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Chapter 1 : Distressed securities - Wikipedia

The table also lists the number of firm-bank relationships associated with each distressed bank (related firms) in the year of the distress announcement and the number of relationships associated with non-distressed banks in that year (unrelated firms).

What kind of investments can produce such diverse returns? The answer is simple: The greater the level of risk you assume, the higher the potential return. Distressed debt sells at a very low percentage of par value. If the once-distressed company emerges from bankruptcy as a viable firm, the once-distressed debt will sell for a considerably higher price. Fixed income instruments such as mortgage-backed securities during the U. The Hedge Fund Perspective Access to distressed debt comes via several avenues for hedge funds and other large institutional investors. The easiest way to acquire distressed debt is through the market. Most mutual funds are barred from holding securities that have defaulted. Consequently, a large supply of debt is available shortly after a firm defaults. Hedge funds can also buy directly from mutual funds. This method benefits both parties involved. Both parties also avoid paying exchange-generated commissions. The third option is perhaps the most interesting. This involves directly working with the company to extend credit on behalf of the fund. This credit can be in the form of bonds or even a revolving credit line. The distressed firm usually needs a lot of cash to turn things around; if more than one hedge fund extends credit, then none of the funds are overexposed to the default risk tied to one investment. This is why multiple hedge funds and investment banks usually undertake the endeavor together. Hedge funds sometimes take on an active role with the distressed firm. By having more control over their investment, the hedge funds involved can improve their chances of success. Hedge funds can also alter the terms of repayment for the debt to provide the company with more flexibility, freeing it up to correct other problems. So, what is the risk to the hedge funds involved? Owning the debt of a distressed company is more advantageous than owning its equity in case of bankruptcy. This is because debt takes precedence over equity in its claim on assets if the company is dissolved the rule is called absolute priority. This does not, however, guarantee financial reimbursement. The first hurdle is actually finding and identifying distressed debt. Using the bond market, like some hedge funds do, is one option. These smaller par value investments allow for smaller positions to be taken, making investments in distressed debt more accessible to individual investors. The risks for individuals are considerably higher than those for hedge funds. Multiple investments in distressed debt likely represent a much higher percentage of an individual portfolio than of a hedge fund portfolio. This can be offset by exercising more discretion in choosing securities, such as taking on higher-rated distressed debt that may pose less default risk yet still provide potentially large returns. The Bottom Line The world of distressed debt has its ups and downs, but hedge funds and sophisticated individual investors have much to potentially gain by assuming the risk. Get a free 10 week email series that will teach you how to start investing. Delivered twice a week, straight to your inbox.

Chapter 2 : CiteSeerX â€” Firms And Their Distressed Banks: Lessons From The Norwegian Banking Crisi

This paper analyzes the relationship between banksÃ¢â‚¬â„¢ divergent strategies toward specialization and diversification of financial activities and their ability to withstand a banking sector.

