

# Financial Misconduct in Financial Intermediation: A Case Study of Ponzi Schemes in Sierra Leone

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## Abstract

*This study examines the improprieties within the financial system, specifically focusing on Ponzi schemes. It explores the impact of these schemes and the conditions that facilitate their growth, such as regulatory deficiencies, a lack of investor education, the allure of high returns, and other related factors. The devastating effects of Ponzi schemes are also investigated, highlighting issues like financial losses, a decline in trust in financial institutions, and potential threats to economic stability.*

*A mixed-methods approach was employed, utilizing both primary and secondary data sources. A well-designed questionnaire was administered to 100 respondents, who were surveyed using convenience and snowball sampling techniques. The gathered data were analyzed with simple statistical software, such as Excel, and the results were presented using various statistical tools.*

*The study's findings reveal that Ponzi schemes in Sierra Leone have caused significant financial and psychological harm over the past decade. It identifies three of the most recent schemes: My-Coin, Wealth Builders, and Super Advertise. Due to the order of occurrence, Super Advertise has the highest victim rate at 77%, as the impacts on victims are still fresh. These findings illuminate the pervasive nature of Ponzi schemes and their devastating effects, providing crucial insights for future prevention and regulation.*

*Notably, the research indicates that both financially illiterate individuals and those with high financial literacy—including 81% of tertiary-educated individuals—fell victim to these Ponzi schemes. The schemes preyed on ignorance, greed, and impatience, undermining the stability of financial markets and eroding trust in the financial system.*

*The paper recommends enhancing regulatory oversight, improving investor education, ensuring transparency and disclosure, protecting whistleblowers, and promoting international cooperation. It also suggests implementing and enforcing strategies that focus on developing early warning systems, understanding the behavioral traits of victims, and analyzing the broader economic impact of Ponzi schemes, emphasizing the empowering effect of investor education.*

**Keywords:** Financial Improprieties, Financial Intermediation, Ponzi Schemes

## Introduction

The importance of financial intermediaries in a country's economy cannot be overstated. Apart from their role as intermediaries between savers and borrowers, financial intermediaries offer their clients several advantages, such as security, asset access, and liquidity. In other words, the availability of investible funds is a key factor in the growth process of any economy. It is a necessary condition for both output and employment growth. Evidence shows that countries that have enjoyed or are enjoying economic prosperity have been linked to an efficient and effective mechanism for mobilizing financial resources and allocating them for productive investment. In short, efficient financial intermediation contributes to higher output, employment, and income levels, which invariably enhance the population's living standards. Every nation, therefore, strives for the efficient and effective performance of these financial intermediaries, as their inability to perform properly subjects the whole economy to systemic vulnerabilities.

Although financial intermediation appears perfect on paper, this is far from the truth. Events have shown that some form of impropriety often arises in the process. Such improprieties include money laundering, fraud, insider trading, bribery, embezzlement, etc.

Financial improprieties refer to any illegal or unethical behavior involving the handling of financial matters. Essentially, it encompasses any action that violates financial regulations or ethical standards, potentially resulting in economic loss, legal consequences, and damage to reputation.

Sierra Leone has not been exempt from these financial challenges or improprieties, as it has experienced fraud, embezzlement, and money laundering, among other issues, in the financial intermediation process.

A classical case is the fraud associated with Ponzi Schemes, which is based on:

- **Fraud:** The scheme is based on deception, misleading investors about the source of their returns and the nature of the investment.
- **Misrepresentation:** The operation provides false information about the investment's profitability and risk.
- **Embezzlement:** Funds are misappropriated, with the operator using new investors' money to pay returns to earlier investors or for personal gain.
- **Violation of financial regulations:** Ponzi Schemes typically operate outside legal financial frameworks, evading regulatory oversight and requirements. Over the years, Sierra Leone witnessed the following Ponzi schemes:
  - **The Wealth Builders (2009-2010)** promised high returns on investments even without a proper financial license.
  - **My Coin (2022)**—The Ponzi scheme gained prominence around 2019. Around that time, the Bank of Sierra Leone declared it illegal and froze the CEO's accounts. Victims,

particularly in Bo, have continued to seek redress since then.

- **Super Advertis (2024)**. This scheme gained attention and subsequently collapsed in early 2024. It scammed hundreds of Sierra Leoneans through a mobile platform promising high returns on small investments.

