

## **Analysis**

# **Factors Affecting Money Laundering: A Lesson for Developing Countries**

Bajrang, Pavitra, Ritika, Piyush, Puneet<sup>1</sup>

Neha Parashar<sup>2</sup>

---

### **Abstract**

*Mahatma Gandhi said, “Capital as such is not evil; it is its wrong use that is evil. Capital in some form or other will always be needed”.*

*The primary function of money is to serve as a medium of exchange, and as such it is accepted without question in the final discharge of debts or payment of goods or services. Money is the root cause of many evils like corruption, black marketing, smuggling, drug trafficking, tax evasion and many more. People want more money to cater to their needs and at a point of time they do not hesitate to have money from any source (black or white). This paper titled “Factors Affecting Money Laundering: A Lesson for Developing Countries” aims to identify and examine the dynamics of Money Laundering in developing countries, India in particular. The paper will give a brief introduction about Money Laundering, its definition, the Process of Money Laundering, historical evolution and Consequences of Money Laundering. It*

---

<sup>1</sup> Finance Final Year Students (Batch 2008-10), SCMHRD, Pune

<sup>2</sup> Assistant Professor,

Institute of Management, NIRMA University, Ahmedabad

Email: [nehaparashar10@gmail.com](mailto:nehaparashar10@gmail.com)

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

*includes a flow chart showing the procedure followed by banks to counter money laundering. We have also presented a timeline of various laws on Anti-Money laundering.*

***Keywords:*** Illegal, corruption, framework, layering, regulations.

---

### **Introduction**

Money Laundering refers to the conversion or "Laundering" of money which is illegally obtained, so as to make it appear to originate from a legitimate source. Money Laundering is being employed by launderers worldwide to conceal criminal activity associated with it such as drug/arms trafficking, terrorism and extortion.

Money Laundering is not an independent crime, it depends upon another crime (predicate offence), the proceeds of which is the subject matter of the crime in money laundering. Money Launderers accumulate enormous profits through drug trafficking, international frauds, arms dealing etc. Cash transactions are predominantly used for Money Laundering as they facilitate the concealment of the true ownership and origin of money. It is well recognized that the huge profits that criminals earn from drug trafficking and other illegal means, by way of money laundering, could contaminate and corrupt the structure of the State at all levels, this definitely leads to corruption.

Criminal associations now tend to be organized like business enterprises and to follow the same tendencies as legitimate firms; specialization, growth, expansion in international markets and linkage with other enterprises. The holders of

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

capital of illegal origin are prepared to bear considerable cost in order to legalize its use.

This long-recognised problem of money laundering is not only linked to organized crime but also to tax evasion or false accounting. Money laundering is now recognised as a widespread problem practised by individuals, businesses, officials and governments.

### ***Definition of Money Laundering***

Money laundering is the process of creating the appearance that large amounts of money obtained from serious crimes, such as drug trafficking, originated from a legitimate source. It is a crime in many jurisdictions with varying definitions.

Money laundering is the processing of criminal proceeds (including but not limited to drug trafficking) to disguise their illegal origin or the ownership or control of the assets, or promoting an illegal activity with illicit or legal source funds.

Money Laundering is the process by which criminals attempt to conceal the true origin and ownership of the proceeds of criminal activities. If successful, the money can lose its criminal identity and appear legitimate.

### ***Process of Money Laundering***

There are three independent steps or stages in Money Laundering as shown below:

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

**Placement** - "Placement" refers to the physical disposal of bulk cash proceeds derived from illegal activity. At this stage, the launderer inserts the dirty money into a legitimate financial institution. This is often in the form of cash bank deposits. This is the riskiest stage of the laundering process because large amounts of cash are pretty conspicuous, and banks are required to report high-value transactions.

**Layering** - "Layering" refers to the separation of illicit proceeds from their source by creating complex layers of financial transactions. Layering conceals the audit trail and provides anonymity. It involves sending the money through various financial transactions to change its form and make it difficult to follow. Layering may consist of several bank-to-bank transfers, wire transfers between different accounts in different names in different countries, making deposits and withdrawals to continually vary the amount of money in the accounts, changing the money's currency, and purchasing high-value items (boats, houses, cars, and diamonds) to change the form of the money.

**Integration** - "Integration" refers to the reinjection of the laundered proceeds back into the economy in such a way that they re-enter the financial system as normal business funds. At the integration stage, the money re-enters the mainstream economy in legitimate-looking form -- it appears to come from a legal transaction. This may involve a final bank transfer into the account of a local business in which the launderer is "investing" in exchange for a cut of the profits. At this point, the criminal can use the money without getting caught. It's very difficult to catch a launderer during the

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

integration stage if there is no documentation during the previous stages.