A bank is considered healthy by the CBN if it maintain the following six criteria. Before any bank can be declared distressed, it must have defaulted in all the six criteria mentioned for more than a month. At times, due to unforseen circumstances, a bank might default in one or a few of the criteria, but it should be able to rectify its default position within a month. If however, it fails, it qualifies to be termed distressed, Ademu It is perceived as a bank which is unable to meet its obligation to its stakeholders as at when due arising from weakness in its financial operational and managerial conditions which could have rendered it either not liquid or insolvent CBN NDIC, This was earlier noted in chapter 1. However, the relevant stakeholders to a bank will include the depositors, the owners of the bank and the economy at large. From the foregoing it will be clear that failed banks will not only include the liquidated banks b ut also the problem banks that have exhibited some form of weakness in their financial, operational and managerial conditions which have rendered them either not liquid or insolvent. Before then, serious incidents of distress were relatively few and far between and generally control by the monetary authorities. The existence since then is of much deeper and more widespread incidence of traceable among others to, unhealthy competition arising from the rapid expansion of banks and non-bank institution, the limited deposit bases of several of the relatively new banks, the relatively large stock of non-performing assets in the portfolio of a number that change rapidly the interest rate especially in the interbank market for reserve balance and inside abuse and unprofessional conduct in a number of financial institutions CBN Annula report and statement of account These manifestation became known with some policy shocks in with the CBN directives to banks that Naira backing for foreign exchange application be lodged with the CBN. This was followed by another directive in requiring public sector deposits to be transferred to the CBN. These two directives exposed the liquidity positions of some banks to danger. What was then thought to be a temporary liquidity problem for a few banks soon caught up with a lot of banks. From , the number of banks that was declared technically insolvent rose steadily to 24 in and 34 in CBN Annual report and statement account The banks are financial distress during the year accounted for N More than two-thirds of the aggregate loans and advances of such banks were non-perforating while their aggregate adjusted capital stood at N4. While the initial core group distressed banks identified in were all owned by state government, identified composition has since become diversified in terms of ownership and include a significant number of privately owned banks. Akpala observed that as at the beginning of , distress in the financial system spread to a wider circle of banks, primary mortgage institutions and finance companies. Between this period and till date, a total of 36 banks licenses have been revoked and put on liquidation. The incidence of banks failure witnessed ins the s cannot be compared with the present situation. Infact the picture has been more dark. A total of 38 banks were distressed in December , This rose to55 in December the market share of the 60 distressed banks in deposit mobilization was N The distressed banks were accordingly overlent with average loans to deposit ratio of 94 percent. In addition, these distressed banks accounted for the N Thus non-performing credit over N This implies that for every one Naira of credit given out by these distressed banks only about 33 kobo is collectable. The capital invested by the owners in the distressed banks have been completely destroyed due to largely amount of non-performing credits. Altogether the 60 distressed banks had a are capitalization requirement ofN It is important to note that the difference in the numbers of distressed banks may have resulted from the use of different indicators by the two authorities. However, what is important is that at least 60 banks were distressed. The extent and magnitude of distress may have worsened as 36 more banks have been quit in liquidation See appendix 1. The current experience which became more manuifest since has the resemblance of the earlier one ins terms of causative factors. However, each occurred in different institutional and regulatory environment. There absent was a pool of trained and experienced personnel in economic and financial matters. However in May , distress in the banking system first came to existence after the withdrawal of treasury funds forms the licensed banks e. By , distress has become widespread in the Nigerian banking sector leading to the closure of four banks in early , Following the grave distressed financial condition of these banks, the merchant bank limited, Alpha merchant bank limited and united commercial bank limited and their licensed revoked by the CBN. The number of banks officially classified as problems banks especially in recent times is on thaw increase and have continued to be a serious concern to the government and the regulatory authorities. The distress in the banking system diminished slightly following the sustained implementation of the failure resolution frame work introduced, thereby putting the number of distressed banks at 52 as at the of December Implications Of Distress For The Economy Ebtiodaghe observed that the intermediating role of banks and their relevance both in transmission of monetary policies and in the payment system underline their importance as well as the problem that bank distress at the prevailing dimension in our economy could cause something bad. In the course of mobilizing financial surpluses bank issue claims securities on themselves to the fund owners. Such securities become less attractive in the event of widespread insolvency thereby increasing the holders risk exposure and also making them lose confidence in the banking system. This clearly paralyzed the development of a good banking culture. But more importantly, this development will cause the banks cost of intermediation to rise as banks will kneed to pay higher returns to attract and retain deposits. Coupled with this, there will also be great comprehensive uncertainly such that the perceived real returns on financial assets will be lowered. Another serious danger posed by widespread distress among banks is threat to