

Failing Fortunes

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Abstract: *The case deals with what happened in an international bank in Calcutta when the Assistant Manager of the branch was a person of doubtful ethical standards. This person was the main functionary to whom the credit officers reported and he tried to push through a working capital limit for a favourite customer by bending the laid down procedures. Misuse of the powers given to a senior officer is one of the worst things that can happen, and the case brings out the dangers of having such people in critical jobs. The case also brings to light the importance of the audit function and how important this function is to a bank so that it functions in accordance with strict standards which are well documented. The discussion point of the case is ethical culture in an organization and how important it is to foster this type of culture.*

Key Words: *whistle blowing, working capital lending, ethical banking, audit function.*

1. INTRODUCTION:

An Overview of the Bank of Taiwan

(Note to readers - this case is based on actual events, which happened in Calcutta in an international bank in which the primary author worked for over two decades. However, the names and identities of the bank and individuals have been disguised. The description of the events in the case reflects what actually happened, though a few minor changes have been taken with the degree of emphasis relating to certain events to bring out the learning perspectives a bit more clearly).

The Bank of Taiwan is a well-established international bank with a presence in India of over 135 years. Prior to 1980, Merchant Bank of Bombay, Imperial Bank of the United Kingdom, and Bank of Taiwan represented the Bank of Taiwan Group in India. In the early 1980s, the Bank of Taiwan took over the assets and liabilities of all these banks along with the staff of the erstwhile independent banks.

2. BODY OF THE CASE:

The Principal Players and Cast

The Principal Players – The Manager of the branch was Graham Mathias who had taken over a year ago from an International Officer. He was the first Indian Manager of the Calcutta branch and naturally everyone in the bank was curious as to how he would perform. Mathias was just over fifty years old and had spent his entire career in the bank. He had joined as a trainee Regional Manager and had worked mainly in the Bombay and Calcutta branches. Calcutta, however, was his home base. He had also worked in the London and Taiwan offices of the bank for around three years in each country. He was an intelligent man and a tough driver of his people

The Assistant Manager of the branch was Narender Sharma. Sharma was a quiet person who meticulously did his job but was in awe of Mathias. This was probably because Sharma had come up from the ranks. He had joined as a clerk 25 years ago and had worked in the Calcutta branch during his entire career. By sheer hard work and intelligence, he had moved up the ranks and become a Staff Officer, then became a junior Regional Manager and now occupied a senior position in one of the largest branches in India.

The Accountant of the bank was Arun Hingorani, again a promoted officer who had come up from the ranks like Sharma. Unlike Sharma, Hingorani was a wily operator and was known to have favourites in the bank and was also not averse to cutting corners when he felt it was to his advantage to do so. Hingorani had worked only in the Calcutta office where he had joined as a clerk. He was in his mid-forties and looked forward to heading the branch and even rising higher. He had not been posted to the Head Office in Taiwan and this rankled. In short, he was a good but untrustworthy banker.

The Cast – The Senior Credit Manager, Biren Mukherjee was a Regional Manager with around 10 years' experience in the bank. He was a conscientious officer and did his work well and diligently. He ensured that all credit

proposals were put up on time and maintained good relations with the clients he personally handled. He was never known to raise his voice and he was popular with the departmental staff. He also got along well with the Assistant Manager, who was his Reporting Officer. In fact, they were both identical in many ways as far as their personal value systems were concerned. This was important because many instances were there (in other banks) where the clients would grease the palm of the officer to whom a proposal had been put up for evaluation. This had never happened in the Bank of Taiwan.

Mukherjee had three Junior Regional Managers under him, and he was operationally responsible for the work they did. The three of the also reported direct the Assistant Manager. Taking everything into account, the department was well run under the guidance of Sharma, the Assistant Manager. All this was to change soon.

Managerial Changes and the Aftermath

It so happened that in 1992, the bank effected a series of transfers in India of its senior staff. As far as the Calcutta branch was concerned, Sharma was posted to Delhi as the Regional Manager (a promotion) and Hingorani took over as the Assistant Manager of the Calcutta Branch (also a promotion).

