

Case Studies of Corporate Misgovernance: A New Approach to Financial Statement Analysis

M. R. Kumara Swamy

*Director, Om Sai Ram Centre for Financial Management Research
Mumbai, India
jfmaosr@gmail.com*

ABSTRACT

It appears from experiences that to-day's governance (Man-Management) has been degraded to such an extent that moral bankruptcy has become an integral part of day to day business activities – as evidenced by recent experiences – where righteousness is at a discount (account tampering, manipulation/falsification of accounts and frauds are rampant); truth has become rare, trickery is spreading and integrity is vanishing); and selfishness is growing alarmingly in all spheres of human activity. There is an urgent need to resort to the use of the proposed new and unique approach to financial statement analysis which, according to the Wharton School (University of Pennsylvania, USA) corporate finance economists, is a unique novel and revolutionary approach.

JEL Classifications: E65, G21, G33, M14, M41, Z12

Keywords: ethic based management; moral bankruptcy; novel financial statement analysis

I. INTRODUCTION

Writing on the revolutionary and new approach to financial statement analysis is a difficult assignment as aptly pointed out by renowned applied financial (accounting) statisticians-cum-corporate finance experts, Lusk et al. (2008) (of the Wharton School: The University of Pennsylvania, U.S.A.) in their seminal paper relating to ‘Idiosyncratic Risk’: “. . . although most often social reaction to moral, dilemma is to increase regulation, monitoring and sanctions, we wish to offer the creative alternative offered by Professor *M. R. Kumara Swamy’s Idea of Ethical-Based Financial Statements* . . . This is a provocative idea (the first time that we have encountered such a revolutionary concept) in the sense that it is an attempt to use a moral or spiritual content for the development of financial statements(Lusk et al(2008))”.

A close examination of the mottos of selected countries – U.S.A. (world's strongest democracy): “In God We Trust”, NIGERIA (Africa's largest country): “Unity & Faith; Peace & Progress”, INDIA (world's largest democracy): “*Truth Alone Wins*” - in the context of Benjamin Franklin’s (the founding father of American Management) ‘*Management Ethic*’ (2001) which constitutes. Individualism; Industry and Frugality; Experimentation and Honesty which is encoded in the cultural DNA that continues to shape the American management vis-a-vis other countries institutions and ‘*Character Ethic*’ which is based on the idea that human existence is governed by objective, fundamental principles to which people must conform for maximum effectiveness in life – runs contrary to the realities in present times where the highly relevant observations of Divine Sathya Sai Baba are pertinent to recall: “When the manager follows the conscience, good results accrue; when the manager follows the vagaries of monkey mind, destructive consequences will follow... we want a Government/ Institution which will make the people tread the path of truth and righteousness. *GOD-MENT* is the real Government (Prasanthinilayam)”.

In the context of present day circumstances and developments, insolvency, bank and company failures; corruption; bribery; frauds like accounts manipulation, forging of letters of credit (LCs)/bankers’ receipts (BRs), etc., have become the norms of present day business (Swamy, 2009). The human mind has a great ability to deceive itself and direct itself along predetermined channels. Among the numerous diseases prevailing in the world, the disease of greed has grown beyond bounds. There is no worse disease than this as aptly pointed out by *His Holiness Pope Benedict XVI (2009)*: “Profit is useful if it serves as a means towards an end... once profit becomes the exclusive goal, if it is produced by improper means and without the common good as its ultimate end, it risks destroying wealth and creating poverty... greed has brought about the worst economic downturn since the Great Depression. The economy needs ethics in order to function correctly – not any ethics, but an ethics which is people centred (2009)”.

The subject, ethics: corporate business and government has, of late, assumed great significance in theory and practice – as encoded in customer service manual and employees rule book of organizations and as a teaching subject: course in educational institutions and organizations. This relates to almost all countries of the world – industrialized, developing countries and lately Russia and, in fact, the focus of the June 2, 2001 Congress of the Russian Association of Industrialists and Entrepreneurs held in

Moscow, was on introduction of civilized rules (based on good ethics) for *corporate governance in Russia* (Mezentsev, 2001).

