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ETHICS IN BUSINESS: A CASE STUDY FROM BANKING SECTOR

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ABSTRACT

Business ethics is a matter of concern now a days. There are many live examples of failure in governance and unethical practices by companies which has doped the investors in turn affecting the economy in a large scale. This paper is an attempt to study the case of Yes Bank which became bankrupt without giving a hint of that to the investors. The study makes an attempt to check if the bankruptcy of Yes Bank could have been predicted. The study also makes an attempt to review the governance and find the reason for the bankruptcy. This paper tries to evaluate the performance of Yes Bank by calculating the Z-score from 2014 till 2019. The study reveals that the bankruptcy could not be predicted by the z-score model. This is because of the non reflection of certain transactions in the balance sheet and internal governance issues which becomes a matter of concern for all the stakeholders, especially the shareholders.

Keywords: *Banking, Bankruptcy, Ethics, Governance, Investors.*

Introduction

The business scenario today is very uncertain due to various environmental factors which are both internal and external. External environmental factors cannot be controlled but it is very transparent. Therefore the effect of external factors can be predicted by the stakeholders especially the investors. There are certain unpredictable internal factors due to non transparency which may effect the shareholders in a big way. It takes away the confidence of the investors in their decision to invest in any corporate shares. Perhaps to be sure of the future of the firm is an matter of concern by all the business houses. The credibility of banks holds prime importance as it relates to financial investments, capacity building, funding, and expansion by reaping back profits. Z score is a model used to evaluate the credit worthiness of the firms. This tool is usually used to predict the bankruptcy of a firm if in case the balance sheets show honest numbers. This paper tries to find out if the distress situation faced by Yes Bank could have been predicted earlier using Z-score model. The model is used by researchers, investors, financial institutions and other practitioners throughout the world.

This has been a very important parameter to both the lenders and investors whose decision is based on solvency estimates. The credit rating agencies also have played a major part in terms of credit rating. In modern day scenario one parameter alone is not enough to know the performance of a company.

Objectives of the Study

- To analyse the governance and ethical issues which lead to the downfall of Yes Bank.
- To calculate the z-score value of Yes Bank from 2014-15 to 2018-19
- To analyse the financial performance of Yes Bank every year for the above mentioned period.
- To check if the tendency of the bank approaching bankruptcy could have been predicted.

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Methodology of the Study

This paper uses only secondary data for the purpose of the study. The data from various literature is used in order to give a background description and supporting description.

Secondary data for the purpose of analysis is taken from www.moneycontrol.com, indiabulls.com, CMIE database and website of Reserve Bank of India. Data is also taken from the official website of the Yes Bank and Google.com.

The ratios are calculated from details mentioned in published statements like balance sheet, cash flow statements, profit and loss statements obtained from the above sources and also annual details found in the annual report of the bank. The data used is for a period of 6 years that is from 2014 to 2019.

Ethics and accountability are two important elements in governance. In majority of the corporates there are crisis regarding this. Progressively it has been understood that the promotors and higher level management cannot resolve this crisis amongst themselves. Strong policies, ethical base, integrity and decentralisation can curb this crisis to a certain extent.

Credit Rating in India

In an ideal situation, everyone would have sufficient money to take care of their needs. However, facing to face the inflation, most of them have no other option but to take credit to meet the life goals, especially when the need is of large amount like buying car, home, etc. To make borrowing money from financial institutions easier and safer, it is important to have a good credit history or credit worthiness which is determined by credit score and credit rating. This is very much essential for large corporations as well if they want to raise capital in the form of debt or equity.

Importance of Credit Rating

For the lenders of money like banks or financial institutions or individual lenders, it helps in better investment decision. No bank or money lending companies would like to lend to a risky customer. By seeing the credit rating, lenders will get an idea about the credit worthiness of an individual or company as a borrower and alsothe risk factor attached with them. By evaluating the credit rating, they can make a better investment decision. Good credit rating score means an assurance about the safety of the money and also that it will be paid back with interest assured on time.

