

Chartered Banker

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It is 2 April. You have recently taken over responsibility for monitoring your bank's lending facilities to a start-up company. Its sole activity to date has been developing an innovative type of valve for heat pumps. The majority shareholder is a university professor who patented the product personally but has formally transferred all rights to royalties to the company. There has been trade interest in purchasing these but the professor has flatly refused all offers, even though the company itself has made no sales. The company's only other significant asset is an un-expired nine-year lease for factory premises on a popular industrial estate.

The problem you face is that, while the company's authorised overdraft is adequately covered by the security that the bank holds over the factory premises and the patents, because of a bureaucratic confusion, your predecessor had allowed the company to exceed its overdraft limit by some £70,000. Your brief is to terminate the banking relationship and to recover as much as possible of the authorised overdraft by exercising the security.

At the start of the meeting at which you intend to tell the professor of this arrangement, you discover that he has earlier in the week raised £35,000 through personal private borrowing from relatives. Moreover, he has found a colleague who is willing to invest £30,000. The professor tells you that he and his colleague will be paying the money into the company tomorrow, ahead of 5 April. In return, the company will issue shares, which will qualify them for tax relief under one of the Government tax incentive schemes. Neither investor has taken independent advice nor is aware that their investments will reduce the borrowing only to around the authorised overdraft level but not provide any new funds. Moreover, your questions ascertain that the professor does not have ready access to any other funds.

Should you warn the professor and the shareholder on 2 April of the intention to terminate the banking relationship or is it ethical to wait until after the new investment of £65,000 has re-paid most of the unauthorised overdraft?

This case study was originally written by David Molyneaux for the Institute's Hutton Prize for Professional Ethics.