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Ethical issues in marketing of Financial Services – with special reference to banking

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Abstract

Financial services, especially banking, play a very important role in the growth of world economies. The boom in these services has led to increase in competition. A multitude of companies and firms have replaced the conventional few big ones. Increased competition means that firms have to strengthen their marketing techniques and tactics to increase their customer base and market presence. From on air TV ads to digital ones to billboards to direct marketing calls, these firms leave absolutely no stone unturned to capture the attention of the prospects. The underlying goal is quite clear – profit maximization. However, spending big bucks doesn't always guarantee strong returns. To minimize losses and make quick profits, many of these firms/banks often resort to unethical practices.

The marketing plan of firms is based on the 7Ps marketing mix. This paper highlights the vices of engaging in unethical practices especially, in banking industry, by compromising two of the most important Ps of the marketing mix – People and Processes. A case study is built around PMC bank by gaining information from various secondary sources mainly newspaper reports.

Keywords – ethics, banks, marketing, services, people, processes.

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Introduction

The herald of new millennium is lauded for increasing the pace of technological developments and ushering in a new wave of innovations that have touched every part of human existence. Industries – medical, automobile, textile, ICT- have gained such unprecedented momentum that it is difficult to identify any other time in man's history which can rival it. The fast changing world has also brought in its wake a new age customer – one whose demands are not easy to satiate. He is constantly looking out for new products and services and only those companies seek to benefit from him which can not only placate all his needs and demands but also delight him.

Financial sector, too, faces similar situation. Companies have to reach out to customers through marketing efforts aimed at enticing the customers into buying their products and services. The added pressure of competition means that the marketing orientation of the companies has to be such that it is able to secure a lofty share in the marketplace. However, it is important to realize that marketing plan of financial products have to be tailored in a distinct manner which makes it easy for the consumers to understand the product/service as people often suffer from low levels of financial literacy.

Financial Services

Ravindra (2014) has defined financial services as, "the services which facilitate deposits, loans and other financial investment or claim". Financial services are those services which focus on people's intangible assets – money or wealth (Ennew, Waite & Waite, 2018). The goal is to compel people to use their savings for investment purposes.

There are many companies and individuals who are in need of money and there are others who sit on a pile of money lying in the form of savings. Therefore two distinct groups of individuals /organizations can be identified:

1. Fund surplus

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2. Fund deficit

Financial services utilize the dormant power of the funds lying unutilized with the fund surplus group (in the form of savings) by transforming them into investments which become available to fund deficient groups in the form of loans and credits. The financial services include loans, credit cards, insurance etc. and the service providers are banks, credit card companies, insurance companies, stock brokers etc. the financial services enable mobility of savings.

Marketing

Marketing is defined as "the human activity directed at satisfying needs and wants through an exchange process" (Kotler, 1980). A more comprehensive definition of marketing is "the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organizational goals" (American Marketing Association, 1985). It is the process by which the needs, wants and desires of the consumers are identified and satisfied. By doing so, marketing enables the economy to grow. Very often people associate marketing with strategy making alone. The idea of marketing being limited to only devising a strategy for sale of goods and services is quite misleading. It is more of a philosophy that guides an organization in decision making and other aspects that help an organization to reach out to the customers in an effective manner (Cowell, 1985). Another way of looking at marketing is by considering it to be a medium that matches company's expertise to customers' expectations (Morgan and Hunt, 1994). Marketing helps an organization to direct its resources – human, physical and financial – to the requirements of its customers (Christopher & McDonald, 1986). Marketing enables companies to maintain relationship with customers by delivering them their needs at a profit (Berry, 1986; Gronroos, 1978). It enables a symbiotic relationship between the service provider and the customer by developing resources which bring benefit to both the parties involved (Ohmae, 1988). Marketing is by no means a static function; on the contrary, it is dynamic in nature (Baer, 1975). The dynamicity is derived from the changing nature of demands and expectations of the consumers. In fact, it is much more than a function; it has evolved into an all-pervasive way of doing business (McKenna, 1991). The evolution of marketing, in its present state, is because of the paradigmatic shift in marketing

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from a production oriented concept to consumer oriented concept. So over the years the spotlight has shifted from understanding customer needs to anticipating them.

An important concept related to marketing is Marketing mix. Marketing Mix is defined as “the set of marketing tools that the firm uses to pursue its marketing objectives in the target market” (Kotler, 2003). The concept of marketing mix was suggested by McCarthy (1964). He identified the components of marketing mix in terms of 4Ps (Bennett, 1997). The 4Ps of marketing mix are – Product, Price, Place and Promotion. The Marketing Mix provides a framework to managers that help them to make important decisions regarding key aspects of their products (Sanghvi, 2014). It streamlines the process of designing a marketing plan for a product by identifying the key attributes for decision making so as to tailor a product to the needs of the customers. Just like it is important to identify the key ingredients and their proportion for making a recipe, it is important to identify the constituents of a marketing plan. The 4Ps are the constituents/ingredients of the marketing plan (Goi, 2009). They tell the marketers just how to make their products more appealing and suitable to the customers and a right understanding of marketing mix has the power to greatly alter the competitive position of a firm (Gronroos, 1994). However, the 4Ps Marketing Mix has been often criticized often for its various shortcomings (Constantinides, 2006; Popovic, 2006; Rafiq and Ahmed, 1995). 4Ps marketing mix has been found to be suitable only for product marketing. Strong criticism was voiced against its non-suitability for services marketing and strong propositions were made for extending the scope of marketing mix to make it suitable for services (Bruner, 1989; Doyle. 1994). Hence, the need for a new marketing mix for services marketing.

