Interview with Dr. Bala V Balachandran

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The interview was conducted Dr. Nagendra V Chowdary, Consulting Editor, Effective Executive and Dean, IBSCDC, Hyderabad.

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–Dr. Bala V Balachandran

Dr. Bala V Balachandran began his teaching career in 1960 while a graduate student at Annamalai University, India. In 1967 he moved to the University of Dayton and in 1971, to Carnegie-Mellon University, Pittsburgh, where he taught management courses while working on his doctorate. In 1973 he joined the Kellogg Graduate School of Management faculty. From 1979-83 he chaired the Department of Accounting and Information Systems; he was appointed Distinguished Professor of Accounting and Information Systems and Decision Sciences in 1984. He was also director of the Accounting Research Center. Balachandran’s teaching interests include managerial accounting, auditing, management information systems, and mathematical programming. He is one of the three Kellogg faculty members who started the Information Resource Management Program (IRM) at Northwestern in 1974. He has authored more than 55 research articles and is currently writing a managerial accounting textbook with emphasis on cost management in an automated manufacturing environment. He is department editor in accounting for Management Science, associate editor for The Accounting Review and is on the editorial boards of support systems. He has been actually involved in setting up Management Institutes in India and was involved in the MBA Programs at MDI, Gurgaon in early 1990s and ISB at Hyderabad at the turn of this century and Great Lakes Institute of Management at Chennai in 2004. Great Lakes Institute of Management is his dream project of putting Chennai on the International Management Education Map. He is the founder and Honorary Dean of this International Class Institute. He was awarded the ‘Padmashri’ in 2001 by the Government of India in recognition of his contribution to the education in India. He also has the rare honor (for an Indian in America) of having an endowed chair professorship in his name. Several colleagues from Kellogg have led a campaign to raise $1 mn for an endowed professorship at Kellogg School of Management in Prof. Bala V Balachandran’s name in recognition of his invaluable and tireless service to the Institute over the last three decades.
Firstly, congratulations for being an illustrious and distinguished professor and for having taken ‘Great Lakes’ to great heights in such a short time? What was the trigger for you to have conceptualized Great Lakes model of management education?

My tryst with Institution building for higher management education goes back to the days of 1973 when the first six faculty of IIM Bangalore, were hired at my home in Chicago with N S Ramasamy at the helm of affairs. Looking back, I realize that the seed for Great Lakes was sown right then. I had a plan, but no resources or more importantly – no experience. The opportunity came with MDI Gurgaon, where I worked with the UNDP grant of US$700,000 and the rest as they say, is history.

The MDI experience at Gurgaon laid the foundation and watered the seedling between 1991 and 1997 where I gained significant exposure to the creation and launch of the PGPM program. This also allowed me to explore the nitty-gritties of collaboration with a foreign university as the PGPM at MDI Gurgaon was set up with a generous grant from UNDP to Kellogg. Soon on the heels of the MDI, came ISB. My stint as the Chairman of Curriculum and Faculty and as the founding faculty of the ISB at Hyderabad during 1998 and 2004, was replete with more learnings and insights into the various components of the PGPM program concept, delivery and liaison with industry and academia. Thus, the time was ripe, I had not only a plan, but also reasonable resources and substantial wisdom and with the help of Dean Donald Jacobs and Dean Jain at Kellogg, Great Lakes Institute of Management was conceived at Chennai with the help and encouragement from my friends all over the world during 2003. We identified some differentiating points while exploring the strengths of the other institutions I built and felt 3 important themes. 1. Global Mindset, Indian Roots. 2. Highest Quality at Affordable cost or US Top Schools Quality but Indian Prices and 3. Meritocracy Transparency and Innovative Curriculum with a 12 months model. In other words, a Super Convex combination of IIM A, B or C and ISB. The result is Great Lakes leveraging my relationships, networks and experience. We announced in July 2003 and the first class started in April 29, 2004 with 124 students. Again the trigger is location and timing which I did, in spite of my quintuple bypass surgery in 2002.

During your very distinguished and illustrious career you would have witnessed several economic crises and for many you would have been consulted. How do you describe the global economy’s mood right now?