For the borrowers it is easy to get loan approval if the credit rating is good. The company with high credit rating will be seen as low/no risk customer. Therefore, banks will approve the loan application easily. One of the major factors that determine the rate of interest on the loan taken is the credit history. Higher the credit rating, lower will be the rate of interest.

Every credit rating agency has their own system to evaluate the credit worthiness. The major factors considered are credit history, credit type, credit duration, credit utilization, credit exposure among others. Every month, the credit rating agencies will collect financial and other information from partner banks and other financial institutions and update the rankings. Once the request for credit rating has been made, these agencies hunt for information and prepare a report based on information collected. Accordingly they grade every individual or company and give them a credit rating score. This rating score is used by banks, financial institutions and investors to make a decision of investing money, buying bonds or giving loan or credit card. The better is the rating, more are the chances of getting money at reasonable interest rates. Depending on the credit rating score public also will value the firm and have confidence to invest in shares of companies.

Literature Review

O'Leary (2001) analyses that prediction of bankruptcy is one of the most important business decision-making problems affecting the entire future of a business, failure results in a high cost to the all the stake holders like collaborators, society and the country as a whole. Over the last 35 years, the topic of prediction of failure of a company has been a major research domain in corporate finance. Academic researchers all over the globe have been working on this factor and have developed a number of corporate failure prediction models. Till today, a clear picture of the application of alternative methods in corporate failure prediction is still not arrived at. Researches have again and again proved that most business failure is caused by poor or inexperienced management styles, fraud, and rapid technological changes amongst other variables. Financial failure may take the form of bankruptcy, insolvency or restructuring.

Dimitras, Koksal, and Kale (2006) mentioned that after 30 years of academic research on this topic, they arrived at a conclusion that there is no generally accepted model for corporate failure prediction that has its base in a causal specification of underlying economic determinants. Due to the confusing variety and restrictive assumptions underlying these classic statistical models, there is a need to diversify into alternative methods. Most of the prior empirical studies of failure have concentrated almost exclusively on financial ratio data.

Chakravarthy, (1986) defends that z-score(Altman, 1968) is a "composite measure of profitability, cash flow, slack, and stock market factors. He says High Z score means strong financial health while low Z score indicate financial distress or bankruptcy.

In the year 2007, Kim studied the quality and strength of the Altman's Z-Score model under the assumption that it was no longer significant due to market factors and some governance issues. Kim had written that the Z-Score was found to be a predictor of financial distress in firms one year prior to bankruptcy, but that the calculations have to be done very utmost care and caution because of the significance of some of the variables. Kim says that prediction by using Z-Score for long periods usually more than one year have lost their significance now.

Sharma and Mahajan in 1980 emphasize that not only do failure prediction models help determine the causes of business collapse, but that they can also be used to develop techniques to assist in avoiding future failures. They also noted that business failure tends are caused by ineffective or poor management, and errors in, or the implementation of, strategic plans. It is said that the business collapses or bankruptcy can be avoided if corrective action is taken on time, and it is effective in treating the cause of the pending failure. However, if the corrective action is ineffective, failure is inevitable.

Nainwat Renu and Meena Ravi in 2013 wrote that ethics or the right way to run a business are inherent in all aspects of corporate governance and in every board decision and action. They also have written that ethical choices are relevant within the core business strategies that boards follow and the way they direct the business as a whole to achieve them. The paper provides a brief account of Indian corporate governance codes, guidelines, Business Ethics, benefits of Business Ethics.

Background of Yes Bank Ltd.

Yes Bank Ltd was incorporated on 21st November 2003. The founder of the bank is RanaKapoor. It obtained the certificate of commencement of business on 21st January 2004. The Bank is providing a range of banking and financial services. It operates in various segments that is Treasury, Corporate / Wholesale Banking, Retail Banking and Other Banking Operations. The Treasury segment includes investments in all the financial market activities undertaken on behalf of the Bank's customers who are trading, maintaining of reserve requirements and resource mobilization from other financial institutions and banks. The Corporate Banking / Wholesale Banking section includes lending, taking deposits and other services which is offered to corporate customers. The Retail Banking section includes lending, taking deposits and other services offered to retail customers. The Other Banking Operations section includes para banking activities such as third-party product distribution and merchant banking operations. Yes Bank had 1050 branches and 1724 ATMs as on 31 December 2017 with 573 Bunch Note Acceptors /Cash Recyclers.