Noted, "Ponzi Schemes are the most egregious examples of financial fraud, exploring both the ignorance of investors and the shortcomings of financial oversight."

As earlier highlighted, Ponzi Schemes illustrate the depths of financial impropriety, exploring regulatory gaps and investor trust through fraud, misrepresentation, and embezzlement [1]. The resulting financial devastation and erosion of market confidence are stark reminders of the need for vigilance and robust oversight in the economic system.

This study explores the rights in financial intermediation, explicitly focusing on the Ponzi scheme as a case study. It will contribute to analyzing discourse on improving the financial intermediation process.

Related Literature.

## Conceptual Framework

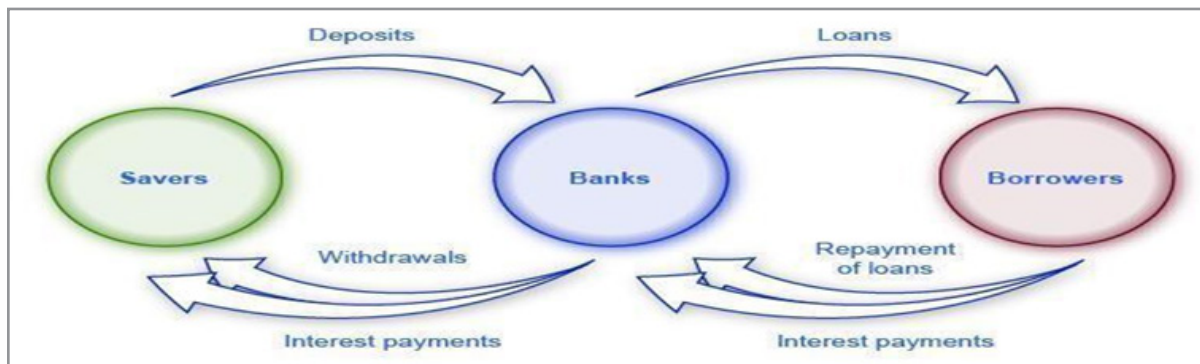
Financial intermediation is how financial intermediaries such as banks, mutual funds, and insurance companies facilitate the flow of funds from savers to borrowers. These institutions collect deposits from individuals and businesses and lend these funds to those needing capital, effectively channeling savings into investment.

According to, financial intermediation involves institutions that channel funds from savers to borrowers, thereby transforming the risk characteristics of their assets. Institutions help to reduce the cost of information acquisition and monitoring, thus increasing the efficiency of the financial market [2].

In the same vein, defined it as a process in which financial intermediaries, such as banks, manage and transform assets and liabilities to create value through efficient capital allocation, risk management, and liquidity provision [3].

Also defined financial intermediation as the process by which financial intermediaries, such as banks and other financial institutions, facilitate the channeling of funds from savers (those with excess funds) to borrowers (those in need of funds).

Financial institutions like banks act as intermediaries because they bridge the gap between savers and borrowers. Savers place their deposits with banks, receive interest payments, and withdraw money [4]. Borrowers receive loans from banks and repay the loans with interest. In turn, banks return money to savers through withdrawals, including interest payments from banks. (See Figure 1)



**Figure 1:** The Process of Financial Intermediation by Financial Institutions. Source: .Werner R.A./International Review of Financial Analysis 46 (2016) 361–379

### Financial Improprieties

While these definitions may highlight the essential and beneficial role of financial intermediaries, suggesting that the process is perfect, it is vital to note that this is not always the case in real life; thus, the concept of financial improprieties and challenges in the process. Financial improprieties have generated significant attention and debate, and various researchers and scholars have examined these improprieties to understand the intermediation process as a whole.

Discussed various ethical issues and improprieties in financial intermediation, such as fraud, embarrassment, and mismanagement. History has shown numerous instances of financial intermediaries engaging in unethical or illegal activities [5].

Other essential aspects of the limitations of financial intermediation include Information asymmetry, which occurs when one party in a transaction has more information than the other, creating an imbalance that can lead to inefficient outcomes as the party with less information is at a disadvantage. Financial intermediaries, such as banks, often have more information about borrowers' creditworthiness than the lenders or depositors they represent. This imbalance can lead to problems such as adverse selection, where borrowers with higher risks are more likely to receive loans because the lender does not fully understand their risks, and moral hazard, where borrowers may engage in riskier behavior after obtaining a loan. For instance, when a bank cannot assess a borrower's risk due to insufficient information, it may charge higher interest rates to compensate for the uncertainty. This may deter low-risk borrowers and attract high-risk ones, leading to a less optimal allocation of resources within the financial system.