The new position of Assistant Manager was a welcome change for Hingorani as he viewed it as a steppingstone to becoming the Manager of the branch in due course. He felt he was on the right track and told his coterie of friends about his feelings. The fact that he had to now exclusively deal with lending related matters was also attractive. He felt that the position held potential which had so far been untapped by his predecessor. But he knew he had to play his cards carefully. He intended to launch his campaign in a couple of months' time and started thinking of how he was to do this. The prize at the end was too attractive to be lost by careless moves or hasty ones. He knew the possibilities of the position he now held and intended to exploit it fully.

He was familiar with lending procedures and soon settled into the job. Simultaneously, he also went out of his way to make friends with the four people in the Credit Administration department (headed by Biren Mukherji) who were directly under him. He did this by calling them to his office often and having long chats with them about various topics not necessarily related to lending. In between, he would introduce something about lending and ask an innocent question such as how kickbacks were the norm in many banks in the credit department and would watch their reactions carefully. Biren was outspoken in his condemnation of this practice but Hingorani could see that the others were ambivalent. This went on for a month and by the end Hingorani knew that he had three potential allies in the department.

One of the important customers of the bank was Osborne and Company whose main line of business was making headlights, side lights and windshields for two of the major brands in India who made trucks. These items were also exported to the Middle East and the company had a good name in the market for producing good quality goods and delivering them on time. The company had a turnover of approximately INR 800 crore and was a profitable one, that is, till recently. The problems arose when Japanese and Korean companies started making these items in India and selling them to Osborne and Company's clients at a much cheaper rate. The quality of their products were excellent and in order to gain market share, the pricing was also aggressive. Osborne and Company could not have matched the prices.

As a result, for the past two years turnover and profits had shrunk alarmingly. The company was also short of funds though they were keen to expand. The request for the working capital funding had these factors behind it as a backdrop.

So Hingorani called the three officers from the department to his office and had a long chat with them. He told them about the proposal from the customer and what he intended to do. He also told them not to tell Biren about what his plans were. He told them in the strictest confidence that in case they fell in line, they would all be 'rewarded' by the customer.

'In what way will he reward us?' asked one of the officers.

Hingorani looked at him and the others. 'You will find out and the less you talk of these things the better. Do you understand what I am saying?'

'Yes sir,' chorused the three officers.

'Then meet me in my office at 5.30 pm. We should have some privacy by that time.'

'We are free now,' said the least perceptive of the three.

Hingorani looked at him without a word. The others hurried their colleague out of the office.

At 5.30 pm on the dot, the three gathered in Hingorani's office. Mathias had already left for the day. Hingorani waved them to the chairs opposite him and started speaking.

'Now, Osborne and Company which is one of our customers and a very good one, is a public limited company, and I was responsible for their opening an account with us. They have been banking with us now for over six years and we know them well. They are in a bit of trouble now for want of funds. All of you know the reasons why this has happened. You also know that they are never late in submitting their audited yearly accounts and have replied to all our queries in time and honestly. In other words, basically they are a well-run company which has got into trouble through no fault of theirs. They have also made no fuss about our inspections of the mortgaged property which we do every year. In short, you are all familiar with the company and they have now requested us to give them a working capital loan of INR 250 lakhs. The Chairman and CEO Ramesh Panjwani is an old friend of mine and I want to get his request approved. As you know, my 'B' limit is 80 lakhs. This means Osborne and Company's request comes under the CEO's sanctioning limit, and they will only do this if it carries the Manager's recommendation. Ramesh has said he will give us a first mortgage on his second home in Bombay and a second mortgage on his bungalow on Alipur Road in Calcutta. This is in addition to the other items mortgaged on pledged to us which covers his existing credit limits. These will be extended to cover the new advance. You all know what these existing limits are; now any questions up to now?'

'No sir, we are familiar with this account,' replied one of the three.