In 2005 the Yes Bank Ltd, entered into retail banking with the launch of International Gold and Silver debit card partneringwith MasterCard International. In June 2005 the bank came up with public issue and the shares were also listed on the stock exchanges. In December 2005 Yes Bank Ltd. bagged Corporate Dossier award from Economic Times. In the year 2006 the Bank also received Financial Express Awards for India's Best Banks. In April 2007 the bank entered into another step of expansion by making a tie-up with the Agriculture Insurance Company of India (AIC). Yes Bank Ltd. was ranked as the No 1 Emerging Markets Sustainable Bank of the Year-Asia at the FT/IFC Washington Sustainable Banking Awards 2008 declared in London. The Bank was also ranked as the No 1 Bank in Business Today-KPMG Best Banks Annual Survey of the year 2008. On 18th of September 2013 the Yes Bank Ltd, had announced that it has successfully closed equivalent to USD 255 million by way of the Dual Currency Multi-tenor Syndicated Foreign Currency Loan Facility.

Credit Worthiness of Yes Bank Ltd.

Yes Bank Ltd, announced on 15th September 2014 that it has received ratings upgrade from credit rating agency ICRA for its various long term debt instruments. The improvement in rating successively in Yes Bank and continued robust performance with its ability to maintain strong asset quality indicators through cycles and improving CASA base with increasing granularity in the liability franchise has improved the goodwill. The high ratings also factor in the successful equity mobilization of USD 500 million by the bank that could further strengthens its capitalization profile.

In 2014 Yes Bank Ltd, announced that it had received upgraded ratings from credit rating agency Credit Analysis & Research (CARE) for its lower Tier II, upper Tier II and the perpetual bonds. The ratings was upgraded because the bank showed consistent profitability performance capital-raising ability and steady asset quality across the economic cycles. After this improvement the bank successfully raised Rs 4906.65 crore from issue of 3.27 crore shares at the issue price of Rs 1500 per share.

The Board of Directors of Yes Bank Ltd. approved sub-division of equity shares from 1 equity share of Rs 10 each into 5 equity shares of Rs 2 each at the meeting held on 26th July 2017 . Yes Bank announced on 21st November 2017 that it has raised USD 400 million through two syndicated loan transactions one amounting to USD 250 million from Taiwanese banks and another JPY 16.5 billion (USD 150 million) from Japanese banks.

On 18th December 2017 the bank moved a milestone ahead by making an entry into the 30-share S&P BSE Sensex. Very next day Yes Bank announced that expansion of renewable energy power generation across India will be supported by a new USD 400 million joint initiative backed by the European Investment Bank (EIB) and Yes Bank Ltd. Yes Bank Ltd, announced on 17th January 2018that it has signed solar energy co-financing Letters of Intent (LoI) with Tata Power Delhi Distribution Limited (up to 10 MW capacity), thereafter Hero Future Energy (up to 1.5 GW capacity) Greenko Group (up to 10 GW capacity) Amplus Solar (up to 1 GW capacity) and Jakson Group (up to 1 GW capacity) for their solar projects in India which is to be completed by 2023. The bank further announced on 16th March 2018that Mahindra Renewables Pvt. Ltd. Which is a wholly owned subsidiary of Mahindra Susten Pvt. Ltd, achieved financial closure for its 250 MW solar power project to be located in Rewa District of Madhya Pradesh with Yes Bank Ltd, for financial assistance in the form of debt to the extent of Rs 750 crore and up to Rs 200 crore from other financial institutions .