the development of an efficient payment mechanism. Settlement of transactions will become mainly cash-based with its associated risks. Also the effectiveness of monetary policies will be reduced direct proportion to the extent of loss of confidence in the banking system as reflected in the instability that will characterized the demand for money and the proportion of money in circulation that will be outside the banking system as banks on longer serve as safe depositories. A good proportion of this represent idle fund that could have been effectively utilized in the productive sector if the banking system is stable, safe and sound. The cash-based nature of our economy not only chokes the development of the financial services industry by restricting efficient resources allocation and financial intermediation. Also there will be financial cost to be incurred by the economy in order of resolve the distress problem. This would even be more sever for a depressed economy that is already on the path of declining growth for example, the present financial condition of the hard core distress banks are tending towards irreversible distress situation Ebbiodghe also observe that the cost of recapitulating the distressed banks amounts to N As if to support this view the central Bank of Nigeria in a public notice January stated: In this connection it should be noted that under the same macro economic and regulatory environment various banks have continued. Whatever the case may be we shall discuss these of actors under two broad heading viz internal and external environment but with particular emphasis on the internal causes. The most prominent are management, fraud, non-performing loans and advances, capital inadequacy. Infect the difference between sound and unsafe banking on the other hand is the equality of management. From the above, it would appear that management is a decisive factor in determining the life or death of a bank. Consequently when banking license was liberalized banks and finance houses grew by leaps and bounds. This rapid growth of the banking system seriously diluted the quality of bank management. Okogi cities reported cases where bank managers accountants and customers colluded to deliberately cheat the bank. Thus, deliberate financial indiscipline, constantly committed by managers, accountants cashiers and clerks in collaboration with customers was a major contributory cofactor. Inept management was evident in credit administrations. Many of the banks had poor credit policies and incases where good policies were in place, such policies were never implemented faithfully. Some banks management environments were often characterized by instability f tenure of director and by management staff, frauds, weak internal control system as will as contraventions of well intended statutory regulations. United commercial bank, commercial trust bank and group merchant bank, commercial trust bank and group merchant bank all owned by payable holdings are cases in point. They are all now in liquidation as well as progress bank plc Oladepo writing on progress bank had this to say, The banks problems are multi-dimensional: It granted loans far excess of the banks ability and accusing fingers have been pointing in different directions among the principal actors. It is not surprising that progress bank which within 13 years of inception established 40 branches and five agencies making it one of the biggest banks in the country and effectively replaced the grounded African continental bank which had been to the Igbo what the National Bank of Nigeria was to the Yoruba failed the way it did. Management dug its grave. Same is the case with other failed banks. Indeed the real cause of bank distress in bad corporate governance as other Causes of distress results from bad management. As earlier stated the rapid growth of banking system saw many individuals without the requisite skills, regulation, knowledge and professional experience managing banks. This type of managers and directors were more interested in securing loans for their companies friends and relations. They grant connected loans without going through the policy procedure of hate institution. Very often no security is provided such securities are not perfected before draw-down. A bank is as strong as its capital base and steady growth in shareholders funds is a sure sign that a bank is sdoing well. Macullock in concluding his piece to America bankers said that the capital of a bank should be a reality not a fiction and that it should be owned by those who have a good number of the countries loans have been undercapitalized till date. These banks were thus not owned by men who had money to lend out by those who borrowed from depositors. In addition the banks capital were no longer a reality. The situation could also be attributed to the fact that many of the banks were established with very little capital. In particular most of the state government owned banks. The new generation banks which were involved in sharp practices, reckless and unbridled lending policies and procedures were equally afflicted by this virus. Today the minimum paid up capital is 25 billion whether the banks will meet this deadline is debatable. Most banks which were recently put in liquidation. The only way out for such banks is recapitalization. Liquidity Liquid connotes the ability of a bank to meet its financial obligation as and when due. It is achieved through efficient funds management. This occurs when there is a miss-match in the maturity profile of its assets and liabilities, that is when it borrows short-term and lends long. Consequently when short term funds are due for repayment they are unable. Akin to this over lending. Because interest rate was high, banks continued to lend without recourse to the lending limits. According to Ebhodaghe distressed banks were overlent with an average loans to deposit ratio of 94 percent which compare unfavorably with the maximum prudential ratio of 70 percent overlending may result in liquidity. When liquidity persists, such banks buy in liquidity by taking funds at excessively high rates. A survey of distressed bank balance sheets will reveal negative solvency ratio. Akintunde in his words says that most of the problems ins the banks are self-inflicted over the years. Fraud in the financial sector has developed is not Frankenstein monster just as easy money became the vogue. Ibrahim coomasic the inspector general of police said more than N

