CHAPTER IV

SUMMARY AND CONCLUSION

The derivatives trade is prone to high risks at different levels and in different ways. Firstly, by its very nature derivatives trading is risky as it deals with betting on the unknown futures, whether in future interest rates, currencies or stock market value. A high degree of speculation is in built in the system.

Secondly, derivatives usually involve huge leverage. A small cash outlay can result in proportionately large gains --- or losees. What may start out as a small investment in terms of the cash allocated to trading can eventually commit a company to cough up a large amount that could wipe out the years' profits or (as the Barings case shows) even the shareholders' capital.

Thirdly, the financial system is now so globalised and so integrated that an activity or decision taken in one place or branch can have a major effect in other places or branches, or even start a chain reaction. Thus, the risk is not localised but has the potential of being globalised.

This case study focussed on the whole episode of how the UK's oldest bank could be brought down single-handedly by a 28-year-old trader. It reveals three factors : Mismanagement (by the Barings Group Managemen's oversightedness), Fraud (Leeson's fraudulent attempts to mislead the Management) and Greed (Leeson's greed and inexperience in not putting a stop on the wrong bet) which led to the whole incident. Such collapse could have been avoided should the Management, trader and regulatory body be more cautious.

In most of the graphical presentations, there are signs of market declination when the news broke. Similar to common belief, the stock markets tend to :

1. react to economic and financial events as they occur and

2. anticipate these economic events and their logical aftereffects.

From the reactions of the major bourses, it is observed that the market did not respond drastically to the event. This is probably due to the timing of the announcement was made. The bank was declared insolvent at late Friday evening (24th February 1995) when all the bourses had closed. When the markets reopened on Monday (27th February 1995), the impact could have been well absorbed during the weekend (as shown in chart 3.2).

Another reason is that when the Barings Bank collapse, the market turned down in anticipation of a possible lack of confidence in the banking industry.

But the fear did not develop, the market rose quickly as investors realised that they overreacted to the event.

Therefore, a surprise event such as this collapse of the England's oldest bank can be seen as a temporary decline leading to just an episode when it occurs in the business cycle.