II. CORRUPTION AND MORAL BANKRUPTCY

Corruption is rampant throughout the world. Empirical research shows that basically there are two causes of corruption namely: greed and need. While needs can be met by reviewing pay packages, etc, no package can take care of the greed which has no end. As an offshoot of moral bankruptcy and consequent devaluation of man – plaguing practically all countries (developing and developed) – there is an increasing tendency to channel funds (to get rich too soon) to maintain unproductive/ non-performing assets (Swamy, 1994, 2002).

It is true but a sad commentary that today's business world has been characterised by moral bankruptcy violating all norms of good business ethics which, in turn, has caused mounting financial problems due to frequent bank failures and/or insolvencies – the result of their engaging in fraudulent deals like currency and drug trafficking, smuggling, corruption, forged letters of credit and bankers receipts and manipulating accounts, etc.

Corruption as uniquely classified after detailed research by renowned financial management expert M. R. Kumara Swamy (2011) as – (i) Democratic Corruption, refers to illegal payment by the people, of the people and for the people; (ii) Hierarchic/Anarchical Corruption, relating to bribery which must be compulsorily paid to get – political party-interested-cum-social utility --work, devoid of prudent financial management considerations, accomplished/ executed with the blessings of the political party (Government) in power through the chain of middlemen (who may not belong to any political party) acting as agents, money laundering, fraud and allied issues are important issues and which have caused government collapse/instability (Swamy, 2011). These important issues have received scanty analytical treatment by financial economists.

In the words of Dr. Hilton Root (1997) of the Hoover Institution, Stanford University, U.S.A.: “Corruption is a political problem that has far reaching economic consequences; opportunities are lost, innovation is deferred, entrepreneurialism and investment are aborted... In a democracy, corruption is difficult to hide; instead, it is publicly debated, discussed and examined. The ability of an economy to encourage the investment needed to sustain long term economic growth ultimately depends on the sustainability of political contracts. This, in turn, introduces uncertainty. If each new government or minister overturns the contracts of its predecessor, an economy will sustain only short-term investments and economic growth will be stifled (Root, 1997)”.

In his epoch-making and brilliant Presidential Address to the 15th Annual General Meeting of the Pakistan Society of Development Economists, Professor S. K. Qureshi (1999) has made the following points: “Widespread corruption is one of the most obvious signs of poor governance. There is a vast and ever-increasing body of literature that documents the effects of bad governance, especially corruption in the economy. Numerous studies have found that corruption reduces public revenue and increases public spending. Thus, it contributes to larger fiscal deficits, making it more difficult for governments to run a sound fiscal policy. Studies also find that corruption is likely to increase income inequality because it allows well-positioned individuals to

take advantage of the government activities at the cost of the rest of the population. *Corruption also distorts markets and the allocation of resources...corruption may slow down or even block the movement towards democracy and a market economy (Qureshi, 1999)*".

III. BLACK MONEY (ACCEPTED ILLEGAL) BUSINESS TRANSACTION

It is a sad but a true commentary that black money transactions have become established business norms as facts of life everywhere in the world, more pronounced and glaring in developing countries. For instance in property dealings, i.e., house/apartment purchase from builders/ contractors, it is mandatory that the purchaser is obligated to pay 60 per cent of the cost of apartment in black (cash: M1) : accepted illegality and the remaining 40 per cent payment in white/cheque which represents the real 'sale deed' value of the flat/apartment (it may be noted that the purchaser) has no choice but to engage in this heinous transaction if he/she wants a dwelling place on ownership in a metropolitan city like Mumbai, India and no legislation can thwart this type of business practice as any transformation on the part of black money receiver and giver must come from within based on dharmic (righteous) principles of honest conduct of business. According to research studies conducted over the years by the National Institute of Public Finance and Policy, black money generated in India accounted for 15 per cent to 18 per cent of G.D.P. (1976 study); 18 per cent to 21 per cent of G.D.P. (1981 study) and roughly 10 per cent according to the 2012 study (NIPFP: 1976, 1981, 2012).

