

## **Pseudo-Investment Scheme in Malaysia: Issues and Problems**

### ***Skim Pelaburan-Pseudo di Malaysia: Isu-Isu dan Permasalahan***

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#### **ABSTRAK**

*Walaupun isu berkenaan skim pelaburan piramid atau skim pelaburan tidak sah sudah lama dibincangkan semenjak tahun 90an lagi, isu ini masih relevan untuk ditekankan dan dibincangkan sehingga kini kerana Bank Negara melaporkan peningkatan berterusan jumlah syarikat dan laman sesawang pelaburan tidak sah yang disenaraihitamkan. Peningkatan ini perlu diberi perhatian khusus daripada pengkaji dan pihak berkuasa. Artikel ini adalah bertujuan untuk membentangkan beberapa justifikasi berkenaan keperluan untuk menjalankan kajian ilmiah dan kajian rintis.*

**Kata kunci:** *Skim Cepat Kaya, Skim Piramid, Skim Ponzi.*

#### **ABSTRACT**

*Even though the issue of the pyramid and illegal investment scheme has been around since the 90's, it is still relevant to be highlighted and discussed due to the current increasing list of illegal investment companies and websites which been compiled by Bank Negara Malaysia. The ongoing increasing list has called for more attention from researchers and authorities to be given on this issue. This paper aims to demonstrate some justification on the necessity of conducting this research through library research and pilot study.*

**Keywords:** *Quick-Rich Scheme, Pyramid Scheme, Ponzi Scheme.*

## **Introduction**

### **Overview of Pseudo-Investment Scheme**

In 1920, an Italian man named Charles "Carlo" Ponzi had promised investors that he would double their money in 90 days by purchasing foreign postal coupons. This "alternative" investment invented by Charles Ponzi appeared to be successful as earlier investors got the promised returns. Nevertheless, the investment scheme failed when he was unable to pay later investors (Tsai, 2009).

This alternative investment scheme has many names and modus operandi. Some called it pyramid investment scheme, and some called it high yield investment program. Existing literature uses the term 'pyramid' which covers a variety of alternative investment products. However, in general, it is popularly known as Ponzi scheme (Sadiraj & Schram, 1999). In Malaysia, it is better known as quick-rich scheme. Pseudo is a word originated from

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Greek which is scientifically uses in denoting close or deceptive resemblance to the flowing element. In this study, the fraudulent investment scheme is referred as a pseudo-investment scheme. A pseudo-investment scheme is a distinctive type of illegal pyramid operation that often promises better-than-average returns to investors.

Usually, returns are paid to current investors using the money from new investors (Tsai, 2009). Moreover, due to its fundamental pyramidal mathematics, a pyramid and illegal scheme will collapse when the supply of money from new investors is insufficient to cover the returns promised to initial investors. It seems like the pseudo-investment scheme is predestined to eventually collapse because of the struggle in convincing new investors to join.

Simmons (1996) categorized these investments as legitimate or illegitimate scheme. A legal pyramid scheme is known as multilevel marketing (MLM) organization which the primary purpose of their existence is to sell an actual product such as encyclopedias, soaps, cosmetics, and so forth. To maintain the return or to earning of the upper levels, ones must retain the sales and new recruitment of the lower levels because the profits are generated from both the commissions on sales of new recruits and also one's commission sales. Meanwhile, in the illegal scheme, the primary restitution of the upper-level investors is generated solely from recruiting new participants and not from the commissions on the sale of any product. Returns on investment of illegal scheme are often higher than the returns offered in the marketplace. For example, financial institutions regularly provide 3.5 % returns to investors who invested in the fixed deposit scheme. Other institution such as EPF offers an average of 6.0% returns per annum.

#### Pseudo-Investment Scheme in Malaysia

Charles Ponzi investment scheme had inspired and influenced many entrepreneurs and business professional to pull off a scheme that operates the same model. Bernie Madoff's infamous Ponzi scheme in 2008 is an example of modern and largest pyramid and illegal scheme in history. Madoff's scheme was called "the Mother of All Ponzi Schemes." It involves a staggering amount of USD64.5 billion loss (Lewis, 2012). In Malaysia, a similar infamous pyramid and illegal investment scheme called "Pak Man Telo" scheme had caught the media attention in 1992 when the scheme was uncovered by the authority. The scheme was founded by Osman Hamzah in 1972 and had caused 50,000 investors to incur losses about RM90.9 million (Muda, Aziz, and Rozali, 2003).

It seems that pseudo-investment scheme not only targeted wealthy investors in well-developed countries. This misconception was proved to be wrong as Sulaiman, Moideen, and Moreira (2016) argue that quick-rich scheme in developing countries like Malaysia, often try lures investors who desperately in need of money such as The Swisscash Mutual Fund scheme in 2006. The growing interest in the online and offline pseudo-investment scheme among Malaysian public might be exacerbated by the influence of social media. Thanks to the rapid development of information communication technology which had made information about such scheme is easy to access and circulated.

