

Failure of Corporate Governance at ZARCO Exchange Company (Private) Limited

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Abstract

Purpose – The purpose of this study is to provide an understanding of different ways in which public money can be misappropriated by foreign exchange companies in developing countries like Pakistan. The study also attempts to disclose the incidence of non-compliance and importance of corporate governance, lack of which leads to closure of financial entities like foreign exchange companies.

Design/methodology/approach – The study is descriptive in nature and uses case study design to present the failure of corporate governance at ZARCO. All the data has been collected from archived published sources such as newspapers and magazines as well as company website.

Findings – The study discloses how ZARCO management while posing to be due diligent company indulged in financial embezzlement. The study unfolds the course of events that lead to the identification of fraud and the consequences that were later faced by the ZARCO management.

Research limitations – The present study solely relies on articles published in leading newspapers and magazines. Therefore, the elucidation presented does not necessarily account for the opinion of the company employees.

Practical implications- This research suggests the importance of ethical conduct and proper control mechanism whereby misappropriation of funds is immediately caught. The case can be useful in understanding how progressive organizations can end up in complete failure if proper checks and balances are not maintained.

Originality/value – In light of the published data, the authors discuss the events that lead to the closure of ZARCO. The study provides room for interesting discussion on need for corporate governance and the causes of financial embezzlement.

INTRODUCTION

The major objective of this paper is to report and present the issue of non-compliance and failure of corporate governance in a well known and progressing foreign exchange company in Pakistan. This case provides indispensable information about an informal and quick way of transferring money commonly known as *Hawala* and/or *Hundi*. The formal banking system of transferring funds does not only entail service charges but is also time consuming. On the other hand *Hawala/Hundi* mechanism does not follow any system; therefore it has been termed as illegal around the world. The stand against this system of transferring money became particularly strong after the 9/11 terrorist incidents in the USA and the start of the War on Terror in 2001. This case starts with an introduction about the ZARCO Exchange – a renowned global money transfer chain operating in Pakistan through their local partner. It further explains the non-compliance and fraudulent transactions at ZARCO exchange and then it illustrates their consequences. At the end it provides conclusions and managerial implications.

METHODOLOGY

The research objectives and the philosophical orientation of the research guided us towards a qualitative research strategy. The study has two main objectives: (a) to highlight the issues of non-compliance and failure of corporate governance in Pakistan; (b) to examine the consequences of this failure at personal, organizational and societal levels. The study is descriptive in nature and uses case study design to present the failure of corporate governance at ZARCO. All the data has been collected from archived published sources such as newspapers and magazines as well as company website.

ZARCO – AN INTRODUCTION

ZARCO group of companies is well-known in the global field of financial services with offices in USA, UK, Pakistan and Canada. Brand ZARCO stands for reliability and authenticity as there is substantial compliance with the local laws and regulations in every territory where it operates.

ZARCO Exchange was formed in June 2003 when the State Bank of Pakistan (SBP) issued working license to Mr. Lakhte Hasnain, the CEO and owner of the ZARCO [1] had their head office in Lahore. It was established with the same respect, credibility and dependability with the objective to provide its customers flawless, cost effective and superior financial services such as money transfers, currency exchange, bank drafts, traveler cheques, cash passport cash cards and postal notes and coins [2]. It was regulated by SBP under the Exchange Companies Ordinance 2002 [2]. The company offered its customers the advantage of largest network of online branches, franchises and payout location both in the urban and rural areas of Pakistan and collaboration with trusted money transfer companies worldwide [2].

The operations of ZARCO Exchange in Pakistan were said to be in compliance with both the internationally and locally applicable laws and regulations. Within two years of operation ZARCO acquired one million customers [3]. ZARCO also received prestigious awards such as 30th FPCCI Best Performance Award in Home Remittances, Businessman of the Year Award and Western Union Agent of the Year Award, in the year 2006 [4], 2007[5] and 2008[6] respectively. ZARCO was also named as the country's premier "Role Model Company" by SBP and was strongly supported by the Government of Pakistan (GOP) [2].

SBP also authorized ZARCO to issue Encashment Certificates as under:

"Certificate of Encashment of Foreign Currency" is issued to the beneficiaries for the Remittances received from abroad and to be paid in Pak Rupees. Moreover, it is advised that there is no restriction from State Bank for issuance of "Certificate of Encashment of Foreign Currency" against these remittances [2].

The company CEO in a ceremony declared that ZARCO's goal was to work along competitive innovation. In this regard, he indicated two elements to be crucial to ZARCO's success: *networking* with both international financial entities like Western Union, Pay Pal and Web Money as well as local banks and franchises to help people in remote areas with their home remittances and *compliance* in order to ensure due diligence to meet the international standards of anti-money laundering [7].