Services and Marketing of Services

Services marketing is a sub-type of marketing. It is that branch of marketing which deals with marketing of services (Jha, 2000, p.10). Services marketing has, over the years, gained more prominence due to the large scale dependence of world economies on service sector. It is estimated that service sector contributes close to about two-thirds of the GDP globally (Johann, 2015). In developed parts of the world such as the USA and the European Union, services account for more than 70% of the economy[1]. As a result, services marketing is expanding rapidly and greater stress is being laid on improvement of services.

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This increased importance of service sector has brought attention towards the meaning of services and what constitutes services. There are multiple definitions of services, some of which are as follows:

Kotler (1990) has defined services as, "Any act or performance that one party can offer to another that is essentially intangible and does not result in ownership of anything. Its production may or may not be tied to a physical product."

American Marketing Association (1960) has defined services as, "Activities, benefits, or satisfactions, which are offered for sale, or provided in combination with the sale of goods."

Gronroos (1990) has defined services as, "A service is an activity or series of activities of more or less intangible nature that normally, not necessarily, takes place in interactions between the customer and service employees and/or physical resources or goods and/or system of the service provider, which are provided as solution to customer problems."

In simple terms services are those activities/benefits/offerings delivered to the customers which are essentially intangible in nature. There are four distinctive characteristics of services:

1. Intangibility – It means that unlike goods, services cannot be identified by physical senses. A physical entity can be experienced by any or all of our 5 senses; for example, a TV can be touched, seen or even heard. But hospitality can only be experienced.
2. Inseparability – It refers to simultaneous production and consumption of services. In case of goods, production often takes place at a location different from their actual consumption. For example, a phone made in a remote location of China is sold in Western Europe.

[1]https://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx

3. Inseparability - In case of services, there is no clear separation of production and consumption. For example, in case of classroom teaching there is simultaneous sharing and absorption of ideas.

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4. Heterogeneity – It means that there is great variability in the service quality. In case of tangible goods, the quality remains more or less constant for all the units of particular product. For example, chocolate produced by a certain brand would be subjected to same quality checks leading to consistency in quality of all the individual units. In case of a service such as hair cutting, the experience varies depending on variables such as time of the day, the products used etc.
5. Perishability – It means that services, owing to their intangibility, cannot be stored/stocked or returned. Goods can easily be stored for future use but services cannot be treated the same. For example, the food sold to a customer in a restaurant cannot be resold.
6. No transfer of ownership – The sale of a product leads to transfer of ownership of the product from the seller to the customer. However, there is no such transfer of ownership for services. For example, one may hire the service of a cook in exchange for money but that does not mean that the one who hires him gets to own him.

The uniqueness of services renders the traditional 4Ps marketing mix inadequate. Consequently, need for services marketing mix was felt. The services marketing mix or the 7Ps marketing mix adds three more Ps – People, Process and Physical evidence- to the traditional 4Ps marketing mix (Booms and Bitner, 1981). The 3Ps were added to suit the intangible nature of services and account for the considerable human involvement. People (in service marketing mix) refers to the personnel involved in designing and delivery of services. For example, the staff in a hotel is its “people”. Process refers to activities and procedures which are part of the delivery of the services. Physical evidence refers to the tangible associations of the service such as furniture, décor, brochures etc.

Ethics andMarketing of Financial Services

Economic growth and development is a continuous pursuit of the economies world over. The promise of development that financial services hold makes them extremely lucrative (Anand and Murugaiah, 2004). Consequently even the comparatively closed economies of Asia have turned to liberalization of their financial sector. The opening up of world markets globally has expanded the scope of financial services. Technological developments in the last few decades have gained such accelerated momentum that every industry has undergone a facelift and financial sector is no exception. In such exceptionally fast changing world, the demands of the consumers are rapidly changing and their expectations from the service providers are on an upward swing. The only way for a service provider to gain foothold in the marketplace would be by keeping track of the pulse of the consumer along with keeping them informed about the offerings of the company. This is where marketing steps in.

Marketing financial services is quite tricky due to three additional characteristics – fiduciary responsibility, duration of consumption and contingent consumption (Ennew, Waite & Waite, 2018). Fiduciary responsibility means that marketers have to be extra careful with respect to management of funds and the financial advice they provide. This added responsibility is derivative of the fact that not everybody out there has adequate financial literacy. Another reason is that people tend to put their trust in financial institutions so the way they manage their funds can have a huge impact on the consumers' lives. Contingent consumption means that the money spent does not lead to immediate realization of benefits. The consumption may be delayed as in case of health insurance or may not occur at all (e.g., life insurance). So the association of customers with financial service providers is usually long term owing to the nature of financial products. This provides a great opportunity to marketers to derive maximum mileage by cross-selling products through relationship marketing. Services, owing to their intangibility, depend highly on advertisements (Rust and Chung, 2006).