A. Sources of Black Money

The sources of black money are:

- *Black Income from Illegal sources:* The important items under this head include, for example, bribery, smuggling, manufacturing of spurious and adulterated products, black marketing and hoarding, etc.
- *Bribery:* Although such cases often go undetected, bribery, illegal commissions and other forms of kickbacks probably generate and protect the bulk of black income in a developing country. It is recognised that in any rent-seeking society attempts to buy political and administrative patronages will be there. The cumbersome administrative practices and bureaucratic red-tapism also encourage the applications of grease money, must be stressed here that filling itself is quite a complicated job. For example, just to get an Import Registration Certificate, an individual has to submit ten different documents which have to be obtained from different offices, If he is issued with the Registration Certificate and a Pass Book, he has to submit another four documents to the nominated bank. Moreover, another seven types of documents are to be submitted by the private sector importers. No wonder then that to save the time and the botheration, and also in order to receive a favourable decision many people will be willing to bribe. However, there is no evidence to concretise the size of black income - both in terms of local and foreign currency which may be flowing through this channel. There is a hunch though that *in the case of business and industry bribery currently amounts to about 10 per cent of total profits.* On this basis a crude estimate for bribe money in 1985-86

amounted to Tk. 212 crores in Bangladesh (Government of Bangladesh, 1985-86; Reza, 1989).

- *Smuggling*: It has got media lime-light in recent times. The major items which are smuggled in by the sea ports- - mainly from Singapore, Thailand and Hong Kong—include cigarettes, electronics, carbon, ball pen, shoes and sandals, cosmetics, baby wear, vests, sugar, alcohol, narcotics, raw-materials for medicine, sulphur, mercury, motor parts including car air-conditioners, cordless telephone sets, spares for garments industry, nylon yarn, dyestuffs, etc. Between Myanmar(Burma) and Bangladesh the items which cross the borders illegally cover betel nuts, clothes, locks, lungi (short length wear), heroin and other drugs: from India, different manufactured items are smuggled in including saris, imitation jewellery, cosmetics, sugar, cycle parts etc. In addition, spices, cattle heads and heroin also come to the local markets. From Bangladesh the items which are smuggled out include second-hand clothes imported from abroad: raw-materials for medicine, raw jute, fish, etc. (In India, the size of black money was officially estimated at around Rs. 80,000 crores, of which Rs. 40,000 crores was by way of gold smuggling). The entry points to Dhaka used by the smugglers are usually Aricha, Fatullah, Narayanganj and Meghna ghats. While both the sea ports of *Chittagong* and *Mongla* are used, the *former is known as the smugglers paradise*. The various adjoining areas of the ports, such as Anowara, Patya, Kutubdia, Moheshkhali, Ram, Satkania, Potenga and Kumira have achieved particular notoriety in this respect; where organized gangs, often with the support of whole villagers, operate with the help of arms, cordless telephone, wireless and various other sophisticated gadgets (Reza, 1989).
- *Others*: These include such illegal activities as setting up unregistered firms to avoid fees and duties, ghost factories to obtain import licences for scarce materials which command a premium in the market and also borrowing funds from commercial banks and other development institutions with deliberate intentions to default. There are also factories which apparently are engaged in legal activities but in fact are depots for adulteration and production of spurious goods. A sizeable amount of black income is also generated by moon shining, hoarding and black marketing of scarce and contraband items. At times there may also occur disguised illegal corporate activities such as inside trading. As a customs official succinctly put it, *while the smugglers are running for their lives, for us it is at best a sport - - a game hunting which will be given up if the risks appear unnecessarily high*. The risk will obviously be great if the customs have no wherewithals — no wireless, no walkie-talkie while at the same time have to chase smugglers by riding a boat with a speed of only six miles per hour (Weekly Bichitra, 1987).

IV. CORPORATE MISGOVERNANCE: CASE STUDIES

In this context, the thought-provoking research findings of financial management analyst-cum-advisor, Kumara Swamy are highly pertinent to quote: “As an offshoot of moral bankruptcy and consequent devaluation of man – plaguing practically all countries (developing and developed) – there is an increasing tendency to channel funds (to get rich too soon) to maintain unproductive/non-performing assets; leading to the emergence, save in exceptional circumstances, of a bogey of Scandalous

manipulation of liquid assets – Cash (M_1) -through Broker-Authorised Dealers (banks through forged letters of credit (LCs)/banker receipts (BRs) – creating artificial(illusionary) Money supply (Ms) – via speculation which is colloquially known as *SCAM* (Swamy, 1998)”.