Analysis and Interpretation (Numbers in Millions)

X_1 = Working Capital / Total Assets

Year	Working Capital	Total Assets	X1
2013-14	812.82	1090.15	0.745603
2014-15	1025.0	1361.70	0.752982
2015-16	1250.1	1652.63	0.756468
2016-17	1642.4	2150.60	0.763715
2017-18	2256.6	3124.45	0.722251
2018-19	2536.9	3808.26	0.666176

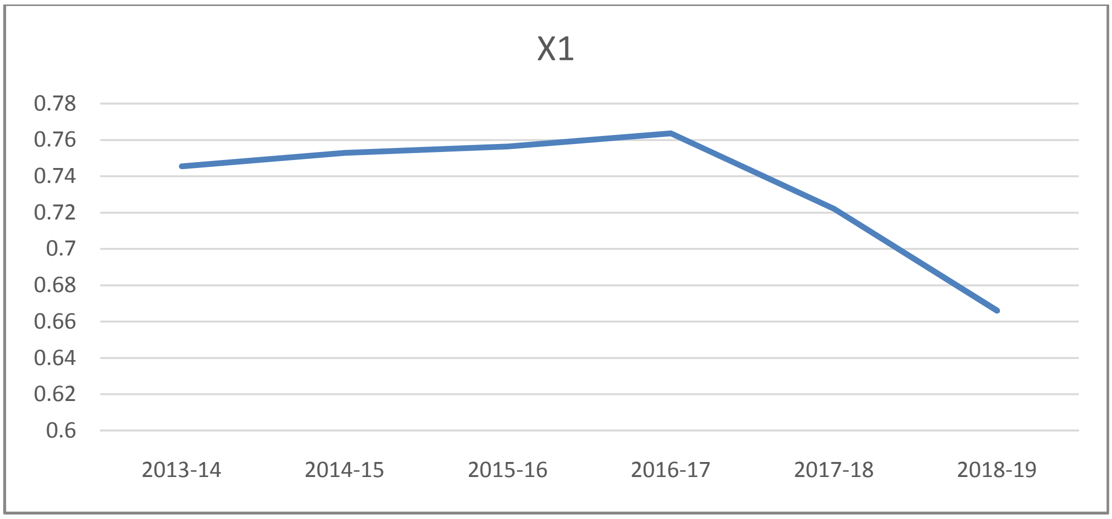

Table 1 and Chart 1: Showing Ratio X_1 for the Period 2013-4 to 2018-19

This ratio measures the net liquid asset relative to the total assets. The working capital to total assets ratio of the bank has been very high during the study period which is a good aspect for a bank or any financial institution. It is observed from the chart and table that after 2017 onwards it has started to decline because of the disproportionate increase of working capital and total assets.

X_2 = Retained Earnings / Total Assets

Year	Retained Earnings	Total Assets	X2
2013-14	67.611	1090.2	0.06202
2014-15	112.622	1361.7	0.082707
2015-16	133.661	1652.6	0.080878
2016-17	215.976	2150.6	0.100426
2017-18	252.977	3124.5	0.080967
2018-19	264.412	3808.3	0.069431

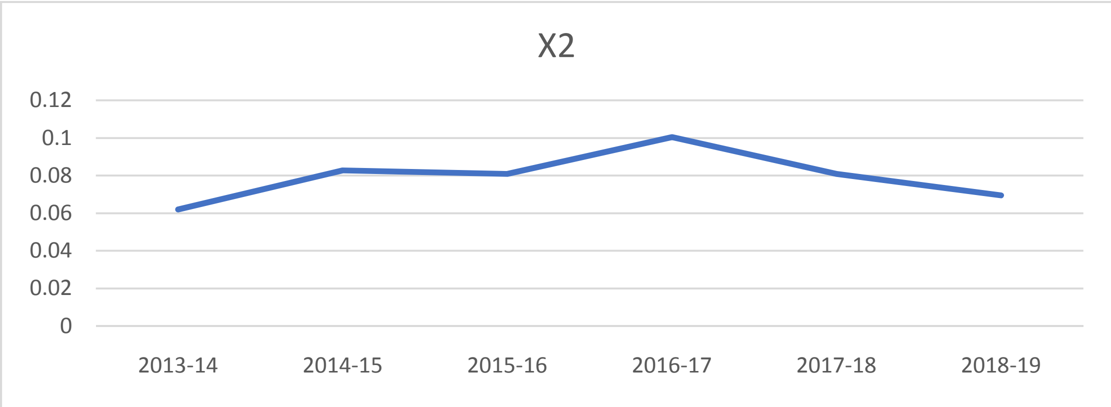

Table 2 and Chart 2: Showing Ratio X_2 for the Period 2013-14 to 2018-19

It measures the financial leverage of the company. The line chart of the ratio between retained earnings and total assets shows a fluctuating trend during the study period. The retained earnings have increased over the years. This could be because of the necessity of capital.This could mislead the investors perception.

