

The Psychology of Financial Fraud and Systemic Failures: A Secondary Review of Behavioural and Institutional Dynamics in Large-Scale Scams

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Abstract

Financial fraud continues to undermine economic stability, investor confidence, and institutional credibility despite significant advancements in financial regulation and corporate governance. This secondary review examines the psychological and systemic factors that contribute to the emergence and persistence of large-scale financial fraud, with a particular focus on the interaction between individual behaviour and institutional failures. Drawing upon academic literature from behavioural psychology, finance, criminology, and organisational behaviour, as well as regulatory reports and landmark case studies from India and across the world, the review analyses major frauds including those involving Harshad Mehta, Satyam Computer Services, Vijay Mallya, Nirav Modi, Enron, Wirecard, FTX, and 1MDB. The findings indicate that financial fraud is rarely the result of individual greed alone; rather, it develops through the convergence of cognitive biases, personality traits, rationalisation, weak governance, regulatory fragmentation, and organisational culture. The review further explores how technological developments, including artificial intelligence and digital financial systems, have transformed fraud methods while continuing to exploit predictable human behavioural patterns. It concludes that preventing financial fraud requires an interdisciplinary approach that integrates behavioural science with financial regulation, corporate governance, technological oversight, and financial literacy to strengthen institutional resilience and promote ethical decision-making.

Keywords: Financial fraud, Behavioural psychology, White-collar crime, Corporate governance, Cognitive biases, Financial regulation, Organisational behavior

1. Introduction

1.1 Background

Financial fraud has emerged as one of the most significant challenges confronting modern economies, posing substantial threats to financial stability, investor confidence, and institutional credibility. While fraudulent financial practices have existed throughout history, the increasing complexity of global financial systems, rapid technological advancements, and interconnected capital markets have transformed financial fraud into a sophisticated and transnational phenomenon (Levi & Smith, 2021). Large-scale financial scams today extend beyond isolated incidents of embezzlement or accounting manipulation; they often involve coordinated networks of individuals, corporations, financial institutions, auditors, and regulators operating within environments characterised by information asymmetry, weak oversight, and opportunities for exploitation (Free, 2015). The consequences of such frauds extend far beyond immediate financial losses, affecting economic growth, employment, public trust, and the long-term stability of financial markets.

The Association of Certified Fraud Examiners (ACFE, 2024) estimates that organisations worldwide lose approximately 5% of their annual revenues to occupational fraud, amounting to trillions of pounds in economic losses each year. Although many cases involve relatively small-scale misconduct, a limited number of high-profile financial scandals account for disproportionately large economic and social consequences. Financial fraud contributes to declining investor confidence, increased compliance costs, market volatility, and reputational damage that may persist for decades (Rezaee, 2005). Moreover, public trust in regulatory institutions and corporate governance mechanisms often diminishes following major scandals, raising broader concerns regarding accountability, transparency, and ethical leadership (Coffee, 2005).

Traditionally, financial fraud has been explained through economic theories that assume individuals commit fraud after rationally weighing potential benefits against the risks of detection and punishment. However, contemporary research demonstrates that financial misconduct cannot be understood solely through economic incentives. Behavioural psychology suggests that cognitive biases, moral reasoning, personality traits, emotions, and organisational culture significantly influence unethical decision-making (Kahneman, 2011; Bazerman & Tenbrunsel, 2011). Individuals engaged in fraudulent behaviour frequently perceive themselves not as criminals but as rational actors responding to temporary pressures or exceptional circumstances (Cressey, 1953). Such findings indicate that psychological processes play an equally important role alongside financial motivations.

At the institutional level, financial fraud is rarely the result of a single individual's actions. Instead, large-scale scams often emerge from systemic weaknesses, including ineffective internal controls, inadequate regulatory coordination, poor corporate governance, conflicts of interest among auditors, and organisational cultures that prioritise financial performance over ethical conduct (Dorminey et al., 2012; Soltani, 2014). Behavioural factors and institutional vulnerabilities therefore interact in mutually reinforcing ways, creating environments where fraudulent activities can remain undetected for extended periods.

The growing integration of behavioural economics, organisational psychology, criminology, and financial regulation has shifted scholarly attention towards understanding fraud as a multidimensional phenomenon rather than a purely financial offence (Gottschalk, 2017). Consequently, examining financial fraud through an interdisciplinary lens has become increasingly important for developing effective prevention strategies, strengthening governance frameworks, and improving regulatory responses in both developed and emerging economies.

1.2 Contextual Examples

Several high-profile financial scandals illustrate how psychological factors and institutional failures combine to facilitate large-scale fraud. These cases differ in geographical location, organisational structure, and fraud mechanisms, yet they reveal remarkably similar behavioural patterns and governance deficiencies.

One of India's earliest and most influential financial scandals was the 1992 securities scam orchestrated by **Harshad Mehta**, who exploited weaknesses in the banking system through fraudulent bank receipts and manipulation of government securities transactions. By leveraging regulatory loopholes and insufficient oversight, Mehta artificially inflated stock prices before the scheme eventually collapsed, exposing significant weaknesses in India's financial regulatory architecture (Bhushan & Katyal, 1992; Varma, 2002).

Similarly, **Ketan Parekh** manipulated selected technology and media stocks during the late 1990s through circular trading, financing arrangements, and coordinated market operations. His activities highlighted the role of network-based manipulation, excessive speculation, and inadequate market surveillance within rapidly expanding financial markets (Varma, 2002).

The accounting fraud at **Satyam Computer Services** represented one of the largest corporate governance failures in India. Founder B. Ramalinga Raju admitted to inflating company assets, revenues, and profits for several years, exposing deficiencies in board oversight, auditor independence, and financial reporting standards (Ramalinga Raju, 2009; Coffee, 2005). The scandal demonstrated that sophisticated governance structures can fail when ethical leadership and effective monitoring mechanisms are absent.

Banking fraud cases involving **Vijay Mallya** and **Nirav Modi** further reinforced concerns regarding regulatory oversight and institutional accountability. Mallya's default on substantial bank loans raised questions about credit risk assessment, political influence, and banking governance, while Nirav Modi's exploitation of unauthorised Letters of Undertaking through Punjab National Bank revealed serious weaknesses in internal controls, technological integration, and supervisory oversight (Reserve Bank of India, 2018). These cases demonstrated that financial fraud frequently depends not only on individual deception but also on organisational complacency and regulatory fragmentation.

Comparable patterns are evident internationally. The collapse of Enron involved accounting manipulation, conflicts of interest, and auditor failures (McLean & Elkind, 2003). Germany's Wirecard scandal exposed weaknesses in financial supervision despite operating within a developed regulatory environment (Murphy & McCrum, 2020). The rapid collapse of FTX illustrated how charismatic leadership, inadequate governance, and excessive investor confidence could contribute to institutional failure in emerging digital financial markets (John, 2023). Similarly, Malaysia's 1MDB scandal demonstrated how political influence, weak oversight, and international financial networks enabled prolonged misappropriation of public funds (Hope, Thomas, & Vyas, 2019). Collectively, these cases suggest that financial fraud exhibits recurring behavioural and institutional characteristics irrespective of national context.

1.3 Research Gap

Financial fraud has been extensively examined across accounting, finance, psychology, criminology, management, and corporate governance literature. Existing studies have generated valuable insights into the causes, consequences, and prevention of fraudulent behaviour. Psychological research primarily investigates cognitive biases, ethical decision-making, personality characteristics, and behavioural motivations influencing fraudulent actions (Kahneman, 2011; Bandura, 1999; Bazerman & Gino, 2012). In contrast, finance and governance literature focuses on regulatory oversight, audit quality, internal controls, corporate governance structures, and market supervision (Coffee, 2005; Rezaee, 2005; Soltani, 2014).

Although these disciplinary approaches have significantly advanced understanding of financial misconduct, they often operate independently. Relatively few studies comprehensively integrate behavioural psychology with institutional and regulatory analysis to explain how psychological tendencies interact with systemic weaknesses to enable large-scale financial fraud (Dorminey et al., 2012; Free, 2015). Furthermore, comparative syntheses examining recurring patterns across both Indian and global financial scandals remain limited despite increasing globalisation of financial markets.

Another notable gap concerns the evolving nature of fraud in response to digital transformation. While recent research has begun examining cybercrime, cryptocurrency fraud, artificial intelligence, and digital financial manipulation, these developments are often studied separately from traditional theories of white-

collar crime and organisational behaviour (Levi & Smith, 2021). Consequently, there remains a need for an interdisciplinary review that integrates behavioural psychology, organisational dynamics, corporate governance, and technological developments within a single conceptual framework.

1.4 Research Question

This review is guided by the following research question:

Why do intelligent individuals engage in financial fraud, and why do institutional systems repeatedly fail to detect or prevent large-scale financial scams?

This question recognises that financial fraud is neither solely the result of individual greed nor exclusively a consequence of regulatory failure. Instead, it seeks to examine the interaction between human cognition, organisational behaviour, institutional weaknesses, and broader environmental conditions that collectively enable fraudulent conduct. By exploring both psychological and systemic dimensions, the study aims to provide a more comprehensive understanding of financial fraud than explanations based on a single disciplinary perspective.

1.5 Research Objectives

The primary objective of this secondary review is to synthesise existing literature on the behavioural and institutional determinants of large-scale financial fraud from an interdisciplinary perspective.

Specifically, the study aims to examine the psychological factors, including cognitive biases, personality traits, rationalisation mechanisms, and ethical decision-making processes, that influence individuals to engage in fraudulent financial activities. It further seeks to analyse the institutional, regulatory, and corporate governance failures that create opportunities for financial misconduct and allow fraudulent schemes to persist over extended periods.

In addition, this review aims to compare major Indian and international financial fraud cases to identify recurring behavioural patterns, organisational characteristics, and governance weaknesses across different economic and regulatory contexts. The study also evaluates the influence of organisational culture, collusion, leadership behaviour, and technological advancements on the evolution of financial fraud. Finally, it seeks to discuss evidence-based policy recommendations that integrate behavioural insights with regulatory reforms to strengthen fraud prevention, improve corporate governance, enhance institutional accountability, and promote ethical decision-making within financial systems.

Through this interdisciplinary synthesis, the review intends to contribute to a broader understanding of how psychological vulnerabilities and systemic failures reinforce one another, ultimately enabling some of the most significant financial scandals in contemporary economic history.

2. Methodology

This study adopts a **secondary qualitative review** research design to examine the psychological and institutional factors underlying large-scale financial fraud. A qualitative review is appropriate because the study aims to synthesise, critically evaluate, and integrate existing knowledge rather than generate new empirical data. By drawing on literature from psychology, finance, management, criminology, corporate governance, and behavioural economics, the review identifies recurring themes, theoretical perspectives, and conceptual relationships that explain how behavioural tendencies interact with organisational and regulatory systems to facilitate financial fraud (Snyder, 2019). This approach is particularly valuable for investigating complex, interdisciplinary issues that remain fragmented across academic fields (Booth, Sutton, & Papaioannou, 2021). It also enables the interpretation of organisational behaviour, ethical

decision-making, and systemic failures that cannot be fully captured through quantitative methods (Creswell & Creswell, 2018).