According to, information asymmetry is central to understanding why credit markets may not be perfect. Interest rates alone do not always equate to loan supply and demand [6]. They argue that information asymmetry leads to credit rationing, where banks limit the supply of loans rather than increasing interest rates, as higher rates could attract riskier borrowers.

Although financial intermediaries' role is to reduce information asymmetry, it can never be eliminated; borrowers and lenders might still possess private information that intermediaries cannot fully access, leading to imperfect lending and investment decisions.

### Agency Problem

Provided an in-depth analysis of agency problems relevant to financial intermediation. Financial institutions act on behalf of savers, and investors may sometimes prioritize their interests over those of clients, leading to agency problems. This can manifest as a conflict of interest [7].

### Market Failure

Examined how limitations to arbitrage can lead to market failures, such as liquidity crises, credit crunches, and bubbles. Financial institutions play a role in these dynamics, sometimes exacerbating market instability [8].

### Regulatory Challenges

Also, central units ensure that intermediaries operate within the bounds of the law and in the best interest of their clients. This requires a robust regulatory framework. However, the regulatory system can be slow to adapt to new financial products, leaving gaps for exploitation.

### History and Nature of the Ponzi Scheme

The scheme is named after Charles Ponzi, who, in 1920, promised investors high returns from arbitrage in international postal reply coupons. Ponzi's scheme collapsed when new investments could no longer cover payouts, revealing the fraud.

A Ponzi scheme is a type of investment scam in which returns are paid to earlier investors using capital from newer investors rather than profits earned by the operation of a legitimate business. The scheme operator leads victims to believe that profits are coming from legitimate business activities when, in fact, they are coming from the contributions of new investors.

According to, the Ponzi scheme is named after Charles Ponzi, who became infamous for using this technique in 1920. Ponzi promised investors a 50% return within 45 days, or a 100% return within 90 days, by buying discounted postal reply coupons in other countries and redeeming them at face value in the United States [9]. However, he did not invest the money. Instead, he was using the funds from new investors to pay returns to earlier investors, creating the illusion of a profitable business. The scheme collapsed when there were not enough new investors to pay off the existing ones.

Madoff Scandal: Bernie Madoff orchestrated one of the most notorious modern Ponzi schemes, defrauding investors of billions

of dollars. This case highlighted the sophistication such schemes can reach and underscored the importance of regulatory oversight.

Identified the similarities and differences between Ponzi and Pyramid schemes. Both are not the same, even though they are fraudulent schemes that rely on recruiting participants to generate profits rather than through legitimate investments or sales [10].

### **Ponzi Schemes**

**Structure:** In a Ponzi scheme, investors contribute funds, and the returns paid to earlier investors come from the funds of new investors, not from profit-generating activities.

**Key Features:** The promoter, or operator, typically controls the entire scheme. Participants are unaware that their returns are sourced from new investors rather than legitimate investments. **Recruitment:** In Ponzi schemes, recruiting new participants is not the primary focus. Instead, the promoter seeks to gain more investors by promising high returns on investment.

### **Pyramid Scheme**

**Structure:** Pyramid schemes require participants to recruit others into the scheme, with the majority of revenue generated from recruitment. Each participant pays a fee to join, and the fees from recruits are used to pay earlier participants.

**Key Features:** Pyramid schemes primarily rely on recruitment to earn participants' earnings, which depend on attracting participants, who, in turn, recruit more participants.

**Recruitment:** Recruitment is essential to sustaining the pyramid scheme, as each participant must recruit others to recover their investment and make a profit [11].

### **Major Difference**

**Sustainability:** Ponzi schemes can sometimes last longer because the recruitment of new investors is less overt, and the scheme can survive with fewer participants as long as new money continues to flow in. On the other hand, pyramid schemes usually collapse more quickly because the need for recruits grows exponentially, making it unsustainable as the pool of potential recruits shrinks.

**Relevance:** Their work is often cited for providing clear-cut definitions and examples, making it a valuable reference for understanding the basic mechanics of these schemes.

