Business Classes Can Be Fun: Teaching Ponzi Schemes

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ABSTRACT: *This paper provides specific suggestions for conducting a Ponzi scheme during a class session with students as the victims. It is suggested that by conducting such an exercise the students will (1) better understand Ponzi schemes, (2) internalize the concept that something that sounds too good to be true probably is, (3) gain a lifelong skepticism of financial scams, (4) realize how "get-rich-quick" schemes are contrary to God's teachings, and (5) have fun.*

INTRODUCTION

Business faculty, perhaps especially those who teach accounting, finance, or ethics, may want to spend one class period on Ponzi schemes. The professor can run a Ponzi scheme with students as the victims. Through such an exercise students (1) better understand Ponzi schemes, (2) internalize the concept that something that sounds too good to be true probably is, (3) gain a lifelong skepticism of financial scams, (4) realize how "get-rich-quick" schemes are contrary to God's teachings, and (5) have fun. Where this exercise has been used, in their end-of-semester evaluations students often say this was the best class session of the semester.

PONZI SCHEMES

The term Ponzi scheme is applied to a plan which purports to be an investment and which promises exceedingly high, and ultimately unrealistic, returns. The unique characteristic of Ponzi schemes is that the money from later "investors" is used to pay off early investors. The early investors generally receive the promised returns, and this credibility encourages later investors to hand over their money.[1]

Ponzi schemes are named after Charles Ponzi, an Italian immigrant who lived in Boston early last century. He promised investors a 50% return in 45 or 90 days. Supposedly, he was able to purchase bulk international postage coupons in Europe and redeem these in the United States at a substantial profit. Ponzi's scam was so lucrative that he opened several branch locations throughout Boston. During the summer of 1920 he soon was taking in over $1 million *per week.* Apparently none of this money was ever used to purchase international postage coupons. Charles Ponzi used some of these funds to pay operating expenses (mainly office rental and employee wages) and some to pay early "investors." Unsurprisingly, Ponzi made sure there was enough money available to support his lavish lifestyle. As all Ponzi schemes must, Ponzi's scheme eventually collapsed. Ultimately, Ponzi was convicted of fraud, served time in jail, and was eventually deported to Italy. He died destitute in Brazil. (See Zuckoff, 2005; see also Dunn, 1975.)

Ponzi schemes continue to thrive. Based on prevalence and seriousness, Ponzi schemes are considered the biggest threat to investors today (North American Securities Administrators Association, 2005). As several articles in *Christianity Today* attest, Ponzi schemes continue to thrive in Christian circles (Fager, March 5, 2001; June 11, 2001; Moll, 2005).

One of the most noteworthy Ponzi schemes of recent years was the Foundation for New Era Philanthropy operated by John Bennett. An outstanding review of this scheme was included in *The Journal of Biblical Integration in Business* (Logue, 2000). Mr. Bennett targeted not-for-profit organizations and offered them the chance to double their money in six months. Supposedly Mr. Bennett represented a very wealthy philanthropist. As a gesture of good faith, a not-for-profit organization was required to turn over to Mr. Bennett an amount equal to the gift it was to receive. After six months they were to receive their original investment back, plus a gift of an equal amount. Soon numerous Christian organizations were participating, including dozens of Christian colleges and universities. During its last 18 months, New Era took in more than $300 million. New Era finally collapsed in May 1995 thanks to Albert Meyer, a perceptive and determined accounting professor at Spring Arbor University who spent months researching New Era's financial statements. Mr. Bennett was ultimately forced to admit that the entire operation was a hoax. (See Stecklow, May 15, 1995; May 16, 1995; May 19, 1995.)

CLASSROOM EXERCISE

How can Ponzi schemes be taught to students so students retain the important lessons they offer? One way to do this is to run a short Ponzi scheme in class.[2] During the fall semester this can be done during the first class session after Thanksgiving, and in the spring semester, the first class session after spring break. Students do not like to do homework during those breaks, and this class session requires no preparation on their part.

The Scam

In order to build some anticipation, during previous class sessions the instructor can tell the students they will be doing something special that day, but not provide any additional information. The instructor can also promise that some of them will walk out of class with more money than when they came in. That certainly gets the attention of the students.

The instructor can begin the designated class session by explaining the rules. Rule #1 is that the rules can change at any time, but when they do change, the instructor will clearly say so. Also, only one person will be allowed to participate each minute and it is perfectly acceptable for a student to not participate. If students do not wish to participate, they simply need to say so and the opportunity will be offered to the next person. The instructor then tells the students that if they give the instructor a dollar, five minutes later the instructor will give them their dollar back, plus another dollar. This will continue until ten minutes before the class ends, allowing time to get money to everyone to whom it is owed, and time to wrap up. Usually at this point the students do not really understand what is happening, but they are very eager to participate.

