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Ponzi Schemes:An Analysis on Coping with Economic Recession in Nigeria

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ABSTRACT

Historically, Ponzi schemes are not new, but have been in operation since the mid 1800"s. Ponzis were rather popularized in the early 1900"s by the mastermind fraudster - Charles Ponzi. Ponzi schemes are fraudulent games where individuals or companies pay out interest returns to some invested parties by borrowing funds from others. In Nigeria, investments in Ponzi schemes are innovative strategies of coping with the strain or harsh economic realities that many experience as the nation fails to provide adequate and realistic means of achieving culturally valued goals of financial security and comfortable standard of living. Hence, Government should revamp the economy through effective economic diversification policies that will enhance provision of socio-economic livelihood like jobs, social security and welfare packages as palliatives to recession induced strain. Also, there should be upward review of the minimum wage as recession induced inflation and rising cost of living predisposes individuals to innovate illegitimate coping means as palliatives to recession induced strain.

Keywords: Ponzi Scheme, Cope, Recession, Economy and Strategy

INTRODUCTION

In 2015, the Central Bank of Nigeria (2015) and International Monetary Fund (2016) stated that Nigeria's economy has slipped into recession. This was evident in the negative economic growth rates and significant decline in economic activities in the country, resulting in increased hardship, rising unemployment, low output, falls in availability of credit, illiquidity and rising inflationary pressures [1-4]. Hence, the need for Nigerians to device strategies to cope with these economic realities became pertinent. Since early 2016 when the country's economy was officially declared to have plunged into a recession, there has been an upsurge in the proliferation of financial Ponzi schemes amongst Nigerians. Perhaps, this is suggestive of the fact that Ponzi schemes may be a palliative to cushion the effects of the recession [5]. According to [6], different unorthodox financial schemes mostly Mavrodi Mundial Movement (MMM), Ultimate Cycler, Zar Fund, Givers Forum, I-charity, Crowd Rising, Get Help Worldwide, Claritta, Twinkas, etc, have continually gained patronage across Nigeria since the recession. Unarguably, most of these schemes especially MMM had earlier existed and collapsed in countries like China, South Africa, Zimbabwe and several other places leading to loss of money by millions of people, not forgetting the associated psychological trauma [7]. Across cultures, various forms of Ponzi schemes exists which are being patronized by desperate money seekers, oblivious of certain inherent dangers [8].

In the U.S.A for example, Ponzi scheme investigations accounted for about 21% of the Security and Exchange Commission's (SEC's) enforcement workload in 2010 alone, compared with 17% in 2008 and 9% in 2005 [9]. According to [10], a notable Ponzi in the U.S, named the 'Problem Solver' targets individuals in financial distress who feel they are down on their luck with increasing debt crises and have nowhere to turn for help. He also noted that 'Debt Resolution' scams were common during the economic recession with failed outcomes as well as ruined credit ratings for customers. As the economic recession lingers in Nigeria, the financial community continues to learn about many Ponzi schemes and other frauds that have proliferated during the period. The consequences are however numerous and many are prone to them as they struggle to eke out a living in the face of unfavorable economic realities. It is in light of this, that this paper examines the proliferation of Ponzi schemes in Nigeria [11].

The Concept of Ponzi Schemes

According to [11], ponzi scheme is a fraud where invested money is pocketed by the schemer and investors who wish to redeem their money are actually paid out of proceeds from new investors. It is also an investment where the fund originator never made a legitimate investment in assets that produce income [12]. According to [13], Ponzi schemes are fraudulent games where individuals or companies pay out interest returns to some invested parties by borrowing funds from others. From the foregoing therefore, Ponzi schemes can be described as an enticing established swindle networking where money of newer entrants or investors are used to pay increased returns to earlier investors rather than from profit earned through legitimate business investment. Historically, Ponzi schemes are not new, but have been in operation since the mid 1800‟s. Ponzis were rather popularized in the early 1900‟s by the mastermind fraudster - Charles Ponzi [14]. He announced an arbitrage business of buying postal reply coupons in Italy and exchanged them for stamps in the U.S.A. He attracted investors by promising extraordinarily high returns of 50% in 45 days [15]. They noted that instead of investing the money to buy the coupons and exchange them for stamps, he simply used the money of later investors to pay returns to earlier investors, extracting huge profits along the way and when it collapsed over $20 million which was estimated to be equivalent of $225 million as at 2011 was lost. Since then, the world has been littered with distinct versions of such schemes; little wonder Ponzis are referred to as the grand-daddy of all financial frauds [16]. Ponzi schemes have been categorized as a white collar crime. The term white collar crime was first coined by Edwin Sutherland in 1940, as a crime committed by a person of respectability and high social status in the course of his occupation [17]. Therefore, Ponzi schemes are forms of non-violent crime which is usually initiated and coordinated by influential individuals who are classified as intelligent, popular and initially well respected in their respective line of work. Example is the recent conviction of Bernard Madoff, a highly-regarded Hedge Fund Manager and a former president of the National Association of Securities Dealers Automated Quotations (NASDAQ) for running a very sophisticated Ponzi scheme which defrauded over 50 billion dollars [18].

