

The second question in this last section sought to find out how often fraud prevention methods were/are reviewed by the bank. Thirty six respondents (60% of the sample size) indicated that the methods were reviewed quarterly while five respondents (28%) indicated it was reviewed half-yearly. Seventeen respondents (8% of sample) indicated that it was reviewed annually while two respondents (3%) said they did not know how often the fraud prevention methods were/are reviewed by the organization (see figure 4.11).
Figure 4.11: How often the bank reviews fraud prevention methods

From this information most respondents were of the view that fraud prevention methods were/are reviewed quarterly, followed by annually review.

The last but not least question in this chapter focused on the budget for fraud prevention in the organization. Asking a yes or no answer, whether the respondent was aware or knows if there was a budget for such purpose. Fifty eight respondents (96% of sample) indicated that there was a budget for fraud prevention while two respondents (4%) said there was no budget for fraud prevention. The high number that overwhelmingly said yes is due to the fact that majority of respondents are senior staff in the bank who deal with fraud prevention and detection as part of their day-to-day work.

The responsibility of organizational culture in fraud reduction is supported by a huge number of previous researches (Mawhinney, 2009; May, 2013; Moorthy et al., 2011; Stringer & Carey, 2010; Porter, 2013; Wells, 2014; Tipton & Krause, 2010). The majority of studies that have been conducted on fraud in the banking system, as well as organizational fraud generally have been conducted in an Anglo-American business environment. However, there are major differences in the emergent African business model (Sardanis, 2010). Some
changes, such as training on ethics or anonymous hotline establishments, have been sluggish in advancing acceptance in the business setting where this research was conducted. The use of organizational transform management practices can promote positive transformation within the organization, and may be useful in the bank in order to improve organizational practice toward fraud prevention (Palmer et al., 2012).

4.6 Chapter Summary

The findings reveal that a majority of the respondents’ view that fraud is a major problem in the banking industry. There is a likelihood that fraud will continue to increase in the financial sector with the banking industry likely to witness a significant increase in the short and long term mainly due to economic pressures within the country, advanced computer technologies, more sophisticated criminals, ineffective justice systems, changing societal values among others. Fraud hugely consisted of diversion and misuse of cheques, theft of cash, and card fraud by manipulating systems and through identity fraud. Fraud losses are projected generally at less than 1% of the revenue of the bank with a few respondents reporting losses of between 1-20%. Detection was uncertain, with 33% of frauds being discovered by accident and 18% being caught by internal controls.

Using Chi square tests the study established that there was no significant association between percentage loss to fraud and the size of the bank. Further Statistical tests also showed there was a significant association between the use of fraud auditing measures and the level and type of fraud detected.

The major factors that motivated fraudsters to commit fraud as indicated by the respondents stemmed from lifestyle habits, financial pressure, the existence of an opportunity to commit fraud and greed.

Research Question 3 sought to find out “Strategies Used to Combat Bank Fraud” This question has been answered through a range of views that considered fraud prevention,
detection and investigation methods, measures resorted to by the bank on discovering fraud. One third of fraud is detected by accident implying that fraud management partly relies on chance discovery of fraud. The respondents also indicated internal controls as a way through ‘which fraud is detected.

Ranking by respondents showed that banks measures habitually adopted to improve the prevention of fraud were: the improvement or review of internal controls, the use of fraud prevention training, the use of an ethical code of conduct, the use of fraud prevention policies, and the use of a fraud hotline (whistle-blowing).

Overall trends indicate that banks lose about 0.01% of their revenue to fraud in the past year with a mean of about 1.18%. As banks grew larger, losses as a proportion of annual turnover grew smaller. This did not show a normal distribution; though, exact figures were not given by all banks, and there was one extreme outlier that affected the analysis.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The intent of this chapter is to assimilate the qualitative and quantitative findings of this study with the existing literature in order to comprehend fraud in the banking industry. Earlier, the nature and uniqueness of fraud in the banking industry and its ability to detect and prevent fraud has been discussed, in line with the research questions linked with this research:

1. What are the causes of fraud in banking institution?
2. What are the risks of fraud?
3. What strategies is the bank using to manage fraud?

The quantitative and qualitative results of this research have identified a number of diverse trends and factors that can be compared to existing studies and analyzed jointly in order to depict conclusions about how the banks are handling the crime of fraud. The result findings conflict in some areas, although not in others, and in some cases do not support the existing state of the literature. This chapter summarizes findings from the qualitative findings, discusses most important themes and issues and relates them to literature, and marries qualitative and quantitative results.