Scam → through *Money Laundering* → overtime leads to → *Financial Distress* and ultimately to → *Financial Bankruptcy*

There is a human tendency to cover up and to assume that the future will be better and everything will come right. The human mind has a great ability to deceive itself and direct itself along predetermined channels. It is true, though unfortunate, that maintenance and financing of non-productive/non-performing assets, deliberately hidden in the financial statements has become an established/ accepted norm, on one hand; on the other hand, this serious financial mismanagement problem leads, overtime, to deliberate loan defaults and associated liquidity problems-cum-wiping out net worth leading to bankruptcy as evidenced by the following case studies of Citigroup (U.S.A.) and GTB(India) (see Appendix A & B).

Table

Unique balance sheet based on ethical values: Pillars of sound financial management formulated by M.R. Kumara Swamy

Available Nature-endowed Resource as Postulated by His Holiness Sai Baba (of Shirdi)		Value		Assets	Liabilities
Resources	Alphabetical Abbreviation	Numerical	Alphabetical		
Body*	B	1	2	Non-violence	Violence
Speech	S	1	19	Truth	Falsehood
Mind**	M	1	13	Dedication	Irresponsible (Corruption, Fraud, etc.)
Senses	S	10	19	Devotion	Laziness
Intellect/ Wisdom***	W	1	23	Discrimination	Indiscrimination
Egoism	E	1	5	Love	Hatred
One's own Nature	N	½	14	Discipline	Indiscipline
One's own thinking (Sense of thinking)	0	1	15	Duty	Shirk
Deduct Senses			-10		Responsibility
Total		16½	100	Righteousness (Dharma)	Unrighteousness (Adharma)

*The body is just an instrument. We eat to sustain the body. We need food for the protection of the body and clothes for protection from cold and heat. The body is a source of all diseases arising out of desire – desire gives rise to attachment and hatred. **As long as the mind is pure no evil can enter the heart, and the mind should be the master and not the slave of the senses. ***Though man is endowed with intelligence (intellect), he is not able to master the senses.

Source: Swamy (2005).

**V. BALANCE SHEET BASED ON ETHICAL VALUES: A NEW APPROACH
TO FINANCIAL STATEMENT ANALYSIS: FORMULATED BY
M.R. KUMARA SWAMY (1987, 2005)**

In tackling these crucial issues of moral bankruptcy like corruption, smuggling, black money, etc., the following points merit serious attention: With several selfish-oriented-cum-greed-based alternative funding proposals springing up and sprouting in the present scenario of global recession and consequent financial crisis, morality-based business management acts as a leverage to make the marriage between ethics and business management a happy and a lasting one by recasting and reformulating the financial statement analysis based on ethical values.

Noted financial accountants and analysts of the world-renowned Wharton School: The University of Pennsylvania, U.S.A., Professors Edward Lusk et al., writing on 'idiosyncratic risk' have opined that the *alternative to the present global financial crisis offered by Professor M.R. Kumara Swamy's marvellous, novel and revolutionary concept of Ethical-Based Financial Statements is an attempt to use a moral or spiritual content for the development of financial statements ... Needless to point out that there are a number of hurdles to breach to move in this direction and this is certainly a topic for further research*(Lusk,2008).

Unless selfish management and fraudulent motives are eradicated in any country or organization, its success is short-lived and myopic. It is important that every manager in the organization becomes a selfless spiritual leader who is able to inculcate the dharmic (ethical) code of value so that money laundering, account manipulation and other heinous crimes become a thing of the past. The mere form of a human being is not significant – what is essential is the observation of human values. The mathematical significance of number $16\frac{1}{2}$, as enunciated by Divine Sai Baba of Shirdi (1987) Senses: 10, Body: 1, Speech: 1, Mind: 1, Intellect (Wisdom): 1; Egoism: 1; Sense of thinking: 1, One's own nature: $\frac{1}{2}$ (see Table) is highly relevant.

If we keep senses under control, good sense would prevail and our discipline would be 100 per cent under control. If we follow senses, there would be ruins and breeds indiscipline (liabilities > assets). If senses are made servants, then discipline reins leading to a situation when assets exceed liabilities.

According to Divine Sathya Sai Baba: "Any number of zeros placed alongside the figure of one (primary number one which represents the Divine) will carry value – value increases manifold with its additional zeros. But without the number one, if one puts zeros, they carry no value of all. So Divine is the Hero and the rest are all zeros (Prasanthinilayam)".