X_3 = EBIT / Total Assets

Year	EBIT	Total Assets	X3
2013-14	26.880	1090.2	0.024657
2014-15	32.496	1361.7	0.023864
2015-16	43.025	1652.6	0.026034
2016-17	58.375	2150.6	0.027144
2017-18	-9.685	3124.5	-0.0031
2018-19	-28.561	3808.3	-0.0075

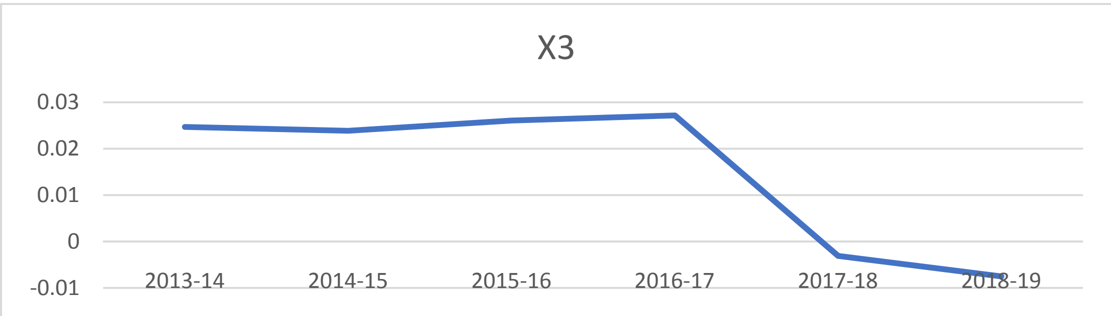

Table 3 and Chart 3: Showing ratio X_3 for the Period 2013-14 to 2018-19

The ratio between EBIT and Total assets has steeply decreased from 2017. This is because of the decrease in operating profit from the financial year 2017-18 onwards. This shows some suspicion in the operations of the bank. Till then the profit was in a continuously increasing direction. This could be because of the unscientific lending practice of the bank which made it fall in the successive year. This one ratio alone cannot be used to come to a conclusion regarding the financial performance of the bank.

X_4 = Market Value of Equity / Book Value of Liabilities

Year	Value of Equity	Total Liabilities	X4
2013-14	712.17	1018.9	0.698932
2014-15	116.80	1244.9	0.093822
2015-16	137.87	1514.7	0.091017
2016-17	220.54	1930.0	0.114266
2017-18	220.54	2650.9	0.083193
2018-19	269.04	3274.8	0.082155