The review relies exclusively on **secondary data** obtained from credible academic and institutional sources. Academic literature forms the primary foundation of the study and includes peer-reviewed journal articles, scholarly books, and review papers in behavioural psychology, behavioural finance, accounting, corporate governance, management, ethics, and criminology. Particular emphasis is placed on established theoretical frameworks, including Cressey's (1953) Fraud Triangle Theory, Sutherland's (1949) White-Collar Crime Theory, Kahneman's (2011) work on behavioural decision-making, and research on organisational misconduct and corporate fraud (Bazerman & Tenbrunsel, 2011; Dorminey et al., 2012; Free, 2015). Preference was given to peer-reviewed publications to ensure the reliability and academic rigour of the evidence.

To complement academic research, the study incorporates **official regulatory reports** from institutions such as the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the Central Bureau of Investigation (CBI), where publicly available. These documents provide factual insights into regulatory oversight, enforcement actions, financial market reforms, and systemic weaknesses exposed through major fraud investigations. The review also draws upon publicly accessible **court judgments, judicial records, and investigative reports**, which offer detailed evidence regarding fraudulent practices, legal proceedings, and institutional accountability. In addition, international case documentation, including regulatory investigations, parliamentary inquiries, bankruptcy proceedings, corporate disclosures, and reports from global organisations, was consulted to provide comparative perspectives on financial fraud across different jurisdictions.

Sources were selected using predefined inclusion criteria to enhance credibility and relevance. Priority was given to publications from recognised academic publishers, peer-reviewed journals, government institutions, financial regulators, international organisations, and official investigative agencies. While seminal theoretical works were included where necessary, most empirical literature reflects contemporary developments in financial regulation, corporate governance, behavioural science, and digital finance.

Case studies were selected based on four criteria: (i) significant economic or regulatory impact, (ii) availability of credible public documentation, (iii) representation of different forms of financial fraud, and (iv) relevance for comparative analysis across India and the global context. Indian cases include Harshad Mehta, Ketan Parekh, Satyam Computer Services, Vijay Mallya, and Nirav Modi, while international cases include Enron, Wirecard, FTX, and 1MDB. Collectively, these cases illustrate securities fraud, accounting manipulation, banking fraud, governance failures, and regulatory shortcomings across diverse institutional settings.

Rather than examining each case independently, this review employs a **thematic synthesis** approach. Evidence is organised into themes such as psychological drivers, cognitive biases, personality traits, organisational culture, governance failures, regulatory fragmentation, collusion, victim psychology, and technological evolution. This method facilitates the identification of recurring behavioural and institutional patterns while recognising contextual differences across jurisdictions, consistent with qualitative review methodologies that seek conceptual understanding rather than statistical generalisation (Snyder, 2019).

3. Theoretical Framework

Financial fraud is a multidimensional phenomenon that cannot be adequately explained through a single

theoretical perspective. While traditional economic theories assume that individuals engage in fraud after rationally weighing costs and benefits, contemporary research demonstrates that financial misconduct results from the interaction of psychological motivations, personality traits, organisational environments, and institutional opportunities (Dorminey et al., 2012; Free, 2015). Accordingly, this review adopts an interdisciplinary framework integrating **Fraud Triangle Theory**, **Behavioural Psychology**, **Dark Triad Personality Theory**, and **White-Collar Crime Theory**. Together, these perspectives explain why capable and intelligent individuals commit financial fraud and why organisational systems frequently fail to detect or prevent such misconduct.

3.1 Fraud Triangle Theory

Fraud Triangle Theory, proposed by **Donald R. Cressey (1953)**, is one of the most influential frameworks for explaining occupational and financial fraud. Based on interviews with convicted white-collar offenders, Cressey argued that fraud typically occurs when three conditions coexist: **pressure**, **opportunity**, and **rationalisation**.

The first element, **pressure**, refers to financial, professional, or personal circumstances that motivate unethical behaviour. Although financial difficulties remain an important source of pressure, executives are often driven by organisational performance targets, shareholder expectations, career ambitions, and the desire to preserve status or reputation (Albrecht et al., 2019). Such pressures may encourage individuals to manipulate financial information rather than acknowledge declining performance (Rezaee, 2005).

The second element, **opportunity**, represents organisational conditions that enable fraud without immediate detection. Weak internal controls, inadequate segregation of duties, poor corporate governance, ineffective auditing, and limited regulatory oversight create opportunities for misconduct (Dorminey et al., 2012). Opportunity is considered the most controllable component because organisations can reduce fraud risk through stronger governance structures, technological monitoring, and independent oversight (Singleton & Singleton, 2010). Major scandals such as Enron, Satyam, and Wirecard illustrate how ineffective governance allowed fraudulent practices to continue despite repeated warning signs.

The final component, **rationalisation**, explains how perpetrators justify unethical behaviour while maintaining a positive self-image. Individuals may convince themselves that the fraud is temporary, harmless, or necessary to protect employees, shareholders, or organisational reputation (Cressey, 1953; Murphy & Dacin, 2011). These psychological justifications reduce feelings of guilt and enable unethical actions to continue over extended periods.

Together, the Fraud Triangle demonstrates that financial fraud rarely results from personal greed alone; rather, it emerges through the interaction of individual motivation, organisational opportunity, and psychological justification.

3.2 Behavioural Psychology in Fraud

Behavioural psychology explains how cognitive biases influence financial decision-making and ethical behaviour. Contrary to the assumption of complete rationality, behavioural research demonstrates that individuals frequently rely on mental shortcuts and subjective perceptions that distort judgement (Kahneman, 2011; Tversky & Kahneman, 1974). These biases are especially relevant in high-pressure financial environments.

One of the most significant biases is **overconfidence bias**, or the tendency to overestimate one's knowledge, competence, and ability to control outcomes (Moore & Healy, 2008). Senior executives and financial professionals may believe they can manipulate financial information without detection or

successfully recover from temporary deception. Early success often reinforces this confidence, increasing the likelihood of continued misconduct (Kahneman, 2011).

Another important bias is **optimism bias**, whereby individuals believe future outcomes will be more favourable than objective evidence suggests (Sharot, 2011). Executives experiencing declining organisational performance may therefore assume that temporary manipulation can later be corrected once financial conditions improve, gradually escalating minor ethical compromises into systematic fraud.

The **illusion of control** further contributes to unethical behaviour by encouraging individuals to believe they can influence events largely determined by external factors (Langer, 1975). Executives may overestimate their ability to manage regulators, markets, or public perception, reducing the perceived risks associated with fraudulent behaviour. Behavioural finance similarly links this bias to excessive risk-taking and speculative decision-making (Barber & Odean, 2001).

Collectively, these behavioural biases demonstrate that financial fraud often results from systematic errors in judgement rather than purely rational criminal intent.

3.3 Personality Constructs

While cognitive biases influence decision-making, enduring personality characteristics may increase an individual's susceptibility to unethical conduct. A widely studied framework is the **Dark Triad**, comprising **narcissism**, **Machiavellianism**, and **psychopathy** (Paulhus & Williams, 2002). Although these traits exist on a continuum within the general population, higher levels are consistently associated with manipulation, unethical leadership, and financial misconduct (Jones & Paulhus, 2014).

Narcissism is characterised by grandiosity, entitlement, excessive self-confidence, and a strong desire for admiration (Campbell et al., 2011). Narcissistic leaders often perceive themselves as exceptional and may disregard ethical constraints to protect their reputation or organisational image.

Machiavellianism reflects a strategic and manipulative approach to interpersonal relationships. Individuals high in this trait prioritise personal objectives over ethical considerations and are willing to employ deception and exploitation to achieve desired outcomes (Christie & Geis, 1970). Such characteristics may facilitate complex fraud schemes requiring long-term planning and manipulation of colleagues or institutional systems.

Psychopathy is characterised by emotional detachment, superficial charm, impulsivity, and a lack of empathy or remorse (Hare, 2003). Individuals displaying psychopathic tendencies may engage in deception without experiencing the guilt typically associated with unethical behaviour.

Although possessing Dark Triad characteristics does not inevitably lead to criminal behaviour, research consistently demonstrates a positive association between these personality traits and workplace deviance, unethical leadership, and financial misconduct (O'Boyle et al., 2012). Personality theory therefore complements behavioural explanations by identifying enduring psychological characteristics that may increase vulnerability to fraud when organisational opportunities exist.

3.4 White-Collar Crime Theory

The sociological foundation of financial fraud research originates from **Edwin H. Sutherland's White-Collar Crime Theory**, introduced in 1939 and expanded in *White Collar Crime* (1949). Sutherland challenged the belief that crime was primarily associated with poverty by demonstrating that highly educated and professionally successful individuals also engage in criminal behaviour during the course of their occupations (Sutherland, 1949).

White-collar crime differs from traditional crime because it involves deception, abuse of trust, financial manipulation, corruption, insider trading, embezzlement, and accounting fraud rather than physical

violence (Friedrichs, 2010). Although these offences rarely involve direct physical harm, they often generate far greater economic and social consequences, affecting investors, employees, governments, and financial markets.

Sutherland further argued that organisational environments significantly influence unethical behaviour. Individuals occupying positions of authority may exploit professional expertise, institutional trust, and access to confidential information to commit complex financial crimes. Weak ethical leadership, excessive performance pressure, and inadequate accountability further increase opportunities for misconduct (Benson & Simpson, 2018). White-Collar Crime Theory therefore complements psychological perspectives by demonstrating that fraud is shaped not only by individual characteristics but also by organisational culture and institutional structures.

Overall, the four theoretical perspectives provide a comprehensive conceptual foundation for this review. Fraud Triangle Theory explains the situational conditions that enable fraud, behavioural psychology examines the cognitive biases influencing unethical decisions, Dark Triad theory highlights personality traits associated with manipulation and deception, and White-Collar Crime Theory situates financial misconduct within broader organisational and institutional contexts. Together, these complementary frameworks provide an integrated understanding of the behavioural and systemic dynamics underlying large-scale financial fraud and serve as the foundation for the subsequent analysis of psychological drivers, institutional failures, and comparative case studies.

4. Psychological Drivers of Financial Fraud

Financial fraud is often perceived as the result of greed or financial desperation; however, behavioural research suggests that its psychological foundations are far more complex. Large-scale financial fraud rarely occurs as an impulsive act or solely because of financial need. Instead, it develops through the interaction of personal ambition, cognitive biases, personality traits, moral reasoning, and organisational influences that gradually shape unethical decision-making (Cressey, 1953; Bazerman & Tenbrunsel, 2011). Individuals involved in corporate fraud are frequently highly educated, professionally successful, and socially respected, demonstrating that intelligence and expertise do not necessarily protect against unethical behaviour (Sutherland, 1949; Benson & Simpson, 2018). Rather than viewing themselves as criminals, many perpetrators perceive their actions as justified responses to exceptional circumstances, organisational pressures, or personal aspirations (Murphy & Dacin, 2011). Understanding these psychological drivers is therefore essential to explaining why financial fraud continues despite increasingly stringent legal and regulatory frameworks.

4.1 Individual-Level Motivations

Financial fraud is influenced by a broad range of motivations that extend beyond the pursuit of financial gain. While monetary incentives remain important, research shows that achievement, power, recognition, competitiveness, status, and fear of failure often exert equal or greater influence on unethical behaviour (Albrecht et al., 2019; Zahra et al., 2005). Senior executives frequently experience pressure to sustain organisational growth, satisfy shareholder expectations, and protect their professional reputations. When legitimate means appear insufficient, unethical alternatives may gradually become psychologically acceptable (Cressey, 1953).