VII. CONCLUSIONS

Righteous Conduct, Peace, Love constitute a single whole and not separate values like our hand which has five fingers and each of them has a specific duty assigned to it. All the five fingers work in unity and harmony while performing a task. If all these – the pillars of sound financial management – are adhered to equally, prosperity dawns; frauds, manipulations, time and energy wastage would be a thing of the past; and, each individual – by using available endowed resources in a righteous way making senses rule over mind and by rewriting the balance sheet based on moral values – would

become a partner in self-less economic progress for the happiness of the society. *It is folly to expect good results from bad deeds.* In every human being good and bad are co-existing. One should strive only to do good deeds which alone will lead one to liberation and prosperity. And, as rightly pointed out by writer James Cardinal Gibbons, 1986: “Reform must come from within, not from without. You cannot legislate for virtue”.

Today money rules every aspect of human and economic life. Man has been enslaved by money. He lives a superficial, sorrowful and artificial life. This is indeed a great pity. In pursuit of money, man descends to the level of the beast by engaging in manipulative dealings like money laundering, falsehood, accounts manipulation and other crimes.

ENDNOTES

1. Note: One crore = Ten million; One lakh = 100000

APPENDIX A

Citigroup fraudulent (unethical) business risk-borne-cum-wrongly-advised Citigroup
rode on the crest of wave dogged by downfall victim of CDOs and MS stock
plummeting too big and too strong to get into bankruptcy trap

Under the acquisitioned direction of Sandy Weill, Citigroup became the world's biggest bank. During the reign of his successor, Chuck Prince(Charles O. Prince III), Citigroup became one of the biggest victims of the credit crunch, through its huge exposure to the complex credit products that began to blow up in 2007 and in this perspective, the findings of the *Massachusetts Institute of Technology (MIT) Commission on Industrial Productivity* (Vice-chairman : Nobel Laureate Professor Robert Solow) are pertinent to recall: “The US is misguided at its corporate core, largely because many managers lack an understanding of their company's basic operations”.

A. 1991: U.S. Recession

- Citigroup, the biggest commercial bank in the U.S.A., on October 15, 1991 stunned Wall Street by revealing a \$885 million loss in the third quarter of 1991. The bank also announced it was halting dividend payments for the first time in its 179-year history; before this, it had paid a continuous stream of dividends since 1813. The Bank's \$1.6 billion of net loan write-offs in the third-quarter of 1991 were more than treble the level a year ago while the \$1.97 billion of write-offs since the start of 1991 was well above the \$2.3 billion recorded in the whole of 1990 – Bad debt provisions were \$2.7 billion in the first nine months of 1991 compared with \$1.68 billion in the whole of 1990.
- Shares in Citicorp were suspended ahead of the news: The third-quarter of 1991 (\$885 million) loss followed a further \$930 million charge to cover asset write downs, restructuring charges, and additions to reserves. John Reed, Citicorp's Chairman announced plans in 1990 to cut 8000 of the company's 90,000 jobs; an extra \$302-million reserve had been set up to cover further severance costs and

premises write downs over the next five quarters. Citicorp refused to say how many more jobs would go.

- An additional \$430 million charge was to cover the 'restructuring' of the information business division -- of this, \$400 million to the loss-making Quotron subsidiary, a financial information service which provide price data to traders and analysts worldwide, and which had been subject to legal action. *The Bank persistently insisted that it would never sell Quotron, the loss-making information services business. Citicorp paid \$680 million for Quotron in 1986, a figure regarded as too much by bank insiders and analysts.* In the earlier five years to 1991 Quotron cost Citicorp nearly \$ one billion in net losses and it no longer considered Quotron to be a core business and that a \$400 million write-down of Quotron could herald its being put on the block.
- Earnings from the *consumer banking division* crashed in the third-quarter of 1991 to \$56 million from \$286 million a year ago.
- Revenues in the mainstream *global corporate finance business*- which covers Japan, Europe and North America were down from \$1.09 billion to \$978 million year-on-year and this division *suffered a \$298 million net loss*, compared with \$27 million of profits a year ago.
- The 1991 third-quarter results left Citicorp with a core capital ratio of just 3.64 per cent, below the minimum 4 per cent regulatory level that took effect in 1992.
- The bank's \$1.6 billion of net loan write-offs in the third-quarter of 1991 were more than treble the level of a year ago, while the \$3.97 billion of write-offs since the start of 1991 were well above the \$2.3 billion recorded in the whole of 1990.