Beaten by the impact and intensity of the economic crisis that was felt in September 2008 and beyond, there was awe and shock though there were many forewarning signs of massive collapses and lapses that probably started in 2003 with the subprime mess and obscene bonuses based on illusory profits and revenues mainly based on greed by many individuals unchecked and poorly regulated. However during this late months may be from July 2009, signs of recovery as we see in the stock markets both in US and in India and some other indicators like the relative ease in credit and in banks, as well as CAPEX investments in many corners signs of recovery are seen in spite of growing unemployment rates in US and in spite of pumping funds in the stimulus packages. I will describe it as slight recovery with cautious optimism;

Having served on the boards of several MNCs and also Federal Reserve, what did the recent US financial crisis mean to you and what are your reflections on the way the world changed since then?

The US financial crisis was expected as early as 2006 because of instruments like subprime lending and under regulated environment, irrational exuberence as Alan Greenspan stated and many other things. It was clear to me that in many companies both in the US and in India, the top line was a VANITY, the middle line was a CALAMITY and therefore the bottom line has no SANITY. It is clear that the only REALITY is cash flow. The mathematicians use complicated models to create financial instruments and “Sophisticated” derivatives which are not easily comprehensible and more importantly do not stand the test of time in a fiercely competitive, highly dependant and dynamic commercial environment and to add to that these innovative instruments have beaten all fundamentals of finance and economics, created illusory revenues and booked profits so that the top brass have been making hefty bonuses without understanding what is going on and overruled those who doubted these in the ranks since money and profits were in abundance. The basic premise of this subprime mess was the future income capable of being earned based on the potential of the individual couple with excessive greed. Right from the final consumer to the banker to the insurance company that has guaranteed the loan, everyone has been motivated by the easy money that the model was capable of yielding. Real estate prices soared from $250,000 to 650,000 in 6 years. As expected, the bubble burst in 2007-08 and the prices normalized themselves. This is when my friend the then Governor of RBI Dr. YV Reddy asked me “Bala: are we lagging behind the US in 2007. How can I regulate the new economy and related instruments?” I asked him, “Venu, do
It is generally believed that the Business Standard book that was recently published on the subject has some of our punch lines and thus we need to revise our book to reflect other findings and is expected to be finished by May 2010.

US Financial Crisis: Causes and Consequences

1. Greed, not only on the part of investment bankers and brokers but also the main street, who, knowing fully well that they don't have net cash flows or disposable income, falsified the accounts to reflect inflated cash flows (could be deemed fraud).

2. Too many middle men who made money at every stage with a booked revenue but not a cash inflow.

3. Too many financial instruments probably created by Mathematicians of PhD type without understanding the instruments.

4. Too many officials who had incentives where they viewed incentives as greed and took the bonus without a real profit but a reported profit.

5. Too many lobbyists who had an agenda and an axe to grind.

6. Regularators who were complacent.

7. Fundamentals of finance out shadowed by half-baked freakanomics:

What were the prime reasons for US Financial crisis that has engulfed global economy forcing everyone to liken this crisis as worse than Great Depression?

I am not going into the actual details of the crisis. Some of the main reasons were:

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It is generally believed that globalization is all about the interplay between 4Cs – Credit markets, Capital markets, Currency markets and Commodity markets. Was the imbalance created between these four markets in some way responsible for the financial crisis?

Not only was there an imbalance among these four C’s and their markets, but the risks of the multi-way transaction traffic was not clearly understood by all participants. The only question every one had was, ‘can I pass my risk to another and not face the axe?’ credit markets were abundant with irrational rationales; capital markets had too many market makers in a fake way; currency markets were at different extremes and risks; commodity markets were appearing to be customized markets because of the differences in the packages; The main thing is there is no one person/authority who is responsible for the combined actions of the 4C’s and each one had their own tunnel vision and the greed was all pervasive. The crux is that in such highly interdependent scenarios, to function independently can kill all.

Who do you think should squarely be blamed for getting the world into such a catastrophic mess – the Wall Street firms with their insatiable desire for “derived” returns, or the regulators or the governments? What was it about the regulatory framework that contributed to the crisis?