Behavioural economics further demonstrates that individuals often make decisions based on subjective perceptions rather than objective realities (Kahneman, 2011). Temporary financial setbacks may therefore be interpreted as serious threats to one's career or identity, encouraging risky or unethical actions.

According to **Prospect Theory**, individuals are generally more willing to take risks to avoid losses than to secure equivalent gains (Kahneman & Tversky, 1979). Executives confronting declining performance may consequently manipulate financial statements or conceal losses in an attempt to restore previous success instead of accepting failure.

4.2 The Role of Ambition, Identity, and Social Validation

Ambition is widely regarded as a positive characteristic because it promotes innovation, leadership, and organisational success. However, excessive ambition can contribute to unethical behaviour when professional achievement becomes closely tied to personal identity and self-worth (Treviño et al., 2006). Individuals who define themselves primarily through wealth, organisational status, or public recognition often experience intense psychological pressure to maintain an image of continuous success, even when genuine performance declines.

According to **Social Identity Theory**, individuals derive much of their self-concept from their professional roles and social status (Tajfel & Turner, 1979). Senior executives and entrepreneurs frequently become deeply identified with their organisations, causing organisational decline to be perceived as a personal failure. This psychological connection may increase the likelihood of manipulating financial information to preserve reputation, authority, or social standing.

The desire for **social validation** further reinforces these pressures. Corporate environments often reward visible indicators of success such as wealth, influence, market reputation, and executive prestige. Continuous recognition from investors, employees, and the media can create incentives to prioritise performance outcomes over ethical conduct (Bazerman & Tenbrunsel, 2011). Consequently, some individuals become increasingly motivated to conceal organisational weaknesses or manipulate financial results to maintain their public image.

4.3 Rationalisation Mechanisms: The "Temporary Borrowing" Mindset

A central psychological mechanism underlying financial fraud is **rationalisation**, which enables individuals to engage in unethical behaviour while maintaining a positive moral self-image. Cressey (1953) argued that fraud becomes psychologically possible only when individuals can justify their actions in ways that reduce guilt or internal moral conflict. Rather than considering themselves dishonest, perpetrators often reinterpret unethical actions as temporary, necessary, or beneficial.

One common form of rationalisation is the **"temporary borrowing" mindset**, in which individuals convince themselves that manipulated financial statements or misappropriated funds will eventually be corrected. Executives may believe that future business improvements will allow them to reverse accounting irregularities before any lasting harm occurs. Similarly, employees involved in financial misconduct may view themselves as temporarily borrowing organisational resources rather than committing theft (Cressey, 1953). Such reasoning reduces immediate psychological discomfort and allows unethical behaviour to continue without fundamentally altering one's self-image.

Behavioural ethics research further explains this process through **moral disengagement**, whereby individuals cognitively reconstruct unethical actions to appear morally acceptable (Bandura, 1999). They may minimise the consequences of fraud, shift responsibility onto organisational pressures, compare their behaviour with more serious offences, or claim that their actions ultimately protect employees or investors. These cognitive strategies weaken ethical restraints and make continued misconduct psychologically easier.

4.4 Emotional and Cognitive Detachment from Consequences

Large-scale financial fraud often affects thousands of investors, employees, creditors, and consumers, yet

perpetrators frequently display limited emotional concern regarding these consequences. This contradiction can be explained through **emotional and cognitive detachment**, which reduces awareness of the human impact of unethical decisions.

Bandura's (1999) theory of moral disengagement suggests that individuals disengage self-regulatory moral processes to avoid feelings of guilt or shame. Through mechanisms such as displacement of responsibility, diffusion of responsibility, dehumanisation, and distortion of consequences, individuals psychologically distance themselves from those harmed by their actions. In corporate settings, financial losses are often viewed as abstract numerical figures rather than human suffering, making unethical decisions easier to justify.

Organisational structures may further encourage detachment by distributing responsibility across multiple departments and hierarchical levels. Such environments create **diffusion of responsibility**, where no single individual feels fully accountable for unethical outcomes (Darley & Latané, 1968). Employees may justify their actions by claiming they were merely following instructions, implementing company policy, or complying with managerial expectations.

Another important mechanism is **ethical fading**, in which ethical considerations gradually disappear from decision-making as attention shifts towards financial targets, strategic objectives, or operational performance (Tenbrunsel & Messick, 2004). Decisions involving accounting manipulation or regulatory circumvention become framed as technical business problems rather than moral choices. Consequently, individuals may participate in unethical practices without consciously recognising their ethical implications.

Repeated exposure to unethical behaviour can also produce **desensitisation**, whereby individuals become increasingly accustomed to violating ethical norms (Bazerman & Gino, 2012). Initial discomfort associated with minor misconduct gradually diminishes, allowing progressively larger violations with reduced emotional resistance. This process explains why many corporate frauds evolve over several years instead of occurring as isolated incidents.

Overall, the psychological drivers of financial fraud demonstrate that unethical financial behaviour is rarely motivated by greed alone. Individual motivations, excessive ambition, identity preservation, social validation, rationalisation, and emotional detachment interact with cognitive biases and organisational influences to shape fraudulent decision-making. Rather than representing a single deliberate criminal act, financial fraud is often a gradual behavioural process in which ethical boundaries progressively erode over time, increasing the likelihood of large-scale organisational misconduct.

5. Institutional and Systemic Enablers

While individual psychology explains why people may be motivated to commit financial fraud, large-scale scams rarely occur because of personal ambition alone. Most significant frauds require organisational environments that either facilitate misconduct or fail to detect it over extended periods. Weak governance structures, ineffective regulatory oversight, inadequate internal controls, information asymmetry, and failures of auditing and compliance collectively create opportunities for fraudulent activities to develop and remain concealed (Coffee, 2005; Dorminey et al., 2012). Accordingly, financial fraud is best understood as the outcome of an interaction between individual behaviour and institutional vulnerabilities rather than isolated acts of deception (Rezaee, 2005; Soltani, 2014).

The growing complexity of modern financial systems has intensified these challenges. Multinational corporations operate across jurisdictions, use sophisticated financial instruments, and interact with

numerous intermediaries, making effective oversight increasingly difficult (Levi & Smith, 2021). Consequently, fraud prevention depends not only on ethical leadership but also on strong governance, coordinated regulation, technological monitoring, and institutional accountability.

5.1 Weak Internal Controls

Internal controls constitute the first line of defence against financial fraud by promoting accountability, transparency, and effective monitoring of organisational activities. These controls include segregation of duties, authorisation procedures, internal audits, risk management systems, and financial reporting mechanisms designed to minimise opportunities for misconduct (Committee of Sponsoring Organizations of the Treadway Commission [COSO], 2013).

However, many financial scandals demonstrate that internal controls frequently fail because of poor implementation, inadequate supervision, or deliberate circumvention by senior management. Executives often possess sufficient authority to override existing controls, particularly when governance structures lack independence (Rezaee, 2005). Weak segregation of responsibilities also increases fraud risk by allowing individuals excessive control over financial transactions, while ineffective internal audits and poor documentation reduce the likelihood of early detection (Singleton & Singleton, 2010).

The **Satyam Computer Services** scandal illustrates these weaknesses. Manipulated financial statements, inflated cash balances, and falsified revenues remained undetected for years because management exercised significant influence over financial reporting and internal oversight mechanisms failed to identify inconsistencies (Ramalinga Raju, 2009; Coffee, 2005). The case demonstrates that formal control systems are ineffective unless supported by organisational transparency and accountability.

5.2 Regulatory Fragmentation and Enforcement Gaps

Financial regulation seeks to maintain market integrity and protect investors through institutions such as the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Central Bureau of Investigation (CBI), and the Enforcement Directorate (ED). While specialised regulation promotes expertise, fragmented oversight may create coordination challenges that sophisticated fraudsters exploit (Reserve Bank of India, 2018).

Regulatory fragmentation occurs when agencies possess overlapping responsibilities but limited mechanisms for information sharing or coordinated investigations (Coffee, 2005). Such gaps may delay regulatory responses and allow fraudulent activities to continue across organisational boundaries.

The **Harshad Mehta** securities scam exposed weak coordination between banks, financial institutions, and market regulators, enabling manipulation of government securities transactions (Bhushan & Katyal, 1992; Varma, 2002). Similarly, the **Punjab National Bank-Nirav Modi** fraud revealed failures in communication between internal banking systems and the SWIFT payment network, allowing unauthorised Letters of Undertaking to remain undetected for years (Reserve Bank of India, 2018).

Enforcement limitations, including resource constraints, procedural delays, and lengthy judicial processes, further weaken deterrence. Behavioural research suggests that individuals are less discouraged by severe penalties when they perceive the likelihood of detection to be low (Becker, 1968). Strengthening inter-agency coordination and improving enforcement efficiency are therefore essential for reducing fraud risk.

5.3 Information Asymmetry

Information asymmetry is one of the most significant structural enablers of financial fraud. It arises when one party possesses substantially more information than another during financial transactions or organisational decision-making (Akerlof, 1970). Senior executives typically have greater access to

operational and financial information than shareholders, regulators, employees, or investors, creating opportunities to manipulate disclosures and conceal organisational problems.

According to **Agency Theory**, managers may pursue personal interests that conflict with those of shareholders when monitoring mechanisms are weak (Jensen & Meckling, 1976). Executives may manipulate earnings, delay disclosure of adverse information, or misrepresent financial performance to preserve bonuses, market valuations, or investor confidence.

Increasing financial complexity further amplifies information asymmetry. Sophisticated financial instruments, multinational corporate structures, and digital transactions make it difficult even for experienced investors and regulators to accurately assess organisational risk (Levi & Smith, 2021).

The **Enron** scandal demonstrated how complex accounting structures concealed the company's true financial position from investors and regulators (McLean & Elkind, 2003). Likewise, **Wirecard** relied on opaque international operations and questionable financial reporting that delayed regulatory intervention despite repeated concerns (Murphy & McCrum, 2020). These cases illustrate how unequal access to information creates significant opportunities for financial manipulation.

5.4 Auditor and Compliance Failure

External auditors and compliance departments play a critical role in ensuring financial transparency by verifying financial statements, evaluating internal controls, and monitoring adherence to accounting standards and legal requirements (International Federation of Accountants, 2022). Nevertheless, several major financial scandals have revealed important limitations within these systems.

A major concern is the potential erosion of **auditor independence**, particularly when audit firms maintain long-term commercial relationships with clients or provide lucrative consulting services alongside audit work (Coffee, 2005). Such conflicts of interest may reduce professional scepticism and discourage rigorous examination of management decisions.

Furthermore, sophisticated fraud frequently involves executive collusion, falsified documentation, and deliberate concealment of evidence, making detection difficult through conventional audit procedures alone (Rezaee, 2005).

The collapse of **Enron** remains one of the clearest examples of auditor failure, with Arthur Andersen failing to identify or adequately report significant accounting irregularities (McLean & Elkind, 2003). Similar concerns arose during the **Satyam** scandal, where manipulated financial statements escaped repeated external audits (Coffee, 2005). These failures prompted significant reforms aimed at strengthening auditor independence, corporate governance, and regulatory oversight.

