To Our Readers

After the East Asia crisis, the World Bank conducted a study on the underlying reasons for the crisis. It was found that at least a major part of the fundamental responsibility was on banks, which had understated their non-performing accounts by as much as 47%. Since this was a study and not an investigation, the fall-out from this revelation was only taken note of. Nevertheless, the Basel Committee on Supervision did take cognizance, and issued circulars and directives not only on Supervision, but also on Internal Functional Management. It will be remembered by those interested that the Basel Committee had also acted expeditiously after the Baring Bank's failure, to separate treasury and lending operations from decision-making processes. Bank failures are nothing new in the world, although we in India have been insulated from such traumas for more than two decades. Nationalisation is certainly a reason, but the eagle-eye of the Reserve Bank of India has also been another.

The sudden spurt in competitiveness in the marketplace for banks has resulted in a race to grab borrowers by whatever means. In many instances, hallowed principles of prudence have been given a go-by and sufficient internal controls and checks have not been observed while lending. It is certainly possible to combat this trend by bringing in more supervision on scheduled and private sector banks so as to reduce the chances of bank failures. However, one must also remember in this context that too much control, especially in these days of cutthroat competition, is as likely to result in the failure of a bank, as too little. Riskless practices do not lead to growth and risky practices are a sure formula for bankruptcy. One needs to realize that risk-based practices and risky practices are not the same thing and, contrary to what most people think, the dividing line between the two is not very thin. This is because one can weave in structured risk management into risk-based practices thereby anticipating and pre-planning for mitigation of risk. Risky practices do not permit such a structured approach.

Whether the Government is right in bailing out a private sector bank is an issue that is decided more by the long-term social security policy of the Government, than by economic reasons alone. Americans learnt it the hard way during the Great Depression of 1930s. Nevertheless, in a situation of scarcity of resources, bailing out somebody means the denial of resources to others. The irony of it is that in performing its duties of proper governance to the larger society through the process of bailing out, the Government excuses the lack of corporate governance in banks.

The solution is obvious; we need to bring back corporate governance in its real sense in the banking sector and all the players in that process must perform their roles properly. A bank is a social institution and the failure of a social institution points fingers to all those in society who are connected to that institution. The rest of the society must then demand and exact a visible price. We hope that the Government and all others concerned have drawn the appropriate conclusions from what has happened very recently, saddling the Indian society at large with an unwanted burden of thousands of crores of rupees.

August, 2004

Editor
The Institute of Chartered Accountants of India