Everyone has to be collectively blamed. If there is no one to watch you and there is money on the ground to be taken, even though it is not yours, why not take it? Where are the virtues of integrity, honesty and transparency and responsibility – we rarely see them in business these days. Right from the actual perpetrators to the end-user and even the innocent bystanders who do not raise an objection, but with their silence have allowed the atrocities to continue are also equally to blame.

A large section of people believe that the crisis was allowed to become bigger because of policy makers’ (both at the companies and the government) indecision. And the full blown crisis is just a price for indecisive governments and indifferent companies, the argument goes. Do you see any merit in this
argument?
It is not just the government and policy maker. Who are they? they are you and I or my brother-in-law or sister-in-law who was educated in a System of 220 Million. The people also went along with it, exploited and leveraged the situation to their advantage. Now that the bottom has fallen out, it is always easier to pass on the blame to the bigger authorities and completely wash one’s hands form the responsibility. The indecision of the policy maker or the government who had a short time horizon and may definitely be true, but one must remember that after all people don’t ‘cast’ their votes; but vote for their castes, caste in a generic meaning encompasses your friends and relatives;

➤ While the Wall Street thought its firms to be “too big to fail”, for the main street “too big to fail” meant a financial institution cannot be allowed to fail. Do you agree with those who say that Lehman had to fail in order for Congress to have the political will to pass any kind of rescue package?

Well, the Titanic was considered unsinkable. So also, Lehman Bros. Lehman Bros were allowed to fail since the policy maker was in the other camp called ‘competition’. A select few relish the thought of watching your competitor drown without giving him a helping hand. The truth is ugly, and life is not fair!

➤ What did the US Financial Crisis mean to global economy and the business? How do you think the governments and the businesses have responded?

If you compare China and India, China believed that they don’t know advanced finance and financial investments and trusted their advisors who are from the US firms. Thus, the thinking here is that if the US is doing something, it has to be right and let us also follow suit and invest. This is something like the Venture Capitalist in the Dot Com World before it became a Dot, invested since the super Venture Capitalist is putting the money. He must be right and now let us go like a sheep. India, had its handful fighting fires at home and hence the inaction helped them and that is why our economy was not very affected.

➤ What can be the lessons learnt from this crisis – for governments and businesses – especially from the point of view of public policy, globalization, financial coordination and information sharing? And also from the viewpoint of developing countries – especially for the emerging and BRIC economies – and developed countries?

Let us look at the history. A 200 plus million people of the US over 70 years after agricultural revolution, industrial revolution created so many great educational institutions and systems, including World Bank, IMF and even United Nations where there was dominance compared to many others in the total world and the British Domination was taken over by the US capitalism. Three things happened in the last 50 years:

First Deng Xiaoping went to Lee Kuan Yew and created Shujow park, Shanghai, Shendgen etc., creating a huge economic prosperity lasting about 17 years before 1991.

Second, the economic freedom of India created by the then PM Shri P V Narasimha Rao, the current PM Dr. ManMohan Singh and the present Home Minster PChidambaram. Then came Gorbachev, who felt the need for prosperity and eliminated the Berlin Wall and made possible the German Unification and Demise of the Soviet Union and with little help from Brazil etc.,

Together these four countries form the BRIC economy and have made about 50% and more of the world economy co-creating wealth for themselves. Thus the model in the next decade will be in these people and the US will still be a formidable market on all dimensions but not a dominating market. Thus whoever takes this opportunity in these four with some cooperation within the Block of 4 will create a new capitalism challenging the US capitalism. I believe it might be a welcome respite to the world economy – in that it need be forced to periodic upheavals mirroring one large country’s economy alone – i.e., the US.

➤ Do you think the crisis is behind us or are we to witness even worse?

The crisis is almost behind us; excepting for the Credit Card Crisis or the 3 C’s. If a high school or higher secondary school student of 12 years can have 4 credit cards each with a cap of $800 without any collateral, in the US alone, and if all the risks are compounded, you do the math – it’s another catastrophe waiting to happen, if the regulatory framework doesn’t open itself up to this possibility and proactively counter it. But, it is yet to be and I am quite hopeful that it can be thwarted.