Ponzi schemers always seek to recruit new investors and so long as new investments are expanding at a healthy rate, the schemer keeps the fraud going. To [9], the survival of a Ponzi scheme depends on the schemer's ability to keep attracting new investors who make sufficiently large contributions to sustain high payouts to existing investors. Operators of Ponzi schemes usually entice new investors by offering higher returns than other investments in form of short-term returns that are either abnormally high or unusually consistent. Initially, the promoter will pay out high returns to attract or lure more investors into putting additional money. The return to the initial investors is paid out of the investments of new entrants, rather than solely from profits. Ponzi schemers descriptions of their investment strategy range from investing in stocks and bonds to real estate transactions, international trade and so forth [11].

The Concept of Economic Recession

The National Bureau of Economic Research [7], defines economic recession as a significant decline in economic activity spread across the economy and lasting for more than a few months, usually seen in economic indicators such as Gross Domestic Product (GDP), real income, employment, industrial production and wholesale-retail sales. It is characterized by rising cost of production, fall in investment, employment, income and demand as well as a fall in firms profitability accompanied by distress in the stock market and banking system. Generally, recession occurs when there is a widespread decline in aggregate expenditure by government, households and firms, which is triggered by international trade imbalances, financial crisis, negative supply shock, and more. More so, a recession is commonly accompanied by a decline in the GDP (a major indicator of economic recession which measures the overall performance of an economy) for two or more consecutive quarters. The International Monetary Fund [11], reports that Nigeria's real GDP growth declined tremendously from 2.7% in 2015 to -1.7% in 2016, thereby suggesting a negative growth rate [13]. This situation portends grave consequences for the economy as the nation continues to swim in the deep waters of recession. One of such consequences is an increase in the level of unemployment as firms lay off employees in a bid to cut cost and resolve the crises of profitability. According to [15], the average rate of unemployment was 18.19% between 2011 and 2015. The progressive deterioration in the unemployment rate of the country reached a dismal level in 2016 (the recession year) when the Nigerian Bureau of Statistics reported that Nigeria's unemployment rate rose from 13.3% in the second quarter of 2016 to 13.9% in the third quarter of same year [11]. The economic recession was indicted for this increase in unemployment rate. Aside unemployment, the recession has impacted negatively on household consumption patterns in the country. The National Bureau of Statistics reported a decline in household consumption demand from - 0.7% to - 2.0% in the third quarter of 2016. This in turn precipitated contraction in business cycle and caused supply shock which triggered inflationary pressure in the economy. Consequently, the [8] noted increase in inflation by the rate of 17.9%. Therefore, the impact of recession on the Nigerian economy cannot be overemphasized as it portends multi-faceted socio-economic problems for the country.

Coping Strategy

According to [9], "coping is a person's constantly changing cognitive and behavioral efforts to manage specific external and/or internal demands that are appraised as taxing or exceeding the person's resources. From their perspective, coping has two primary functions which are to regulate stressful emotions and to alter the troubled person-environment relationship that causes distress. Similarly, [9] defines coping as a way to act and manage resources in unusual, abnormal and adverse situations. To [12], the use of resources here implies physical and social manners to gain livelihood and ability to access safety. From the foregoing therefore, coping strategy refers to the specific efforts, either behavioral or psychological that people employ to master, tolerate, reduce or minimize stressful events such as a natural disaster or as in this case, an economic recession.