The instructor then shows the students a briefcase loaded with loose bills – mainly ones, but some fives, tens, and even twenties. The instructor explains that his/her goal is to give away as much money as possible in the next 50 minutes. The instructor then recruits two volunteers, a recorder who goes to the board and records transactions, and a timekeeper who will watch the clock and tell the class every time a new minute starts.

The exercise then begins. When the timekeeper says a new minute has started the first student is asked if he/she wants to participate. If so, the student gives $1 to the instructor who puts it in the briefcase. The recorder at the board lists the person's name, $1, and the time $2 is to be given back. Occasionally a student does not wish to participate, but most are willing to risk a dollar to see if they will really get back $2. The recorder reminds the instructor when $2 distributions are needed. Of course, the instructor continues to collect a new dollar each minute.

Then the pace begins to pick up. After the first few times of giving back $2, the instructor announces a Rule Change. The instructor states that money is not being given away fast enough, so effective immediately, each minute two people will be allowed to participate. Also, each student will be allowed to put in $1, $2, or $3. Of course, five minutes later they will get back $2, $4, or $6, respectively. Most students opt to invest more than a dollar. The recorder continues to list each transaction on the board. By now money is flying back and forth. Students still don't understand what is going on, but they see others doubling their money in five minutes.

After several more minutes the instructor announces another Rule Change. Money is *still* not being given away quickly enough. Students can continue to put in $1, $2, or $3, and double their money in five minutes. Or, they can put in $5, and get back $10. But with this higher amount they will need to wait eight minutes to get their $10. Also, "just to be safe" the instructor will stop accepting money fifteen minutes prior to the end of the class period to make sure all students have time to get the money that is owed to them.

In most Ponzi schemes, people are almost begging to be allowed to participate. In order to emulate this, the instructor can first offer this "opportunity" to the students in every other row. Students who are "allowed" to participate consider themselves especially fortunate, and in most cases participate gladly. After having been around the room once, using every other row, the skipped students usually insist that they be given the opportunity to participate.

After several more minutes the scam is taken to the next level; another Rule Change is announced. If students want to participate, they need to put in either $5, and get back $10 in eight minutes, or they may put in $10, and get back $20, but they will need to wait ten minutes. Most students still gladly participate. Each minute the instructor will collect $15 or $20, and give back half that amount to earlier investors.

This proceeds for about five minutes and the instructor then announces another Rule Change. Every Rule Change so far has allowed the students to receive more money so they are eager to hear about the new rule. But the students are in for a rude awakening. This time the instructor closes the briefcase, tells the students that the game is over, reminds them of Rule #1 ("the rules can change at any time") and walks out of the room with the briefcase full of money. The students are stunned. After some time in the hall, the instructor returns for a debriefing with the class.

Assignments

Upon returning, the instructor explains to the students that what they have just experienced is known as a Ponzi scheme. The instructor can tell the students something about Charles Ponzi and the original Ponzi scheme. As the discussion proceeds, the students can be asked to identify what they believe to be the main characteristics of a Ponzi scheme. These should be put on the board, and most times this list of characteristics includes the following:

- Exorbitant returns are promised, returns that seem too good to be true
- The explanation for the high returns seems plausible
- It appears exclusive. It is presented in such a way that people are often begging to be allowed to give their money
- Money from later "investors" is used to pay off early "investors"
- The person running the scheme invariably skims lots of money for personal use
- Early investors usually get what they are promised
- Later investors always lose
- Eventually a Ponzi scheme must collapse

Most students are thinking that they would never get sucked into a "real" Ponzi scheme, so it is useful to remind them of New Era, and how several Christian schools, run by intelligent and well meaning people, lost millions of dollars in that Ponzi scheme. Students should be reminded that they need to be very careful how they invest their personal funds. The instructor can also remind students that as they move into financial and management positions, whether with Christian or secular organizations, they have a great responsibility to invest funds appropriately.