The increased dependence of consumers on financial institutions and financial advisors brings into play the role of ethics. Ethics are universal in nature in the sense that they impact everybody (Koontz&Weihirich, 1993).Ethics is defined as a set of rules or moral principles that helps a person to distinguish between right and wrong (Velasquez, 1996). Marketing ethics investigate morality of marketing practices with respect to 4Ps such as safety of products, fair pricing, truthfulness of claims advertised and bias in distribution (Smith & Quelch, 1996).The role of ethics in marketing of services has received great attention over the years as intense competition provides wide scope for indulging in ethical violations (Kennedy and Lawton, 1993). This is especially true when marketers rely on relationship marketing for intensifying trust building efforts with customers which clearly has ethical dimensions (Whysall, 2000). Mittal et al. (2014) have identified some of the factors of unethical behavior in services marketing. These include technical knowledge deficit of consumers about services, absence of warranty or guarantee and scope for influencing customer decisions through fear and greed. Ethical behavior is much valued and important in financial sector where reputation can impede or strengthen revenue stream (Brickley et al., 2000). Unethical practices have for long plagued financial sector (Talwar and Ali, 2016). Some of the common unethical practices in marketing of financial services include non-disclosure of facts, aggressive selling of unsuitable products to the customers, falsification of facts etc. (Ravindra, 2014).

Banking and Need for Ethics

Banks form the cornerstone of the financial system (Sunayna and Kaur, 2017). There are multiple functions performed by banks in the financial system ranging from mobilization of resources to development of priority sectors (Alagarsamy and Wilson, 2013). They primarily foster conversion of savings into investments thereby providing credit to the investors and act as an intermediary between the depositor and creditor. There are multiple other functions of the banks in consonance with the above stated ones such as issuing travelers' cheques and letters of credit (Goyal and Joshi, 2011). So there is real need of banks being ethical in transactions (Solaiman et al., 2007). Ethics are of supreme importance in securing a strong financial system (Baumgartner and Rauter, 2017). Banks should not succumb to the pressure of high performance at the cost of integrity (Carse, 1999). Maintaining integrity is the hallmark of an ethical organization (KPMG, 1999). The complexity of bank transactions coupled with inadequate technical knowledge of customers puts them in a vulnerable position leaving them with no option but to place their trust in the banks(Khan, 2002; Frenkel and Lurie, 2003). Bankers should realize that they are responsible for safeguarding the trust of the customers (Bozovic, 2007). A bank should never take for granted the trust that their customers have placed in them as any complacency in this regard can throw them out of business (Chiami and Fullenkamp, 2002). Consequently bankers should realize their social responsibility and carry out business in an ethical manner (Sunayna and Kaur, 2017). Trust deficit among customers continues to be a relevant issue in the banking industry. A dearth of ethical culture and responsible behavior in the

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banking industry is the main cause of the trust deficit (Nienaber et al., 2014). The financial crisis of 2008 in USA has its genesis in the irresponsible decision-making of the banks (Fair, 2009). If such a situation is to be averted in the future, then banks will have to let go of fraudulent practices and irresponsible behavior. The aim of the banks should not only be restricted to profit maximization but should also include human and environmental well-being (Goyal and Joshi, 2011).

Literature supports the claim that banks that uphold ethical standards are found to hold more attraction than other financial institutions (Cowton and Thompson, 1999; Kitson, 1996). This is because ethical practices translate into higher customer satisfaction which strengthens competitive position of an organization (Holme,2008). A socially responsible organization is synonymous with good reputation, high returns investment portfolios and highly productive employees (Carroll, 1991). Unethical practices create customer dissatisfaction (Ferrel, 1989). Customer dissatisfaction leads to customer attrition. It is all about being truthful to the customer. Loss of customers is a loss to the firm as the company then has to shell out more money to acquire new ones. An ethical organizational culture holds great importance in financial institutions because of the power to make transformation possible in an organization (Schneider et al., 2013). It provides a positive reflection of the image and personality of the organization. An organization turns more profitable by adopting an ethical culture (Baumgartner & Rauter, 2017). Companies that are ethical save billions of dollars each year as they are not party to any lawsuit against them for unethical practices such as theft (Frooman, 1997). A firm based on ethical values is likely to attract employees who stand committed to the welfare of the firm they serve (Hunt et. al., 1989). This gives all the more reason to firms to adopt ethical culture as it serves to benefit them in the long run (Chowdhury, 2011).

Ethical Violations in Bank Marketing

Ethical marketing is a philosophy that seeks to avoid unfair practices in marketing. The goal is to promote ideals like honesty and responsibility in all marketing activities (Sunayna and Kaur, 2017). In an attempt to gain maximum share of the market pie, banks often resort to unethical

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marketing practices. Such practices not only endanger the interests of the customers but also put to stake the reputation of the bank. The ethical issues of bank marketing can be understood with the help of the following variables of the 7Ps marketing mix:

Products: Banks design a lot of products for the ease of the customers. These include things like credit cards, debit cards, letters of credit etc. Many of these products are so complex that it is difficult for an ordinary person to comprehend them. The technical complexities of the products make it easier for the banks to entice the customers in buying their products which aren't suitable for them. Investigations by Financial Services Authority (FSA) of America found serious fallings in the conduct of the high street banks such as Barclays and HSBC in the way complex financial products had been sold to clients which were not at all meant for them (Central Finance Board of the Methodist Church). Banks, while offering products, should stick to principles such as honesty, integrity, fairness and social responsibility. Complex financial products should mandatorily have all the disclosures accompanying the product mentioning clearly the suitability of the product. This would help in educating the customers and also increase transparency.