5.5 The "Too Big to Question" Phenomenon

An important but often overlooked institutional enabler is the **"Too Big to Question"** phenomenon, whereby highly successful individuals or influential organisations receive reduced scrutiny because of their reputation, perceived competence, or economic importance. Unlike the concept of "Too Big to Fail," this phenomenon reflects a behavioural tendency to assume that successful leaders are inherently trustworthy.

Authority bias, halo effects, and excessive trust frequently influence organisational decision-making (Kahneman, 2011). Charismatic executives may face limited questioning because boards, auditors, regulators, and investors assume their past success guarantees ethical behaviour (Bazerman & Tenbrunsel, 2011). Employees may also hesitate to challenge influential leaders because of fear of retaliation or career consequences (Ashforth & Anand, 2003).

Several financial scandals illustrate this pattern. Figures such as **Bernie Madoff**, **Jeffrey Skilling**, **Vijay Mallya**, and **Markus Braun** cultivated reputations as visionary business leaders, reducing early scrutiny of their actions and allowing fraudulent practices to expand before meaningful intervention occurred (McLean & Elkind, 2003; Murphy & McCrum, 2020).

Overall, institutional and systemic enablers demonstrate that financial fraud is rarely sustained through individual deception alone. Weak internal controls, fragmented regulation, information asymmetry, failures of auditing and compliance, and excessive trust in influential leaders collectively create environments in which unethical behaviour can flourish. These institutional weaknesses reinforce the psychological mechanisms discussed in the previous section by increasing opportunities for misconduct while reducing the likelihood of detection. Understanding this interaction between behavioural motivations and systemic failures is essential for explaining the persistence of large-scale financial fraud and provides the foundation for the comparative case study analysis presented in the following section.

6. Case Study Synthesis: Indian Financial Scams

The examination of major financial frauds provides valuable insights into how psychological characteristics interact with institutional weaknesses to facilitate large-scale economic crimes. While each financial scandal emerges within a unique organisational and regulatory context, comparative analysis reveals striking similarities in behavioural patterns, governance failures, and systemic vulnerabilities. The selected Indian case studies, Harshad Mehta, Ketan Parekh, Satyam Computer Services, Vijay Mallya, and Nirav Modi, span more than three decades and represent diverse forms of financial misconduct, including securities market manipulation, accounting fraud, banking fraud, and corporate governance failures. Despite differences in fraud mechanisms, these cases collectively demonstrate that financial misconduct is rarely attributable to a single individual or isolated organisational failure. Instead, they illustrate the interaction between individual psychology, organisational culture, regulatory oversight, and institutional design that enables fraudulent activities to remain undetected for prolonged periods (Coffee, 2005; Dorminey et al., 2012; Free, 2015).

A comparative examination of these cases also highlights the evolution of financial fraud in India. Earlier scams primarily exploited weaknesses in manual banking systems and underdeveloped capital market regulations, whereas more recent frauds have leveraged technological systems, international financial networks, and complex corporate structures. Nevertheless, recurring behavioural themes, including overconfidence, excessive ambition, rationalisation, identity preservation, and abuse of organisational trust, remain remarkably consistent across different periods. These observations suggest that although financial systems continue to evolve, the underlying psychological and institutional drivers of fraud have remained relatively stable.

6.1 Harshad Mehta: Overconfidence Bias and Systemic Loopholes

The **1992 securities scam** involving Harshad Mehta remains one of the most influential financial scandals in Indian economic history. Widely known as the "Big Bull" of the Indian stock market, Mehta exploited procedural weaknesses within the banking system to divert funds intended for government securities transactions into the equity market, artificially inflating stock prices before the scheme eventually collapsed (Bhushan & Katyal, 1992; Varma, 2002). The scandal not only exposed deficiencies in India's financial infrastructure but also prompted significant reforms in banking regulation, securities trading, and market supervision.

From a psychological perspective, Mehta's behaviour reflects characteristics associated with **overconfidence bias** and the **illusion of control**. Behavioural research defines overconfidence as the tendency to overestimate one's knowledge, predictive abilities, and capacity to manage complex situations (Moore & Healy, 2008). Mehta's extraordinary success in manipulating stock prices reinforced a public image of exceptional financial expertise, likely strengthening his belief that he possessed superior market knowledge and could continue exploiting regulatory loopholes without detection. As repeated success reduced perceptions of risk, confidence in his own judgment may have encouraged progressively larger and more sophisticated fraudulent activities (Kahneman, 2011).

Equally important were the **systemic loopholes** that enabled the fraud. At the time, India's banking system relied heavily on paper-based transactions, manual reconciliation processes, and Bank Receipts (BRs) that could be misused in government securities transactions (Bhushan & Katyal, 1992). Limited coordination between banks, financial institutions, and regulatory agencies created opportunities for manipulation, while inadequate technological infrastructure delayed detection of irregular transactions. Consequently, the scam illustrates how psychological confidence alone cannot explain financial fraud; rather, overconfidence became effective only because institutional weaknesses provided opportunities for sustained misconduct.

6.2 Ketan Parekh: Network-Driven Manipulation

The stock market manipulation orchestrated by Ketan Parekh during the late 1990s and early 2000s demonstrated a different yet equally sophisticated model of financial fraud. Unlike Harshad Mehta's reliance on banking loopholes, Parekh's strategy centred on coordinated trading networks, preferential financing arrangements, and circular transactions designed to artificially inflate selected technology, media, and telecommunications stocks, commonly referred to as the "K-10" stocks (Varma, 2002). By leveraging relationships with brokers, financial institutions, promoters, and market participants, Parekh generated speculative demand that substantially increased share prices before the eventual collapse of the scheme.

Psychologically, this case highlights the importance of **social influence**, **network-based trust**, and **strategic manipulation**. Rather than acting independently, Parekh relied extensively on interpersonal relationships and coordinated behaviour among multiple market participants. Such behaviour reflects characteristics associated with **Machiavellianism**, including calculated planning, interpersonal manipulation, and strategic exploitation of social networks for personal gain (Christie & Geis, 1970). Financial fraud in this context was not merely an individual act but a coordinated organisational process requiring cooperation among numerous actors who collectively reinforced the appearance of legitimate market activity.

Institutionally, the scandal exposed deficiencies in market surveillance, disclosure requirements, and regulatory monitoring. During the rapid expansion of India's capital markets, technological systems and surveillance mechanisms were still developing, allowing coordinated trading strategies to remain undetected for extended periods. Information asymmetry between insiders and ordinary investors further amplified the fraud, as retail participants interpreted rising share prices as indicators of genuine corporate performance rather than artificial market manipulation. Consequently, the Ketan Parekh case illustrates how financial fraud can emerge through complex networks of collaboration rather than isolated individual misconduct.

6.3 Satyam Computer Services: Corporate Governance Failure

The accounting fraud at Satyam Computer Services, publicly disclosed in 2009 following the confession

of founder B. Ramalinga Raju, is widely regarded as one of India's most significant corporate governance failures. For several years, the company systematically overstated revenues, profits, cash balances, and assets while understating liabilities, creating an illusion of sustained financial growth that attracted investors and strengthened market confidence (Ramalinga Raju, 2009). The fraud eventually resulted in substantial financial losses, erosion of investor confidence, and comprehensive reforms in corporate governance and auditing standards.

Unlike market manipulation cases, the Satyam scandal primarily illustrates the consequences of **organisational governance failure**. Although formal governance mechanisms, including an independent board of directors, audit committees, and external auditors, were present, these institutions failed to detect persistent financial misrepresentation. This failure highlights a critical distinction between the existence of governance structures and their effective implementation (Coffee, 2005; Rezaee, 2005). Board independence was compromised by excessive reliance on executive management, while internal controls proved insufficient to challenge or verify reported financial information.

From a behavioural perspective, the scandal demonstrates how **ethical fading** and **incremental rationalisation** can develop within organisations. Rather than beginning as large-scale fraud, financial manipulation appears to have evolved gradually through repeated adjustments to financial statements intended to conceal earlier misrepresentations (Ashforth & Anand, 2003). Once initial discrepancies required further concealment, executives faced increasing psychological pressure to continue falsifying financial reports in order to maintain organisational credibility and investor confidence. This escalation reflects the "slippery slope" phenomenon described in behavioural ethics literature, whereby relatively minor ethical compromises gradually evolve into extensive organisational misconduct (Bazerman & Gino, 2012).

The Satyam case also underscores the significance of auditor independence and effective board oversight. The inability of multiple governance mechanisms to identify prolonged accounting manipulation demonstrates that sophisticated organisational fraud often reflects collective institutional failure rather than isolated managerial misconduct.

6.4 Vijay Mallya: Identity and Entitlement Psychology

The financial crisis surrounding Vijay Mallya and the subsequent default on substantial loans obtained from Indian public sector banks represents a distinctive example of the interaction between psychological identity, organisational decision-making, and banking governance. Although the legal complexities surrounding the case differ from traditional accounting fraud, the controversy raised significant concerns regarding credit risk assessment, corporate governance, political influence, and institutional accountability within India's banking sector.

From a psychological perspective, Mallya's case illustrates the influence of **identity preservation** and **entitlement psychology**. Identity theory suggests that individuals frequently derive their self-concept from professional success, social status, and public recognition (Tajfel & Turner, 1979). Over several decades, Mallya cultivated an image associated with luxury, entrepreneurial success, and the "King of Good Times" brand, making corporate reputation closely intertwined with personal identity. Behavioural research suggests that when organisational decline threatens such identities, individuals may become increasingly motivated to preserve status, prestige, and social legitimacy through progressively riskier strategic decisions (Campbell et al., 2011).

The concept of **psychological entitlement** further explains how successful individuals may come to believe that conventional rules or institutional constraints apply less strictly to themselves than to others

(Campbell et al., 2004). Such perceptions may encourage excessive borrowing, optimistic risk-taking, and expectations of institutional accommodation despite deteriorating financial conditions. Although entitlement alone does not explain financial misconduct, it may influence managerial decision-making by reducing sensitivity to financial risks and increasing confidence in eventual recovery or institutional support.

Institutionally, the case exposed weaknesses in banking governance, loan appraisal procedures, monitoring mechanisms, and recovery systems. Questions surrounding repeated loan restructuring, inadequate due diligence, and delayed enforcement suggested that organisational and regulatory failures contributed significantly to the scale of financial losses. The case therefore illustrates how psychological motivations and institutional deficiencies may reinforce one another within complex banking environments.

6.5 Nirav Modi: System Exploitation and Collusion

The fraud involving Nirav Modi, uncovered in 2018, represents one of the largest banking frauds in India's history. The scheme centred on the fraudulent issuance of **Letters of Undertaking (LoUs)** through officials at Punjab National Bank, enabling access to overseas credit without proper authorisation or integration into the bank's core banking system (Reserve Bank of India, 2018). The estimated financial losses exceeded ₹13,000 crore, while the case exposed substantial weaknesses in technological integration, internal controls, and supervisory oversight.

Psychologically, the fraud illustrates the interaction between **strategic planning**, **risk normalisation**, and **collaborative misconduct**. Unlike impulsive financial crimes, the scheme required long-term coordination, detailed knowledge of banking procedures, and confidence that institutional weaknesses would prevent timely detection. Such behaviour reflects characteristics associated with Machiavellian strategic thinking, whereby manipulation is carefully planned and sustained through interpersonal coordination rather than spontaneous decision-making (Jones & Paulhus, 2014).