B. September 2007 - To date (U.S. Recession)

- In September 2007, with Wall Street confronting a crisis caused by too many soaring mortgages, *Citigroup Chief Executive Charles O. Prince III learned for the first time that the Bank owned about \$43 billion in mortgage-related assets*- - He asked Thomas G. Maheras who oversaw trading at the Bank to look into this matter - - He told the CEO that no big losses were looming and hoodwinked everyone. A risk-management team was dispatched to more rigorously examine Citigroup's huge mortgage related holdings. They were too late, however. Within several weeks, Citigroup announced billions of dollars in losses. But many Citigroup insiders opined the bank's risk managers never investigated deeply and because of long-standing ties that clouded their judgment, the very people charged with overseeing deal makers eager to increase short-term earnings and executive's multimillion-dollar bonuses failed to rein them. By end 2008, *Citigroup, once the U.S.'s largest and mightiest financial institution, has been brought to its knees by more than \$65 billion in losses, write-downs for the troubled assets and charges to account them for future losses. More than half of that amount stems from mortgage-related securities created by Maheras team.*
- Citigroup's stock plummeted to its lowest price in more than a decade, closing on November 21, 2008 at \$3.77. At that price the company was worth just \$20.5 billion, down from \$244 billion two years ago. Waves of layoffs have accompanied that slide, with about 75,000 jobs already gone or set to disappear from a work force that numbered about 375,000 a year ago.

- **The bank's downfall was in the making and involved many in its hierarchy,** particularly CEO Prince and Robert E. Rubin, an influential director and senior adviser. *Citigroup insiders and analysts Prince and Rubin played pivotal roles in the bank's current woes, by drafting and blessing a strategy that involved taking greater trading risks to expand its business and reap higher profits based on selfish motives.* For a time, Citigroup's megabank model paid off handsomely, as it rang up billions in earnings each quarter from credit cards, mortgages, merger advice and trading.
- *But when Citigroup's trading machine began churning out billions of dollars in mortgage related securities, it courted disaster. As it built up that business, it used accounting manoeuvres and manipulations to move billions of dollars of the troubled assets off its books, freeing capital so the bank could grow even larger.*
- Because of pending accounting changes. Citigroup and other banks had been bringing those assets back in-house, raising concerns about potential losses.
- David C. Bushnell was the senior risk officer who was supposed to keep an eye on the bank's bond trading business and its multibillion dollar portfolio of mortgage-backed securities. Those activities were part of what the bank called its fixed-income business, which Thomas Maheras supervised. *One of Maheras's trusted deputies, R.H. Barker, helped oversee the huge build-up in mortgage related securities at Citigroup. But Bushnell, Maheras and Barker were all old friends, having climbed the banks corporate ladder together. Because Bushnell had to monitor traders working for Barker's bond desk, their friendship raised eyebrows inside the company.*
- CEO Prince started putting pressure on Thomas Maheras and others to increase the Bank's earnings particularly in the creation of collateralized debt obligations (CDOs) securities that packaged mortgage and other forms of debt into bundles for resale to investors. *Chuck Prince going down to the corporate investment bank in late 2002 was the start of that process. Chuck was totally new to the job, so he looked for someone for advice and support. That person was Rubin.* Rubin had always been an advocate to being more aggressive in the capital markets arena.
- From 2003 to 2005, Citigroup more than tripled its issuing of CDOs, to more than \$20 billion from \$6.28 billion. Companies issuing the CDOs generated fees of 0.4 per cent to 2.5 per cent of the amount sold meaning Citigroup made up to \$500 million in fees from the business in 2005 alone. *In December 2005, with Citigroup diving into the CDO business, Prince assured analysts that all was well at his bank.* Even as the first shock waves of the subprime mortgage crisis hit Bear Stearns in June 2007, Citigroup's top executives expressed few concerns about their banks exposure to mortgage-linked securities. *When examiners from SEC began scrutinizing Citigroup subprime mortgage holdings, the bank told them that the probability of those mortgages defaulting was so tiny that they excluded them from their risk analysis.*
- Later that summer of 2005 when the credit markets began to shrink and, values of various CDOs began to plummet, Maheras, Barker and Bushnell participated in a meeting to review Citigroups exposure. The slice of mortgage-related securities held by Citigroup was viewed by the rating agencies to have an extremely low profitability of default (less than 1.01 per cent), according to Citigroup slides used at the meeting. Around the same time, *Maheras continued to assure his colleagues*

that the bank would never lose penny. Maheras assured the group, which included Rubin and Bushnell, that Citigroup's CDO position was safe.