Price: In service industry, price refers to charge on services (Ravindra, 2014). In banking industry, charges manifest in the form of interest rates, fees, commissions etc. In order to extract even the last penny out of the customers, banks often charge unjustified and exuberant interest rates on loans and other financing activities which make them culpable of usury (Sunayna and Kaur, 2017). Usury is defined as the practice of demanding unjust and excessive amounts of interest/charges to the customer. Another form of usury is pushing customers towards irresponsible credit at sky-high interest rates. Other instances include deductions from customer's account without consent. In a court case, Coimbatore court ordered a bank to compensate the aggrieved customer Rs 14000 for deducting Rs 12 from the customer client without obtaining consent (Revathy, 2016). Although deductions may be small and erratic, yet they amount to violation of the client's trust. Other price related issues include hidden charges on products like credit cards. There should be a clear disclosure of the charges associated with the product so that the customer can make an informed decision.

Place –In services sector, Place encompasses not just decisions located to the location but also the distribution channels. The distribution channels of a bank are its ATMs and salespersons. For products, such as insurance, mutual funds and SIPs (Systematic Investment Plans), there are

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specialized personnel such as the agents and advisors. This leaves the customers susceptible to mis-selling by the bank personnel who quite often use deceptive techniques such as misrepresentation of facts about the product (Singh, 2016). A case in point is that of Ms, Suchitra Krishnamoorthi who found herself victim of unscrupulous activities of the bank personnel. She was swindled off Rs 2 crore of the total Rs 4 crores of her wealth that was being managed by HSBC bank (Halan, 2013). SEBI (Securities and Exchange Board of India) had to serve a show-cause notice to the HSBC noting that this was a case of mis-selling of unsuitable mutual funds which the bank then used for earning commissions (Tiwari et al., 2017). With advancement in ICT, banks have taken big time to internet banking. On one hand, it has facilitated customers' bank interactions; on the other hand, loopholes in the technology leaves them vulnerable to cyber thefts and privacy breaches. The banks are known for not owning up to any of these breaches leaving the customer utterly helpless. Also, a general laxity is noticed in upkeep of ATMs and bank branches. Long queues outside ATMs are a constant fixture owing to the frequent breakdown of the ATMs causing great inconvenience to the customers and general public.

Promotion – Advertising and personal selling are two of the most popular promotional tools of banks. Personal selling takes place through face to face interaction of customer with the bank personnel. Unethical practices in this case include hiding of facts regarding the financial product or aggressive selling of a product to the customer. This causes loss of wealth and enormous financial discomfort to the customer. Selling ahigh risk portfolio to a naïve customer without disclosure of the risk factor is one of the many deceptive tactics that bankers use to earn commissions and fleece the customers of their hard earned money. It is important to present an honest summary of the risk and return associated with a financial product/service.

Misleading claims in the advertisements and falsification of information are serious ethical violations that have been making headlines worldwide. A common advertising technique of misleading the customer is through bait- and – switch tactics. It involves advertising a product/service at an attractive/reasonable price and just when the customer is ready to buy it, the bank informs him that the product/service is no longer available; instead he is pushed towards a higher priced product (American Bankers Association, 2016). It is no wonder then that the Bank of America had to pay $727 million to customers for engaging in deceptive marketing of a pair

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of credit card protection products as per a ruling of the Consumer Financial Protection Bureau of USA (Truth in advertising, 2020).

People – The sales staff, the bank personnel involved in client interactions and others who are involved in the design of its financial products/services are its “people”. It is they who are responsible for securing accounts, investments, portfolios and deposits for the bank. The banking business rests on their shoulder. From the customers’ perspective, they are the ones who guide them in making prudent choices about the purchase of financial products/services. So a lot of responsibility rides on them. But not everybody in the business understands this responsibility. To them a customer is nothing more than a lucrative business opportunity which needs to be exploited in every possible manner to derive the maximum profit home. As such, a significant number of unethical practices thrive among them. These include – 1) complicating the design of the product/service to oversell its usefulness at a premium and 2) aggressive selling of irrelevant and unsuitable products. Other issues include high handedness of the staff when approached for resolving a problem and citing of procedural protocol to avoid complete disclosure of facts associated with a financial product/service.

Process – Any set of activities that are targeted towards a specific purpose are said to encompass a process. Since banks are by themselves such complex entities, they entail processes which are equally, if not more complex. Even simple processes such as opening and closing of a bank account is time consuming to the extent that it drains a person completely. Even though banks have turned digital now, yet there is a long way for all processes to become hassle free which should be one of the important goals of a financial entity. Other bank processes which prove to be vexing and often find mention in the customer complaints is constant change of terms and conditions to suit the interests of the bank (Ravindra, 2014). Another instance of banks making the whole banking experience nightmarish for customers is when customers reach out to them for resolving an issue and the banks constantly spin them from one customer executive to another. This attitude of indifference may seem trivial to the banks but they leave a bitter taste with the customer. In today’s competitive times, even one instance of complacent service is enough for a customer to shift loyalties to another bank.