Perhaps the most significant feature of the case was the role of **collusion**. Fraud of this magnitude would have been difficult to sustain without cooperation among multiple individuals operating within the banking system. Organisational research demonstrates that collusion frequently emerges when employees perceive low detection risk, weak oversight, or implicit organisational tolerance for procedural violations (Ashforth & Anand, 2003). Repeated successful circumvention of institutional procedures may gradually normalise unethical practices, reducing psychological barriers to continued misconduct.

Institutionally, the scandal exposed serious deficiencies in technological integration and organisational governance. The absence of real-time connectivity between the SWIFT messaging platform and Punjab National Bank's core banking system enabled unauthorised financial guarantees to remain outside formal accounting records (Reserve Bank of India, 2018). Inadequate internal auditing, ineffective supervisory monitoring, and insufficient reconciliation procedures allowed the fraud to continue over several years. The case therefore demonstrates that sophisticated financial fraud increasingly exploits not only human behaviour but also technological and organisational vulnerabilities within modern financial institutions. Collectively, these five case studies reveal consistent patterns despite differences in time period, organisational structure, and fraud mechanisms. Overconfidence, ambition, identity preservation, strategic manipulation, and rationalisation repeatedly influenced individual behaviour, while weak governance, ineffective oversight, fragmented regulation, technological deficiencies, and institutional complacency created opportunities for fraud to flourish. These recurring themes suggest that large-scale financial scams are best understood as the product of an interaction between behavioural psychology and systemic failure

rather than as isolated incidents of individual misconduct. The persistence of these patterns across multiple decades further highlights the need for integrated approaches that combine behavioural insights with stronger governance, technological safeguards, and regulatory coordination to prevent future financial fraud.

7. Global Comparative Analysis

Financial fraud is not confined to any single country or regulatory system. Over the past three decades, several of the world's largest corporate scandals have demonstrated that sophisticated fraud can emerge even in highly regulated economies with mature financial institutions. Although governance structures and legal frameworks differ across countries, comparative research shows that major financial scandals share similar behavioural and institutional characteristics (Coffee, 2005; Free, 2015). Psychological biases such as overconfidence, narcissism, moral disengagement, and excessive risk-taking often interact with organisational weaknesses, ineffective oversight, and information asymmetry to create environments conducive to financial misconduct.

This section examines four internationally significant cases, **Enron** (United States), **Wirecard** (Germany), **FTX** (Bahamas/United States), and **1MDB** (Malaysia). Despite differences in industry and regulatory context, these cases demonstrate recurring patterns of psychological vulnerability and systemic failure.

7.1 Enron: Corporate Culture and Executive Overconfidence

The collapse of **Enron** in 2001 remains one of the most influential corporate scandals in modern history. Once regarded as one of America's most innovative companies, Enron concealed billions of dollars in debt through Special Purpose Entities (SPEs) while overstating profits and financial performance (McLean & Elkind, 2003). The bankruptcy erased more than US\$60 billion in shareholder value and contributed to the collapse of Arthur Andersen, one of the world's largest accounting firms (Coffee, 2005).

Psychologically, Enron reflected executive overconfidence, hubris, and ethical fading. Leaders such as Jeffrey Skilling and Kenneth Lay fostered a culture centred on continuous growth and exceptional performance. Their confidence in managing increasingly complex financial arrangements encouraged them to underestimate regulatory scrutiny and justify deceptive reporting as necessary to protect investor confidence (Kahneman, 2011; Bazerman & Tenbrunsel, 2011).

Institutionally, the scandal exposed failures in corporate governance, board oversight, and auditor independence. Arthur Andersen's dual role as auditor and consultant created conflicts of interest, while the board failed to effectively challenge executive decisions (Coffee, 2005). The scandal ultimately led to the **Sarbanes–Oxley Act (2002)**, which strengthened financial reporting requirements, executive accountability, and internal controls (Coates, 2007).

7.2 Wirecard: Reputation Bias and Regulatory Blind Spots

The collapse of **Wirecard** in 2020 challenged assumptions regarding the effectiveness of financial regulation in developed economies. Once celebrated as one of Europe's leading fintech companies, Wirecard admitted that approximately €1.9 billion reported on its balance sheet did not exist (Murphy & McCrum, 2020).

Behaviourally, the case illustrates the influence of **authority bias, confirmation bias, and the halo effect**. Investors, regulators, and analysts were heavily influenced by Wirecard's reputation as a successful technology company, causing many stakeholders to dismiss repeated warnings from journalists and whistleblowers (Kahneman, 2011). Positive corporate narratives encouraged market participants to interpret criticism as attacks rather than legitimate concerns.

Institutionally, the scandal revealed weaknesses within Germany's regulatory framework. The Federal Financial Supervisory Authority (BaFin) initially investigated critics instead of examining allegations against the company, illustrating how excessive institutional trust weakened regulatory scepticism (Murphy & McCrum, 2020). The case prompted reforms strengthening financial supervision and auditor oversight.

7.3 FTX: Charismatic Leadership and the Psychology of Trust

The collapse of **FTX** in 2022 represents one of the largest failures in the cryptocurrency industry. Founded by Sam Bankman-Fried, FTX rapidly became a leading cryptocurrency exchange before investigations revealed misuse of customer funds, poor governance, and inadequate financial controls (John, 2023).

Unlike traditional accounting scandals, FTX highlights the importance of **charismatic leadership, trust heuristics, and optimism bias**. Bankman-Fried cultivated an image of intellectual brilliance and ethical entrepreneurship, encouraging investors to place confidence in his leadership despite limited organisational transparency (Lewis, 2023). Behavioural research suggests that people frequently rely on perceived credibility rather than objective evidence when evaluating complex financial decisions (Kahneman, 2011).

Institutionally, FTX exposed governance challenges within rapidly evolving digital financial markets. Weak internal controls, ineffective boards, and fragmented international regulation allowed significant misconduct to develop before meaningful intervention occurred, demonstrating the need for stronger global coordination in digital asset regulation.

7.4 1MDB: Political Influence and Institutional Capture

The **1Malaysia Development Berhad (1MDB)** scandal represents one of the largest public-sector financial frauds in modern history. Established as a sovereign wealth fund to promote economic development, 1MDB became the centre of a multi-billion-dollar international money laundering and embezzlement scheme involving government officials, financial institutions, and intermediaries across several countries (Hope, Thomas, & Vyas, 2019).

Psychologically, the scandal demonstrates how **power, entitlement, and moral disengagement** can influence decision-making among political and organisational elites. Individuals occupying influential positions may gradually perceive public resources as extensions of personal authority, while the complexity of international financial networks reduces awareness of the social consequences of misconduct (Bandura, 1999).

Institutionally, 1MDB illustrates the dangers of **institutional capture**, where political influence compromises the independence of regulatory and investigative agencies. Weak governance, limited transparency, and inadequate oversight allowed financial misconduct to continue across multiple jurisdictions before coordinated international investigations began (Hope et al., 2019).

7.5 Comparative Insights

A comparison of Indian and international financial scandals reveals striking similarities despite differences in geography, industry, and regulation. Across **Enron, Wirecard, FTX, 1MDB**, and the Indian cases discussed earlier, recurring behavioural patterns, including overconfidence, excessive ambition, narcissistic leadership, rationalisation, and moral disengagement, consistently influenced unethical decision-making (Cressey, 1953; Kahneman, 2011; Bazerman & Tenbrunsel, 2011). These findings reinforce the view that intelligence and professional success do not necessarily promote ethical behaviour. Similarly, institutional weaknesses appear across nearly every major fraud. Weak internal controls, ineffective boards, compromised auditor independence, information asymmetry, fragmented regulatory

oversight, and delayed enforcement repeatedly enabled fraudulent activities to persist (Coffee, 2005; Rezaee, 2005; Soltani, 2014). These similarities suggest that financial fraud is fundamentally systemic rather than purely individual.

Nevertheless, regulatory responses have varied. The United States introduced the **Sarbanes–Oxley Act** following Enron, Germany strengthened financial supervision after Wirecard, Malaysia pursued extensive international investigations following 1MDB, and India implemented reforms to banking supervision, corporate governance, and securities regulation after scandals such as **Harshad Mehta**, **Satyam**, and **Nirav Modi** (Coates, 2007; Reserve Bank of India, 2018).

Despite these reforms, financial fraud continues to evolve alongside technological innovation and increasingly complex global markets. This indicates that regulatory changes alone are insufficient unless accompanied by stronger organisational ethics, behavioural awareness, technological oversight, and international cooperation. The recurring patterns observed across jurisdictions reinforce the central argument of this review: large-scale financial fraud results from the continuous interaction between human psychology and systemic institutional vulnerabilities.

8. The Psychology of Collusion and Organisational Behaviour

Large-scale financial fraud is rarely the product of a single individual. Instead, it often involves employees, managers, auditors, consultants, and other stakeholders who either actively participate in misconduct or remain silent despite recognising unethical behaviour. This collective nature distinguishes major financial fraud from many other forms of economic crime and highlights the importance of organisational behaviour in understanding corporate misconduct. Research suggests that organisational environments strongly influence ethical decision-making by shaping perceptions of acceptable behaviour, authority, accountability, and responsibility (Ashforth & Anand, 2003; Treviño, Weaver, & Reynolds, 2006). Consequently, financial fraud should be viewed not only as a failure of individual morality but also as a consequence of organisational cultures that gradually normalise unethical practices.

Behavioural scholars argue that unethical conduct develops incrementally through leadership influences, shared norms, institutional incentives, and social interactions (Bazerman & Tenbrunsel, 2011). Employees rarely enter organisations intending to commit fraud. Instead, prolonged exposure to unethical leadership, unrealistic performance expectations, and weak accountability mechanisms gradually reshapes ethical perceptions, making misconduct appear routine or even necessary for organisational success (Ashforth & Anand, 2003).

8.1 Groupthink and Conformity

One of the most influential explanations for collective unethical behaviour is **groupthink**, introduced by Janis (1972), which describes situations where the desire for group harmony suppresses critical thinking. Within highly cohesive organisations, employees may avoid questioning management decisions or raising ethical concerns in order to preserve unity. As dissent decreases, questionable financial practices become increasingly accepted.

Closely related is **conformity**, whereby individuals adjust their behaviour to align with perceived group norms (Asch, 1956). Classic psychological research demonstrates that people frequently conform even when they privately disagree with the majority. In corporate settings, employees may therefore accept misleading financial reporting or aggressive accounting practices simply because such behaviours appear normal within the organisation.

Fraud often develops through this gradual normalisation. Employees entering organisations with established unethical practices may perceive them as standard operating procedures rather than deliberate misconduct (Ashforth & Anand, 2003). Such conformity is particularly common in organisations characterised by rigid hierarchies, intense competition, and limited opportunities for open ethical discussion.

Cases such as **Enron** and **Satyam** illustrate these dynamics. At Enron, a highly competitive culture rewarded financial performance while discouraging dissent (McLean & Elkind, 2003). Similarly, prolonged financial manipulation at Satyam gradually became embedded within organisational routines, making unethical reporting appear increasingly acceptable.

8.2 Authority Bias

Another important contributor to organisational fraud is **authority bias**, the tendency to assign excessive credibility to individuals in positions of power (Milgram, 1974). Employees often assume that senior executives possess superior knowledge or strategic understanding, making them less likely to question ethically questionable decisions.