'Right, Ramesh will give us a no encumbrance certificate for his house in Bombay. Now what I want you all to do is to get the property in Bombay valued and give the certificate to me. Now, once that is done what I propose to do is this. Once the new securities are in place, I will ask Ramesh to do a few things. Now I want you to understand that what I am going to tell you from now on is totally confidential. So, if anyone does not wish to get into this, now is the time to leave.' He looked around but no one said anything. They were curious and intrigued by what was to come.

'Right, then I will tell you what I have asked Ramesh to do with his company.' Hingorani paused and looked at the ceiling for half a minute to gather his thoughts. He continued after this pause.

'I have told Ramesh to split the company into four different companies. As you all know, split-ups are mainly executed either because a company seeks to focus on different business lines in an effort to maximize efficiency and profitability, or because the government forces this action in an effort to combat monopolistic practices. The last bit of course, does not apply in this case. So far so good?' The three officers nodded.

'You mean that Osborne and Company will no longer exist?' asked one of the listeners.

'No, it will but only in name. It will now be four companies with different names. If all goes according to my plan, Ramesh will then ask for the working capital limit – the same amount – but it will be spread amongst the four different companies. His Director Finance is his close relation and so there should be no problems from him. And his board is also filled with his friends who will do as he asks, and Ramesh will head all the four companies. The reason he will give to them (which is a genuine one) for splitting the company will be that he intends to pursue independent product lines for each of the four companies. These products will all be in business of producing new and additional ancillary items for trucks, in which they have the required expertise. But most importantly' he paused and looked enquiringly around with a slight smile.

'It will now be within your limit, sir,' said the brightest of the lot. 'You can approve the four requests and keep it within the branch.'

'Exactly. You will amongst the three of you, process the request and put it up to me for approval. And not a word to Biren or anyone else. You also know that Mathias is not too interested in lending approvals which fall within my purview. He thinks they are too small for him to go into deeply. He usually just glances through them. He cares only for the ones which are at the CEO and Head Office levels; this is because the last two have to carry his recommendations. So, we can keep this more or less to ourselves. I know we are skating on very thin ice and so we will have to keep going fast to see that we do not fall into the lake. But I am sure that I can rely on you, gentlemen.'

'What lake, sir?' asked one of the officers whose command of English idioms was not too good. One of his friends explained to him what Hingorani meant.

'Yes sir,' came the enthusiastic reply to Hingorani's question in a ragged chorus, shortly thereafter.

In the fullness of time, Ramesh Panjwani did all that the bank asked him to do. The reason he gave for splitting the company was that he wanted each one to focus on different product lines. This would be more efficient; he told the Board of Directors. As Hingorani had predicted, there were no major objections to the splitting of the company from the Board and Panjwani got all the internal and external approvals reasonably fast after six months or so. Panjwani, after the approvals were in place, formally approached the bank for working capital advances to the four companies totalling INR 250 lakhs. The advance was now a secured advance and came within Hingorani's category 'B' authorization limits.

And so matters rested for the space of six months when a full Head Office audit took place in the branch without warning as was the usual practice. Hingorani had not expected an audit so soon and was worried. True, he knew of the practice of an audit being conducted when an officer changed jobs, but as the earlier audit was done eight months previously, he thought there would be a relaxation as far as this rule was concerned. The coming of the auditors was a rude awakening for him.

A team of seven auditors led by a Deputy General Manager (Ian MacFarlane) walked in at 3.30 pm one afternoon and went straight into the office of the Manager. The head of the team had a letter from David Turner (the Group General manager Audit) authorizing the audit and requesting the branch management to give the audit team access to all information they wanted. Standard operating procedures required that the branch had no previous inkling of the visit of the auditors. They did their own hotel reservations from Head Office and came to the branch in taxis. Mathias, after the initial pleasantries, took them to his deputy's office and introduced them to Hingorani. Unknown to anyone but the auditors, Hingorani's tendency to cut corners was known to a certain extent in the Head Office, and the auditors intended find out for themselves what the truth was during this audit.