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Chapter 3 : EconPapers: Firms and their distressed banks: lessons from the Norwegian banking crisis

Although banks experienced large and permanent downward revisions in their equity value during the event period, firms maintaining relationships with these banks faced only small and temporary.

History[edit] The market developed for distressed securities as the number of large public companies in financial distress increased in the s and early s. The major buyers of distressed securities are typically large institutional investors, who have access to sophisticated risk management resources such as hedge funds , private equity firms and units of investment banks. Investors may also invest new capital into a distressed company in the form of debt or equity. While there is no precise definition, fixed-income instruments with a yield to maturity in excess of 1, basis points over the risk-free rate of return e. They depend on accurate market data from institutions such as CDX High Yield Index and India -based Gravitas, which combines risk management software with sophisticated risk analysis using advanced analytics and modeling. They produce customized scenarios that assess the risk impact of market events. Gravitas uses IBM Risk Analytics technology formerly Algorithmics , which is also used by major banks, to help hedge funds meet regulatory requirements and optimize investment decisions. Private investment partnerships such as hedge funds have been the largest buyers of distressed securities. The United States has the most developed market for distressed securities. The international market, especially in Europe , has become more active in recent years as the amount of leveraged lending has increased, capital standards for banks have become more stringent, the accounting treatment of non-performing loans has been standardized, and insolvency laws have been modernized. Sovereign debt[edit] In , Seveq observed that the emergence of the secondary debt market led to a "modern sovereign debt litigation" and the creation of an industry of "professional suers of foreign states". The strategy is most effective when the sovereign state lacks bankruptcy protection. These investors however are constrained by "the sovereign-immunity rules that national legislatures have enacted and national courts have elaborated" to protect the vulnerable nation states from litigation. In , a British high court granted the company "permission to enforce a claim for tens of millions of dollars against the Government of Zambia ". Before the hedge funds could collect their money, the Debt Relief Developing Countries Act [23] was passed in the UK parliament in after Liberian president and Nobel Peace Prize winner Ellen Johnson Sirleaf appeared on the BBC Newsnight program for the hedge funds to "have a conscience and give this country a break". Nick Dearden of the Jubilee Debt Campaign said of the change, "It will mean the poorest countries in the world can no longer be attacked by these reprehensible investment funds who grow fat from the misery of others". The law was made permanent in but there are still havens for this activity, such as the Channel Islands and the British Virgin Islands. A series of attempts were then made in Britain and the United States by organizations such as Jubilee USA Network , Oxfam and the Jubilee Debt Campaign to change the laws so that hedge funds would not be able to collect on their awards. He told The Guardian that the Democratic Republic of the Congo "desperately needs to be able to use its rich resources to alleviate poverty, not squander them on paying unjust debts". In , the nation restructured its debts. The original loans were exchanged for Brady Bonds , dollar-denominated bonds issued in the original amount of the loans. Elliott filed an injunction to prevent Peru from paying off its restructured debt without also paying Elliott. It was argued that Peru violated the " pari passu " clause, which states that no creditor can be given preferential treatment. The Ghanaian court held that Argentina had waived sovereign immunity when it contracted the sovereign debt being enforced. An appeals court heard oral arguments on February 27, and in June , the U. Levitin argued that the relationship between distressed securities investors and the U. He claimed that while these distressed debt investment funds can choose to "play the game" and "put their head in the mouth of the Leviathan ", the U.

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Chapter 4 : Why Hedge Funds Love Distressed Debt | Investopedia

1 Decoupling the Distressed Banks and their Clients, and Coupling the Distressed Firms and their Lending Banks Abstract This paper simultaneously investigates the responses of stock prices of the related banks.