Milgram's obedience experiments demonstrated that individuals frequently follow authoritative instructions even when they conflict with personal moral standards (Milgram, 1974). Similar processes operate within organisations, where employees may believe responsibility ultimately rests with senior management rather than themselves.

Authority bias is reinforced when leaders enjoy strong reputations for competence or success. Behavioural research suggests that the **halo effect** causes positive perceptions of leadership ability to influence assumptions about honesty and integrity (Kahneman, 2011). Consequently, boards, investors, and employees may overlook warning signs because they trust successful executives.

Scandals involving **Enron**, **Wirecard**, **FTX**, **Harshad Mehta**, and **Vijay Mallya** demonstrate how reputation and perceived expertise can reduce institutional scepticism, allowing misconduct to continue with limited internal scrutiny (Murphy & McCrum, 2020; Lewis, 2023).

8.3 Fear versus Incentive Structures

Employee behaviour is also shaped by the balance between organisational incentives and fear. Companies that reward financial performance while neglecting ethical conduct may unintentionally encourage excessive risk-taking and unethical decisions (Treviño et al., 2006). Behavioural ethics research indicates that individuals are more likely to compromise ethical standards when promotions, bonuses, or job security depend heavily on ambitious financial targets (Bazerman & Tenbrunsel, 2011).

Compensation systems focused primarily on short-term financial performance reinforce the **pressure** element of the Fraud Triangle by increasing the perceived costs of organisational failure (Cressey, 1953). Executives facing declining earnings may therefore manipulate financial information to protect organisational performance and personal rewards.

Conversely, cultures characterised by fear discourage ethical reporting and whistleblowing. Employees who fear retaliation, career setbacks, or social exclusion are significantly less likely to report suspicious activities (Near & Miceli, 1995). The combination of strong financial incentives and fear of challenging management creates conditions in which unethical behaviour can persist with minimal resistance.

Modern governance frameworks increasingly emphasise balanced incentive systems, independent reporting mechanisms, ethical leadership, and whistleblower protection to reduce these psychological pressures (Organisation for Economic Co-operation and Development [OECD], 2023).

8.4 Ethical Fading

A central psychological mechanism underlying organisational fraud is **ethical fading**, in which ethical considerations gradually disappear as decision-makers focus increasingly on financial or operational objectives (Tenbrunsel & Messick, 2004). Rather than consciously choosing between ethical and unethical alternatives, individuals begin treating questionable actions as technical business decisions.

Within organisations, financial manipulation may be described as "earnings management," regulatory violations as "creative compliance," or accounting fraud as "temporary adjustments." Such language reduces the perceived moral significance of unethical actions (Bazerman & Tenbrunsel, 2011).

Repeated exposure to ethically ambiguous situations gradually weakens emotional resistance, allowing misconduct to become routine (Bandura, 1999). This process explains why fraud often evolves over several years rather than occurring through a single deliberate decision. Both **Enron** and **Satyam** demonstrated how repeated rationalisation gradually shifted organisational attention from ethical transparency towards financial performance (Coffee, 2005).

8.5 Internal "Fraud Ecosystems"

Large-scale financial fraud frequently develops within **internal fraud ecosystems**, organisational environments where behavioural, structural, and cultural factors collectively sustain misconduct (Ashforth & Anand, 2003). Rather than isolated acts of deception, fraud becomes embedded within interconnected networks of individuals, incentive systems, informal norms, and institutional weaknesses.

In these environments, employees across accounting, finance, compliance, and executive management may each perform seemingly minor tasks that collectively enable major fraud. **Diffusion of responsibility** reduces personal accountability because no single individual feels solely responsible (Darley & Latané, 1968). Simultaneously, repeated success without detection reinforces confidence that existing practices are acceptable.

These ecosystems are further sustained through limited transparency, selective information sharing, and weak internal reporting mechanisms. Employees aware of irregularities often remain silent because colleagues do the same, creating a process similar to the **normalisation of deviance**, where repeated rule violations gradually become accepted organisational norms (Vaughan, 1996).

The Indian and international case studies discussed throughout this review consistently reflect these organisational dynamics. Whether examining **Enron**, **Satyam**, **Wirecard**, **FTX**, or the **Punjab National Bank fraud**, misconduct persisted because organisational environments discouraged questioning, rewarded short-term success, weakened accountability, and normalised unethical practices.

Overall, the psychology of collusion demonstrates that financial fraud is fundamentally a social and organisational phenomenon. Groupthink, conformity, authority bias, poorly designed incentive systems, ethical fading, and internal fraud ecosystems explain why individuals may participate in or tolerate misconduct they would otherwise reject independently. Preventing financial fraud therefore requires not only stronger regulations and internal controls but also organisational cultures that encourage ethical leadership, psychological safety, constructive dissent, and independent oversight.

9. Victim Psychology and Market Behaviour

Financial fraud does not succeed solely because of the actions of perpetrators; it also depends on the psychological responses of victims. While fraudsters design sophisticated schemes to manipulate markets and conceal financial irregularities, investors and consumers often make decisions under conditions of uncertainty, incomplete information, and emotional pressure. Behavioural finance and cognitive

psychology demonstrate that individuals do not always evaluate financial opportunities rationally. Instead, investment decisions are frequently influenced by cognitive biases, emotional reactions, social influences, and mental shortcuts known as heuristics (Kahneman, 2011; Tversky & Kahneman, 1974). These psychological tendencies are normal aspects of human decision-making but can be deliberately exploited by fraudsters to gain trust, encourage risky investments, and discourage critical evaluation.

Traditional financial theories assume that investors behave rationally by carefully assessing risks and expected returns. However, behavioural finance challenges this assumption by demonstrating that individuals are systematically influenced by emotions such as fear, greed, optimism, and regret, particularly during periods of market uncertainty (Shiller, 2015; Thaler, 2015). Consequently, victims of financial fraud should not simply be viewed as uninformed or careless individuals. Instead, they often become susceptible because fraudsters intentionally exploit predictable psychological biases that affect decision-making across different demographic groups, educational backgrounds, and levels of financial experience.

Large-scale financial scandals illustrate that victim psychology extends beyond individual retail investors. Institutional investors, financial analysts, banks, auditors, and regulators may also become vulnerable to behavioural biases that reduce scepticism and increase confidence in fraudulent organisations (Bazerman & Tenbrunsel, 2011). Understanding the psychological characteristics of victims is therefore essential for developing effective financial literacy programmes, regulatory safeguards, and fraud prevention strategies.

9.1 Scarcity Bias

One of the most commonly exploited psychological principles in financial fraud is the **scarcity bias**, which refers to the tendency for individuals to assign greater value to opportunities perceived as limited or exclusive (Cialdini, 2021). Behavioural research suggests that scarcity increases perceived desirability because people associate limited availability with higher quality, greater profitability, or privileged access. Consequently, investors often become more willing to make rapid financial decisions when they believe an opportunity may soon disappear.

Fraudsters deliberately create artificial scarcity by claiming that investment opportunities are available only to a limited number of participants or for a short period. Exclusive investment clubs, private funding rounds, invitation-only schemes, or "limited allocation" offers generate psychological pressure by encouraging individuals to fear missing valuable opportunities. Rather than carefully evaluating financial risks, investors focus increasingly on securing access before the opportunity appears to expire.

Scarcity bias was evident in several investment frauds involving private placements, unregulated investment funds, and cryptocurrency offerings, where promoters emphasised exclusivity rather than transparency. Behavioural studies indicate that scarcity reduces analytical thinking and increases emotional decision-making, particularly when financial opportunities appear highly profitable (Cialdini, 2021). As a result, investors may overlook warning signs, ignore incomplete disclosures, or fail to conduct adequate due diligence.

9.2 Urgency and Time Pressure

Closely related to scarcity is the psychological influence of **urgency**, whereby individuals experience pressure to make immediate decisions without sufficient time for reflection. Time pressure significantly reduces cognitive processing because people increasingly rely on intuitive judgement rather than deliberate analysis (Kahneman, 2011). Fraudsters frequently exploit this tendency by presenting investment opportunities as highly time-sensitive, claiming that immediate action is necessary to secure exceptional returns or avoid financial losses.

Behavioural research demonstrates that decision-making under time constraints encourages greater reliance on cognitive shortcuts and emotional reactions (Tversky & Kahneman, 1974). Investors confronted with urgent deadlines may neglect independent verification, disregard contradictory evidence, or fail to consult financial advisers before committing substantial resources. This reduction in analytical thinking increases vulnerability to misleading information and deceptive marketing.

Urgency is particularly common in digital financial fraud, where victims receive messages warning of imminent account suspension, limited-time investment opportunities, or rapidly changing cryptocurrency prices. Social engineering attacks frequently combine urgency with fear by suggesting immediate financial danger unless prompt action is taken (Hadnagy, 2018). Such tactics exploit the human tendency to prioritise immediate action over careful evaluation during emotionally stressful situations.

The effectiveness of urgency-based persuasion demonstrates that financial fraud often relies more on manipulating psychological states than on presenting technically convincing financial arguments. Once emotional pressure dominates decision-making, individuals become significantly more susceptible to deception.

9.3 Social Proof

Another influential psychological mechanism is **social proof**, defined as the tendency to interpret the behaviour of others as evidence of appropriate or desirable action (Cialdini, 2021). Under conditions of uncertainty, individuals frequently rely on the decisions of peers, experts, celebrities, or large groups when evaluating unfamiliar financial opportunities. Social proof serves as a cognitive shortcut that reduces uncertainty but may also increase vulnerability to manipulation.

Fraudsters deliberately construct the appearance of widespread investor participation by displaying fabricated testimonials, exaggerated client numbers, celebrity endorsements, or inflated investment volumes. Individuals observing apparent enthusiasm from others often assume that the investment has already undergone adequate evaluation, reducing their own motivation to conduct independent research. The influence of social proof becomes particularly pronounced during speculative financial bubbles. Investors may observe rapidly increasing asset prices and interpret widespread participation as confirmation of genuine investment value rather than recognising the possibility of irrational market behaviour (Shiller, 2015). This psychological process contributes to herd behaviour, in which individuals imitate collective market decisions despite limited understanding of underlying financial fundamentals.

Several historical financial bubbles, including the dot-com bubble, cryptocurrency speculation, and meme stock trading, demonstrate the influence of social proof on investment behaviour. Although not inherently fraudulent, such environments create favourable conditions for fraudsters because heightened investor enthusiasm reduces scepticism and encourages rapid participation. Consequently, social proof frequently amplifies the effectiveness of fraudulent investment schemes.

9.4 Ponzi Schemes and Fear of Missing Out (FOMO)

One of the most powerful psychological drivers of investment fraud is the **Fear of Missing Out (FOMO)**, a phenomenon describing anxiety that others are benefiting from opportunities unavailable to oneself (Przybylski et al., 2013). FOMO has become increasingly influential in modern financial markets due to widespread social media use, real-time financial information, and constant exposure to reports of extraordinary investment success.

Ponzi schemes rely heavily on FOMO by generating the illusion of consistently high returns during their initial stages. Early investors often receive genuine payments funded by subsequent participants rather than legitimate investment profits. These apparent successes generate positive word-of-mouth

recommendations that attract increasing numbers of investors, reinforcing perceptions of legitimacy (Frankel, 2012). As more individuals appear to benefit financially, hesitation among prospective investors decreases because social validation replaces independent financial analysis.