This exercise should also incorporate discussion of a Christian view of material wealth and attitudes toward money. (Alternatively, the instructor could incorporate a discussion of business ethics; however, because of time constraints it is probably not feasible to include both discussions in this class session.) The instructor can begin with a biblical view of the world. It is helpful to remind students that God created all, owns all, and is Lord of all. "For by Him all things were created: things in heaven and on earth, visible and invisible, whether thrones or powers or rulers or authorities; all things were created by Him and for Him" (Colossians 1:16, NIV). "The earth is the Lord's, and everything in it" (Psalm 24:1, NIV). See also Deuteronomy 10:14, Psalm 50:10-11, and Haggai 2:8. Because God is the creator and owner of everything, our role is that of a steward. It may be useful to discuss the parable of the talents (Matthew 25:14-30). Also relevant is 2 Corinthians 5:21. Because of God's great love for us (John 3:16), we can be assured that He will provide for us. This is made clear in the Sermon on the Mount, where Jesus stated:

> *"Therefore I tell you, do not worry about your life, what you will eat or drink; or about your body, what you will wear. Is not life more important than food, and the body more important than clothes? Look at the birds of the air; they do not sow or reap or store away in barns, and yet your heavenly Father feeds them. Are you not much more valuable than they?"*
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> Matthew 6:25-26, NIV

Problems arise when this biblical view is ignored. God warns us to avoid greed (Psalm 119:36, Isaiah 57:17, Luke 12:15, Ephesians 5:3), but because of our essential sinful condition, our natural tendency is to be greedy (Isaiah 56:11). Further, God warns us against profiting from dishonest transactions. "A fortune made by a lying tongue is a fleeting vapor and a deadly snare" (Proverbs 21:6, NIV); see also Proverbs 13:11. We are told to be fair and honest in our business transactions (Leviticus 19:36 and Deuteronomy 25:13-16). Because Jesus understood the fleeting value of material goods, he warned us of the importance of laying up treasures in heaven rather than treasures on earth, where moth and rust destroy (Matthew 6:19-20). The instructor can remind students that Ponzi and other "get-rich-quick" schemes flourish because they appeal to our sinful nature. Our natural tendency is to acquire as much as we can with as little effort as possible. But this is clearly not consistent with God's teachings as shown in the Bible.

Finally, using the information the recorder has on the board, the instructor then states that, unlike most other Ponzi schemes, those who are ahead will have to give back their gains to those who lost money.[3] After this redistribution occurs, the instructor can remind students that the students were promised that some would leave the classroom with more money than they had when they arrived. The instructor then opens a roll of quarters and gives each student in the class a single coin.

To reinforce these concepts, at the next class session the instructor can ask the students for the main characteristics of Ponzi schemes. The instructor writes them on the board and spends no more than a few minutes discussing them. On the next test the instructor can include a question: "What are three characteristics of a Ponzi scheme?" Even if they have not been told that Ponzi schemes will be on the test, students invariably do an excellent job answering this question.

FINAL THOUGHTS

When an instructor conducts this exercise, the instructor is open to several possible criticisms. Some might say the instructor is encouraging students to be greedy. Others might say the instructor is taking advantage of students. Instructors should be comfortable with the reasons they are conducting this exercise and be able to positively respond to any such comments. This exercise has much to offer — the students learn something that is important, and they do it in a way they will remember.

This exercise is adaptable to many different situations. It would be very applicable to an upper-level auditing course. On the other hand, its use in an introductory accounting or finance course will expose more students to the pitfalls of Ponzi schemes. This exercise also fits neatly into a course in business ethics. This would allow for more extended discussion, in subsequent class periods, of the integration of biblical principles and business practices.

Perhaps not surprisingly, it should be noted that students are not that much different from faculty. This exercise was conducted with a group of Christian business faculty and after the first few minutes they were waving money in the air and virtually begging the facilitator to take it. During the debriefing some said they had actually taught Ponzi schemes and certainly knew what was happening, but they hoped (and in many cases this was a false hope) to get in early, double their money, and get out. Others had no idea what a Ponzi scheme was. They knew there had to be a "catch" somewhere, but they saw money being handed out and they wanted their "fair share."

Students learn well some very important lessons and they have fun. It is a great way to spend a class period.

ENDNOTES

[1] Erroneously, at times the terms Ponzi scheme and pyramid scheme are used interchangeably. Although similar, they are not identical. Both rely on payments from later participants to fund promised payoffs to earlier participants. However, in a pyramid scheme it is clear that earlier participants will not receive their money unless there are later participants. In a true Ponzi scheme, the opportunity for payoff appears to be based on some legitimate source and ostensibly does not rely on later investors. A classic pyramid scheme is a chain letter. More recently, several locales have been beseeched with women's empowerment dinners, which are a nothing more than a large scale pyramid scheme.

[2] As outlined, this exercise can be comfortably completed during a 50-minute class session. As a help to those who may like to adopt this exercise, a video of the author conducting a Ponzi scheme in an actual accounting class is available for a nominal fee. Contact the author, *larry.sayler@greenville.edu*, to obtain this video.

[3] Interestingly, there is some precedent for those who came out ahead in a Ponzi scheme returning money to those who have lost. This was done, with a very high degree of success, after the collapse of New Era.

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