5.2 Summary

The results of the quantitative and qualitative research had some significant implications in terms of their connection to the literature. The findings were consistent with the conceptual framework, although there were several emergent themes not included in the model. The structural and interpersonal relationships within the banking industry play a clear role in determining both the prevention and occurrence of fraud. However, these relationships, mainly intra-industry associations such as references and the KBA are not being used effectively to prevent fraud. A third issue and perhaps one of the most significant issues
because it cannot be rectified through bank or industry level changes, is the failure of legal institutions, which make it extremely difficult to prosecute fraud in a timely manner.

Overall trends indicate that the bank lost about 0.01% of its turnover to fraud in the past year with a mean of about 1.18. As the bank grew larger, losses as a percentage of annual revenue grew smaller. This did not show a normal distribution; however, precise figures were not provided by the bank, and there was one extreme outlier that affected the analysis. Most respondents felt that bank fraud was a major issue that was increasing in importance.

The results demonstrate that, above all, the problem of insider fraud in the bank is not simply a failure of the individuals, the bank involved, or indeed the banking industry. Instead, it is a broader social problem that is related to government policy and institutions. The advancement of the banking system and structure means that the banking institution, perceived as being one of the cream of the crop institutions, is secluded and does not have access to outside resources to control fraud. However, this is not only a matter of elitism, but of structural adjustment and resulting deregulation.

In general, the findings were largely consistent with the requirements of the Fraud Diamond and Fraud Triangle Theories and to a lesser extent the differential association, agency theory, and the eclectic theories. From this study the presence of collusion, in essence, adds an extra dimension to the fraud elements identified in other studies. These results also pointed to a link between the internal organizational culture and the external environment, demonstrating that there are issues that are seen in wider society and that need to be addressed there.

5.3 Discussion

5.3.1 Causes of Bank Fraud
The lack of a general database for banks has facilitated identity fraud in the banking industry. There is some industrial discussion about centralizing identities in a national database (Ndungu and Etemesi, 2010). This research does support the need for this service. However, creating a national database raises issues of security of data, ownership, financial capacity,
individual rights, access management, and human resources (UNDP, n.d). It is unlikely to be an immediate fix.

In addition, socio-cultural issues are also reflected in the acceptance of corruption as well as economic situations that generate economic stress at many levels of society (Zahra et al., 2014; Bakre, 2010). Ethical issues in banking are reflected in a sense that fraud is accepted within society, although the use of whistle-blower programs does mitigate the outcomes (Aguilaret al., 2010). This can also be mitigated by the fact that the bank should maintain a written code of ethics that should be read and signed on a regular basis by the employee.

Information technology is reflected both in the availability of IT approaches to fraud reduction and to differentials in use and access (Fernandez & Gonzales, 2015). The relative lack of access of IT banking has decreased vulnerability on one front, although it may increase vulnerability on another. Fraud crimes have been boosted by the introduction of the Internet and e-commerce (Seetharaman et al., 2014). Rusch (2011) also noted that there was a rapid increase in the growth of Internet fraud in e-commerce. The current research identified two issues of importance to the bank in respect to IT including the use of online banking and the problem of chip and pin cards.

In addition, there are an increasing number of technology changes that could both prevent and encourage fraud. The bank need to focus more on preventative technologies in order to get ready for the development of inward threats, which are already beginning to be seen within the industry.

5.3.2 Risks of Bank Fraud
The research revealed that those who perpetrated the crime had ready or easy access to the funds. Most of the internal fraudsters used their positions – tellers, IT personnel and accountants -for committing fraud. The majority of frauds perpetrated, were small-scale frauds that were based on cash and cheque misappropriation, manipulation of customer accounts, or other means that were readily available to the staff. This is consistent with the need for opportunity (Cressey, 2013; Wells, 2010). Cheque and cash handling controls could lessen this opportunity. It is possible that, given the relatively small sums of misappropriated
funds (which are large in relation to salary), that sentiment underpaid could be an unsaid motivating factor. This will be consistent with Cressey’s model.

