# SHARED RESPONSIBILITY: A CASE FOR BANKS

*by Hiran Perera*

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**T**oday entrepreneurs, businessmen and financiers are all concerned about the position banks are taking during these times of "economic challenges". All eyes are seemingly fixed upon them in the hope of appealing to their conscience. Banks no doubt, are important benefactors of the economy, and they will continue to occupy an eminent place in today's business. world. As banks are the main actors in the theatre of the business world, they are bound to take a responsible stand when it comes to providing finance for businesses that are in difficulty.

Banks are not impetuous nor are they quick to take to the path of least resistance. Perhaps, there is another way to see the problem banks are faced with in today's context. That problem might not reside within banks. On the contrary, it may well be the people behind the corporate wheel who need to re-examine themselves if they are expecting banks to be more lenient with them under challenging economic circumstances.

More often than not, the fact is that somewhere down the line in the history of the company, it made several critical management errors of commission or omission that took them far off the mark. When banks loan out their money to businesses they provide finance for one purpose but sometimes companies use it for quite another. There are no laws to regulate such misapplication of loan disbursements. Some entrepreneurs may argue that they have mortgaged their assets, and they have the right therefore to decide how to apply the loan money.

It is rumoured and to be read in newspapers that those Pettah small-businesses, which faced greater challenges in the past, are today illiquid and face charges of bankruptcy. The big-ticket businesses too face similar charges of insolvency and banks are accused of having precipitated their ruin.

Amidst rising interest rates, due to defence expenditure shooting up, inflation and market illiquidity has been attended by market rigidity.

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It is in this context that banks are called upon to play a vital role in helping to resuscitate those businesses that are now taking a beating of their lives. But, with due respect to banks, both local and foreign banks are meeting these challenges. Those who paint a different picture may, perhaps, have another perspective.

At this stage it is worth examining as to what differentiates banks from other private or public quoted companies. The principal difference can be found if we look at where their primary responsibility and accountability lies. Banks, unlike companies, are the custodians of depositors' monies, which therefore engenders a primary duty of accountability to them. Thereafter, banks are accountable to shareholders to fill their piggy banks at the end of the day.

Banks also owe a duty of care, of a fiduciary nature, to their customers, to whom they offer a range of services to attract deposits, which form the basis of their ability to maintain their own investments and to loan money at interest. Banks therefore vouch safe to keep this pledge today and tomorrow.

Many of the businesses that are declining today, in any case may not have performed well enough during the more fortuitous times. These downturns merely coincide with today's economic outlook, but has probably nothing to do with today's economic changes.

It is only after several shots at rescheduling loans and granting moratoriums, and after protracted discussions, and after carefully crafted strategies – that include corporate re-engineering and when everything has failed – that banks reluctantly end up foreclosing on assets. No bank will rely on the most talked about last resort as the first way to get paid as no one can afford an image crisis.

**Last Resort**

But a bank's collateral arrangement is only a source of comfort, if not anything else, since they base their judgment firstly on at borrower's ability to repay his borrowing from the cash generated from his business. Foreclosing assets is a last resort and is never to be considered a principal part of banking practice either in Sri Lanka or in any other part of the world.

If a business has failed to turnaround, and its reserve base has also been depleted over the years, and all these seem to coincide with an economic downturn, it would be naive to think that banks will continue to fund loss-incurring activities of the company concerned. If banks are still willing to give their best shot to an ailing business, then the bank should also have a right to intervene and manage the company concerned. But this is strongly resisted by the company. In any case, it is not the business of banks to manage businesses that are not their own.

If businesses which had an upslide in their performance in normal economic conditions are now surviving on their past business goodwill, and incur losses under the current economic circumstances, then funding losses during the ups and downs of any business is a business decision that banks cannot avoid.

It is here that most bankers are looking for ways to rescue the economy from falling apart and are, in a positive spirit, granting moratoriums to borrowers and rescheduling loans. There is certainly some ancient truth in the theory of the extra-mile, for it has gone a long way to resuscitate those businesses which are in dire straits.

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Most banks do take a responsible stand when it comes to providing “relief” for businesses whose problems seem to be endemic.

If banks seize their assets in a bid to out their losses, they would send the wrong signal to the economy, and in the manner of the self-fulfilling prophecy, they too would lose thereby. In a time of market illiquidity disposing of collateral, e.g. property and stock- in-trade is not so easy as saying it. When everything is steadily losing its market value, selling property would only precipitate another crisis: the fall of the property market. The responsibility foisted on banks cannot, therefore, be taken lightly.

**S-Curve**

Most businesses that lack detailed planning are walking a tight rope. If we look at a company’s forecast figures, they depict, what one leading banker described as a “hockey stick” projection in which future projections are based on the assumption of business expansion – bottom – up and up without conceiving in their plans the cyclic nature of business trends.

True enough, businesses must conceive of business expansion, but they must also include a period of business refocus and consolidation; in which case, the forecast performance must show at more realistic upside curve. This insight may have a deep impact on the way bankers are to appraise a loan proposition.

At this crucial juncture, it may not be fair to urge banks to take the entire brunt of business decline when the shareholders themselves have an important role to play. Funding losses in which businesses have a semblance of recovery, must be borne partly through shareholders capital contribution and the balance through borrowings. Moreover, there may be exceptions for a particular industry such as the hotel sector. The hotel industry’s poor results is largely attributable to the particular problem endemic to the industry in the aftermath of domestic strife, followed by adverse international publicity.

Industrialists are therefore lobbying with the government to provide immediate relief to the hotel sector and are pressing for interest rates to be halved.

There may be a perception that banking is a profitable business and that they are earning hefty profits. Lobbyists, therefore, argue that granting moratorium and slashing interest rates are to be expected of banks.

But banks cannot and *will not* agree to anything they consider unreasonable because the primary objective is to pay on demand or on the due dates of their customers' deposits. These deposits are entrusted to banks by customers for either, safe-keeping or loaned by them with the expectation of attracting interest. Before thinking of their profit spreads and funding loss incurring businesses, banks must meet depositors' claims as and when they do mature. No depositor will take kindly to a bank which postpones the repayment of the interest or principal.

It is in this context that granting moratoriums and funding loss-incurring businesses have to be weighed and considered, after taking into account the deposit and interest claims a bank is obliged to meet. In short, a bank's interest charges on borrowers are inextricably linked to interest claims to be paid on its interest bearing deposits, overheads for its own maintenance, and cost of raising funds in the market. It must be borne in mind that economies of scale do not occur during periods of economic depression where banks are concerned. In fact, it is the reverse.

The local banks' cost/income ratios are said to be between 52% – 60% which is in line with international norms. The interest rate banks charge to borrowers cannot unthinkingly be reduced without impinging on their primary objective, which is to safeguard the depositor's money in the first place.

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If lobbyists are moving for interest rates to be scaled down to as much as 10% pa the government should bear this cost, *not* banks. How do lobbyists expect banks to bear the full brunt, without banks sacrificing their liquidity and profitability? But banks are considering ways and means of accommodation and wherever possible, they are in fact providing loans at concessional rates.

Given the cost of raising funds, banks can probably reduce interest rates which engender no profit spread to a specific sector requiring special concessions, so as to tide over a period of economic hardship. It cannot provide this relief to all sectors, and not for a long period either. There has to be a shared responsibility among shareholders, the government and the banks.