History of private equity and venture capital and Early history of private equity The seeds of the US private equity industry were planted in with the founding of two venture capital firms: Morgan arguably managed the first leveraged buyout of the Carnegie Steel Company using private equity. History of private equity and venture capital and Early history of private equity The first leveraged buyout may have been the purchase by McLean Industries, Inc. These investment vehicles would utilize a number of the same tactics and target the same type of companies as more traditional leveraged buyouts and in many ways could be considered a forerunner of the later private equity firms. In fact it is Posner who is often credited with coining the term " leveraged buyout " or "LBO" [53] The leveraged buyout boom of the s was conceived by a number of corporate financiers, most notably Jerome Kohlberg Jr. Many of these companies lacked a viable or attractive exit for their founders as they were too small to be taken public and the founders were reluctant to sell out to competitors and so a sale to a financial buyer could prove attractive. Their acquisition of Orkin Exterminating Company in is among the first significant leveraged buyout transactions. Private equity in the s[edit] Main articles: Carl Icahn developed a reputation as a ruthless corporate raider after his hostile takeover of TWA in One of the final major buyouts of the s proved to be its most ambitious and marked both a high-water mark and a sign of the beginning of the end of the boom that had begun nearly a decade earlier. It was, at that time and for over 17 years, the largest leveraged buyout in history. The event was chronicled in the book and later the movie , Barbarians at the Gate: Many of the major banking players of the day, including Morgan Stanley , Goldman Sachs , Salomon Brothers , and Merrill Lynch were actively involved in advising and financing the parties. In and , a number of leveraged buyout transactions were completed that for the first time surpassed the RJR Nabisco leveraged buyout in terms of nominal purchase price. However, adjusted for inflation, none of the leveraged buyouts of the â€" period would surpass RJR Nabisco. Milken left the firm after his own indictment in March Brady , the U. History of private equity and venture capital and Private equity in the 21st century The combination of decreasing interest rates, loosening lending standards and regulatory changes for publicly traded companies specifically the Sarbanes-Oxley Act would set the stage for the largest boom private equity had seen. Marked by the buyout of Dex Media in , large multibillion-dollar U. As ended and began, new "largest buyout" records were set and surpassed several times with nine of the top ten buyouts at the end of having been announced in an month window from the beginning of through the middle of In , private equity firms bought U. July and August saw a notable slowdown in issuance levels in the high yield and leveraged loan markets with few issuers accessing the market. Uncertain market conditions led to a significant widening of yield spreads, which coupled with the typical summer slowdown led many companies and investment banks to put their plans to issue debt on hold until the autumn. However, the expected rebound in the market after 1 May did not materialize, and the lack of market confidence prevented deals from pricing. By the end of September, the full extent of the credit situation became obvious as major lenders including Citigroup and UBS AG announced major writedowns due to credit losses. The leveraged finance markets came to a near standstill during a week in Nevertheless, private equity continues to be a large and active asset class and the private equity firms, with hundreds of billions of dollars of committed capital from investors are looking to deploy capital in new and different transactions. In the s, insurers were major private equity investors. Later, public pension funds and university and other endowments became more significant sources of capital. Investor categories[edit] US, Canadian and European public and private pension schemes have invested in the asset class since the early s to diversify away from their core holdings public equity and fixed income. Instead, institutional investors will invest indirectly through a private equity fund. Certain institutional investors have the scale necessary to develop a diversified portfolio of private equity funds themselves, while others will invest through a fund of funds to allow a portfolio more diversified than one a single investor could construct. Investment timescales[edit] Returns on private equity investments are created through one or a combination of three factors that include: A key component of private equity as an asset class for institutional investors is that investments are typically realized after some period of time, which will vary depending on the investment strategy. Private equity investments are typically realized through one of the following avenues: Large institutional asset owners such as pension funds with typically long-dated liabilities , insurance companies, sovereign wealth and national reserve funds have a generally low likelihood of facing liquidity shocks in the medium term, and thus can afford the required long holding periods characteristic of private equity investment. The buyer exchanges a single cash payment to the seller for both the investments in the fund plus any unfunded commitments to the fund. Private equity secondary market The private equity secondary market also often called private equity secondaries refers to the buying and selling of pre-existing investor commitments to private equity and other alternative investment funds. Sellers of private equity investments sell not only the investments in the fund but also their remaining unfunded commitments to the funds. By its nature, the private equity asset class is illiquid, intended to be a long-term investment for buy-and-hold investors. For the vast majority of private equity investments, there is no listed public market; however, there is a robust and maturing secondary market available for sellers of private equity assets. Increasingly, secondaries are considered a distinct asset class with a cash flow profile that is not correlated with other private equity investments. As a result, investors are allocating capital to secondary investments to diversify their private equity programs. Driven by strong demand for private equity exposure, a significant amount of capital has been committed to secondary investments from investors looking to increase and diversify their private equity exposure. Investors seeking access to private equity have been restricted to investments with structural impediments such as long lock-up periods, lack of transparency, unlimited leverage, concentrated holdings of illiquid securities and high investment minimums. Secondary transactions can be generally split into two basic categories: Nearly all types of private equity funds e. The transfer of the limited partnership interest typically will allow the investor to receive some liquidity for the funded investments as well as a release from any remaining unfunded obligations to the fund. Sale of Direct Interests â€" Secondary Directs or Synthetic secondaries, this category refers to the sale of portfolios of direct investments in operating companies, rather than limited partnership interests in investment funds. These portfolios historically have originated from either corporate development programs or large financial institutions. Private equity firms[edit] Main articles: Private equity firm and List of private equity firms According to an updated ranking created by industry magazine Private Equity International [86] published by PEI Media called the PEI , the largest private equity firm in the world today is The Blackstone Group based on the amount of private equity direct-investment capital raised over a five-year window. The 10 most prominent private equity firms in the world are:

Chapter 5 : Financial Distress

CiteSeerX - Document Details (Isaac Councill, Lee Giles, Pradeep Teregowda): We use the near-collapse of the Norwegian banking system during the period to measure the impact of bank distress announcements on the stock prices of firms maintaining a relationship with a distressed bank.

Lack of commitment on the part of employees Irrational compensation structure Lack of expenditure control system Conflict among key personnel Deteriorating quality External Environment: The external environment may also affect the operations of a company adversely. Some of the major issues, which are generated by the external environment, are: Government policies regarding taxation, power tariff, power supply, customs duties and import duties, restrictions on imports and exports etc. Entry of large number of firms thereby sudden increase in the capacity 4. Development of new technology 5. Sudden withdrawal by some of the major customers resulting into decline in orders 6. Strained relationship with the external government 8. A change in the lending policies of the financial institutions Symptoms of Distress The financial distress is not developed overnight. Distress is the culmination of various factors. The symptoms of distress are visible in an organization when the unit shows incipient sickness. Some of these symptoms are: Declining sales revenue coupled with large number of rejections of consignments by the customers. Delayed payment to suppliers resulting into withdrawal of credit facilities by them 3. High leverage because of over borrowings 4. Default in repayment of interest and principal to financial institutions, bondholders etc. Declining capacity utilization 7. Lack of proper maintenance of plant, machinery and equipments 8. Poor asset turnover 9. Large accumulation of inventories Suppliers showing reluctance to offer trade discounts High labour turnover Extension of accounting period Value erosion in respect of shares and debentures Declining market reputation Default in payment of statutory dues A firm in distress needs assistance to tide over the situation. Often such assistance involves costs. The distress condition involves costs. The primary cost is the bankruptcy or insolvency costs. The cost of financial distress depends on the probability of distress and management of the distress costs Brealey and Myers â€” The bankruptcy costs to the owners depends on the type of organization. But in a joint stock company, where the liability of members is limited, the shareholders can walk off leaving the burden on the creditors. The loss to the shareholders depends on the value of the firm. A firm which was enjoying high market value, if suddenly turn to bankrupt, the shareholders may feel the loss heavy because of the sudden decline in the value of shares and thereby the decrease in their wealth. Now the question is whether the losses are for the shareholders alone. What about the other stakeholders like employees, suppliers of raw materials and spares, ancillary units and their employees, the shops and establishments in and around the company, retail outlets of the company, the state and the central governments, local administration etc. In a broader sense, the distress cost has to be born be the whole village or township or the area where the company is located. A distressed firm will always look for more funds and start borrowing heavily. This increases their leverage pushing them to a debt trap. Apart form the normal interest cost; a distressed firm has to pay overdue interest for the default too. Besides since the firm may be defaulting submission of essential financial and other information to the lenders, they may have to face penalty as well. The distressed firm will find it difficult to raise funds due to poor credit rating. Such firms may have to pay higher interest charges on their borrowings. This is in addition to the sacrifices they have to make by way of wage cut, cost reduction, expenditure cut etc. Remedies Any distressed person need the assistance of another person to come out of the distress state. The financial distress is also not an exception to this rule. Financial institutions have to identify their borrowers who are in distressed condition and refer them to a counselling centre. Centre for Resource Development Research CRDR had identified this need as back as in and had established a separate centre for financial counselling. Though the bankers had promised to direct the distressed borrowers to our