5.3.3 Strategies Used to Combat Bank Fraud

Internal controls was discovered as the major way to fight the crime of fraud, but were not essentially successful. Customers are the reason for any existence of any business, and although there are safeguards against known fraudulent customers in place they are often circumvented. However, customers are also vital in fraud detection as they are a major contributor in discovery of fraudulent activities occurring in their bank accounts. Socioeconomic conditions including financial pressure, lifestyle habits and high unemployment rates are seen as key factors in bank fraud.

The bank reported complacency when hiring new employees, which increased the chance of fraud. The bank through the data collected also indicated different attitudes toward fraud budgets depending on their by and large view of fraud. However, debit and credit card skimming and identity theft were common. The bank is currently in the process of modernizing their computerized fraud detection systems, and some of these systems remain manual. Moreover, the bank does use a code of ethics, but this is not consistent and the view on whether or not this is effective varies.

Findings also indicated that the bank used job rotation, as a control mechanism. This had the effect of both breaking up existing collusion and presenting an opportunity for oversight from other staff members. Job rotations are known to be one of the most useful means of fraud control, decreasing loss to fraud by 61%, even though they are not often used (ACFE, 2011). However, the organizations did not frequently use surprise audits, an additional internal control that is known to be effective, lowering median loss to fraud by 66% (ACFE, 2011).

In addition it was noted that the bank did not carry out regular unscheduled audits. Carrying out regular and at times unscheduled audits causes the staff to be weary that they are being checked on. Auditing therefore serves as a deterrent (AICPA, 2012). In the present economic environment there is a greater demand for internal controls to work effectively. Like the
USA, UK and other nations that are leading the way in reinforcing the role of auditing in fraud prevention and detection, the banking industry in Kenya can profit by learning from finest practices around the world.

A noteworthy weakness in the internal controls related to staff screening procedures. Recruiting the right staff is one of the first steps in preventing fraud. As already highlighted in the literature review suitable background checks are important and uncover an individuals’ professional and educational credentials, history of employment, criminal record, media and credit checks as well as honesty/integrity testing (Brody, 2010). However, this was an area of apparent weakness in the study. In some cases banks recruited employees that have been known or later discovered to have had a fraud history, and who have gone on to commit fraud. Furthermore, background checks are not fully effective, and honesty and integrity testing are recommended (Brody, 2010). None of the responses showed that the bank used this method. Approving with Albrecht’s (1984) fraud scale, low personal integrity are likely to lead to fraud. The problem of new hiring has been recommended in a confidential police report from the Banking Fraud Investigation Department recently released to the press (Bank Fraud Report Shocker, 2010). This report questions hiring criteria, indicating that most bank frauds involve bank staff, and that there was a strong connection between hiring practices and fraud. However, reference checks from credible sources are difficult to come by in Kenya, due to lack of centralized systems and other organised criminal databases. In Kenya the “Certificate of Good Conduct” is taken as proof. However, this system is susceptible to corruption, making it less reliable.

Responses relied on technical controls to prevent and detect fraud. Nonetheless, these seemed to be more often than not ineffective, with customers and staff noticing most fraud. This is consistent with previous research, which has indicated that only around a third of complex fraud is detected by technical controls (Goode & Lacey, 2010). This does not make technical controls unnecessary, but instead shows that they should not be relied on.
Finally, KBA is representative of a self-regulatory organization (SRO), which are held up as major mechanisms for the reduction of fraud (Nunez, 2011). SROs operate on the principle that industry regulation by the members of the industry itself is a far more important mechanism than government regulation, that it is cheaper, and more effective than government regulation. This has been shown to be the case, with even corrupt SROs, which are vulnerable to bribery, having a higher level of self-regulation than industries that do not have this type of organization (Nunez, 2011). Kenyan banks have an opportunity through the KBA to do more in sharing of information. By working together and sharing fraud information the banks can have an enhanced stability, degree of transparency and lower shared costs for screening and monitoring fraud (Giannetti et al., 2010; Mwanza, 2010).

5.4 Conclusions

5.4.1 Causes of Bank Fraud

The first research question addressed the characteristics and causes of fraud in the Kenyan banking industry. In general, the bank personnel are highly aware of fraud, with 90% of respondents indicating that fraud is a major problem, 88.3% saying that fraud was likely or very likely to be experienced in the bank, and 83.3% of respondents saying that it was either increasing or increasing rapidly. This evidently indicates that the bank (represented by the staffs who were the respondents) is greatly aware of the problem of fraud and its implications for the industry. Advancements in technology, economic pressure, and sophistication of criminals are seen as the major reasons behind the general increase of fraud in the banking sector but on the other hand improved technological measures and control coupled with a small improvement in the effectiveness of the justice system have enhanced the increase in fraud.