### ***Consequences of Money Laundering***

- **Finances Terrorism:** Money laundering provides terrorists with funds to carry out their activities.
- **Undermines rule of law and governance:** Rule of Law is a precondition for economic development – Clear and certain rules applicable for all
- **Affects macro economy:** Money launderers put money into unproductive assets to avoid detection
- **Affects the integrity of the financial system:** Financial system advancing criminal purposes undermines the function and integrity of the financial system.
- **Reduces Revenue and Control:** Money laundering diminishes government tax revenue and weakens government control over the economy

### ***The Alarming Statistics***

Estimating how much money is actually laundered in India or globally is extremely difficult. Money Laundering is a largely secretive phenomenon. The exact number of launders that operate every year, how much money they launder in which countries and sectors, and which money laundering techniques they use is not known. John Walker (1995) was the first to make a serious attempt at quantifying money laundering and initial output. His model suggests that US\$2.85 trillion are

## DRISHTIKON

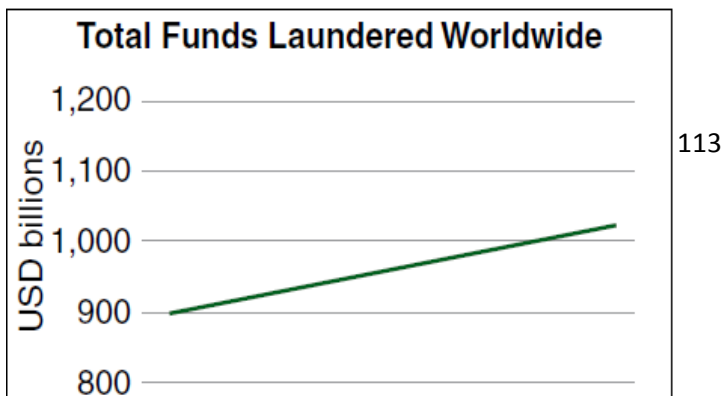
Symbiosis Centre for Management and HRD

Vol 3, No. 2

laundered globally. As per an estimate of the International Monetary Fund, the aggregate size of money laundering in the world could be somewhere between 2 and 5% of the worlds' Gross Domestic Product. Although money laundering is impossible to measure with precision, it is estimated that US\$300 billion to US\$500 billion in proceeds from serious crime (not tax evasion) is laundered each year. According to international accounting firms, India is estimated to have a parallel economy of nearly 40 percent of its \$600 billion Gross Domestic Product.

Every year world loses \$1.5 trillion to Money Laundering. It is the second biggest industry by size. The fight to deter money laundering and terrorist financing has been a high priority by law enforcement agencies and financial regulators around the globe. Global awareness in the Banking and Financial Industry has created the opportunity for the Indian Software companies. The financial services sector, in particular, faces significant reputation and regulatory risk should it be deemed to have inadequate arrangements to prevent money laundering. Banks and financial institutions are vulnerable from the Money Laundering point of view since criminal proceeds can enter banks in the form of large cash deposits. Bank officials therefore need to exercise constant vigilance in opening of accounts with large cash deposits and in checking suspicious transactions.