Behavioural finance suggests that FOMO interacts closely with **regret aversion**, whereby individuals fear the emotional discomfort associated with failing to participate in highly profitable opportunities (Kahneman & Tversky, 1979). Investors may therefore overlook warning signs because avoiding future regret becomes psychologically more important than objectively assessing financial risk.

The fraudulent investment operation managed by **Bernard Madoff** remains one of the most prominent examples of these dynamics. Despite promises of unusually consistent returns, many sophisticated investors continued investing because existing clients reported positive experiences and the scheme enjoyed substantial social credibility (Lewis, 2012). Similar psychological patterns have emerged in numerous cryptocurrency scams, fraudulent investment platforms, and high-yield investment programmes promoted through digital media.

The relationship between Ponzi schemes and FOMO demonstrates that financial fraud frequently depends less on technical sophistication than on exploiting universal emotional responses associated with opportunity, competition, and social comparison.

9.5 Trust Heuristics in Financial Decision-Making

Financial decision-making frequently occurs under conditions of uncertainty, making it impossible for investors to independently verify every available investment opportunity. Consequently, individuals rely on **trust heuristics**, mental shortcuts based on perceived credibility, expertise, reputation, or familiarity, to simplify complex financial choices (Kahneman, 2011). While these heuristics often facilitate efficient decision-making, they also create opportunities for manipulation when trust is deliberately exploited.

Investors commonly associate professional appearance, institutional affiliation, educational qualifications, media visibility, and previous success with honesty and competence. Fraudsters intentionally cultivate these characteristics through sophisticated branding, impressive offices, prestigious partnerships, charitable activities, or endorsements from respected public figures. Such signals increase perceived legitimacy even when objective financial evidence remains limited.

Behavioural research further identifies the **halo effect**, whereby positive impressions in one domain influence evaluations of unrelated characteristics (Thorndike, 1920). Successful entrepreneurs, respected financial advisers, and charismatic business leaders may therefore be perceived as trustworthy across multiple dimensions despite limited evidence regarding their ethical behaviour. This cognitive bias contributed significantly to public confidence in several financial scandals discussed earlier, including those involving Harshad Mehta, Vijay Mallya, Wirecard, and FTX, where personal reputation and organisational prestige reduced critical scrutiny (Murphy & McCrum, 2020; Lewis, 2023).

Trust heuristics also influence institutional decision-making. Banks may rely on historical client relationships, investors may depend on analyst recommendations, and regulators may place excessive confidence in corporate disclosures. Consequently, psychological biases affecting trust operate not only among individual consumers but also within professional financial institutions responsible for monitoring and oversight.

The increasing digitisation of financial services has introduced additional challenges. Online investment platforms, social media influencers, artificial intelligence-generated content, and sophisticated phishing techniques enable fraudsters to create highly convincing digital identities capable of rapidly establishing trust among potential victims (Hadnagy, 2018). As financial interactions increasingly occur through digital

channels, understanding trust heuristics becomes essential for strengthening both investor education and regulatory protection.

Overall, victim psychology demonstrates that financial fraud succeeds because it exploits universal features of human cognition rather than deficiencies unique to particular individuals. Scarcity, urgency, social proof, FOMO, and trust heuristics are adaptive psychological mechanisms that normally support efficient decision-making but become vulnerabilities when deliberately manipulated by fraudsters. These cognitive biases affect retail investors, institutional participants, and even regulators, explaining why financial fraud continues to occur despite improvements in financial literacy and regulatory oversight. Recognising these behavioural patterns highlights the importance of integrating psychological insights into investor education, financial regulation, and fraud prevention policies. Rather than assuming that victims simply lack knowledge, effective prevention strategies should acknowledge the predictable cognitive biases that influence financial decision-making and design interventions that reduce their exploitation in increasingly complex financial markets.

10. Technology and the Evolution of Fraud

Technological advancement has fundamentally transformed the nature, scale, and execution of financial fraud. While traditional scandals such as the **Harshad Mehta securities scam**, **Enron**, and **Satyam** relied primarily on accounting manipulation, regulatory loopholes, and governance failures, contemporary fraud increasingly exploits digital technologies, artificial intelligence (AI), online financial systems, and global connectivity. The rapid expansion of internet banking, digital payment platforms, cryptocurrencies, and social media has created significant opportunities for economic growth while simultaneously providing fraudsters with sophisticated tools to deceive individuals and institutions across geographical boundaries (Levi & Smith, 2021).

Unlike conventional financial fraud, which often required organisational authority or insider access, digital fraud can now be conducted remotely with relatively low financial investment. Cybercriminals combine behavioural psychology with technological sophistication to manipulate victims without physical interaction (Button & Cross, 2017). Consequently, financial fraud has evolved from institution-centred offences involving corporate executives to increasingly decentralised forms of deception targeting individuals, businesses, governments, and financial institutions.

This transformation has also altered fraud prevention strategies. Traditional approaches focused on auditing, corporate governance, and regulatory oversight, whereas contemporary responses increasingly require cybersecurity, AI governance, digital identity verification, and behavioural awareness.

10.1 Digital Fraud Psychology

Digital environments have changed the psychological conditions under which financial decisions are made. Online transactions occur rapidly and often without face-to-face interaction, reducing many of the social cues people use to assess trustworthiness. Behavioural research suggests that individuals rely more heavily on cognitive shortcuts in digital environments because they must process large amounts of information quickly (Kahneman, 2011). As a result, users often judge credibility based on website design, social media presence, online reviews, or perceived authority rather than careful verification.

Fraudsters deliberately exploit these tendencies by creating professional-looking websites, verified social media profiles, convincing emails, and realistic mobile applications that closely imitate legitimate financial institutions (Hahnagy, 2018). Such digital environments encourage immediate decisions before victims critically evaluate available information.

The **online disinhibition effect** further increases vulnerability, as individuals often behave less cautiously online than in face-to-face interactions (Suler, 2004). People may click suspicious links, disclose financial credentials, or approve digital transactions that they would question in traditional settings. Similarly, instant payment systems encourage rapid financial decisions, leaving little time for reflective thinking. Behavioural economists argue that such environments increase reliance on intuitive rather than analytical reasoning, making users more susceptible to deception (Thaler, 2015).

10.2 Social Engineering Tactics

Modern financial fraud increasingly relies on **social engineering**, a form of psychological manipulation designed to persuade individuals to voluntarily disclose confidential information or perform actions that benefit fraudsters. Rather than exploiting technological vulnerabilities alone, social engineering targets predictable aspects of human behaviour, including trust, fear, urgency, authority, curiosity, and reciprocity (Mitnick & Simon, 2002).

Common techniques include phishing emails, fraudulent phone calls (vishing), text message scams (smishing), impersonation, fake customer support services, and fraudulent investment opportunities. These attacks often imitate banks, government agencies, or well-known corporations while deliberately incorporating psychological triggers such as scarcity, urgency, authority bias, and social proof (Hadnagy, 2018).

For example, phishing emails frequently warn users that their bank accounts will be suspended unless immediate action is taken, while fraudulent investment schemes promise limited-time opportunities with unusually high returns. Fraudsters increasingly personalise these attacks using information obtained from social media and public databases, making communications appear more authentic and increasing victims' trust (Button & Cross, 2017). Because organisations are also targeted, effective fraud prevention now requires behavioural awareness training alongside technological security measures.

10.3 AI-Driven Deception: Deepfakes and Identity Fraud

The rapid advancement of artificial intelligence has created new opportunities for both financial innovation and financial crime. AI systems capable of generating realistic text, images, audio, and video have significantly increased the sophistication of fraudulent activities (Europol, 2023).

One of the most concerning developments is the rise of **deepfakes**, which use machine learning to create highly realistic synthetic voices and videos capable of impersonating executives, financial advisers, government officials, or family members. Fraudsters can use these technologies to persuade victims to transfer funds or disclose confidential information. Recent incidents have demonstrated how synthetic voice technology has been used to imitate senior executives and authorise fraudulent financial transfers (Europol, 2023).

AI has also enhanced **identity fraud** by enabling the creation of counterfeit identification documents, fabricated customer profiles, and synthetic digital identities capable of bypassing conventional verification systems. Combined with personal data obtained through cyberattacks or social media, these technologies facilitate fraudulent account creation, loan applications, investment scams, and money laundering.

Psychologically, AI-driven deception exploits fundamental trust heuristics. People naturally rely on familiar voices, faces, and visual evidence when assessing credibility. As AI-generated content becomes increasingly realistic, distinguishing genuine communications from fraudulent ones becomes more difficult, highlighting the need for stronger verification mechanisms beyond human judgement.

10.4 From Institutional Fraud to Decentralised Fraud

Historically, large-scale financial fraud primarily involved corporate executives, banks, auditors, or public

officials abusing organisational authority. Today, financial fraud increasingly reflects a shift towards **decentralised fraud**, where individuals or loosely organised criminal networks exploit digital technologies across multiple jurisdictions (Levi & Smith, 2021).

Cryptocurrency markets exemplify this transformation. Decentralised finance (DeFi), blockchain technology, and digital assets have enabled innovative financial services while creating opportunities for **rug pulls, fraudulent token offerings, pump-and-dump schemes, cryptocurrency investment scams**, and decentralised Ponzi schemes (Financial Action Task Force [FATF], 2023). Social media has further accelerated decentralised fraud by allowing anonymous influencers and coordinated online communities to rapidly spread misleading financial information and fraudulent investment opportunities.

Unlike traditional institutional scandals that primarily affected corporations and shareholders, digital fraud increasingly targets ordinary consumers through mobile banking, online marketplaces, cryptocurrency platforms, phishing campaigns, romance scams, and fraudulent advertisements. Although technology has transformed the methods of financial crime, the underlying psychological mechanisms remain largely unchanged. Fraudsters continue to exploit overconfidence, authority bias, social proof, scarcity, FOMO, and trust heuristics, the same behavioural principles observed in traditional corporate scandals.

Overall, technological innovation has expanded financial fraud beyond organisational settings into highly interconnected digital ecosystems. Digital communication, social engineering, artificial intelligence, and decentralised financial systems have increased both the sophistication and global reach of financial crime while complicating regulatory oversight. Nevertheless, the persistence of familiar behavioural biases reinforces the central argument of this review: technology changes the tools of deception, but human psychology remains the primary mechanism through which financial fraud succeeds. Effective fraud prevention therefore requires combining technological safeguards with behavioural education, cybersecurity awareness, AI governance, and internationally coordinated regulatory frameworks.

11. Discussion

The findings of this secondary review indicate that financial fraud is best understood as the result of an interaction between individual psychology, organisational behaviour, institutional weaknesses, and environmental conditions rather than the actions of isolated unethical individuals. Across the Indian and global cases examined, including Harshad Mehta, Ketan Parekh, Satyam Computer Services, Vijay Mallya, Nirav Modi, Enron, Wirecard, FTX, and 1MDB, a consistent pattern emerges. Individuals with high levels of intelligence, technical expertise, and professional credibility engaged in fraudulent behaviour within systems that either enabled or failed to detect misconduct. At the same time, regulators, auditors, investors, and organisational stakeholders often overlooked warning signs until significant financial damage had occurred. These findings suggest that neither psychological explanations nor institutional analyses alone sufficiently explain financial fraud; instead, fraud develops through the interaction between human behaviour and systemic vulnerabilities (Coffee, 2005; Dorminey et al., 2012; Free, 2015).