#### Literature Review

There is little attention has been given in this topic especially in Malaysia. The literature on the subject of the behavior of pseudo-investment scheme investors' behavior is sparse. This maybe because pseudo-investment scheme investor is often viewed as "victims" rather than investors. Therefore, previous research only focused on the technical aspect such as the operation aspect or the legal side of a pseudo-investment scheme. Furthermore, field data on

the pseudo-investment scheme's hard to access due to its sensitivity issues. Besides, these schemes are illegal and therefore do not have public records. Also, sampling real pseudo-investment scheme investors in the real environment are strenuous.

Due to these constraints, previous research on this topic was conducted in a laboratory setting. Sadiraj and Schram (1999) investigated the behavior and the decision process of the investors using experimental games approach. They suggest that pseudo-investment scheme investor can be divided into two categories. The first type of investor is the informed investors and the second one is the uninformed investors. The informed investors are the initial investor who makes the first move and belongs to the highest level of the pyramid scheme. They also function as the recruiter who tries to maximize their earnings by influencing people using positive information and impressed everyday people to join the investment scheme. The informed investors usually exit the scheme on time as they possess access to information about a particular scheme. While, the uninformed investors, are the ordinary people who frequently become victims and face losses when the scheme fails.

Nonetheless, there has been an attempt to investigate the behavior of pseudo-investment scheme investor in Malaysia. Muda et al. (2003) conducted an exploratory study to investigate the activities of the pseudo-investment scheme in Peninsular Malaysia. This study has provided a fascinating insight in understanding the operation of the pseudo-investment scheme and the motivation of the investors and the recruiter. They suggested that the phenomenon of the pseudo-investment scheme affects all walks of life regardless of their educational level, financial capability or social status (Muda et al., 2003). Thus, it is paramount to investigate the underlying mechanism of investing in a pseudo-investment scheme to obtain a better understanding of why investor decided to invest in such scheme.

## Issues and Problems

Pseudo-investment scheme is nothing new. History recorded that pseudo-investment scheme comes and go. So does the investors. From the infamous "Pak Man Telo" investment scheme in 1992 (RM90.9 million losses) to the Swisscash Mutual Fund scheme in 2006 (RM190 million losses), investors had lost a staggering amount of money. Bernama (2016) reported that more than a thousand investors in Penang were deceived by an illegal investment company which had caused them an accumulative loss of RM15 millions. Most recently, 7,600 investors were defrauded by an investment scheme called Federal Reserve Chicago Bond which caused them a loss of RM90 million (Nazri, 2016).

According to Bank Negara Malaysia, illegal foreign exchange trading and gold investments are the most favored pseudo-investment scheme in Malaysia (Spykerman, Sivanandam & Joibi, 2016). Despite the fact that the authorities such as BNM, AKPK, and Security Commission joined the effort to continuously educate the public about the detrimental effect of the pseudo-investment schemes, the new scheme continues to flourish every year as the list of illegal investment companies and websites is growing.

Ever since 2012, Bank Negara Malaysia (BNM) updated the list of companies and websites which are neither authorized nor approved under the relevant laws and regulations administered by BNM. For this year, BNM listed the total number of 277 companies and websites that are conducting activity of illegal deposit taking from the public. The following table is the comparison of the entire unauthorized investment companies and websites for the year 2012 till 2016.

**Table 1: The Total Listed Illegal Investment Companies and Websites**

<b>Numbers</b>	<b>Year</b>
277	2016
247	2015
197	2014
131	2013
81	2012

**Source: Extracted and modified from Bank Negara Malaysia (2016)**

Looking at the trend, the numbers of companies and websites added to the list is increasing. On the other hand, the numbers of reported pseudo-investment scheme cases also in arise. For the period of January to June 2016, 485 cases had been reported. Below is the comparison of pseudo-investment scheme cases for 2014 till 2016.

**Table 2: The Total of Reported Pseudo-Investment Scheme Cases**

<b>Numbers</b>	<b>Year</b>
485	2016(Jan-June)
591	2015
289	2014

**Source: Extracted and modified from Ramendran (2016)**

Pseudo-investment scheme have a significant impact on the macroeconomic (Jarvis, 2000). The collapse of Albanian economy in 1997 after four years of rapid growth is one of the robust examples of the impact of pseudo-investment scheme. He explains that huge numbers of Albanians was declared as bankrupt and lost their life savings funds due to the Ponzi scheme investment. This has led the country into political and economic turmoil that took its toll on the country's stability and growth until now. Meanwhile, in Malaysia, it was reported that in the first quarter of 2016, pseudo-investment scheme investors had lost more than RM100 million. Below is the comparison of the monetary losses due to pseudo-investment scheme for the first quarter of 2014, 2015 and 2016.