**Figure 1: Total Funds laundered worldwide.**



**DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

*Source: Celent Report*

**Figure 2: Money Laundered by Region**



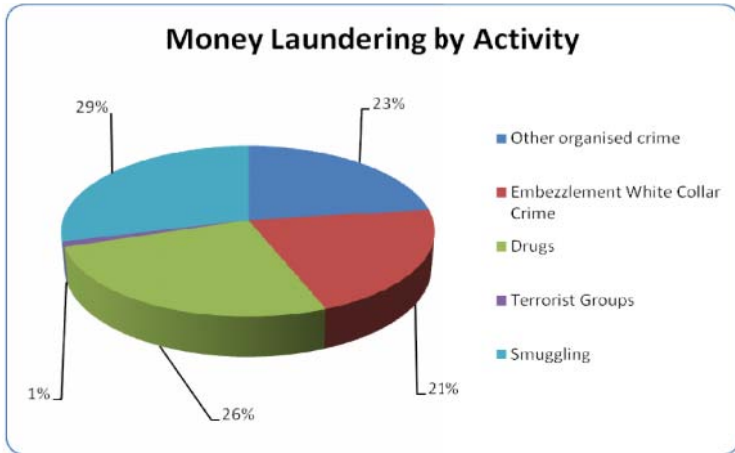
**Source: Celent Report**

**Figure 3: Money laundering by activity**

**DRISHTIKON**

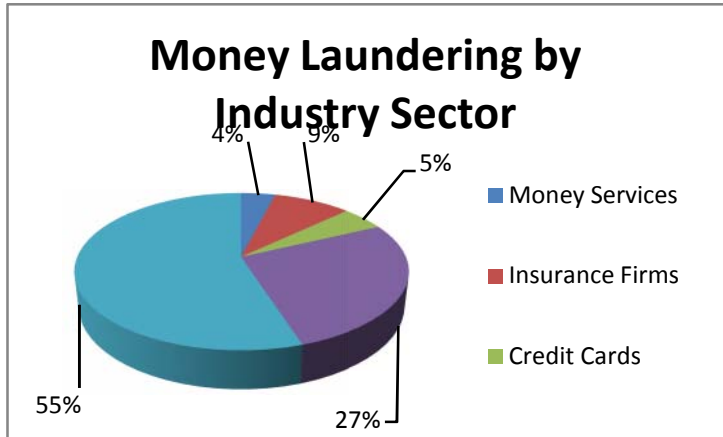
Symbiosis Centre for Management and HRD

Vol 3, No. 2



Source: *Celent Report*

**Figure 4: Money Laundering by Industry Sector**



**Source: Celent Report**

## **Literature Review**

Gotz, E., & Jonsson, M. (2009) basically in the paper provide an overview of anti-money laundering (AML) efforts and high-risk sectors in Georgia and explain changes in this field over time. The study finds that AML efforts have drastically improved in Georgia following the Rose Revolution, even though significant high-risk sectors remain and a certain tendency towards “selective implementation” (where political opponents of the ruling government are targeted the most) of AML regulations can be detected

Shukla, A., & Bhagat, B. (2009) While stringent anti-money laundering (AML) legislation has proved effective in combating illegal activity in developed countries, it has resulted in the unfortunate step of propelling it into

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

developing markets – primarily in the Asia-Pacific region. This means that developing countries are now facing an increasing threat of illegal activity. The onus of AML implementation lies with financial institutions, which see it as a financial and operational burden. However, the success of these AML programs depends on a strong partnership between government bodies and financial institutions.

Ampratwum, E. (2008) The paper aimed to survey current academic and policy debates on combating corruption and the implications of the various international initiatives on social and economic development in both developing and transition economies. The methodology used was review of a range of published articles (1967-2005), which provide theoretical and practical research on corruption and development. The paper generally concedes the wastefulness of corruption.

Biagioli, A. (2008) The paper aimed to reflect on some issues concerning the measurement of the magnitude of money laundering. The approach used was a survey of various research works devoted to the measurement of the volume of laundered funds. Focus mainly has been on quantitative approaches based on statistical methodologies. The paper addresses questions that have long attracted international attention and interest regarding the costs and benefits of the system of control of and fight against phenomena of money laundering and terrorism financing; as well as the need of revamping empirical research along new, more efficient, shared methodologies.

Salifu, A. (2008) The purpose of this paper was to examine the question of whether corruption and economic crime can be

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

controlled in developing economies and whether the cost of doing that can be justified. It also explores the implications of corruption in the development of developing economies.

Singh, V.K. (2009). Controlling Money Laundering in India- Problems and Perspectives The purpose of this paper was to go through the concept and processes of money laundering which also point out the challenges and losses and is a kind of primer to money laundering. It brought about the fact that Combating money laundering is a dynamic process because the criminals who launder money are continuously seeking new ways to achieve their illegal end, moreover Money Laundering- A sophisticated crime not to be taken very seriously at the first glance by anyone in the society as compared to street crimes.

### **Research Methodology**

The primary research objective is to identify and examine the dynamics of Money Laundering in developing countries, India in particular.

### **Objectives**

To identify the macroeconomic factors responsible for the pervasiveness of Money Laundering Activities in developing countries.

To determine the influence of each factor on the volumes of illicit fund flows.

To understand the legal framework for combating Money Laundering in India.

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

To understand the current processes followed to reduce/eliminate Money Laundering activities in the Indian Banking Sector.

### ***Sample Size***

The sample size for our Secondary Research was 36 developing countries. This list of countries was obtained from the Global Competitiveness Report, 2009 which has classified countries into developing and developed based upon the level of development in the respective country – either factor driven economy, efficiency driven or innovation driven.

The sample for our Primary Research was both Public and Private Sector banks in Pune. We administered the questionnaire to 5 banks.