### **Cases of Financial Improprieties**

The history of finance is riddled with examples of financial improprieties, demonstrating the enduring allure of quick riches and individuals' vulnerability to exploitative schemes. This section explores several real-life cases of financial impropriety, highlighting the diverse forms these schemes take and the devastating consequences they can have:

- **The Madoff Investment Scandal:** One of the most notorious cases of financial impropriety is the Bernie Madoff Ponzi scheme. Madoff, a prominent Wall Street financier, ran a multi-billion-dollar Ponzi scheme for decades, defrauding thousands of investors. The scheme promised investors high returns, but instead of investing their money, Madoff used

new investor funds to pay earlier investors, creating a fraudulent illusion of profitability. The scheme collapsed in 2008, resulting in billions of dollars in investor losses and a 150-year prison sentence for Madoff.

- **The Enron Corporation Collapse:** Enron Corporation, once considered a model of corporate success, was ultimately exposed as a massive fraud. The company used complex accounting maneuvers to inflate its profits and hide significant debts, leading to its bankruptcy in 2001. The scandal exposed deep-seated corruption within the company and highlighted the dangers of unchecked corporate greed.
- **Charles Ponzi (1920):** Ponzi's scheme involved arbitraging international reply coupons, promising 50% returns in 45 days. It collapsed, leading to losses estimated at \$20 million.
- **The Satyam Computer Services Scandal:** The Satyam Computer Services scandal involved a complex web of financial improprieties in India. The company's founder, B. Ramalinga Raju, confessed to manipulating the company's financial records, inflating revenue, and misappropriating funds. The scandal shook the Indian corporate world, highlighting the need for stronger corporate governance and transparency.
- **The Bernard L. Madoff Investment Securities LLC:** In 2008, the Bernard L. Madoff Investment Securities LLC, a prominent Wall Street investment firm, was exposed as a massive Ponzi scheme. Madoff, the firm's founder, admitted to defrauding investors of an estimated \$65 billion. The scheme used money from new investors to pay existing investors, creating a false impression of profitability. Madoff was sentenced to 150 years in prison for his crimes [12].

### **Mitigating Financial Improprieties in the Digital Age**

While technology has facilitated financial improprieties, it also offers tools and strategies to combat these risks. Effective mitigation requires a combination of regulatory oversight, technological innovation, and public awareness.

#### **Regulatory Measures**

Governments and financial institutions increasingly implement stringent regulations to monitor and control digital transactions.

Know Your Customer (KYC) and Anti-Money Laundering (AML) policies are crucial in identifying and preventing illicit activities [13].

#### **Technological Solutions**

Advanced technologies such as artificial intelligence and machine learning can enhance the detection of suspicious activities. Although associated with cryptocurrencies, blockchain technology also offers the potential to create transparent and immutable transaction records, thereby reducing the risk of fraud.

#### **Public Awareness and Education**

Educating the public about the risks associated with online financial transactions and digital currencies is essential [14].

Awareness campaigns can help individuals recognize and avoid potential scams, reducing the likelihood of falling victim to financial improprieties.

#### **Methodology**

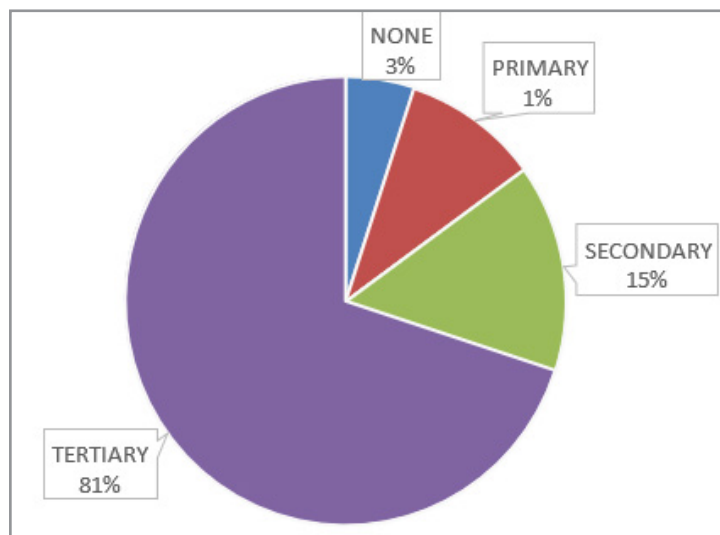
A mixed-method approach was utilized to gather data from both primary and secondary sources. A carefully crafted questionnaire was distributed to 100 respondents who had fallen victim to Ponzi schemes such as Wealth Builders, My-Coin, and Super Advertise. These participants were selected using Cochran's sample size formula, ensuring a 95% confidence level, and were surveyed through Convenience and snowball sampling techniques. Convenience sampling allowed for the collection of data from readily accessible respondents, while snowball sampling involved reaching out to known victims who could then refer additional victims, which helped in engaging those who were hesi-

tant to come forward about their experiences with such schemes. The collected data was analyzed using basic statistical tools, including Excel, and the results were displayed using various statistical methods.