Theoretical Framework

This paper is anchored on the theoretical assumptions of the strain theory as propounded by [9]. The theory explains deviant behavior and crime as inevitable outcome of the strain individuals experience when society does not provide adequate and approved means to achieve culturally valued goals. It holds that society puts pressure on individuals to achieve socially accepted goals (e.g. financial security), but often they lack the approved means in actualizing such goals. This situation is what Merton referred to as structural strain i.e. the discrepancy between culturally defined goals and the institutionalized means available to achieve these goals. Structural strain can lead to individual strain which is the frictions and pains experienced by many unprivileged individuals as they search for ways to satisfy their needs. Strain therefore occurs when there is a gap between an individual's goals and their current status which may lead the individual to seek out for dishonest or illegitimate means in meeting those needs such as engaging in criminal activities.

Ponzi as a Coping Strategy

There is no clear record of the origin of Ponzi schemes in Nigeria. [5], however asserts that Ponzi schemes are not new in Nigeria and noted the earlier existence of schemes such as "Pyramid" and "Green World". In addition, other earlier Ponzi schemes include Umana-Umana "in Calabar and Port Harcourt in the 1980s, Planwell in Edo state from 1991-1992, as well as Nopecsto "in Lagos state from 2002-2007 [9]. In ascertaining if Ponzi schemes are coping strategy to economic recession in Nigeria, Jack et al (2018) assert that the schemes that are most popular are MMM, Twinkas, cycler, Givers Forum, Charity, Get Help World Wide, Clarrita, Smile2Charity, Help2Get, and Donation Hub. The study found that all the respondents had participated in more than one Ponzi schemes, partly as a result of the referral bonuses attached to the schemes and the drive to recruit new investors to get paid and the need to diversify the Ponzi portfolio for increased income. Investigation into the reasons why Nigerians invest in Ponzi schemes indicates that majority attributed it to the economic conditions associated with recession. In addition, some others affirmed that they participate in Ponzi schemes due to the quick turn over on investment within a short period of time. Also, others said they invest as a means of diversifying their streams of income, and another set reported they participated in Ponzi schemes due to poverty, inadequate interests on bank deposits and greed to get-rich-quick respectively. In the light of the above, within the context of this study, as the Nigerian economy is beset with myraids of economic problems ranging from unemployment to bad leadership and structure of governance that has climaxed into economic recession; Ponzi schemes according to [12], became a coping alternative to the harsh economic realities in the country. They submit that the presently constituted economy is not viable and as hunger, poverty and unemployment continue to rake the nation, people seek alternative means to cushion the effects. A similar study conducted by [13], investigated the perception of business education students in Rivers State University, regarding ponzi scheme. Findings revealed that the respondents agreed that Ponzi schemes legitimately increased their income and reduced the impact of recession on them. They agreed that Ponzi schemes are scams that will surely crash, but that the durability is based on the continued joining of more people. This implies that despite knowing the implications, many involve in Ponzi schemes as a strategy for cushioning the effects of harsh economic realities. The foregoing findings suggests that participation in Ponzi schemes are therefore means through which people seek to meet their financial needs so as to be able to cope with the hardship associated with the economic recession. Again, the finding that Ponzi schemes are thriving as a result of harsh economic realities in the country corroborates that of [9] where they submitted that the Nigerian economy as currently constituted is not viable and as hunger, poverty and unemployment continue to rake the nation, people seek alternative means to cushion the effects. To this end, it can be concluded that Ponzi scheme is one of the means by which Nigerians cope with the hardship associated with economic recession; hence the proliferation of these schemes since early 2016 when the nation's economy slipped into recession is not mere coincidence.

CONCLUSION/RECOMMENDATION

Investments in Ponzi schemes are innovative strategies of coping with the strain or harsh economic realities that many experience as the nation fails to provide adequate and realistic means of achieving culturally valued goals of financial security and comfortable standard of living. Hence, Government should revamp the economy through effective economic diversification policies that will enhance provision of socio-economic livelihood like jobs, social security and welfare packages as palliatives to recession induced strain. Also, there should be upward review of the minimum wage as recession induced inflation and rising cost of living predisposes individuals to innovate illegitimate coping means as palliatives to recession induced strain.

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