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# Corporate banks in a world of pain

BY ET CONTRIBUTORS | UPDATED: MAR 03, 2018, 10.55 AM IST

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By R Balachandran

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Avid readers of history will recall Emile Zola’s open letter to the President of France titled J’accuse (“I accuse” in French) in the Dreyfus affair, accusing members of the army, judiciary et al in the wrongful conviction of Alfred Dreyfus, in an espionage case. The letter published on the first page of L’Aurore a Paris newspaper, electrified and divided the nation and was the first case in modern history when media and public opinion played a pivotal role in correcting a gross injustice.

## PNB

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In Láffaire [PNB](#) such accusations have been made in the media against all involved, viz. the chief protagonist safely ensconced abroad now, the political establishment current and previous, management and operations staff of the bank, auditors, regulators, and banks that extended finance against PNB’s undertaking.

### AN OPEN SECRET IN TRADE FINANCE CIRCLES

It is widely known that inland letters of credit (LC’s) and bills raised under them are often prone to fraud. The industry has a unique term for them, “accommodation” bills; here banks issue LC’s on behalf of their customers favouring so called suppliers who exist only on paper. In turn the “suppliers” raise bills for non-existent transactions and get them discounted with other banks under the strength of the LC. When the bill falls due, it gets paid by raising a fresh one.

When the cycle is disrupted, all hell breaks loose. Sounds familiar? Excepting that in PNB’s case it happened through Letters of Undertaking and import bills; no credit limits were in place. The latter takes the cake, even in the murky world of trade finance. Other time tested methods include failing to repatriate export proceeds with the foreign “buyer” being a shell company of the promoter,

deliberately invoking bank guarantees issued for non-existent projects awarded by the promoter's own related company etc. In most cases, shell companies/related parties of the promoter are the commonly used vehicles to divert funds from the bank funded borrower to the coffers of the promoter.

So why do banks and their customers resort to such convoluted transactions? Banks feel comfortable in financing trade rather than providing unsecured loans where end use of funds is difficult to track. Availing finance for fictitious trade transactions has proved to be an easy way for unscrupulous promoters to game the system with the help of gullible or bent bankers.

### **BETWEEN THE DEVIL AND THE DEEP SEA**

At the other end of the spectrum, treasury officials at credit worthy corporates and a bank's corporate relationship team have antithetical objectives. The former's KPI is to reduce banking costs, while the latter's goal is to increase revenue for the bank. Corporates play one bank against the other in getting the best possible rates. Doing business with top corporates yields abysmal spreads and fees, making it unattractive. Climbing down the credit ladder, banks can get more profitable business. But regular blowups, either due to genuine business failure or wilful defaults (which is often the case), make lending to this segment clearly unviable.

The banking system has built in safeguards in the form of capital requirement to withstand downturns. But those in business compete with each other to defraud banks and shareholders, with the system unable to bring the culprits to justice. Politicians who are close to the masses have gone to jail, albeit decades after the crime, but fraudulent businessmen are parked in safe havens in other countries. Perhaps businessmen have designed better exit strategies than politicians!

### **WHAT CAN CORPORATE BANKS DO?**

When lending to corporates, it is never easy to judge the promoter's intention. Horror stories abound, of Indian businessmen shopping around in Europe for import of machinery seeking the best possible quote not for what is good for the company (least cost of equipment) but what's good for the promoter (winning bid is the one that offers the highest kickback in an offshore account). Adding the promoter's upfront take-out grossly inflates the project cost, making it unviable from day one. And once the project commences operations there are innumerable ways to bleed the company's cash flows into the hands of the promoter. "Trade finance" can come in handy here.

Not all businessmen indulge in malfeasance. India has produced icons of corporate governance like the Tatas, [Narayana Murthy](#), Deepak Parekh and [Azim Premji](#). Sadly their numbers are far exceeded by those who strip the shareholders and banks bare. There are yet others who have turned legitimate and run some of India's most valuable corporations. "Behind every great fortune there is a crime" is a maxim attributed to Honore de Balzac.

Project, business and financial appraisal skills apart, being able to identify the intentions of a promoter to run the business, or to bleed it dry, makes the case for a successful corporate bank. That of course, is easier said than done.

*(The author is an expert on corporate banking and debt mutual fund investments).* Views expressed above are the author's own.

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