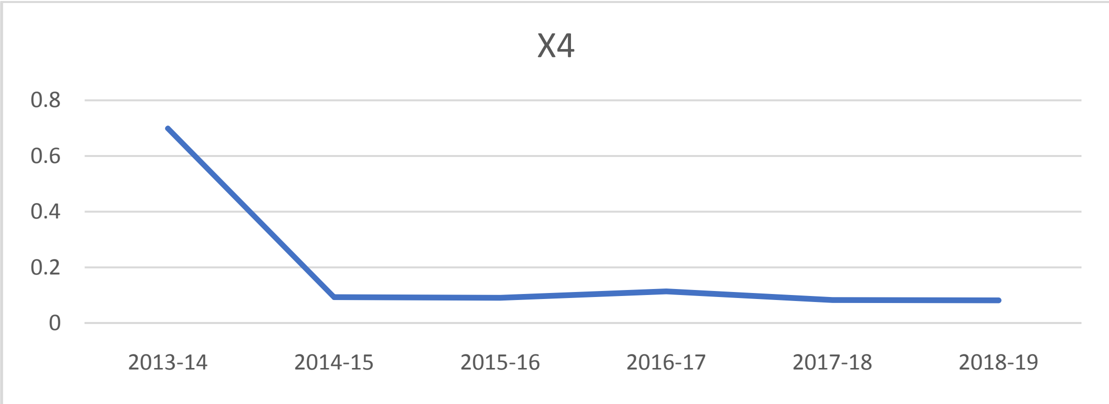

Table 4 and Chart 4: Showing Ratio X_4 for the Period 2013-14 to 2018-19

The value of equity was very high before 2014. It dropped all of a sudden in 2014-15 hence forth was able to sustain slowly till the financial year 2018-19. This never showed any signs of the bad times ahead for the bank. The rest is now history. This is sufficient enough to show that investors were clueless.

Z-SCORE = $6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$

Year	X1	X2	X3	X4	Z score
2013-14	0.74560316	0.06201952	0.024657	0.698932	5.992913754
2014-15	0.752982141	0.08270725	0.023864	0.093822	5.468070077
2015-16	0.756468303	0.08087755	0.026034	0.091017	5.496611131
2016-17	0.76371459	0.1004258	0.027144	0.114266	5.639740724
2017-18	0.722250625	0.0809667	-0.0031	0.083193	5.068436543
2018-19	0.66617632	0.06943113	-0.0075	0.082155	4.632324944

Table 5: Showing ratio Z-score value for the period 2013-4 to 2018-19

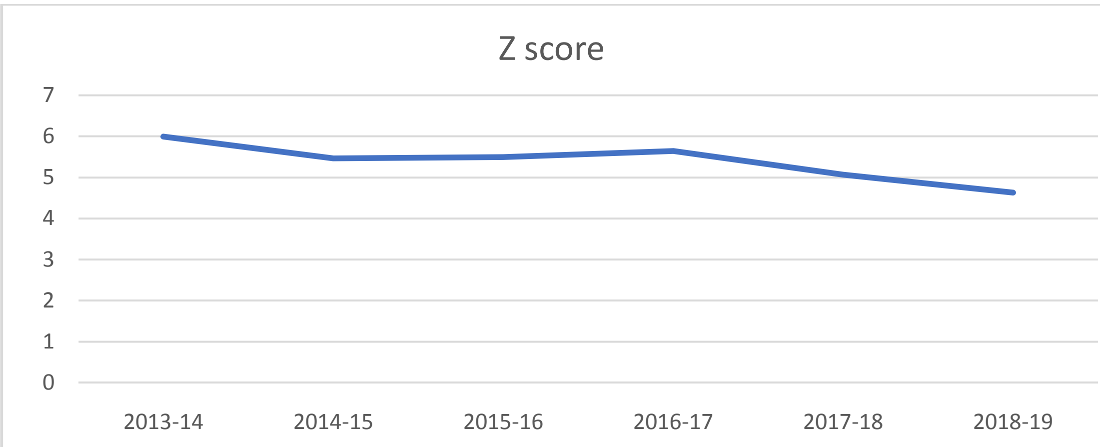

Chart 5: Showing Z-score value for the Period 2013-14 to 2018-19

The z score of Yes Bank Ltd. shows a good sign. Even though the score was continuously dropping during the study period, it never dropped below 2.6. This shows no signs of bankruptcy, distress or any sort of disturbance. Out of the bankrupt companies tested during developing the model only 70%-80% of success was achieved. Yes Bank z score remained high up to the previous year of its going into bankruptcy. A very risky condition for a investor as well as other stakeholders to depend on. This clearly shows that there was no transparency in the accounting practices. Unethical practices were followed by the Board and top level management in the governance and kept the other stakeholders in the dark

One Sample T-Test

One Sample T-Test

		stat	df	p	Mean difference	95% Confidence Interval Lower	95% Confidence Interval Upper
A	Student's t	27.9	5.00	< .001	5.38	4.89	5.88
	Wilcoxon W	21.0		0.031	5.47	4.63	5.99

Descriptives

	N	Mean	Median	SD	SE
A	6	5.38	5.48	0.473	0.193

Table 6: Table showing Descriptive Statistics and t Test

The mean of the z score was found to be 5.38 and standard deviation is 0.473. This shows that the bank had maintained the z score above 2.6 which means good performance according to this model. The z score of the bank failed to predict the movement of the bank towards bankruptcy. Student t-test and Wilcoxon test were performed to get the mean difference of 5.38 and 5.47. The test was performed at 95% confidence interval and found that the p value is less than 0.001 which shows very high significance of the result. The occurance of this kind of an error could be one of the limitations of the Altman's model.

