

A fool and his money are soon parted

By Mary Isaacs

Many people cannot resist the allure of investment schemes that promise extraordinary high returns in a short period of time. That is why many have been caught up from time to time in fraudulent schemes that did not live up to their promise of great riches. Often they manage to take all that you have and then some.

Ponzi schemes are named after Charles Ponzi who in 1920 promised people that he would double their money in 90 days. His scheme was exchanging international postal reply coupons. He collected US\$ 15 million (KShs. 1.13 billion) from 40,000 people.

In Kenya these schemes flourished between the years 2002 and 2007 and collected money estimated at 34 billion Kenya Shillings. These losses left many devastated people in their wake especially those who had invested a big percentage of their resources or used borrowed money. At least 20 people even committed suicide

These “get rich quick” kind of schemes usually take two forms. In one, money from new members is used to pay previous members in a hierarchical pyramid. New members pay those above them in the hierarchy, with the expectation of benefiting from those that join afterwards. These pyramid schemes are dependant on attracting a growing number of new customers. The problem is that it is only those members at the top of the pyramid who get paid and the pyramid unravels when there are no more new investors.

Beware of the Fatal Attraction of Ponzi Schemes

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In another form, you are asked to deposit money with the promise of very high short term returns, say 50% after one month. The company may tell you they are investing in some very lucrative stocks overseas, dealing in foreign exchange or other impressive enterprises with sky-high returns. You are then encouraged not to withdraw but to keep on reinvesting the capital and interest earnings every month. This system may be able to sustain some payments if there are limited withdrawals. However when many people want to withdraw and there are few new investors, the system quickly unravels especially since company directors usually take out most of the money as it comes for their own use.

Even though these schemes are named after Charles Ponzi, his was not the first such recorded fraud. There are records of ponzi schemes from the 19th century .One of these involved a woman called Sarah Howe who in 1880 opened up a “Ladies Deposit’ in Boston promising eight percent interest, although she did not explain her method of making profits. Her unique scheme was dubbed “for women only”. Another notable scheme by a woman was that of Dona Branca of Portugal who, between 1970 and 1984 maintained a scheme that promised to pay 10% per month. She claimed she was trying to help the poor. During her trial in 1988, it was proved that she had taken 85 million euros (Kshs.9.35 billion)

On March 13, 2009, a 67 year old Ohio woman named Joanne Schneider was sentenced to three years in prison, the minimum allowed, for operating a Ponzi scheme that cost investors an estimated 60 million dollars (Kshs. 4.5 billion).. The largest ponzi scheme in history is that of Bernard Madoff who was engaged in a securities fraud that in December 2008 was estimated to have cost people US\$50 billion (Kshs. 3,750 billion!)

Right now many people think they have learnt their lesson. However, these schemes have always been there and will probably always be there in the future. People throughout the ages have always come out with a slightly different format that completely fools a great number of people. The financial regulators usually take some time before they are aware of the scheme and take action, and often, investors do not take seriously the warnings not to make such investments.

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As in Kenya where some churches were used by fraudsters, history has many instances where the faithful were duped into making these dubious investments. For example from 1993 to 1997 a church named Greater Ministries International headed by Gerald Payne defrauded 18,000 people out of US\$ 500 (Kshs.37.5 billion). Payne and other church elders promised the church members “double the blessings”, that people would get back twice what was invested. They cited Biblical scripture. However, nearly all the money was lost and hidden away. Church leaders received prison sentences ranging from 13 to 27 years.

Do not be fooled. Ponzi schemes can be run by anyone. Their selling point is the false confidence of safety and trust they instill in you. They steal money by exploiting human weakness.

Often a smile is more effective than a gun.

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