



RESEARCHER HAS KNACK FOR SPOTTING UNDERHANDED BEHAVIOR IN MARKETPLACE

BY: JIMMIE R. MARKHAM

While pursuing his undergraduate degree in Turkey during the early 1990s, Umit Gurun quickly developed the calculation muscles needed to adapt to inflation rates that were as high as 120 percent.

That environment nurtured a future research economist whose academic pursuits focus on exposing companies and individuals seeking to gain unfair advantages over unsuspecting consumers and investors. He does so by drawing on unique identification strategies and data sets that uncover unscrupulous behavior.

"It is exciting to work on data to identify who is being fooled and who is taking advantage of the system," Gurun, a Jindal School accounting professor, says. "One can find patterns in the data if you know incentive structure and also the history of how that system evolved over time."

Gurun offers an illustration of how his background as an industrial engineering student trained to spot opportunities to eliminate factory waste and increase productivity helped attune him to detecting such patterns:

"During high inflationary times, managers often seek short-term profits over improving productivity," he says. "For example, they can speed up collections of receivables from customers, delay payments to suppliers and invest the proceeds in securities that offer a high interest rate. Doing so effectively converts a widget producer into a financial institution. I was surprised to see that significant profits were coming from financial activities in a manufacturing facility."

The perspective Gurun gained during his undergraduate years opened his eyes to detecting and scrutinizing hidden quid-pro-quo

relations between otherwise unrelated entities. His ongoing interest led him to investigate the implications of these relationships on asset prices, firm disclosure policies and uninformed investors. His work has been fruitful.

Gurun's latest research focuses on discovering new patterns in the ripple effect caused by the massive Bernie Madoff Ponzi scheme.

Gurun and fellow researchers Dr. Noah Stoffman of Indiana University and Dr. Scott E. Yonker of Cornell University obtained court documents that listed home addresses of more than 11,000 victims of Madoff's fraud and then created a map to identify which areas in the U.S. had highest exposure to the biggest Ponzi schemes on record. They also made a request via the Freedom of Information Act to the Securities and Exchange Commission and Federal Deposit Insurance Corp. to obtain detailed information on the assets managed by registered investment advisors and banks..

They looked for connections between these three data sets and discovered that consumers who live in close proximity to Madoff's victims lost trust in the financial system and consequently withdrew their investments, opting instead to make safer bank deposits.

"This trust shock created a ripple effect in the victims' social circles," Gurun says.

The study shows that the ripple effect is pervasive and has an adverse effect on the economy. The investment advisors whose clients live close to Madoff victims become tainted with this trust shock and were more likely to go out of business than their counterparts whose clients were not affected. The trust shock exhibited by the victims and their social networks continues to this day and shows no sign of dissipating any time soon.

Gurun, Stoffman and Yonker published the results of their research in "Trust Busting: The Effect of Fraud on Investor Behavior." The paper recently won the 2016 Wharton School-WRDS Best Paper Award in Empirical Finance at the Western Finance Association Western Finance Association annual meeting in June.



UMIT GURUN