5.4.2 Risks of Bank Fraud

Fraud for the responding bank averaged between 1% and 1.5% of annual revenue.

Moreover, the findings of this research indicated that the greater part of fraud in the bank is both not technologically sophisticated and is relatively low-volume fraud. The majority of
the crime occurred through theft, direction, or misappropriation of cash or cheques; only a few cases of crime were linked with credit cards, and there was little online fraud reported. Over ally fraud that is detected is not very sophisticated. However, there is a noteworthy concern that problems faced in fraud detection are due to lack of sophisticated fraud detection systems; the study indicated that the majority of fraud cases that were reported were in fact found by accident. Evidence shows, however, that this is not unique to the Kenyan banks, and in fact insufficient fraud controls is an issue that affects the bank globally in the various geographic locations it has presence in. Thus, the Kenyan bank is perhaps not very different in terms of the fraud that is experienced globally, however there are some differences created by the level of IT used within the bank.

5.4.3 Strategies Used to Combat Bank Fraud
The habitually engaged measures used by the bank in preventing fraud include improving or reviewing internal controls, establishing fraud prevention policies, establishing an ethical code of conduct, training employees on fraud prevention and screening or reference checks on new employees. The use of protective passwords, software and constant auditing offer the bank some gauge of security against fraudulent actions.

On the other hand, highly effective software approaches such as data sampling, data mining and digital analysis are less commonly employed by the bank supporting results by Bierstaker et al. (2012). In the future the bank need to invest in fraud detection and software approaches such as data mining, digital analysis and forensic services as these have been found to be greatly effective by a minority who use them. Anti-fraud technology comes with a very high price tag. However, the bank must consider the profit of such technology which far outweighs the cost and results in efficient fraud detection and prevention. Currently, as revealed by this study, fraud may be seen to be small scale fraud. The scale of fraud is nonetheless expected to increase necessitating prospect investment in robust technology.

The research through hypothesis tests also found that fraud loss did vary with the bank size but not consistently. The findings therefore did not support previous studies by Murphy (2013) and Barnes and Webb (2010) perhaps due to the use of a smaller sample.
Overall, fraud is an important concern in the Kenyan banking industry, even if the loss figures are not proportionately on a large scale. The overall loss to the bank was primarily from low-volume. However, the senior banking personnel seemed to be very aware of fraud and its potential for significant growth.

5.5 Recommendations

The discussion of the results has generated a couple of recommendations for the bank, as well as for whole reform of the Kenyan banking and legal system in order to decrease the likely-hood for fraud within the system. These results and findings have been used to generate a set of recommendations for the bank, the Kenyan banks for policymakers as well as the KBA to improve conditions in the banking institution.

5.5.1 Recommendations for the Study

5.5.1.1 Causes of Bank Fraud

The bank should pay more attention to online banking fraud because as the research has indicated the changing competitive environment means that it will soon become important as the bank begin to initiate online banking to all its consumers in the near term. Mechanisms should be laid down to prevent online fraud before systems are implemented. Issues like online credit and debit card fraud, which is committed by people associated with the bank, also needs to be considered.

5.5.1.2 Risks of Bank Fraud

Under risks of bank fraud is a tactical recommendation concerning the way the bank considers fraud. In many cases, responses in this research indicated that fraud was considered to be a one-time loss, and so it was not significant assigning routine resources or its employees to deal with the problem. Nevertheless, the bank also reported repeated multiple, ‘sporadic’ losses. This indicates that this is not a short-term problem, but a routine occurrence that should be considered seriously.
5.5.1.3 Strategies Used to Combat Bank Fraud

This crime is unlikely to be caught by the current systems. The bank need to consider their security levels on external IT systems, as these systems are likely to come under attack from the outside and may result in major losses. The bank in Kenya, under the KBA, could look at best practice of other banks worldwide to learn how they have tackled similar crime of fraud and so possibly take advantage of the benefits of internet adoption.

A second recommendation is that Anti-fraud policies should be applied in the framework of wider business strategies. This research highlights how the security dimensions of the “Know Your Customer” (KYC) policies are being undermined by marketing and competitive considerations.