## Research findings/Results

### Level of Education

The public outrage holds the view that the primary factor leading victims to fall prey to Ponzi schemes is illiteracy, among others. This prompted the researchers to elicit data on the respondents' educational level, and the data is depicted in Figure 2 below.



**Figure 2: Victims' Level of Education**

Source: Field Survey 2024

The figure above clearly shows that both financially illiterate individuals and those with high financial literacy, including 81% of tertiary-educated individuals, fell for these Ponzi schemes. These exploit ignorance, greed, and impatience, undermining the financial market stability and eroding trust in the financial system.

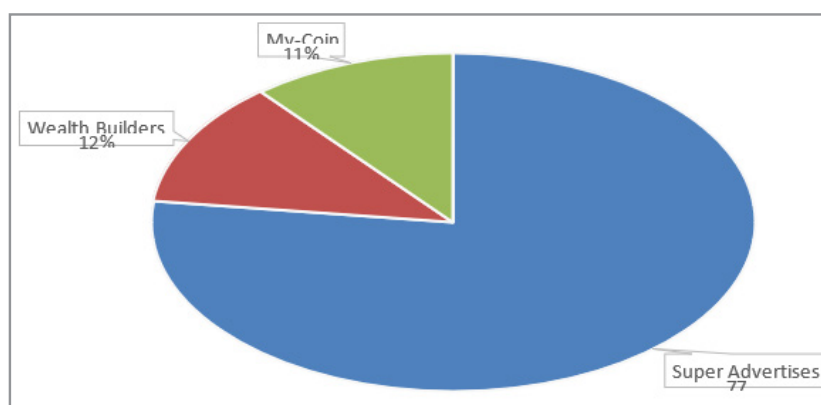
### Victims' Awareness of the Operations of Ponzi Schemes

As the adage goes, "Once bitten, twice shy", the researchers deem it necessary to explore the victim's awareness about the operation or existence of Ponzi schemes in the study area. It is believed that the higher the understanding of the schemes' operations, the more careful the public is expected to be. However,

our study shows that more than half, 68%, of our respondents claimed to have understood the schemes they joined properly. There, though not wished for, the data suggests that most of the victims of such schemes are not oblivious to the racketeering tendencies of such scheme owners.

### The Prevalence and Types of Ponzi Schemes in the Study Area

Although other Ponzi schemes depicted areas and the country at large, their consequences on the victims and the economy were not as gruesome as the ones under the researchers' purview, as presented in Figure 3 below.



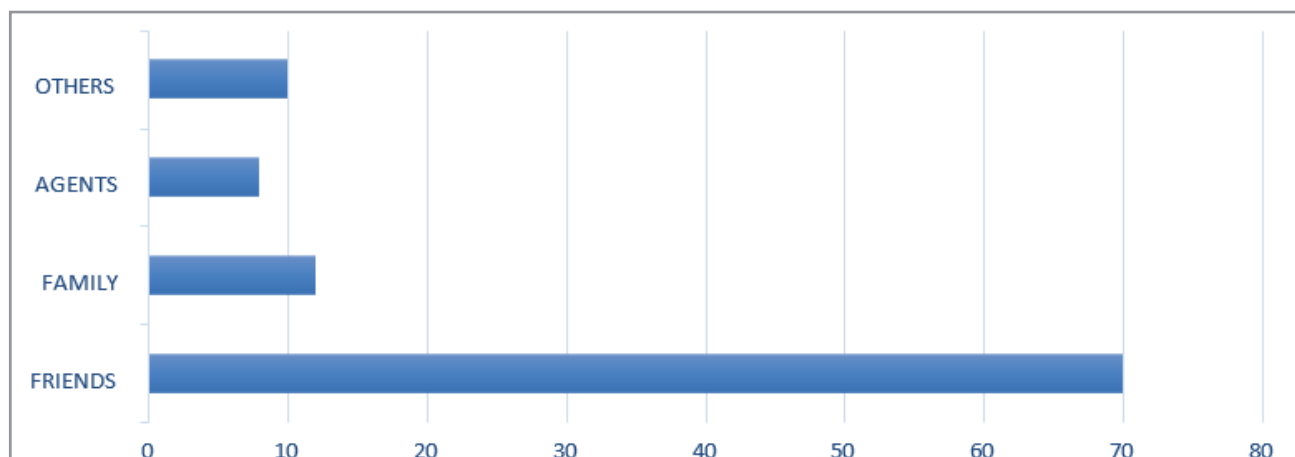
**Figure 3: Types of Ponzi Schemes in the Study Area.**