➤ How has Wall Street changed during the past year, and what will these changes mean for the stock markets and the investors?

There are certain circuit breakers which have been put in and it is hoped that the stock-markets will not reflect a complete depression state. It is also hoped that these measures will introduce a level of stability and prevent drastic highs and lows in the indices. But the stock market being what it is, is largely affected by sentiments and perceptions of people and stock values of companies can plummet or sky rocket based on the market sentiments and reactions to news about the company, economy or even politics. All this considered, I must also add that these circuit breakers are for known or anticipatory problems. There are very imaginative culprits who can outsmart any system. The only way to prevent these is through moral
leadership and honesty, integrity and transparency.

- A lot has been said in the past 12 months about financial sector reforms. In his speech (September 14, 2009), President Obama called it, “the most ambitious overhaul of financial regulatory system since the Great Depression.” What new financial regulations have been put in place, what has been accomplished so far and what remains to be done as far as financial reforms go?

The past year has seen a huge focus on increased regulatory reforms and inclusion of several mechanisms such as bonus cap, obscenely high salaries and forewarning systems etc. But please note that many can outsmart the same. Heavy, stringent and non-lenient punishments including public humiliation could serve as deterrents. Only ethical values and value based education can affect a significant change which should start from the home when the kid is only 3 years old and not in a business school. I can get an A Plus Grade in an ethics Course and I can also be a perfect crook. But that’s not the objective. A cultural upheaval is necessary for these reforms to work in tandem with individual cleansing so that as a whole the loopholes in any system are not manipulated to the advantage of a select few.

- It’s hard to talk about reform without talking about the reformers. Could you help us evaluate the policies of Treasury Secretary Tim Geithner and Federal Reserve Chairman Ben Bernanke? Is there anything that the regulators could have done differently?

Both Tim Geithner and Prof. Benanke, who is a colleague of the Nobel laureate Paul Krugman are strong minded and passionate with some compassion. Also to be amazingly able yet humble is a rare combination. I think they can do it and have strong values and commitment. If they cannot do it, God help the world.

A year after the global economic system collapsed, many companies are finally finding ways to increase profits under the new conditions. However in a recent McKinsey survey (September 2009) almost as many expect profits to continue falling and executives also indicate that their broader financial hopes remain fragile. Many expect government involvement in economies and industries over the long term. Should that be the only way out?

I think the pre 2007 profits are profits of the past. As I said earlier, the assets are still there. The balance sheet was intact except the assets are overvalued and the liabilities are undervalued. The income statement therefore has no sanity. Those who had strong cash flows will win and will be profitable. The government will try to get involved via the stringent transparency and corporate governance norms that are in bad need of repair and overhaul, but the government is not brilliant either. Even though the position of CFO at General Motors has a one million dollar ticket scaled by government, they have not been able to find a taker for the past 2 months. Now there are a large number of persons whose salary is proposed to be cut. I think a reasonable compromise between willing parties needs to evolve. You don’t correct a mistake by another mistake.

- A powerful tension is at work today in global economic sentiment. The financial markets, pundits, and policy makers think the global economy is out of the woods, but executives aren’t so sure. What should be done in the short term and in the long term to restore the confidence and not get sucked up in such hubris?

The economy has reached its bottom and now on the upward curve. Is it U shaped or V shaped? There are debates and by the time the debate is over, you will see those who made quick decisions and exploited the mess to their advantage will succeed. The moment one sheep is growing and enjoying other sheep will follow. It is now time to think about “money value of time” and opportunity costs and not “the time value of money” and discounted cash flows alone. This is for the short term. As for the long term, I personally believe that the science of economics holds undisputed sway over the ups and downs of economic progression. What goes up must come back down and I don’t think there is any point in hoping that the depression won’t happen again. The only addition that we see nowadays is that these economic crests and troughs are happening in quicker succession than they used to earlier. Also, the troughs are rather like heavy falls (one could debate whether this is actually brought on by unscrupulous commercial practices) from which recovery also takes more time than earlier. The best advice under the circumstances would be to expect this to happen and secure one’s finances through secure and realistic instruments and wait out the depression.