5.5.2: Recommendation for the Research

There are four major recommendations that have emerged from this study for the Kenya Bankers Association (KBA), addressing guidance, information sharing, improved customer awareness, international ties, and legal institutions.

The first issue is that of customer awareness campaigns. The bank is reluctant to take on with customer awareness campaigns about fraud, even though they are known to be efficient, because of the likely-hood for reputation loss. Bearing in mind that brand identity is key to maintaining customer loyalty in the banking industry (Sweeney & Swait, 2013), and that the banking industry in Kenya is crowded with over 40 banks offering consumers abundant choices, this is not likely to change. However, the KBA, as a banking association connected with all banks, is well-placed to conduct such a campaign. The KBA ought to take on a role in customer education, producing materials to be disseminated through all member banks regarding the potential for fraud, how to detect it, and how to report it. And this case the bank under study will benefit.

The second subject concerns the urgent formation of a centralized fraud database. The centralization of peoples’ identity in a national database system will aid establishment of a
fraud management system, strengthen the investigative capacity of the Bank Fraud Investigations Department (BFID) of the Central Bank of Kenya and enhance judicial prosecution.

The third recommendation is on international fraud issues. The KBA has an affiliate role with international banking associations. These associations could help to improve international fraud detection capacity and help to leverage international fraud detection know-how and practice for use in the Kenyan banking system. The KBA should create strategic partnerships between banking associations in other nations and the KBA, allowing for access to technical knowledge as well as formation of network relationships that could benefit the Kenyan banking industry as a whole. Dahan et al. (2010) confirm that similar associations have been formed between multinational firms and non-governmental organizations in the region in order to improve technology and knowledge transfer as well as advance regional business. Other literature shows that this approach could be modified in order to allow for cooperation by business associations, in order to harvest some of the same profit (Sweeney & Swait, 2012).

A fourth recommendation in this section is to use the KBA’s political ‘clout’ to advance the judicial and legal handling of the issue of bank fraud. Special concerns include lack of formal credit card laws, out-dated and antiquated banking fraud laws and slowness of change. Organizations like the KBA have power to transform these conditions using direct power on the government through lobbying activities and public awareness and motivation of the public to change these laws (Bernhagen & Bräuninger, 2012).

The recent enactment of the Anti-Money Laundering Law in December 2009 and the establishment of CRB in 2009 will help to enhance the banking industry’s fight against fraud. However, it is clear that the Kenyan legal system must undergo some structural reforms in order to increase the robustness of the Kenyan banking system towards fraud. Although banking fraud is not considered to be a significant problem at this time, the evidence indicates that this will become an increasing problem over time. For example, drawing from literature, telecoms fraud (of which some banking fraud is a subset) resulted in a loss of $700
million in Africa in 2009 (Ghosh, 2010). These figures are only expected to increase over time. This is mainly problematic with the growth of mobile banking service, which are highly popular in Kenya and Africa on the whole as a means of providing non-branch banking services. Frimpong (2012) notes that the probable for banking fraud is often seen as one of the factors that put (SMEs) off the idea of online banking, reducing the uptake of internet banking even in cases where this could be a possible development over existing banking services. Thus, it is clear that the government must act to reduce the structural barriers to prosecution and improve access to the judicial system for banks hoping to reduce fraud levels.
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APPENDICES

Appendix 1: Introductory Letter

John Yego,
United States International University,
P.O. Box 14634 – 00800,
Nairobi, Kenya.

Dear Respondent,

RE: RESEARCH STUDY.

I am a graduate student at the United States International University (USIU) – Africa pursuing a Masters degree in Business Administration (MBA). As part of my program, I am currently undertaking a research study research project on “The Impact of Fraud in the Banking Industry: A case of Standard Chartered Bank”, with the aim of identifying the reasons and damage of fraud.

Your participation in this study is essential and will be highly appreciated. Kindly spare a few minutes to fill in the attached questionnaire which will take you approximately 10 minutes to answer.

I assure you the information provided will be treated with the utmost confidentiality and will only be used for academic purposes. Thank you for your time.