Issues of Ethics in Governance

The Z-score failed to predict the banks movement towards distress even in the previous year. The actual reason for the banks performance was failure of ethics in governance. The internal fight between the promoters and the aggressive lending policy of the bank led towards the downfall of the strong empire. There was report in Business which said that there was around Rs 35,000 crore of stressed loans, most of which was lent in post-2008 period. None of these reflected transparently or evidently in the annual report. The method of reporting it in the annual report itself was wrong. Yes Bank Ltd, lent large amount of loans to companies which were struggling in their businesses. This practice is against the policy. The very purpose of knowing the credit worthiness of the companies is a waste if it is not being used by the lenders and borrowers. These companies included the Anil Ambani Group of Companies, the Essel Group, the DHFL and IL&FS. Out of these companies DHFL and IL&FS have collapsed and now the restructuring plan in on. By the time dispute between the promoters Kapoor and Kapurs settled, the bank had already started heading towards distress and had reached the point where taking a U turn was impossible.

According to UBS, a global major financial services firm, the Yes Bank Ltd, had the strongest growth in loans to potentially stressed companies which was reported on 7th July 2015. According to the report Yes Bank is most vulnerable to a prolonged weak credit cycle. The UBS downgraded Yes Bank's stock to sell as the company was heading to doom. Instead of setting right the loopholes, Rana Kapoor-headed bank moved the SEBI against UBS. After the collapse of IL&FS in 2018, the Yes Bankhad no means to recover. But the major problem was that it was not ready to admit its problems and under reported its stressed loans again thus cheating the public who usually refer the annual reports . This is the reason why z-score couldn't predict any danger.

The bank experienced governance issues like unethical practices in recent years which led to the decline of the bank. Issues like under-reporting of NPAs to the tune of Rs.3,277crore in 2018-19 is one of the many such issues. Even after showing symptoms of distress the RBI constantly tried to find ways to strengthen its balance sheet and liquidity. Yes Bank Ltd had assured that some investors had promised to invest. But in reality it was not true.

Conclusion

With the intervention of the RBI, it is now known, that the Yes Bank has been passing through a financially unsound period for long. In August 2018, the then CEO Rana Kapoor was asked to quit the bank by 31st January 2019. This is because it was clearly proved that the real problem was the unethical governance and source of bad loan practices. After a brief intermediary period, the RBI appointed Ravneet Gill as the chief executive of the Yes Bank Ltd., which was the fourth largest private sector bank before its collapse. Ravneet Gill later disclosed that there had been large under-reported stressed assets in the Yes Bank Ltd which was not transparent. As a result, Yes Bank Ltd. reported its maiden loss in March 2019 quarter. The Bank continuously made efforts to raise capital to infuse fresh lease of life to the bank. It initially planned to attract $2 billion in the current fiscal. But later its board rejected a $1.2 billion investment in the bank by Canadian investor SPGP Group/ Erwin Singh Braich.

The bank's co-founder Rana Kapoor had to sell his entire stake in Yes Bank Ltd, in November 2019, at the time when Yes Bank had turned completely un-bankable. He was taken to custody of the Enforcement Directorate (ED) on charges of money laundering in connection with a case, registered by the CBI. The case is about an alleged bribe of Rs 600 crore by the DHFL to Rana Kapoor family on a quid pro-quo basis for investment of Rs 3,700 crore in DHFL. The non transparency in accounting practices and scam by the promoters actually cheated the stakeholders especially the shareholders.

SBI-led consortium has given a bailout in March 2020 this year thereby giving Yes Bank another chance to get back to business. In the April-June quarter, the bank received the much-needed survival capital through a follow on public offer (FPO).

Good governance is a in-thing which is expected from the corporates.

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