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The Banker's Predicament – A Study In Compliance Backed Decision Making- Saawann Global Industries Ltd.

The case is written by Rajesh Ramakrishnan and Smita Roy Trivedi for the purpose for classroom discussion. The situation and people are fictitious and do not refer to any real-life scenario. The authors do not want to illustrate either effective or ineffective handling of a managerial situation. The data for the case is available in public domain. The authors have no conflict of interest to report. The views and suggestions presented here are solely of the authors, and do not reflect the viewpoint of the National Institute of Bank Management.

Abstract: The case discusses credit and transactional related instances pertaining to Saawann Global Industries Ltd. which could potentially have been identified as early warning signals. Timely actioning could have avoided financial losses to the concerned lending banks.

Key Words: Credit frauds, Trade based Frauds, Early Warning Signals

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The case is meant for classroom discussions and the names of individuals and organisations have been changed in order to maintain anonymity.

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I. PRESENT DAY

It was another hectic day. Mr. Pandey, the Senior Vice President, at Ethical bank, Mumbai had received a top-priority mail from Unit Head, Mr. Jha, which made him pause*¹. Mr. Pandey was heading trade Central Processing Centre (CPC) for the last five years and had an impeccable record for being able to manage growing volumes while keeping a tight grip on quality and controls. The mail informed him that one of the bank's premium customers, Saawann Global Industries Ltd. had submitted a request for two Letters of Credit (LC), covering the import leg of merchant trade transactions. The LCs had been kept on hold due to existing devolvement's in the account.

Mr. Pandey was cognizant of the inherent risks of non-fund instruments like LCs. Any instance of non-payment of committed obligations by the customer would result in devolvement, which would have far-reaching implications with respect to the credit profile and relationship with the customer.

A quick glance at the recent credit appraisal note told Mr. Pandey that the LC request was a regular requirement in keeping with the customer's business model and till date the conduct of the account had been satisfactory.

However, the fact that the escalation has come from the unit head, Mr. Jha, whom he knew to be a prudent officer and an experienced hand in trade finance operations, underlined that the mail required a prompt and considered revert. Though such instances of devolvement, on account of short-term cash flow mismatch of the customer were not unique, Mr. Pandey could think of cases in the past where such issues, overlooked by either the processing or relationship team, later led to avoidable escalations and reporting.

II. THE FACTS

Saawann Global Industries Ltd. had submitted two applications for opening of import letters of credit (LC) for USD one million each. Saawann Global Industries Ltd. was a premium client

¹ * Names and situation presented in this section have been created for the purpose of case discussion. This is a fictitious account of the circumstances.

of the bank with a strong promoter backing (See Appendix A for details). The LC applications were to cover the import leg of merchant trade for purchase of Palm oil from Singapore. When the LCs were received for processing, the same was flagged by the unit head in charge of LC processing as requiring approval from head of trade processing, since there were existing LCs' which were devolved and remained unpaid.

The company had also submitted packing export packing credit application for Rs 50 crores. Though there were no Export Packing Credit overdue, the previous orders had some irregularities. While usually LCs should not be devolved, sometimes companies had temporary cash flow mismatches which led to devolvement. However, such devolvement's were usually regularised once funds were received.

In such instances both the business as well as the credit team were intimated of such devolvments. As long as there was no limit freeze or any instruction to the contrary, fresh LCs were processed. In the present instance however, the team lead and the unit head had indicated that they were not very comfortable due to few facts:

- LCs were for merchant trade transactions covering the import leg
- The reason for devolvement given by the customer was that the export leg receipt was delayed due to some technical issues which would be resolved soon. As such the company timed the transaction such that export proceeds are received prior to import payment due date.
- On further scrutiny some of the documents submitted for the import leg basis, for which the bank had sent acceptances, seemed to have transactional discrepancies.
- There were inconsistencies like port of despatch not matching with the place of issue of BL. The customer had, however, undertaken to accept the documents despite any discrepancies.
- Prior to current devolvement in a couple of instances Lcs had been honored by way of a grant of additional Temporary overdraft pending receipt of funds.
- The company has also availed export packing credit on various occasions which was outstanding as of date. The export packing credit were for the company's main business and not merchanting trade business.