Physical evidence – It refers to all those features which make a service turn into more of a tangible entity. For example, bank services are intangible but bank branches and ATMs are

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tangible. Banks put up their branches with really high quality and expensive infrastructure in prime locations in the city to attract customers. But in the garb of all this, they try to mislead the customers by practices such as false presentation of key information. This is unethical and amounts to gross violation of the customers' trust.

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Case Study – PMC Bank

Introduction

Indian banking system has for long enjoyed the image of one of the most robust banking systems anywhere in the world. Even in 2008, when the world was reeling under recession, India seemed to have had only the mildest impact. This, to a large extent, was due to the stability provided by its effective banking system. This, however, does not mean that it is completely fool-proof; there have been quite a few instances in the recent past where the country has been rocked by bank scams. The government, on its part, has been trying its best to plug the loopholes. However, these scams are not just due to erroneous judgement but it's due to the failure of the one the most important components of the service marketing mix –People. Greed has taken over ethics and bankers are increasingly falling prey to this evil resulting in frauds and embezzlements.

PMC bank fraud discussed in this case study illustrates how the bank management engaged in financial misappropriation to gain personal mileage. Rules and regulations took backseat while personal gain and wealth making was chosen to be the goals. Initial estimates put a figure of Rs 4635.62 crores to the scam but investigations revealed that the amount was over Rs 6600 crores. It is not just the scale of the scam but also the sheer disdain for rules and ethics shown by the perpetrators (which in this case was the top bank management) that is both appalling and alarming at the same time.

About the Bank

Punjab and Maharashtra Co-operative Bank (PMC bank) is a state run co-operative bank. The bank was established in 1984. Its presence spans over half a dozen states. There are close to about 137 operational branches and over 9 lakh depositors. The bank has a stronger presence in Maharashtra where it has about 100 branches. It has been successfully able to keep pace with the digitization of the modern world and has well adapted electronic banking to provide the latest value added services to its customers. The bank website mentions quite a few laurels to its name:

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1. The youngest bank in India to achieve the Scheduled Status.
2. Nine times recepient of the Padmabhushan Vasantdada Patil Award for the "Best urban Co-operative Bank", awarded by the Maharashtra State Co-operative Banks' Association Ltd.
3. Recipient of the "Special Jury Award" from NPCI. The award was conferred for maintaining the lowest dispute ratio in co-operative banking sector and for the lowest unscheduled downtime in 2012.

Unfolding of the Scam

The fateful day of 23rd September 2019 remains engraved in the minds of the lakhs of customers of the PMC bank as the day their bank dashed their hopes and dreams and left them virtually penniless even when lakhs of rupees remained locked in their accounts. All this for no fault of theirs except for maybe one – they had sought to place their savings and trust in a bank which they thought would safeguard both. To them there was no reason why their withdrawals were capped at Rs 1000 for duration of 6 months by RBI when they clearly had no role or even inkling of the financial irregularities that their bank had been engaging in for long.

This created frenzy among the customers who felt that they were being made to pay the price for the mistakes of the bank. There was widespread public and media outrage at the apathy of the government towards the customers. The Mumbai branches witnessed complete chaos outside their gates with customers demanding that they be allowed to withdraw their deposits and the guilty be punished. India, had in the past too, been rocked by multiple financial scams where the culprit was allowed to go scot-free and it was the taxpayers who had to bear the brunt. This time around the public was not ready to let the whole debacle be met with a quiet burial. The customers formed a delegation which went on to file a complaint, at Sion police station in Mumbai, against the bank officials for engaging in fraud. The same day RBI increased the withdrawal cap to Rs 10000. The amount was subsequently revised to Rs 25000, Rs 40000 and Rs 50000 by November 5, 2019. The move was aimed to ease the problems of the customers. In a latest development, RBI has extended the restrictions till June 22, 2020.

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Soon there were revelations of the involvement of a company named HDIL in the fraud. Consequently, an FIR was filed against the former bank officials and promoters of HDIL in PMC.

The Genesis of the Crisis

The origin of the crisis dates back to 2008. It was around this time that the bank started lending loans to a now bankrupt real estate developer company named Housing Development and Infrastructure Ltd (HDIL). HDIL was mainly involved in projects related to slum rehabilitation in Mumbai. These projects did not really take-off well leading to great financial strain and ultimately bankruptcy of the company. The bank continued to fund the company even when its financial position had turned weak and the company had started to default on its payments. At no point of time, the PMC made any disclosure about HDIL turning into a Non-Performing Asset (NPA) for the bank. The bank continued to be its lender even when HDIL was defending itself against the insolvency proceeding in the National Company Law Tribunal (NCLT). All this was done in great secrecy. The earlier estimates pegged the total risk exposure to about Rs 4635.62 crores; however, it was later revealed in the course of the investigation that the bank's loan exposure to the beleaguered firm was over a staggering Rs 6500 crores. It is interesting to note that RBI mandates that a bank should restrict its single entity exposure to about 15% of its capital fund; for PMC, the exposure to HDIL was about a whopping 73%. This is no casual contravention of the rules and guidelines but a clear indication of the connivance of the bank officials with the HDIL top-honchos with the sole aim being personal profit.