- **As the subprime prime market plunged further, CDO prices began to collapse. Credit-rating agencies downgraded CDOs**, threatening Citigroup's stockpile and Merrill Lynch aggressively marked down similar securities, forcing other banks to face reality. *By early November 2007, Citigroup's write-downs ballooned to \$8 billion-\$11 billion. Barker and Maheras lost their jobs, as Bushnell did later on and on November 4, 2007, Prince told the board that he, too, would resign.* Although Prince received no severance, he walked away with Citigroup stock valued then at \$68 million along with a cash bonus of about \$12.5 million for 2007.
- *Prince was replaced in December 2007 by Vikram S. Pandit, a former money manager and investment banker whom Rubin had earlier recruited in a senior role.* Since becoming chief executive, Pandit was scrambling to put out fires and repair Citigroup's deficient risk-management systems.
- Citigroup held \$20 billion of mortgage-linked securities on its books, the bulk of which were marked down to between 21 cents and 41 cents on the dollar. It had billions of dollars of giant buyout and corporate loans. And it also faced a potential flood of losses on auto, mortgage and credit card loans as the global economy plunged into a recession. Also, *hundreds of billions of dollars in dubious assets that Citigroup held off its balance sheet started moving back onto its books, setting off yet another potential problem.* \$500 billion of assets were earmarked for disposal or run-off. Much of that total would be reached by the bank winding down parts of its huge American mortgage business.
- In an effort to streamline the Citigroup and placate restive shareholders, Pandit sold or closed over 45 branches in eight states and disposed of Citigroup's building in Tokyo and its investment-banking base in New York and ditched over \$12.5 billion in loans used to finance corporate buyouts and jettisoned the Diners Club credit card franchise, Citigroup's commercial leasing divisions and a big pension administration unit. Further write-downs of at least \$8 billion (£4 billion) were anticipated in addition to the \$40 billion of write-downs the bank has already announced since the subprime crisis erupted last summer 2008.
- Although Citigroup raised more than \$50 billion in new capital to repair its balance sheet, analysts believed it needed even more new cash to see it through the financial crisis. It was reported that Citigroup was merging its Smith Barney brokerage into a joint venture with Morgan Stanley to cushion Citigroup \$2.7 billion in badly needed cash.
- It was reported that Prince Alwaleed bin Talal -- known as Warren Buffett of Mid-East -- already the single largest individual shareholder in Citigroup, would raise his stake to over 5 per cent as the bank was said to be dramatically undervalued.
- The US Treasury Department bought \$25 billion of preferred shares and warrants from Citigroup in October 2008 when it injected capital into banks under the U.S. Government - \$700 billion bailout plan. It could buy more, boosting Citigroup's capital and a renewed government willingness to support the bank, which could boost the confidence of investors.
- U.S. Federal regulators approved a radical plan to stabilize Citigroup in an arrangement in which the U.S. government could soak up billions of dollars in

losses at the struggling bank. The Complex and confidence plan, announced on November 23, 2008, called for the government to back about \$306 billion in loans and securities and directly invest about \$20 billion in the Citigroup.

As stated by Citigroup CEO Pandit: “Citigroup has a solid capital position, and that employees should not focus on the bank’s falling share price because that is not what regulators and credit rating agencies worry about – the shares were down to \$3.77 on November 21, 2008 – another 20 per cent decline from \$4.71 close on November 20, 2008 – in a recent statement, Citigroup CEO has thanked US tax payers for reposing confidence in the Citigroup restructuring and revamping operations – the Federal Government bailout of \$45 billion received in late 2008 built a bridge over the crisis to a sound footing on organic financial management path”.

Alas, Citigroup CEO Pandit was forced to resign in late 2012 due to extraneous factors like professional jealousy and selfish considerations.