Multiple linear regression was used to determine if the factors chosen had a significant impact on the volume of illicit fund flows. Factor Analysis was also used to group the factors into major influencing factors.

### ***Analysis and Interpretation***

A model to establish the relative influence of the explanatory variables on the dependent variable was developed by means of a linear regression using the OLS technique.

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

The explanatory variables being considered here are as follows:

- Technology
- Innovation
- Business Sophistication
- Financial Sophistication
- Macroeconomic stability
- Higher Education and Training
- Auditing and Reporting standards
- Ethical behavior of firms

These attributes were selected by going through some published papers on the topic.

All the raw data has been scaled down to a 1 to 7 point scale, where 1=very bad and 7=very good.

The dependent variable is the amount of illegal money flows in the countries due to transfer pricing, which is an indicator of the amount of money laundering happening in that country.

Methods of determining Illicit Fund Flows:

- Hot Money Method

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

- Dooley Method
- World Bank Residual Method
- Trade Mispricing Method

Illicit financial flows involve the transfer of money earned through activities such as corruption, transactions involving contraband goods, criminal activities, and efforts to shelter wealth from a country's tax authorities.

We have used the Trade Mispricing Model in order to obtain data on illicit fund flows. Trade mispricing is one of the major reasons for the existence of the shadow market.

### **Trade Mispricing Model**

This method tracks the over-invoicing of imports and under-invoicing of exports by domestic residents in order to capture their illicit holdings of foreign currency abroad. The volume of illicit fund flows into and out of a country is arrived at based on the "misinvoicing" concept. Corporate, in order to evade taxation, either over-invoice their imports or under-invoice their exports. For instance, if country A has exported goods to country B, the mismatch between the export value reported by country A and the import value reported by country B will give an indication of the amount of illicit funds. This is the basis on which this model works.

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Since all the independent variables were scaled down to a scale of 1 to 7, we scaled down the data for illicit fund flows also to a scale of 1 to 7, where 1=very bad and 7=very good

The formula which was used to scale down the data sets was:

$$-6 \times [(country\ score - sample\ minimum) / (sample\ maximum - sample\ minimum)] + 7$$

### ***The Hypothesis***

The hypothesis that we want to validate through this empirical study is that money laundering depends upon the above mentioned factors and that factors such as ethical behaviour have a positive effect on the degree of money laundered i.e. as the ethical behaviour of firms increases the amount of money laundered decreases.

We also expect that with the strengthening of the financial markets in the developing countries the opportunity for money laundering will become lesser. With increase in business sophistication the opportunity for money laundering is expected to increase as the increased complexity in business operations will lead to greater problems in tracking of funds.

The effect of technology could be two fold; on one hand with greater penetration of technology in various parts of the countries people will have more and easy access to the financial systems. This will bring down the amount of money transferred via illegal channels such as the hawala system, thus bringing down the amount of money laundered. On the other hand; with easy access to technology and fund transfer, money launderers can now transfer money easily several

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

times to different accounts overseas thus making the tracking of such transactions extremely difficult.

Innovation is expected to have a negative impact on the amount of money laundered. This is because as people become more innovative they become more adept at beating the system.

Money laundering is expected to decrease with greater macroeconomic stability and stronger auditing and reporting standards in the country.

Model development and parameter estimation

The model is a linear regression model with the attributes as the explanatory variables and the illicit flow of money as the dependent variable.

$$\begin{aligned} Y &= \beta_0 + \beta_1(\textit{Technology}) + \beta_2(\textit{Innovation}) \\ &+ \beta_3(\textit{Business Sophistication}) \\ &+ \beta_4(\textit{Financial Market Sophistication}) \\ &+ \beta_5(\textit{Macroeconomic Stability}) \\ &+ \beta_6(\textit{Higher Education}) \\ &+ \beta_7(\textit{Auditing and Reporting Standard}) \\ &+ \beta_8(\textit{Ethical Behaviour}) \end{aligned}$$

Where, Y = Illicit financial flows due to transfer pricing,

## DRISHTIKON

Symbiosis Centre for Management and HRD

Vol 3, No. 2

$\beta_0$  = Constant

The model parameters  $\beta_0$ ,  $\beta_1$ ,  $\beta_2$ , etc. were estimated using the OLS(Ordinary Least Squares technique). These parameters were estimated from a dataset of thirty six developing countries from around the world. The data used is given below:

Table 1 Dataset of thirty six developing countries from around the world

Country	Money	Tech	Innov	Bus_soph	Fin_soph	Macro	Edu	Auditing	Ethical
Bangladesh	6.85	2.45	3.47	2.52	4.18	4.45	2.57	3.6	3.1
Bolivia	7.00	2.34	3.04	2.23	3.20	4.70	3.51	3.2	2.6
Camodia	6.93	2.66	3.45	2.72	3.85	3.40	2.78	3.8	3.7
Cameroon	6.97	2.68	3.42	2.80	3.24	5.24	2.82	3.9	3.3
Ethiopia	6.91	2.29	3.28	2.69	3.05	3.76	2.67	3.8	3.6
Honduras	6.58	3.13	3.72	2.70	3.94	4.44	3.22	4.5	3.7
India	1.00	3.33	4.76	3.73	5.10	4.23	3.96	5.5	4.1
Kenya	6.98	2.99	4.18	3.41	4.67	3.43	3.69	4.6	3.8
Madagascar	6.97	2.66	3.44	2.95	3.06	3.38	2.88	3.5	3.4

**DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Mali	6.88	2.70	3.30	2.97	3.08	3.91	2.66	3.5	3.7
Mauritania	7.00	2.81	3.21	2.46	2.97	3.84	2.41	3.1	3.4
Mongolia	6.98	2.79	3.05	2.80	3.38	3.95	3.55	3.7	2.9
Mozambique	6.97	2.92	3.23	2.76	3.29	4.18	2.54	4	3.2
Nepal	6.92	2.21	3.21	2.34	3.76	4.44	2.69	3.7	3.2
Nicaragua	6.84	2.62	3.35	2.57	3.55	3.33	3.19	3.9	3.4
Nigeria	6.13	2.91	4.00	3.06	4.37	5.43	3.03	3.9	3.5
Pakistan	6.84	2.87	3.80	2.98	4.25	3.81	2.86	4.4	3.6
Philippines	3.80	3.32	4.06	2.84	3.85	4.54	3.92	4.9	3.3
Tajikistan	6.99	2.57	3.25	2.87	2.99	2.63	3.21	3.7	3.4
Tanzania	7.00	2.61	3.53	2.89	4.10	4.54	2.58	4.4	3.8
Zambia	6.85	2.74	3.62	2.91	4.65	4.00	2.97	4.7	4.1
Zimbabwe	6.83	2.29	3.25	2.48	3.79	1.00	3.16	5	3.6
Algeria	6.97	2.56	2.64	3.13	2.79	6.39	3.30	3.6	3.3
Alzerbaijan	6.45	3.41	3.53	3.90	4.23	5.30	3.88	4.5	4.1
Egypt	6.56	3.35	3.03	3.98	4.01	3.46	3.62	5.1	4.4
Georgia	6.90	2.92	2.56	3.33	3.84	3.73	3.70	4.2	3.8
Guatemala	6.71	3.53	2.99	4.32	4.23	4.43	3.34	4.9	3.9

## DRISHTIKON

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Indonesia	4.28	2.20	3.57	4.49	4.30	4.82	3.91	4.6	3.5
Jamaica	6.93	3.90	2.96	3.82	4.58	2.25	3.83	5.3	3.9
Kazakhstan	6.93	3.53	3.15	3.70	3.48	4.71	4.13	4.1	3.6
Kuwait	6.98	3.94	2.96	4.29	4.25	6.23	3.72	4.8	4.2
Morocco	6.77	3.41	2.88	3.83	3.81	5.24	3.40	4.1	3.9
Paraguay	6.87	2.88	2.41	3.27	3.68	3.95	2.78	3.6	2.8
Qatar	5.21	4.81	3.65	4.55	4.59	5.73	4.93	5.5	5.1
Saudi Arabia	6.79	4.18	3.70	4.61	4.44	5.86	4.29	5	4.9
Venezuela	6.79	3.16	2.51	3.01	3.06	4.38	3.71	3.8	2.9

Source: *The Global Competitiveness Report, 2009*

The regression analysis was run in SPSS the output from which is given below:

### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.797(a)	.635	.527	.81415

## DRISHTIKON

Symbiosis Centre for Management and HRD

Vol 3, No. 2

This result shows that the regression co-efficient for this model is .797. This validates our assumption that there is a strong correlation between the attributes selected by us and the dependent variable. Thus, it is reasonably correct to say that the illegal flow of money between the nations depends on the attributes like innovation, technology, business and financial market sophistication, ethical behaviour of firms, education and reporting standards in the country.

