Barings bank's failure

Literature, Russian Literature

When establishments, businesses and organizations are prosperous and very successful, barely anyone anticipates that someday they would fall down. Instead, people tend to envision a more dynamic, booming and more successful business whose position would seem stable that no problem can shake it down. This is exactly the case with the Barings Bank. After its share of success, the bank failed due to organizational architecture.

The debacle of the Barings Bank, also called the “ Queen’s Bank” (FundingUniverse, n. d.), became one of the hot topics when it comes to banking, finance, economics and management. The case shows an example of how one powerful company can be ruined by its shortcomings.

The Barings Bank achieved success for a long time and was even respected as it was the United Kingdom’s oldest merchant bank (Sungard, 2009). It was established by a team of brothers, Francis and John, in London during the 1700s. During the Napoleonic Wars, the company financed military campaigns in Britain and helped France to recover financially.

The company was also known for assisting America in buying Louisiana from France. Prosperity also rained down when the bank went into international trade (FundingUniverse, n. d.). Barings Bank has $900 million in capital, but its share of success suddenly went to a halt in 1995 when it suffered from unauthorized trading losses which amounted to $1 billion (Sungard, 2009). Some experts say that the losses showed the ineffective controls and inappropriate incentives within the company (Hentschel and Smith, 1996).

Others think that the demise was a result of financial risk management that went wrong (Riskglossary. com, 1996). For whatever reason, the person

responsible behind the bank's demise was Nick Leeson, a trader promoted as general manager in the Singapore branch. Although he was capable of making millions for the company, he got involved in unauthorized trading activities that initially went unnoticed because he handled trading and back office functions (Sungard, 2009). Leeson traded and made mistakes which the bank's management did not notice. The more bets Leeson made, the moremoneyhe lost.

This indicates that Leeson, who has gained much power and authority, has acted outside the bank's official authority and worked not in the best interests of the bank's owners (Hentschel and Smith, 1996). This kind of problem occurs in different settings wherein employees, shareholders and senior management have different interests. It occurs when an agent such as Leeson enjoys private incentives to stray from things that would maximize the company's value. Also, the structure of the organization can affect employee's incentives. Thus it can worsen or control the problems.

Three facets of organizational architecture that have effects are reward systems, decision rights and control systems. In reward systems, a compensation package must be readily available and must have " strong incentive components. " In Leeson's case, however, the objective is to generate profits and not to stabilize firm value. Compensation based on the contract's payoff can have bad side effects. Decision rights, on the other hand, indicate that decision rights must be allocated to treasury employees so that internal controls at low cost will be improved.

However, traders and dealers like Leeson have extensive decision rights over their positions. Meanwhile, control systems in the Barings Bank case failed

because a difficulty in monitoring within the company existed. The senior management at Barings Bank claimed that they were unaware of Leeson’s activities. To prevent such cases there should be strict control and supervision on business activities. The company could have set position limits so that traders and dealers will not be able to abuse their positions. Another shortcoming of Barings Bank was that it did not separate settlement and trading responsibilities.

Otherwise the company could have monitored all sorts of activities because the separation can facilitate agreement with the set position limits (Hentschel and Smith, 1996). Thefailureof Barings Bank was attributed to its organizational architecture. Nick Leeson, a trader whose losses caused the bank to go into bankruptcy, worked to generate profits. The power and authority that came with his position blinded him into making bets that he did not win. The bank, on the other hand, failed to make careful control and monitoring over the activities done on its part. References FundingUniverse.

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