- Government and Business: The New and Defining Moments

- Governments have responded vigorously with their bailout packages and that meant in one sense private losses being funded by public money. Henrique Abreu cited a lesson of the late Milton Friedman that “it is a different thing spending your money on someone else (Warren Buffet) or spending someone else’s money on someone else (government intervention). What is the efficacy of government bail outs, especially for the scale of bailouts doled out? It is clear no one wants to put good money over bad money. Governments sometimes tend to do that as there may be a political Agenda and the need to be reelected to power.
Regulatory reform will mean what are the major global trends instead of attempting to regulate monopolies exist, to ensure fair pricing and service levels. Greater competition means stronger productivity growth, which in turn means a faster-growing economy and more wealth to share. Yet governments everywhere struggle to get regulation right. Unfortunately, regulation often has a negative effect. What can governments do to get it right?

In each country, there are individuals who are brilliant, extremely well-educated, possess a decent amount of wealth and have spearheaded quality initiatives and public service and have a superb reputation. For example, MS Swaminathan on Agricultural and Green Revolution, Kurien on white Revolution and Milk Production, Sam Pitroda on Telecom Revolution and many others with known competence of that country including Dr. Raghuram Rajan of University of Chicago. I am so glad that Dr.Mannohman Singh, Dr. Montek Singh Ahluwalia, Dr. Abdul Kalam, and other leaders have identified such people and invited them as advisors as their competence, vision, passion and devotion are outstanding. India does not need big deal consultants and I am confident that the educated government does indeed know what is right and also how to go about doing it. So also in the US or any country for that matter. The question is execution. Sometimes they don't go through with it for political reasons or sometimes the system has been so messed up over the past like with corruption etc., that we are unable to execute the plans properly. However in the last 10 years at least in India regardless of the party, progress has been made in a significant measure and inclusive growth (even if out of fear of Naxals) is in existence. In next 10 years the growth will be relatively better and one can hope many things can be executed through a substantially less corrupt and maligned system.

Should boards view the current crisis as an opportunity to review the way they function. During tough times – and they haven't been this tough for generations –directors are supposed to ask difficult questions about their companies. Yet they rarely ask hard questions about themselves, such as, "Are we the right people, asking the right questions, providing the right sort of leadership, challenging management in the most productive ways?" A healthy self-assessment can go a long way toward improving a company's performance. What kind of reassessment do you suggest for the boards and their directors?

The boards by and large are good in good companies and nowadays many board members are asking the right questions at the right time. With a self evaluation among board members and with significant competent and independent board members a company can achieve more. The key is not the question or even the answer. But the timing of the execution with a sense of urgency. Otherwise it will be too late and the conditions that existed at the time of the question and discussion may no more be relevant.

What are the major global trends that businesses should be thinking about? Do you envision new approaches to management and new ways of interacting?

As always a huge upheaval and renaissance in the way management educated is delivered and in the way that companies practice management is imminent. Already, we have had questions regarding the perpetrators of the various scams – that they are leading ivy leaguers and by extension the question also arose as to the quality of the management education imparted by these prestigious institutions. I wish to add that several schools in the west are taking huge steps towards inclusion of Vedic literature (such as the lessons of
Bhagwad Gita and Asian scriptures which are valuable sources of direction and wisdom in revamping and designing their courses of ethics. This is a step in the right direction which aims to impart value-based education and in creating managers who are also attuned to being morally responsible leaders of tomorrow.

What specific three measures do you suggest to ensure that such crises do not recur? To what extent should the government intervene in business to check immoral behavior of executives and/or entrepreneurs? Integrity and honesty, ability with humility and passion with compassion. As for government intervention, we need to remember that the government is an entity that is also composed of people. An enterprise is only as good as its people. Hence, while intervention is definitely recommended along broad lines, it cannot make a significant contribution if the people involved (both on behalf of the government and the enterprise) are not up to the task.

The interview was conducted by
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