The values of the co-efficient in the regression equation are as shown below:

Table 2: Coefficients (a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta	B	Std. Error
1	(Constant)	12.904	1.288		10.020	.000
	Tech	.340	.438	.168	.775	.445
	Innovation	-1.584	.404	-.646	-3.926	.001
	Bus_soph	-.571	.433	-.325	-1.317	.199
	Fin_soph	.427	.439	.214	.973	.339
	Macroeco	-.131	.165	-.120	-.797	.432
	Edu	-.392	.408	-.194	-.961	.345
	Auditing	-1.060	.510	-.579	-2.080	.047
Ethical	1.213	.501	.540	2.422	.022	

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Thus, the regression equation is:

$$\begin{aligned} Y &= 12.904 + .340(\text{Technology}) - 1.584(\text{Innovation}) \\ &- .571(\text{Business Sophistication}) \\ &+ .427(\text{Financial Market Sophistication}) \\ &- .131(\text{Macroeconomic Stability}) \\ &- .392(\text{Higher Education}) \\ &- 1.060(\text{Auditing and Reporting Standard}) \\ &+ 1.213(\text{Ethical Behaviour}) \end{aligned}$$

### **Interpretation and hypothesis testing**

From the model parameters we can say that there is a strong and positive influence of Ethical Behaviour of firms on the amount of illicit money flows. In other words as the firms become more ethical in their business operations they will be less inclined to launder their dirty money as a result of which money laundering will reduce. Thus, effort should be made to make people and firms aware of the harmful effects of money laundering on the economy in order to discourage them from doing so.

Financial market Sophistication also has a positive impact on the amount of money laundered i.e. as the markets become more efficient the money laundering activities also decrease. Business Sophistication has an inverse impact on money flows as well. This is in line with our hypothesis that as the business complexity increases money laundering becomes easier.

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Technology seems to have a positive influence in the reduction of illicit money flows indicating that it could be due to increased and easier access to financial systems for money transfer. This bypasses the need to route money through illegal money laundering channels such as the hawala and hundi systems.

Innovation also has a positive influence on the laundering activities indicating that as people become more innovative and enterprising they find newer methods to evade the system.

Macroeconomic stability and Higher education and training do not appear to have any significant influence on money laundering activities.

### **Backward Regression**

If backward regression is run on the same dataset we see that the main predictors for illicit money flows are:

- Innovation
- Business Sophistication
- Auditing
- Ethical Behavior of firms

The results of this analysis are as shown below:

Table 3: Model Summary

**DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.797(a)	.635	.527	.81415
2	.792(b)	.627	.534	.80832
3	.788(c)	.622	.543	.79985
4	.782(d)	.612	.547	.79640
5	.770(e)	.593	.541	.80202

Table 4: Coefficients (a)

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta	B	Std. Error
(Constant)	12.904	1.288		10.020	.000
Tech	.340	.438	.168	.775	.445
Innovation	-1.584	.404	-.646	-3.926	.001
Bus_soph	-.571	.433	-.325	-1.317	.199
Fin_soph	.427	.439	.214	.973	.339
Macroeco	-.131	.165	-.120	-.797	.432
Edu	-.392	.408	-.194	-.961	.345
Auditing	-1.060	.510	-.579	-2.080	.047
Ethical	1.213	.501	.540	2.422	.022
(Constant)	12.833	1.275		10.063	.000
Innovation	-1.657	.390	-.676	-4.250	.000
Bus_soph	-.562	.430	-.320	-1.306	.202
Fin_soph	.432	.436	.216	.992	.330
Macroco	-.099	.158	-.091	-.629	.535