A couple of lending experts from the team hit the Credit Administration department in half an hour of their reaching the branch. The other auditors spread out after the meeting with the Assistant Manager and occupied the sensitive desks dealing with cash, travellers' cheques, securities and stamped paper. This speed was essential as it gave no time for the branch staff to get rid of any wrongdoing if such were indeed the case.

The two auditors who were auditing the Credit Administration Department requested the files of all sanctions given to customers since the new Assistant Manager had taken over. 'We will come to the others later,' they told the officers.

A list was given to them by the department and Biren Mukherji told his colleagues to verify the list. They did this and found it to be correct. Osborne and Company was being handled by the three junior officers in the department collectively. The next day, the auditors asked for the credit files of a few companies on the list; a random sample of 10 companies which they would go into thoroughly. When the list was shown to Hingorani, he was startled to see that it contained the names of the four new companies which Panjwani had created. However, there was nothing he could do about it and he handed the list back without saying anything.

The two auditors started going through the credit files of each account and simultaneously asked the four officers in the department questions if they had any doubts. The credit files contained all correspondence exchanged with the customer and copies of the last three years' audited accounts and the external auditors' comments. It also contained copies of all proposals for advances received from the customer which were approved at the branch level or recommended for approval by the branch. In short, a detailed appraisal of the credit file would tell the person studying them almost everything about the customer.

Two days passed and the audit appeared to be going smoothly. Routine questions were asked and were answered evidently to the auditors' satisfaction. Routine checks were made on security pledged and these were found to be in order. On the third day, the auditors were having a quick lunch in a room adjacent to the reception hall which also served as their makeshift office. They preferred this as it was quicker than going to the dining room. They were discussing the audit when one of them who was in charge of the Credit Administration Department said, 'by the way I came across a funny thing. I saw two requests for working capital loans spaced 10 days apart. Same amount, same security which was adequate for both the companies, and same management – you'd have thought they would have clubbed them in one go. It would have been much easier.'

'That's strange, I too came across the same thing,' said his colleague. 'I just saw it before I came here and was going to check the matter after lunch.'

'That's four requests then.' They looked at each other. 'Let's examine the four files a bit more.'

'Yes, sounds good to me,' came the response.

They mentioned this curious matter to MacFarlane and he also agreed that the matter required a bit more investigation.

‘Keep me informed of what you find,’ he told his two team members. ‘I have a strange and bad feeling about these advances.’

After lunch, the auditors took the four credit files into their office and started digging into the contents in detail. They soon saw that the working capital requests to the bank seemed to be deliberately staggered though the management of the companies was the same. The security offered also seemed to be the same but of sufficient value to cover the advances. What intrigued and worried them was the time lapse – 10 days – between the requests. They felt something was wrong here. They called Biren Mukherji into their office and asked for details of the advance. Mukherji told them that he was not handling these accounts and that his three junior colleagues would know more about the matter. They were sent for and came into the office looking a bit nervous. They were not asked to sit down.

‘Know anything about these companies?’ asked one of the auditors pointing at the names on the files.

‘Yes sir’ said one of them.

‘Why did the requests for working capital come in with exactly a gap of ten days?’

The three officers looked at each other. ‘We don’t know - we just assumed they were routine requests. Nothing more.’

‘Did these companies have a long relationship with the branch? They must have as otherwise you would not have sanctioned the advances so quickly. Did you know the owner – this chap Ramesh Panjwani? Did you have any earlier dealings with him?’

‘No sir, but he is a friend of the Assistant Manager. A close friend.’

‘Should we then ask the Assistant Manager for more details?’

‘Yes sir, that would be the best thing to do.’ The three officers were now frightened, and it showed on their faces. The auditors were quick to notice this. The three officers only wanted to be out of the office as quickly as possible.

‘We then want to meet with the Credit Administration team – all four of you and the Assistant Manager in ten minutes. Ian MacFarlane will also be present. And the Manager.’