Yours faithfully,

John Yego
Appendix 2: Corruption Perception Index, 2012


Appendix 3: Ownership Structures of Banks

a) Foreign owned institutions
i) Foreign owned not locally incorporated
   - Bank of Africa (K) Ltd.
   - Bank of India
   - Citibank N.A. Kenya
   - Habib Bank A.G. Zurich
   - Habib Bank Ltd.
ii) Foreign owned, locally incorporated institutions (Partly owned by locals)
   - Bank of Baroda (K) Ltd.
   - Barclays Bank of Kenya Ltd
   - Diamond Trust Bank Kenya Ltd.
   - K-Rep Bank Ltd.
- Standard Chartered Bank (K) Ltd.
- Ecobank Ltd.
- Gulf Africa Bank (K) Ltd.
- First Community Bank

iii) Foreign owned but locally incorporated institutions (Wholly owned subsidiary)
- UBA Kenya Bank Limited

Appendix 4: Mergers in the Kenyan Banking Industry

![Mergers within the banking industry](image)

*Mergers in the Kenyan Banking Industry*

(Source: Adapted from Central Bank of Kenya, 2013)
Appendix 5: Questionnaire

Section A: Background of the Respondent

1. Indicate your gender:
   - Male [ ]
   - Female [ ]

2. Marital Status
   - Married [ ]
   - Single [ ]
   - Divorced [ ]

3. Indicate your highest academic /professional qualification
   - Graduate [ ]
   - Post graduate [ ]

4. How many years have you worked in the bank
   - Below 5 years [ ]
   - 5-10 years [ ]
   - Above 10 years [ ]

5. What is your average monthly income?
   - Below Kshs 50,000 [ ]
   - Kshs 50,000 – 100,000 [ ]
   - Kshs 100,000 – 150,000 [ ]
   - Above Kshs 150,000 [ ]
Section B: Causes Of Bank Fraud

1. How would you classify the problem of fraud in the banking industry?

- Major problem [ ]
- Minor problem [ ]
- Not a problem [ ]

2. How would you assess the likelihood of frauds occurring in the financial sector over the next five years?

- Very Likely [ ]
- Quite Likely [ ]
- Likely [ ]
- Quite Unlikely [ ]
- Very Unlikely [ ]

3. What in your opinion is the overall trend of fraud in the financial industry?

- Increasing Rapidly [ ]
- Increasing [ ]
- Constant [ ]
- Decreasing [ ]
- Rapidly Decreasing [ ]
4. Who was/were the main perpetrator(s) of the fraud?

Staff

Customer

Non-Customer

Other (specify)  

5. What type of fraud was it?

Cash

Cheques

Credit card

Other  

6. What was (were) the perpetrators principle motivating factor(s) for committing the fraud?

Personal

Financial pressure

Lifestyle habits

Don’t know

Other  

Section C: Risks of Bank Fraud

1. If possible, could you estimate the overall monetary loss from this fraud incidence as a percentage of business turn-over (income)?

   Less than 1%  
   1% - 20%      
   More than 20% 
   Don’t know    

2 Was there a significant damage to the business?

   Yes          
   No           

3. If Yes, what was the type of damaged caused?

   Loss of money by the organization 
   Loss of money by the customer     
   Reputational/Goodwill loss       
   Customers exit                   

   Any other (specify) __________________________

4 How was the fraud detected?

   By accident  
   Audit        
   Whistle blower 

   Other (specify) __________________________
Section D: Strategies Used to Combat Bank Fraud

1. What measures have/are being taken to prevent fraud in your organization? Please rank up to five of the most important ones with ‘1’= the most important, ‘2’= the next most important to ‘5’= the 5th most important

<table>
<thead>
<tr>
<th>Measure</th>
<th>Rank (1-5)</th>
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<tbody>
<tr>
<td>Improvement or review of internal controls</td>
<td></td>
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<tr>
<td>Establishing fraud prevention policies</td>
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<tr>
<td>Establishing an ethical code of conduct</td>
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<tr>
<td>Implementing a fraud hotline (whistle blowing)</td>
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<td>Training employees on fraud prevention and detection</td>
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<td>Screening/reference checks on new employees</td>
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<td>Establishing a fraud budget</td>
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<td>Automated fraud prevention e.g. use of surveillance equipment (cameras)</td>
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<td>Staff rotation policy</td>
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<td>Security department</td>
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<td>Ethics training</td>
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<td>Use of forensic accountants</td>
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<td>Close supervision</td>
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<td>Fraud auditing</td>
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</table>

2. How often do fraud prevention methods get reviewed?

- Quarterly
- Half yearly
- Annually
- Other
- Don’t know

3. Is there a budget for fraud prevention in your organization?

- Yes
- No