FRAUD AT ZARCO

While working on a campaign against *hawala* (undocumented/informal fund transfers) business, initiated on the directions of SBP and Interior Minister GOP, the FIA Punjab booked six foreign exchange companies and their owners. Amongst these was ZARCO; the FIA report stated that the Chief Executive of ZARCO illegally transferred Rs 1,870 million to his bank accounts abroad, while his company performed Foreign Telegraphic Transfers (FTTs) of \$346.71 million under the hawala business between January and November 2008. The report asserted that hawala business resulted in the loss of capital and depletion of foreign exchange reserves of the country. ZARCO was therefore confirmed to have violated the rules set out by SBP [8]

In February 2009, Western Union detached itself from ZARCO after the FIA reports surfaced [9]. Interestingly, in early August 2009, a First Information Report (FIR) was filed under sections 420,468,471,408/34 of Pakistan Penal Court (PPC) on the complaint of the ZARCO

Exchange Company's Chief Executive. He alleged that his company's employees embezzled Rs. 1.25 billion through 'dummy accounts'. Consequently, FIA, raided the head office of ZARCO Money Exchange Company at Lawrence Road in Lahore and took into custody all the records relating to money transfer on August 8, 2009 [12]. 727 branches of ZARCO Money Exchange company across the country including its head office were closed while nine company employees nominated in the FIR were arrested [9] [12]. A few days later, Lahore High Court (LHC) received an application from a ZARCO customer complaining of a fraud. The applicant had sought transfer of \$3000 which were to be paid to an institution in France, as tuition fees for his son, but the money never reached the destination. At the same time, a number of newspapers reported swindling of ZARCO franchises, depriving people of their assets. Hence, the Chief Justice of LHC issued a suo moto notice and summoned the Director General of FIA, Deputy Attorney General, Advocate General Punjab and Director Securities and Exchange Commission of Pakistan [10] [11].

CONSEQUENCES

State Bank of Pakistan (SBP) suspended ZARCO's license for a limited period in August 2009. Subsequently, the exchange company, its head office, branches, franchises, payment booths and currency exchange booths were barred from undertaking any kind of foreign exchange business activity during the suspension period [12] [13].

The SBP declared that ZARCO owed \$6 million to the Western Union and Rs 90.048 million to its local business associates [8]. The court dismissed the pre-arrest bail of ZARCO's CEO on suspicious involvement in money laundering and he was arrested from outside the courtroom by FIA [16] [17].

ZARCO became second Forex Company to be bankrupted after Khanani and Kalia in August 2009. 727 branches of ZARCO Exchange across the country including its head office were closed and more than 7000 of its employees had to sit home after the company, on grounds of financial embezzlement, was forced to shut down.

DISCUSSION

As per the Foreign Exchange Regulation Act (FERA) 1947, SBP is the regulatory body of all financial institutions in Pakistan. A new law called the Protection of Economic Reforms Act (PERA), was introduced in 1992 by the Nawaz Sharif government with the objective to attract foreign investment to the country. Although the new law provided complete freedom to the individuals to transfer foreign exchange within or outside Pakistan, it did not cancel the 1947 law, hence making both laws simultaneously operational. In 1999, the free movement of foreign exchange was curtailed to a certain extent by making an amendment in the 1992 law, however, there was still sufficient freedom available to informally transfer funds. These changes in the law created confusion regarding the regulatory control of the SBP.

In November 2004, the GOP was trying to keep the foreign exchange reserves of the country at \$10 billion; SBP's role became crucial in ensuring money transfer only through the formal and documented financial means. Previous amendments in the regulatory laws had made it impossible for the SBP to exercise control. In spite of several warnings, exchange companies brought in less than one billion dollars in home remittances while the currency export was over \$4 to \$5 billion a year.

The SBP further instructed small money changers to operate as mini exchange companies or 'B' category exchange companies, with a paid up capital of Rs. 25 million while it made it mandatory for the big exchange companies to operate with a minimum paid-up capital of

Rs100 million. Representatives of exchange companies expressed their resentment over SBP's instructions, declaring that they would incur losses especially with the Pakistani rupee becoming weaker than the SBP's agreed rate.

The SBP gave operating licenses to a number of big exchange companies, third parties and 'B' category exchange companies to form a network of over 900 business locations. None of these were however, allowed to provide the services of *Hawala* or *Hundi*.

CONCLUSIONS

Experts say it is very difficult to stop the *Hawala* system, especially in remote places where no reliable system of money transfer is in place. Dr Shahid Hasan Siddiqui, Chairman, Research Institute of Islamic Banking and Finance, says; "A large number of unregistered money changers are working in every nook and corner of the country and the State Bank is well aware of the fact, but action has been taken to stop them,"

Today there are some 300 licensed money changers operating in the country, including about 50 in Karachi. Ironically, there are about as many unlicensed money changers operating in the country. Although the emergence of licensed money changers have helped reduce the circulation of fake currency by almost one-tenth, the challenge of stopping the unofficial transfer of funds is still huge.

LIMITATIONS

The present study solely relies on articles published in leading newspapers and magazines. Therefore, the elucidation presented does not necessarily account for the opinion of the company employees. This case has a focused approach to present failure of corporate governance so many of the legal formalities, terms and procedures were explained in simple manner.

MANAGERIAL IMPLICATIONS

This research suggests the importance of ethical conduct and proper control mechanism whereby misappropriation of funds is immediately caught. The case can be useful in understanding how progressive organizations can end up in complete failure if proper checks and balances are not maintained.

ORIGINALITY/VALUE

In light of the published data, the authors discuss the events that lead to the closure of ZARCO. The study provides room for interesting discussion on need for corporate governance and the causes of financial embezzlement.

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