How did the PMC bank officials manage to hood-wink RBI?

To understand the mechanism of deception adopted by PMC to disguise its dealings with HDIL, one needs to understand the relationship between the two entities as that would explain the reasons as to why the bank sought to create a smokescreen over its nature of business with HDIL.

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It was an old association between the bank and the Wadhawans that culminated into one of the biggest bank frauds to hit the country in recent times. PMC, which started operations in 1984, did not have a steady start. By 1986, the bank was soon in crisis and was on the verge of closing down. It was then that the bank was redeemed by Rajesh Kumar Wadhawan, who at that time was a director of Land Development Corporation and many other companies run by Dewan family (Dewan Housing Family Limited). He revived the collapsing bank by pumping in as much as Rs 13 lakh that year. Besides, the family also kept substantial deposits in the bank. This kept the bank afloat. At another time, in 2004, when the bank was once more in troubled waters, it was again the same messiah Rajesh Wadhawan who came to rescue. He put in a massive amount of Rs 100 crores into the ailing bank just to keep it sailing. This gave fresh impetus to the otherwise dying bank and the crisis subsided. PMC won back its customers and garnered many others in the process. It had been saved from the doom.

The relationship between the bank and HDIL flourished. HDIL had a successful business and it made PMC its exclusive banking partner. It would pay an interest rate of more than 20% to the bank. This helped in sky-rocketing the bank's profitability. The bank's ambitions rose and its branches sprung up in multiple locations across the country. It even acquired three other cooperative banks. The relationship was mutually beneficial to the two concerned parties.

The bank was delighted to have HDIL as its client. The relationship brought so much profitability to PMC bank that the bank feared losing its prime client to other banks when HDIL started extending its banking network to other banks. It readily overlooked all its financial woes that had begun to plague its most sought after client. Incidents which should ordinarily alert a lender bank about a client's deteriorating financial health were happily neglected and not brought to the notice of the shareholders and the board.

It was during 2012-13 that HDIL started defaulting on its payments to PMC. It was around this time that the fortunes of Rajesh Wadhawan began to dwindle. The prime reason being that the big project which he was counting on, slum rehabilitation near Mumbai International Airport Limited (MIAL), was cancelled. Soon, the company started defaulting on payments to all the banks. The company could no more raise fresh capital from these banks for their other projects. As such, the other projects too had to be cancelled. The company soon started facing insolvency cases by multiple lenders including Andhra Bank and Jammu & Kashmir Bank. But PMC kept

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lending more and more money to it. As a matter of fact, it was the PMC bank that bailed it out by approving a loan of Rs. 96.5 crores when another bank - Bank of India - sought to drag the company to court and initiate insolvency proceedings against it. This act of the bank should have immediately brought it under the scanner of RBI. But the bank chose to hide it in order to protect its own interests. Clearly, the bank's top management wasn't interested in making the revelation as its own chairman S.Waryam Singh was himself no less than a director of HDIL! This in itself is a violation of RBI rules as conflict of interest becomes quite inevitable in such cases. He had been on the board of the company for a total of nine times from 2006 till 2015. He had also amassed two percent stake in the company during this period. He was part of the committees/boards that had approved loans to HDIL. As a rule, the bank should have promptly classified these loans as related –party transactions but the bank thought better of it. This was not a case of momentary lapse of judgment but a clear case of greed overtaking morality and principles.

This, however, begets the question. "What exactly was the modus operandi used by the bank to pull wool over the RBI's eyes?"

To escape RBI's attention, PMC had fabricated over 21000 accounts to hide 44 loan accounts of HDIL. PMC created this façade to escape the regulator's detection. It did not just stop here. An elaborate net was woven to conceal the defaults. The bank did not record the loans in their core banking system software/MIS called Opine. The MIS had been tampered to the extent that it could not include HDIL accounts as NPA or flag them in the overdrafts list of accounts. Out of a total of 1800 employee, only about 25 were given special codes to access HDIL accounts. This restricted visibility to others and the likelihood of the scam being busted was thus minimized. Surprisingly, these discrepancies were not even picked up by the concurrent auditors of the firm and their role too is being investigated and a few of them have been arrested as well. The bank resorted to cooking up of account books to mislead the regulator RBI and for quite some time the bank appeared to be successful in this pursuit as the RBI fell for what appeared to be a healthy balance sheet. All this happened with the complicity of the top executives of the bank including the now sacked managing director and Chief Executive Officer Joy Thomas. He confessed to the bank's misdeeds in a five page letter to the RBI, dated September 21, 2019.