## DRISHTIKON

Symbiosis Centre for Management and HRD

Vol 3, No. 2

<b>Edu</b>	<b>-.275</b>	<b>.376</b>	<b>-.136</b>	<b>-.730</b>	<b>.472</b>
<b>Auditing</b>	<b>-1.012</b>	<b>.503</b>	<b>-.553</b>	<b>-2.015</b>	<b>.054</b>
<b>Ethical</b>	<b>1.365</b>	<b>.458</b>	<b>.607</b>	<b>2.981</b>	<b>.006</b>
<b>(Constant)</b>	<b>12.607</b>	<b>1.211</b>		<b>10.413</b>	<b>.000</b>
<b>Innovation</b>	<b>-1.703</b>	<b>.379</b>	<b>-.695</b>	<b>-4.499</b>	<b>.000</b>
<b>Bus_soph</b>	<b>-.663</b>	<b>.395</b>	<b>-.377</b>	<b>-1.678</b>	<b>.104</b>
<b>Fin_soph</b>	<b>.411</b>	<b>.430</b>	<b>.206</b>	<b>.957</b>	<b>.347</b>
<b>Edu</b>	<b>-.316</b>	<b>.367</b>	<b>-.156</b>	<b>-.862</b>	<b>.396</b>
<b>Auditing</b>	<b>-.875</b>	<b>.448</b>	<b>-.478</b>	<b>-1.954</b>	<b>.060</b>
<b>Ethical</b>	<b>1.342</b>	<b>.452</b>	<b>.597</b>	<b>2.973</b>	<b>.006</b>
<b>(Constant)</b>	<b>12.334</b>	<b>1.163</b>		<b>10.601</b>	<b>.000</b>
<b>Innovation</b>	<b>-1.749</b>	<b>.373</b>	<b>-.713</b>	<b>-4.687</b>	<b>.000</b>
<b>Bus_soph</b>	<b>-.847</b>	<b>.331</b>	<b>-.482</b>	<b>-2.560</b>	<b>.016</b>
<b>Fin_soph</b>	<b>.499</b>	<b>.416</b>	<b>.250</b>	<b>1.199</b>	<b>.240</b>
<b>Auditing</b>	<b>-1.028</b>	<b>.409</b>	<b>-.562</b>	<b>-2.512</b>	<b>.018</b>
<b>Ethical</b>	<b>1.420</b>	<b>.440</b>	<b>.632</b>	<b>3.225</b>	<b>.003</b>
<b>(Constant)</b>	<b>12.301</b>	<b>1.171</b>		<b>10.502</b>	<b>.000</b>
<b>Innovation</b>	<b>-1.542</b>	<b>.333</b>	<b>-.629</b>	<b>-4.629</b>	<b>.000</b>
<b>Bus_soph</b>	<b>-.759</b>	<b>.325</b>	<b>-.432</b>	<b>-2.337</b>	<b>.026</b>
<b>Auditing</b>	<b>-.770</b>	<b>.351</b>	<b>-.421</b>	<b>-2.196</b>	<b>.036</b>
<b>Ethical</b>	<b>1.386</b>	<b>.443</b>	<b>.617</b>	<b>3.131</b>	<b>.004</b>

The new equation according to model 5 is:

$$Y = 12.301 - 1.542(\text{Innovation}) \\ - .759(\text{Business Sophistication}) \\ - .770(\text{Auditing and Reporting Standard}) \\ + 1.386(\text{Ethical Behaviour})$$

### *Factor Analysis*

## DRISHTIKON

Symbiosis Centre for Management and HRD

Vol 3, No. 2

In order to identify the main factors affecting the pervasiveness of money laundering in developing countries we performed factor analysis on the dataset of 36 countries. The method used was principal component analysis and the results from this analysis are presented below:

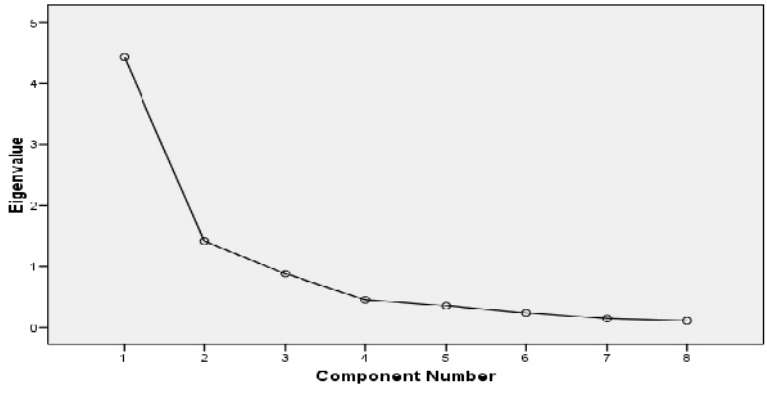
**Table 5: Rotated Component Matrix (a)**

	Component	
	1	2
Tech	.857	.263
Innovation	-.138	.799
Bus_soph	.880	.266
Fin_soph	.344	.827
Macroeco	.610	-.264
Edu	.784	.275
Auditing	.521	.765
Ethical	.645	.571

From the above results it is concluded that the pervasiveness of money laundering depends on two main factors. This can be visualized from the scree plot shown below.

**Figure 7: Scree Plot**

Scree Plot



## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Money laundering activities are being pushed into developing countries due to tighter regulations in the developed world. To further compound the problem, in comparison to developed countries, developing countries face a much broader slate of challenges in curbing these activities. Most developing countries already have AML legislations in place, but they are not as advanced as those in developed countries.