As analysed by financial management expert M.R. Kumara Swamy (2009): Influential Director & Senior Advisor → With selfish motives and with concerned fraudsters (*COALITION*) → Hoodwinked Risk Analysts and Bank CEO by hiding unfavourable data regarding losses (collateral debt obligations(CDOs) and mortgaged securities) and falsely/mischievously presenting rosy picture of bank's operations *COLLUDED* → with other persons of questionable virtue.

With CDOs values plummeting → Prompted credit agencies to intervene and Citigroup’s losses ballooned ranging from \$8 to \$11 billion → Almost reached a state of bankruptcy/*COLLISION* → Director and Senior Advisor and CEO quit Citigroup

Source: Analysis based on official releases and media reports (various years).

APPENDIX B

Stock-broker colluded and manipulated Global Trust Bank (GTB) rode on the crest of wave dogged by downfall

The genesis of the collapse of India's private sector bank, Global Trust Bank and its take-over by a nationalised bank, Oriental Bank of Commerce is significant.

A. Chronology of Significant Events

- Incorporated in 1993, the private sector Global Trust Bank (GTB) was promoted (in the wake of the country's economic liberalisation policies) by former CEO (Chairman RG) of one of the country's leading private banks, Vysya Bank – RG and his associates whose share contribution amounted to 40 per cent managed to rope in the International Finance Corporation and the Asian Development bank as the GTBs other major shareholders.
- Overtime, GTB, by violating all dharmic principles of running sound and honest banking business, advanced large amounts of loans to bull – (speculator-driven and stock market manipulator) – KP and his associated companies of questionable norms (practically every investment company of the KP group had an account at GTB and enjoyed generous funding by GTB) whose ways of doing business were: come what may, get rich too soon by loan diversion and misuse of sanctioned

loans, manipulation, swindling and related unethical business practices. As a result of these unethical bank practices and with stock market scam in 2000, GTB landed itself in a position where GTB had a negative net worth of about Rs.1500 crores (one crore = 10 million) with negative capital adequacy ratio.

- As a result, GTB-sanctioned loans turned into bad loans and wiped out its (GTB) equity and reserves by crossing the capital exposure limit. These unpalatable fraudulent events forced CEO of GTB to quit in 2001.
 - Also, GTB along with UTI Bank had signed a merger proposal which was later withdrawn/cancelled after investigations by the Securities and Exchange Board of India revealed that GTB CEO and KP had colluded to inflate share prices for the merger ratio to be favourable to GTB.
- (i) In December 2003, the Securities and Exchange Board of India (SERI) debarred GTB promoter and associates from dealing in GTB in any manner for alleged manipulations in the Bank's shares until the SEBI completed the investigations; (ii) The Annual Inspection of GTB by Reserve Bank of India in 1999-2000 had clearly documented irregular lending to KP and his associated companies and had pointed to large write-off of bad loans, etc. It had pointed to the fact that the KP-associated companies mobilised large sums of money by way of share application and convertible debentures and used that money to buy GTB shares; (iii) Further, the Audit and Consulting Firms, Ernst & Young in 2001, in their review reports of some of the major accounts of GTB, had clearly pointed to the fact that loan accounts of KP-associated companies were diverted to a number of KP entities.
- Thanks to the 2000 stock scam, GTB as on July 24, 2004 was saddled with accumulated losses of Rs. 273 crores and non-performing assets of Rs. 915 crores – GTB needed Rs. 700 to 800 crores mainly to write-off bad loans in the Bank books.

Result: GTB-non performing asset-led bad loans amounted to Rs. 915 crores, wiped out its net worth (equity and reserves) and GTB went bust. As analysed by financial management expert, M. R. Kumara Swamy: *GTB*(Private Bank) → Formed → With Bull (KP) – stock market manipulator (*COALITION*) → Advanced fraudulent loans – running into crores of rupees(*COLLUSION*) → Diverted such loans to KP-associated companies → Ultimately to KP-owned companies.

With Stock Market Scam

The KP-associated companies → (*COLLIDED*) faced the wrath of steep fall in stock prices and rendered them unable to payback GTB loans. Expressing great concern on the serious problems of bad debts plaguing the Indian banking system, India's Finance Minister stated: "Non-performing assets of Rs. 83000 crores (one crore = 10 million) is loot and not debt". (Finance Minister's Statement in the Rajya Sabha: Parliament: 2002, July 23).

Source: Swamy, M. R. K., 2004.

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