The literature further demonstrates that financial fraud is rarely a single impulsive act. Instead, it evolves gradually through processes of rationalisation, moral disengagement, and ethical fading (Bandura, 1999; Cressey, 1953; Tenbrunsel & Messick, 2004). Behavioural factors such as overconfidence, optimism bias, illusion of control, and excessive ambition influence how individuals perceive risk and justify unethical decisions (Kahneman, 2011). However, these psychological tendencies become consequential only when organisations possess weak governance, inadequate internal controls, fragmented regulation, or ineffective

oversight. Similarly, organisational cultures characterised by conformity, authority bias, and performance pressure reduce the likelihood that unethical actions will be questioned or reported (Ashforth & Anand, 2003). The recurring interaction between these behavioural and institutional factors explains why similar patterns of fraud emerge across different industries, countries, and regulatory systems.

The case studies strongly reinforce this integrated perspective. Harshad Mehta exploited weaknesses within India's banking and securities systems, while Satyam combined executive rationalisation with failures in corporate governance. Wirecard demonstrated how corporate reputation and regulatory blind spots delayed intervention, whereas FTX illustrated how charismatic leadership, investor trust, and weak governance enabled large-scale misuse of customer assets. Likewise, the 1MDB scandal highlighted how political influence and institutional capture weakened accountability mechanisms. Despite differences in jurisdiction and industry, these cases consistently reveal that fraud succeeds when psychological motivations coincide with systemic opportunities.

Another important finding concerns the relationship between intelligence and ethical behaviour. Many perpetrators of financial fraud possessed exceptional academic qualifications, financial expertise, and professional success. Behavioural ethics research suggests that intelligence improves analytical ability but does not necessarily strengthen ethical judgement (Bazerman & Tenbrunsel, 2011). In some situations, highly capable individuals may become more effective at identifying regulatory loopholes, constructing rationalisations, or concealing misconduct. Furthermore, universal cognitive biases such as overconfidence and confirmation bias affect experts and non-experts alike (Kahneman, 2011). These observations indicate that professional competence alone cannot prevent unethical behaviour, highlighting the need for ethics education, behavioural awareness, and stronger governance alongside technical expertise.

The review also demonstrates the reciprocal relationship between human behaviour and institutional systems. Weak controls, poor regulatory coordination, information asymmetry, and ineffective auditing increase opportunities for misconduct while reducing the perceived risk of detection (Coffee, 2005; Rezaee, 2005). Conversely, behavioural factors such as groupthink, authority bias, ethical fading, and incentive-driven decision-making gradually weaken organisational governance by discouraging accountability and normalising unethical practices (Janis, 1972; Milgram, 1974). Technological developments further reinforce this interaction by creating new opportunities for fraud while simultaneously requiring stronger institutional safeguards and behavioural awareness.

Overall, this review supports a conceptual understanding of financial fraud as the product of three interconnected dimensions: individual psychology, institutional gaps, and environmental triggers. Cognitive biases, personality traits, and rationalisation motivate unethical decisions; weaknesses in governance, auditing, regulation, and compliance create opportunities for fraud; and external pressures such as market competition, technological disruption, and economic uncertainty intensify incentives for misconduct. These factors reinforce one another through continuous feedback, allowing relatively small ethical compromises to evolve into large-scale financial scandals. Consequently, preventing financial fraud requires an interdisciplinary approach that combines behavioural science, corporate governance, financial regulation, technological oversight, ethical leadership, and financial literacy. Such an integrated framework offers greater potential for strengthening financial integrity and reducing the recurrence of systemic fraud in increasingly complex global financial systems.

12. Policy Implications and Recommendations

The findings of this review suggest that preventing financial fraud requires a shift from reactive enforce-

ment to proactive risk prevention. Although stricter laws, higher penalties, and stronger compliance frameworks remain important, the persistence of large-scale fraud across countries demonstrates that legal reforms alone are insufficient. As shown throughout this review, financial fraud emerges through the interaction of behavioural psychology, organisational culture, institutional weaknesses, and environmental pressures. Therefore, effective anti-fraud strategies should integrate behavioural science with corporate governance, financial regulation, technology, and public education (Bazerman & Tenbrunsel, 2011; OECD, 2023).

One important recommendation is the adoption of **behavioural auditing systems** alongside traditional financial audits. Conventional audits primarily assess accounting accuracy, internal controls, and regulatory compliance, yet many major frauds persisted despite regular audits (Dorminey et al., 2012). Behavioural auditing would evaluate organisational culture, leadership behaviour, ethical climate, decision-making patterns, whistleblower confidence, and concentration of executive power. Employee surveys, anonymous ethical assessments, and behavioural risk indicators could help identify environments where overconfidence, conformity, or ethical fading are developing. Advances in artificial intelligence and data analytics can further support continuous monitoring of unusual transaction patterns and organisational risk signals, enabling earlier intervention before fraud becomes systemic.

Strengthening **whistleblower frameworks** is equally essential. Evidence from numerous financial scandals shows that employees often detect unethical practices long before regulators or auditors. However, fear of retaliation, authority bias, and organisational loyalty frequently discourage reporting (Near & Miceli, 1995). Governments and organisations should provide stronger legal protection, confidential reporting channels, and independent investigation mechanisms to ensure that whistleblowers are protected from professional or personal consequences. Creating a culture of psychological safety, where raising ethical concerns is viewed as responsible conduct rather than disloyalty, is equally important. Although financial incentives may encourage reporting, research suggests that trust, confidentiality, and organisational support are stronger determinants of whistleblowing behaviour (Treviño et al., 2006).

The review also highlights the need to **reduce regulatory silos** through greater coordination among regulatory agencies. Cases such as Harshad Mehta, Nirav Modi, Wirecard, and FTX demonstrate how fraudsters exploit gaps between supervisory authorities (Coffee, 2005). In India, improved collaboration among RBI, SEBI, the Ministry of Corporate Affairs, the CBI, and other agencies would strengthen oversight, while internationally, greater cooperation among financial intelligence units and law enforcement agencies is increasingly necessary due to the global nature of financial crime. Shared databases, integrated digital monitoring systems, AI-supported analytics, and real-time information sharing would improve early detection and reduce opportunities for regulatory arbitrage.

Another significant implication is the need to **embed behavioural psychology within financial regulation**. Traditional regulatory models assume that individuals respond rationally to legal incentives, yet behavioural research demonstrates that decision-making is strongly influenced by cognitive biases, emotions, and social influences (Kahneman, 2011; Thaler & Sunstein, 2021). Regulatory bodies should therefore incorporate behavioural experts when designing investor protection policies, corporate governance standards, and supervisory procedures. Behaviourally informed interventions, such as structured ethical decision checklists, independent review processes for high-risk decisions, and behavioural training for directors and auditors, could reduce overconfidence, improve accountability, and strengthen organisational ethics.

Finally, **financial literacy interventions** should move beyond teaching basic investment concepts to include behavioural awareness and fraud recognition. Since fraudsters routinely exploit biases such as scarcity, urgency, authority, social proof, trust heuristics, and Fear of Missing Out (FOMO), education programmes should help individuals recognise these psychological influences before making financial decisions (Cialdini, 2021; Kahneman, 2011). Schools, universities, financial institutions, and government agencies should integrate financial psychology, digital fraud awareness, cybersecurity, and safe online financial practices into educational programmes. As digital finance, artificial intelligence, and cryptocurrency continue to expand, behavioural financial literacy has become increasingly important for both consumers and future financial professionals.

Overall, the recommendations presented in this review support a preventive and interdisciplinary approach to fraud prevention. Behavioural auditing, stronger whistleblower protections, improved regulatory coordination, psychology-informed regulation, and comprehensive financial literacy programmes address both the human and institutional dimensions of financial fraud. Together, these measures offer a more sustainable strategy for strengthening financial integrity, enhancing public trust, and reducing the recurrence of large-scale financial fraud in an increasingly complex and technology-driven global financial system.

13. Conclusion

Financial fraud remains one of the most significant challenges facing modern financial systems, affecting not only economic stability but also public trust, institutional credibility, and sustainable development. This review examined financial fraud through an interdisciplinary lens by integrating behavioural psychology, finance, organisational behaviour, criminology, and corporate governance. The evidence demonstrates that financial fraud cannot be explained solely through legal or economic perspectives. Instead, it emerges from the interaction between individual psychology, organisational culture, institutional weaknesses, and external environmental pressures.

The review identified several recurring psychological drivers of financial misconduct. Cognitive biases such as overconfidence, optimism bias, illusion of control, authority bias, confirmation bias, and rationalisation influence decision-making by encouraging individuals to underestimate risks and justify unethical behaviour (Kahneman, 2011; Cressey, 1953). Personality traits associated with the Dark Triad, particularly narcissism, Machiavellianism, and psychopathy, further increase the likelihood of unethical conduct (Paulhus & Williams, 2002). However, these behavioural tendencies translate into large-scale fraud only when organisations provide opportunities through weak governance, ineffective oversight, poor internal controls, and fragmented regulation.

The comparative analysis of Indian and international scandals, including Harshad Mehta, Ketan Parekh, Satyam, Vijay Mallya, Nirav Modi, Enron, Wirecard, FTX, and 1MDB, revealed strikingly similar patterns despite differences in geography and regulatory systems. Across these cases, organisational factors such as ethical fading, authority bias, groupthink, information asymmetry, weak board oversight, and auditor failures repeatedly enabled misconduct. Technological developments have further expanded opportunities for fraud through digital finance, artificial intelligence, social engineering, identity theft, and decentralised financial systems. Although the methods of fraud continue to evolve, the underlying behavioural vulnerabilities remain remarkably consistent.

A key finding of this review is that intelligence and professional success do not necessarily promote ethical behaviour. Many perpetrators possessed exceptional expertise and credibility, while sophisticated

investors, auditors, and regulators also failed to detect fraud. These findings reinforce behavioural research suggesting that ethical judgement is distinct from cognitive ability and that expertise does not eliminate psychological biases or moral disengagement (Bazerman & Tenbrunsel, 2011). Consequently, fraud prevention must complement technical competence with behavioural awareness, ethical leadership, and stronger organisational cultures.

The review also highlights the reciprocal relationship between human behaviour and institutional systems. Psychological biases influence organisational decisions, while institutional weaknesses reinforce unethical behaviour by reducing the perceived likelihood of detection. Financial fraud therefore develops through a self-reinforcing cycle in which behavioural motivations and systemic vulnerabilities interact continuously. This explains why repeated regulatory reforms have reduced certain risks but have not eliminated financial fraud altogether.

Accordingly, this review recommends an integrated approach to fraud prevention that combines behavioural auditing, stronger whistleblower protection, improved regulatory coordination, behaviourally informed financial regulation, and financial literacy programmes incorporating psychological awareness. Such measures emphasise early identification of behavioural and organisational risks rather than relying solely on reactive legal enforcement.

In conclusion, financial fraud should be understood as a behavioural and systemic phenomenon rather than merely a legal or financial offence. Sustainable prevention requires integrating behavioural science with governance, regulation, technology, and organisational ethics. As financial systems become increasingly digital and globally interconnected, interdisciplinary approaches will be essential for strengthening institutional resilience, enhancing investor protection, and fostering more transparent and trustworthy financial markets.

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