The two auditors by now knew that something was definitely not right and wanted to put the pressure on without giving the officers time to think of a way out and also consult Hingorani. In ten minutes, the four officers, Hingorani, MacFarlane, and the two credit auditors met in Mathias’s office.

‘Please sit-down gentlemen, and what can I do for you?’ asked Mathias. Mathias obviously had no idea of the problem faced by his branch from the auditors. MacFarlane had been quickly briefed by his team members before the meeting.

‘Well Graham,’ said MacFarlane. ‘We seem to have an unusual set of accounts here. We have four working capital advances given to the four companies with a ten days gap in between each sanction. Same security and same management, though the value of the security is adequate.’ He showed Mathias the four files. Mathias went through them and asked, ‘can you please tell me a bit more about these accounts? These working capital advances you just referred to are the latest and were okayed by Hingorani. Perhaps he can help.’ He looked at his Assistant Manager sharply.

‘Yes, Ramesh Panjwani started four new companies and wanted our support for them. There’s nothing more to these accounts. No mystery. It was just a straightforward advance.’ said Hingorani.

‘That’s the owner of Osborne and Company, right?’ asked Mathias.

‘That’s correct. He told me that he was setting up four new companies; he wanted to split the original company into these four. I told him to go ahead.’

‘But what was the urgency to do that? Osborne was doing quite well from what you told me.’ Mathias looked at the credit team. They all looked very uncomfortable and Mathias now knew something was radically wrong.

‘I think it is time you came up with the truth,’ he told them. ‘Otherwise, I will see that you are punished in a way you will not believe. Biren, what do you know about this?’

‘Nothing, sir. I was kept away by the Assistant Manager from all discussions with Mr. Panjwani. But I know that Osborne and Company was not doing well for the last two years. Too much competition from Japanese and Korean companies. In fact, a friend of mine in the company told me they were very much strapped for funds at a time when they wanted to expand. I once mentioned this to the Assistant Manager, but he cut me short. I did not then pursue the matter as he was very rude.’

Mathias now looked ready to explode.

‘Thank you, Biren.’ He looked at the other three and said, ‘Out with it. We have no time to waste. And let Head Office see how the principled lending on which we pride ourselves really works.’

The junior-most of the three looked ready to cry. Mathias instinctively focused on him and just said ‘Well?’ He kept on staring sharply at the helpless officer.

‘Sir, I will tell you all that happened. But please don’t sack me as we were forced to do what we did.’

It took almost two hours for the entire shoddy story to come out. The facts were fully laid out in with all its accompanying miserable details. Hingorani did not contribute much to the narrative except to try and defend his actions. No one believed him.

At the end Mathias asked the credit team to leave. He then turned to Hingorani. ‘Well, do you have substantive to say? You have put all ethical norms to one side so that you could approve the limits yourself. This is not how I want the branch run and I plan to talk to David Turner along with Ian MacFarlane and see what he has to say. You have also set a very bad example to your department. You will be hearing from us. You can leave now.

A dejected, nervous, and subdued Hingorani left the office. He was followed by the Head Office audit team who looked angry and disgusted. They did not say anything to the Manager.

3. Epilogue :

Retribution was swift and savage. Turner, with the Group Staff Controller’s and other required approvals, got Hingorani demoted and sent him as a departmental head to the Delhi office. The three credit officers were dismissed from the bank. Mathias was told to be more vigilant in his monitoring of the credit approvals of his deputy in future. Turner also gave a piece of his mind to Mathias at the lack of supervision displayed by the latter. Mathias should have caught what the auditors did, when the approved limits can to him as was the practice. But then as we know, he was much more interested in the proposals which went up to the Area Management Office and Head Office. Mathias heard him out and had the sense not to try and defend himself. To be on the receiving end of the voice of an angry Turner was not something anyone relished. All this happened in the space of one week of the fateful meeting in Graham Mathias’s office in the presence of the Head Office auditors who on their return had given a blow-by-blow account of all that they had uncovered in the Calcutta branch.

For the record, there were no more such incidents in the Calcutta branch.

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