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RBI continued to trust the bank until around 2017 when the offsite inspections by the regulator raised doubts. RBI then demanded old records from PMC. The bank again resorted to fudging the accounts book and gave a slip to the regulator. It is believed that a team of six people was actively engaged in fudging the accounts

This continued till again in September 19, 2019 when RBI restarted its inspections. Around this time, someone from this core group tipped off the regulator, in a letter, about the wrongdoings of the bank. This proved to be the flash point for the RBI imposed crackdown and the regulator finally cracked its whip on the bank on September 23, 2019. While the earlier withdrawal limit was decided to be Rs1000, it was capped to Rs 10000 only after the regulator had thoroughly analyzed the mean deposit pattern. The analysis brought to light the information that close to about 64% of the depositors had upto Rs 10,000 of deposits.

Investigations revealed that hiding information from RBI is not a new practice at the bank. The whole practice started around in 2008 when PMC did not reveal some of the large accounts to the regulator in an attempt to keep its image tarnish free. Again in 2011, out of a total of Rs 2000 crores that the bank had lent to various companies, close to about Rs 1,026 of advances were given to HDIL. Clearly, the bank did not think much of the rules even back then!!! Another interesting point about these advances, as claimed by Joy Thomas in his letter, is that the bank chose not to classify them as NPAs as that would have prevented them from charging interest and thus compounded the losses. Also, the disclosure would have brought a death blow to the bank as the reputation would have dealt a serious blow and led to subsequent closing down of the bank.

Impact of the Scam

1. **Impact on Depositors** – The depositors were the worst sufferers of the whole debacle.Not only did they have to come to terms with the fact that the bank they had trusted for so long had chosen to brazenly engage in fraud but they also had to bear the brunt of an enforced liquidity lockdown that prevented them from having full access to their own money. It was not just savings account holders, but also business establishments who had their current accounts in the bank. They, too, could not access

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their accounts which meant that they could not pay their employees or meet other expenses such as rent payment. For some the shock was too much to bear and there were reports that a few lost their lives because they could not pay their medical bills in spite of having lakhs in their accounts. The intense speculation over the future of the bank also meant that the customers had to face the anguish of uncertainty. Capital distress, along with trauma, have caused many to raise questions about the stability of the banking system in the country.

2. **Impact on Banking Sector** – The collapse of PMC Bank has stirred fear among the depositors about the safety of their money in banks in general especially in private banks and cooperative banks. It has sparked a widespread crisis of confidence in banks and has also brought to fore the instability of banking system in India. These fears were exacerbated when a few state governments started circulating guidelines about being careful when depositing government funds. It also raised questions about the efficacy of RBI as the regulator of banking sector in the country. There were questions like, "How could a cooperative bank engage in a scam of this scale right under the nose of RBI?", "Why should the public face problems for the incapacity of the regulator to make timely detection of the wrong doings of the bank?" A multitude of such questions damage not just the reputation of the banking sector in the country but also raise doubts about the effectiveness of the RBI. The government and the RBI would have to engage in a lot of trust building initiatives to bridge the trust deficit among the customers.

3. **New norms and legislations–** In an attempt to boost the depositors' confidence, the government has made a five-fold increase on the insurance cover on bank deposits. The earlier insurance cover of Rs 1 lakh was heavily criticized especially in the wake of the PMC scam. There were loud demands for increasing the insurance cap. Consequently, the government increased the insurance cover to Rs 5 lakhs. This insurance cover ensures that a depositor receives a total amount of Rs 5 lakhs in case his/her bank goes bankrupt. This amount remains the same irrespective of the amount of his deposit. However, the downside is that if a bank goes bankrupt then a person having a deposit of Rs 10 lakhs

and another depositor having a deposit of Rs 1 crores, would both get an insurance cover of Rs 5 lakhs only.

Additionally, many other curbs have been imposed by RBI on cooperative banks. These include measures like mandatory reporting of credit information for those Urban Cooperative Banks which have total assets of worth Rs 500 crores and submission of information to Central Repository of Information on Large credits (CRILC). CRILC is maintained by RBI.

Another important development is that the government has sought to introduce The Banking Regulation Amendment Bill 2020. The bill strengthens the power of the RBI over the cooperative banks with the goal of enhancing professionalism along with transparent governance in the cooperative banks. Other highlights of the bill include – auditing of cooperative banks as per norms of the RBI and approval of RBI to be sought for appointments of chief executives of the bank. The Bill proposes to safeguard the interests of the depositors by ensuring fair business transactions. This bill is considered a step towards improving the financial health of the cooperative banks to prevent them from embroiling in fraudulent transactions.

4. **Impact on High-value depositors -** While easing restrictions on depositors brought relief to many, there are still others for whom the travails continue to last a little longer. As of March 31, 2020, close to about 78% of the depositors have been able to recover their money. However some of the high value depositors of the bank are still waiting to get back their money. These include RBI employee cooperative credit societies – The Reserve Bank Officers’ Cooperative Credit Society Limited (RBOCCS) and Reserve Bank Staff and Officers Cooperative Credit Society Limited. These societies have a combined deposit of Rs 190 crores parked in the bank with no idea as to when they would be able to get access to their money.

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5. **Impact on stock market**

One of the biggest and immediate impacts of any financial event in the country is on the stock market. The RBI imposition on the PMC bank was followed by intense rumour mongering. Intense speculations started about possible undisclosed NPAs of other banks to sick companies. This fluttered the investors and generated a widely palpable crisis of confidence. By October 3, 2019, the bank stocks had lost upto 42% of their market value. This led to release of clarifications from both the banks and the borrower companies reassuring the public about their stable financial health.