The Major influencers of Money Laundering in developing countries are:

$$Y = 12.301 - 1.542(\text{Innovation}) \\ - .759(\text{BusinessSophistication}) \\ - .770(\text{AuditingandReportingStandard}) \\ + 1.386(\text{EthicalBehaviour})$$

- Innovation
- Business Sophistication
- Auditing and Reporting standards
- Ethical behavior of firms

Innovation, Business Sophistication and Auditing & Reporting Standards have a negative influence on Y (i.e. as these parameters increase, the ranking of the country on quantum of illicit fund flows moves down, which means that Money Laundering activity increases) while Ethical behaviour has a positive influence.

In the Indian context, one of the primary reasons for individuals engaging in Money laundering is for the evasion

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

of taxes. Banks have implemented the Anti Money Laundering and KYC norms laid down by the RBI, however the extent of implementation varies from bank to bank. This is due to the impact that the implementation will have on the day to day costs of the bank.

Some new and innovative disruption techniques could also be contemplated.

Banks being the backbone of the Indian economy should follow the KYC norms as prescribed by the Basel recommendations more strictly. They should do proper research before giving ATM cards and online facilities to people. This has to be monitored at periodic intervals.

Further we have understood from our Primary Research that the Anti Money Laundering Norms laid down by the RBI are extremely stringent, the problem lies with the implementation. The extent of implementation varies from bank to bank. It is important for all the banks to come to a level playing field.

From our primary research we also came to know that in many of the banks and other financial institutions the operating staff are not very well educated about the money laundering procedures, its impact and the processes put in place to detect them. First, people within the organization should be informed and made aware of the existing processes for combating money laundering and second some metric or supervision method should be developed to monitor to what extent these processes are being followed.

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

A huge amount of black money is estimated to be locked in overseas bank accounts and safe havens. Indian government should try to get as much information on such accounts as possible so that proceedings can be started against these people and this money can be brought back into the system as legal money.

Regulatory bodies should take care to properly screen companies before allowing them to be listed on the stock exchanges as some of them turn out to be fronts for terrorist organizations

## **References**

- Ampratwum,E.(2008). The fight against Corruption and its implications for development in developing and transition economies. *Journal of Money Laundering Control*, 11, page 76- 87.
- Biagioli, A.(2008).Financial Crime as a threat to the Wealth of Nations: a Cost-Effectiveness Approach. *Journal of Money Laundering Control*, 11,1, page 88- 95.
- Buchanan,B.(2005).Corporate Governance and Social Responsibility: Combating Money Laundering in the Asia Pacific Region. *Contemporary Studies in Economics and Financial Analysis*, 86, page 435-452.
- Chaim, E.Z. Indian Parliament Moves to Finally Implement Money Laundering Laws, 19, page 86.

## **DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

- Forman, M. (2006). Combating terrorist financing and other financial crimes through private sector partnerships. *Journal of Money Laundering Control*, 9, 112-118.
- Geiger, H., & Wuensch, O. (2007). The fight against Money Laundering – An economic analysis of a cost – benefit paradoxon. *Journal of Money Laundering Control*, 10, 91-105
- Gotz, E., & Jonsson, M. (2009). Political Factors affecting AML/CFT efforts in post communist Eurasia - The Case of Georgia. *Journal of Money Laundering Control*, 12, 59-73.
- Kar,D.,&Cartwright,D.S.(2006) Illicit Financial Flows from Developing Countries: 2002-2006.
- Kumar, B.V. (2003). The prevention of money laundering in India.*Journal of Money Laundering Control*, 7,158-169.
- Office of the Comptroller of the Currency Washington. (2002). *Money Laundering: A Banker's Guide to Avoiding Problems*
- Salifu, A.(2008).Can Corruption and Economic Crime be controlled In Developing Economies – And if so, Is the Cost Worth It? *Journal of Money Laundering Control*, 11,3,273- 283.

**DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Shukla, A., & Bhagat, B. (2009). Anti-Money Laundering – Are Developing Countries Ready for the Challenges Ahead?. The Guide to Working Capital Management, 137-143.

Singh, V.K.(2009). Controlling money Laundering problems in India: Problems and Perspectives.

The Global Competitiveness Report, (2009-2010). World Economic Forum.

**Appendix**  
Questionnaire

Name:

Bank:

Q1. What are the factors responsible for money laundering in India?

-----

-Q2. What kind of checks do you do to keep a track on money laundering in your bank?

-----

-

**DRISHTIKON**

Symbiosis Centre for Management and HRD

Vol 3, No. 2

Q3. How has PMLA (2002) and KYC (2006) affected the working of your bank?

-----

Q4. How much has been the increase in your day to day cost because of implementation of PMLA and KYC?

-----

Q5. How effective do you think are the present government and legal regulations in preventing money laundering?