Source: Field Survey 2024.

As depicted in Figure 3 above, the study found that the prevalent Ponzi schemes in Sierra Leone have caused significant financial and psychological harm over the past decade. The study identifies several schemes that have caused the most damage to Sierra Leoneans in the past three decades, such as My-Coin, Wealth Builders, and Super Advertise. Super Advertise has the highest victim rate of 77%, considering its frequency, as the wounds of Super Advertise are still fresh in the minds of the victims.

### Distribution of Individuals Who Introduced the Victims to the Ponzi Schemes

The researchers were tempted to elicit data from the respondents to find out who had introduced them to the schemes. This is to unearth the root that connected the victims and the Ponzi schemes.



**Figure 4: Ponzi Schemes Connectors**  
Source: Field Survey 2024

As indicated in Figure 4 below, the study found that the victims were introduced to the scheme by other individuals, such as family, agents, friends, and others. The promise of higher returns, the commitment of small funds for a quick buck, and the speculations promoted by greed were the major driving forces to get people involved in the schemes.

### Discussion

This study addresses the multifaceted improprieties surrounding financial intermediation, focusing on Ponzi schemes. These schemes exploit ignorance, greed, and impatience, undermining financial market stability and eroding trust in the economic system. The result implies that even though people were aware, they still committed their money to those schemes with the notion that "the future belongs to the risk takers, not the comfort seekers," as Brian Tracy postulated.

The study identifies several schemes that have caused the most harm to Sierra Leoneans in the past three decades, such as My-Coin, Wealth Builders, and Super Advertise. Super Advertise has the highest victim rate of 77%, considering its sequence of occurrence, as the victims' wounds are still fresh in their minds.

The study also found that the majority of the victims were introduced to the schemes by their friends, who were able to canvass them using different baits, such as the promise of higher returns, commitment of small funds for a quick buck, and speculations that were promoted by greed and impatience.

### Conclusions

The paper explored the issue of financial improprieties during financial intermediation, specifically examining Ponzi schemes in Bo City as a case study. It highlighted that, over the past decade in Sierra Leone, there has been a surge in Ponzi schemes,

with notable examples such as "My Coin," "Wealth Builders," and "Super Advertise." These schemes have resulted in significant psychological and financial challenges for many individuals. The impact of Ponzi schemes extends beyond the financially illiterate, as they have also affected self-identified financially literate individuals. A common thread among victims is a sense of greed paired with financial indiscipline or a lack of financial literacy. Additionally, Ponzi schemes can jeopardize the stability of financial markets, eroding trust in financial institutions and ultimately diminishing profitability and confidence in the broader financial system.

### Recommendations

Based on the findings of this study, the following recommendations were proffered:

- **Enhanced Regulatory Oversight:** To prevent the proliferation of Ponzi schemes, regulatory bodies should strengthen their oversight of financial institutions and investment products. This can be achieved through regular audits, financial statement monitoring, and strict penalties for non-compliance.
- **Investor Education:** Financial literacy programs should be implemented to educate investors about the risks associated with Ponzi schemes and the importance of due diligence in investment decisions.
- **Transparency and Disclosure:** Financial institutions should be required to provide clear and transparent disclosure of investment products and services, including risks, fees, and returns.
- **Whistleblower protection mechanisms** should be established to safeguard whistleblowers who report suspected Ponzi schemes, ensuring their confidentiality and safety.
- **International Cooperation:** International cooperation and information sharing between regulatory bodies and

law enforcement agencies should be enhanced to combat cross-border Ponzi schemes.

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