6. **Impact on PMC bank and HDIL**

The scam has caused severe damage to the reputation of both the institutions. HDIL has not only lost face but the bankruptcy proceedings against it have gained momentum. Its promoters have already been arrested and if proved guilty would have to face a long jail term. The bank, even if it continues to be, would have a real tough time to re-establish itself as a trust worthy institution.

Timeline of the Scam:

23rd September 2019	:	RBI issues first round of restrictions for a period of six months. The order placed the bank directly under control of RBI and barred it from engaging in any sort of business transaction. It also capped the deposit withdrawals of the customers at Rs1000 for six months.
26th September 2019	:	RBI increased withdrawal limit to Rs. 10000. A delegation of the PMC customers registered a complaint against the bank officials at Sion police station.
30th September 2019	:	Economic Offences Wing (EOW) of the Mumbai Police filed

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	FIR against the former bank management and promoters of HDIL in PMC bank. The FIR was filed based on a complaint by RBI appointed administrator. The case leveled was for offences such as forgery, cheating and criminal conspiracy
3rd October 2019	: Two high rank officials of the HDIL firm arrested. The arrested were identified as Rakesh Wadhawan, executive chairperson of HDIL, and Sarang Wadhawan, managing director of HDIL.
4th October 2019	: Joy Thomas, Ex-MD of PMC Bank , arrested.
5th October 2019	: S. Waryam Singh, former chairman of PMC bank, arrested
11th November 2019	: Two auditors of the PMC bank were arrested by EOW
13th November 2019	: Another auditor of the PMC bank were arrested by EOW
16th November 2019	: One of the bank directors arrested
3rd October 2019	: Withdrawal limit increased to Rs. 25000.
14th October 2019	: Withdrawal limit increased to Rs. 40000
5thNovember 2019	: Withdrawal limit increased to Rs. 50000
21st March 2020	: Restrictions were extended by RBI for further 3 months starting from March 23rd to June 22nd 2020

The Actual Malaise

The banking industry rests on a two important variables –Ambition and Trust; neither one of which should be compromised for the other. The ambition to rise high and to make huge profits is what dictates a bank or for that matter most of the financial institutions. It becomes problematic only when rules and ethics are ignored for making a quick buck and the Trust of the

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customers is jolted. It is unlikely for a bank to be able to restore the confidence and trust of its customers once it has chosen to forego it.

Emphasis on Ambition at the cost of Trust has been a common thread in almost all the banking frauds that have taken place in recent times in India – the PNB Bank Scam, the Madhavpura Mercantile Bank scam or the Yes Bank scam. The People within the bank have exploited the loopholes in the bank Processes. So, two very important parameters of the Service Marketing Mix have been compromised in these bank frauds – People and Processes.

The top management of PMC bank identified the lacunae in the bank operations and exploited the same for their own profit and to secure the interests of its biggest client –HDIL. One of the reasons for rampant abuse of power in PMC was because its board of management excluded the board of directors from any major decisions. They, too, were left in darkness.

The PMC top executives and the HDIL promoters are not the only culprits; the fraud was carried out with the full complicity of the bank's inspectors and its auditors who kept on verifying the bank accounts without identifying the wrongdoings.

PMC scam is a convoluted saga of greed, falsification of accounts and underreporting of NPAs. The bank approved loansrecklessly for HDIL by throwing caution to the wind even when other banks and lenders had become extra-vigilant in providing loans to firms and industries which had a reputation of defaulting on loans. It is a toxic cocktail of greed and poor corporate governance which has led to the turbulence in the whole banking industry of India.

Conclusion

Bank frauds are not exclusive to India alone; they occur everywhere. However, what sets them apart from the rest of the world is that while other countries use them as opportunities to strengthen their banking system; in India, they are politicized to score points in the next elections. Every time a financial scam surfaces in the country, politicians engage in passing the buck to score a few brownie points. The government on its part merges the scam hit bank with a bigger healthier one and the whole issue is conveniently brushed under the carpet and given a quiet burial. The 2008 recession that dented the world economy was triggered by the collapse of

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a couple of big banks in the United States of America. The USA, instead of engaging in petty politics, introduced many important pieces of legislations to increase stability in the financial sector and to safeguard its customers. These measures included Dodd-Frank Wall Street Reform and Consumer Protection Act. India, too, needs to wake up and institutionalize reforms.

Also, there needs to be some sort of accountability- fixing and customers must be compensated for their damages – whether monetary or psychological. The country needs to set a precedent in this regard, otherwise this, too, would be a wasted opportunity. It is the crippling attitude of the government and the RBI that is boosting the confidence of the fraudsters in the country that in the true sense has put our banking system in such a fix. The government and the regulator need to put their act together and work seriously towards securing a stable financial system which not only generates profits but also respects the trust of its customers. This goal might sound simplistic but in essence, if used as a guiding principle and viewed from an ethical standpoint, would become a great tool in reinstating and replenishing the highly eroded faith of the customers in the Indian banking system.

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