- Few of the packing credit was liquidated against advance inward remittances for some other order.
- There was no matching of export order with the remitting party, most of whom were third party remitters.
- Additionally, company had not submitted any proof of completion of orders for which packing credit was availed or advance received.
- Company had given various reasons such as change of buyer, delay in delivery schedule etc for delays in order execution. Extensions were sought based on such reasons.
- In a couple of instances packing credit availed was immediately transferred to group entities
- Given the fact that there were irregularities as stated above, the team was of the opinion that any fresh disbursement warranted transaction specific approvals from both the business as well as the credit/ risk team.

III. THE DILEMMA

Mr Pandey was aware of the importance of the customer Saawann Global Industries Ltd. and its promoters to the bank. They were customers of the bank since early 2000s. In addition to the main account, accounts of other group companies and subsidiaries too were with the bank. The promoters had their personal banking accounts as well with the bank. The promoters, moreover, were well entrenched in the City's ecosystem having been in business for the last five decades. Their annual Diwali celebrations were attended by all the high-profile members from the city and state.

Mr Jha was in a fix. While he understood the implications of devolved LC's and would have liked to freeze all future transactions till the account was regularised, he was also hesitant to stop further exposure unless he had specific transactional level evidences which showed violation or potential violation of FEMA and sanction terms.

He had been previously been warned, albeit indirectly, about following a too strict interpretation of rules which was resulting in business diverting to competitor banks.

He decided to task his head of trade compliance Mr Mathur to examine the transactions with an unbiased eye and prepare a note either justifying or denying fresh exposure. The same would then be presented by him to top management. Time was running, the client needed the LCs immediately.

IV. Decision to be taken

- Given the facts provided what should be the action taken by Mr Pandey?
- Should he allow the fresh LCs to be issued keeping in mind the relationship value and urgency of the client, keeping the business and credit team in loop?
- Or should he freeze further transactions and request the business and credit team to review the account given the facts presented? Please keep in mind the profile and possible repercussions of such action.

Appendix A

Company Background

Saawann Global Industries Ltd. was incorporated in 1990's. It was part of a well-known business group hailing from Udaipur, Rajasthan. Its promoters were, Mr M L. Lal, Mr. V.Y Lal Mr A.Z Lal. The family was in the business of distilling of alcohol and sold alcohol under its popular brand of 'Tropical.'

The company had roped in several Bollywood stars for its advertisements and had instant recall across the country. The family also had a packaged drinking water business sold under the brand name 'Varsha'.

In 2000 the family business was split up with M.L Lal getting ownership of the alcohol business and his brother V.Y Lal getting ownership of Saawann Global Industries Ltd. V.L Lal did not waste any time in making 'Varsha' the most visible water brand in the country. Young Bollywood celebrities were roped in to gather eyeballs of the target audience which was school and college going students. 'Varsha' was soon one of the largest selling drinking water brands in India generating steady and increasing cash flows for the company.

The Company controlled its activities from its corporate office situated at Udaipur and had branch offices, spread across the country, i.e., in Mumbai, Delhi, Goa and Ahmedabad. The Company catered to both domestic and international market and dealt with clients located in more than ten countries.

In the late 1999 and early 2000s the country's business groups were still getting used to the opening up of the economy and relaxation of various rules and regulations, Foreign Exchange Regulation Act, 1973 (FERA) was replaced with Foreign Exchange Management Act, 1999 (FEMA) and the government was generally trying to provide a business-friendly atmosphere with minimum interference, all to boost the country's economic sector. It was in this phase that the promoters of Saawann Global Industries Ltd. decided to branch off into new business which promised a quick and high rate of return with minimum investment.

The company soon branched off into trading of agri-products, metals, ores, minerals mall development, mouth fresheners, among others. The company soon identified merchant trade transactions as an instrument to take advantage of the price differences across markets internationally. Soon the company had diversified into three primary business streams.

- Sales of packaged drinking water- its main bread-and-butter cash flow business.
- Domestic procurement of Agri products, minerals, ores, diamonds, soyabean etc
- Merchant trade transactions where the company acted as an intermediary between buyers and suppliers in different countries with no actual goods reaching Indian shores.

Appendix B

Banking arrangement

Outstanding of Saawann Global Industries Ltd. on the date of the transaction:

<i>S.No</i>	<i>Type of facility</i>	<i>Limit (Rs crores)</i>	<i>Present outstanding</i>
1	Fund based limit	250	200
2	Non-Fund based limits	1000	800*
3	Total	1250	1000

*Devolvement: 50 Crores.