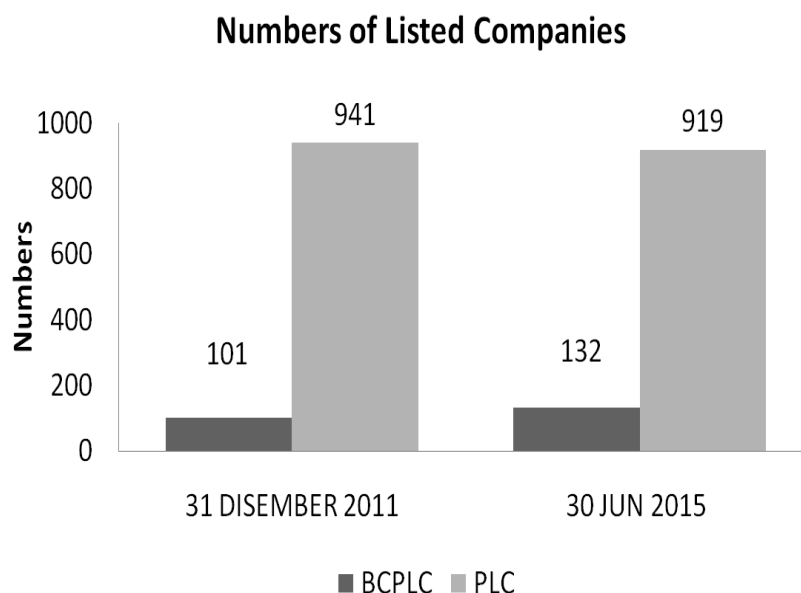
**Table 3: The Total of Monetary Losses Due to Pseudo Investment Scheme.**

Amount (RM)	Year
116, 116, 657.68	2016(Jan-June)
134, 996, 703.91	2015
53, 517, 630.73	2014

**Source: Extracted and modified from Shah (2016)**

Investors in Malaysia especially Bumiputra seems to be more interested in investing in the pseudo-investment schemes compared to the sound investment such as Bursa Malaysia. According to Muda et al. (2003), the majority of pseudo-investment scheme investors are Bumiputra. The government mission of achieving 30% of Bumiputra corporate equity ownership by the year 2020 is yet to reach its target. According to the prime minister in the 2015 budget speech, the Bumiputra's effective control over a corporation is currently around 10% (Securities Commission Malaysia, 2015). Majlis Tindakan Ekonomi Melayu Berhad (MTEM) reported that till 30th June 2015, Bumiputra Controlled Public Listed Companies (BCPLC) stood at 132 companies compared to Public Listed Companies (PLC) as at 919 companies. In other words, Bumiputra only has control of 14.4% out of the overall listed businesses in Bursa Malaysia. This problem could be due to Bumiputra participation in the pseudo-investment scheme which can be justified by the statistics presented earlier.

**Figure 1: Bumiputra Corporate Equity Ownership**



**Source: Persatuan Remisier Bumiputra Malaysia (2016)**

The pseudo-investment scheme seems to affect all walks of life, from the wealthy to poor and desperate investors, from the highly educated to the illiterate investors, and from the

highest ranking professional to the lowest non-professional labor (Muda et al., 2003). Moreover, the low Bumiputra corporate equity ownership might indicate that Bumiputra investors are not interested in investing in legal, financial assets. It is speculated that investors were attracted to pseudo-investment scheme due to the high return promised by the organizer. However, there is no empirical evidence to support this proposition. The driver behind investors' motivation to invest in the pseudo-investment scheme remains inconclusive. This paucity of knowledge has called for more attention to be given in this area of research. This research offers new perspective compared to previous research as it focuses on the psychological biases of the investor. Findings in this area could bridge the missing link between the growing interest in the pseudo-investment scheme and the low Bumiputra corporate equity ownership. Meanwhile, it is speculated that the pseudo-investments scheme are recruiting the Malaysian public servant to invest in the scheme. According to Othman (2016), the police stated that 53 percent of pseudo-investment scheme investors in Kelantan are the public servant.

## Conclusion

This paper is an attempt to demonstrate the justification of the problem statement in the proposal and the findings relevant to the issue of the pseudo-investment scheme in Malaysia. Even though this issue has been around since the 90's, it is still relevant due to growing interest among the public and the lack of attention being given in this research area. Apparently, this paper demonstrates three problematic issues. Firstly, the growing list of illegal investment companies and websites which indicate the growing interest and increasing demand to invest in such scheme among Malaysian public. Secondly, the low Bumiputra corporate equity ownership might indicate that Bumiputra investors do not interested in investing in legal financial assets. Lastly, the issue of public servants being targeted by the pseudo-investment scheme's organizer. The reasons behind these problematic issues need to be addressed. And this brings to a question of do Bumiputra investors favor pseudo-investment scheme more than the statutory investment scheme endorsed by the authorities? Therefore, based on these three problematic issues, it strongly justifies the need for conducting this research due to lack of empirical studies in the pseudo-investment schemes in Malaysia.

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