centre, no customer were directed to us by any banks. However we had identified two cases and counselled these entrepreneurs. But the scheme did not take off due to lack of co-operation from the clients as absence of support from any financial institution. The process helped us to identify the following essential conditions for making the counselling process successful: The client should feel that he is in a distressed condition and need assistance; 2. The client should be willing to approach a counsellor 3. The client should enter into a contract with the counsellor that he would be committed to implement the solutions emerging out of the process. The client should divulge all his financial dealings to the counsellor in order to enable him to prepare various solutions so that the client can choose one among them. The client should have confidence on the counsellor and should be ready to work with him. The client should understand that financial counselling is not consultancy and the counsellor is not committed to obtain the financial assistance from any bank. The counsellor can only assist the client to prepare viable proposals and giving support to negotiate with the banks. The financial counselling is not a debt recovery mechanism. The counselling is a continuous process and the counsellor should be ready to work with the client until he comes out of the crisis. Financial counsellors should have excellent knowledge on banking practices and procedures as also working on financial projects. K who had put in 27 years of banking service, major part in credit and foreign exchange divisions and also holds 14 years of teaching experience in finance for business management students. Reserve Bank of India had identified this need and had started initiative in by appointing two committees; one headed by Mr. Both the committees had recommended to establish Financial Literacy and Counselling Centres FLCC by banks to assist the distressed farmers and borrowers. Hence RBI has issued a circular on February 04, directing all banks to establish FLCCs keeping an arms length from the banks by constituting trusts incorporating eminent persons outside the bank. No bank staff are permitted to be part of FLCCs other than paying occasional visits or giving dummy calls to check the efficiency of the working of the centres. Details of this scheme can be obtained from the RBI website www. P Lane, Thottakkattukara, Aluva, Kochi or send e-mail to crdrkerala rediffmail.

Chapter 6 : Firms and their distressed banks: lessons from the Norwegian banking crisis ()

Bank Structure and Competition FIRMS AND THEIR DISTRESSED BANKS LESSONS FROM THE NORWEGIAN BANKING CRISIS) Steven Ongena 'ilburg university.*

We test hypotheses about the effects of bank size, foreign ownership, and distress on lending to informationally opaque small firms using a rich new data set on Argentinean banks, firms, and loans. We also test hypotheses about borrowing from a single bank versus multiple banks. Our results suggest that large and foreign-owned institutions may have difficulty extending relationship loans to opaque small firms. Bank distress appears to have no greater effect on small borrowers than on large borrowers, although even small firms may react to bank distress by borrowing from multiple banks, raising borrowing costs and destroying some relationship benefits. So What Do I Get? Specifically, does establishing a lending relationship today add value for the Specifically, does establishing a lending relationship today add value for the bank by increasing the probability of attracting future business from the same customer? Indeed, many bankers view the generation of additional business as the principal reason for engaging in relationship lending. Our results show that a lender that has a strong relationship with a borrower has far greater odds of providing it with future loans compared to a lender lacking such a relationship. Existence of lending relationships are also strongly associated with an increased probability of winning future debt underwriting business from the same customer. Prior lending relationships also translate into a higher likelihood of a winning a co-manager role on equity underwritings. In sum, we document direct and measurable evidence of the value of relationships to lenders. We use a unique, new, database to examine micro depositor level data for a bank that faced a run. We use minute-by-minute depositor withdrawal data to understand the role of social networks, the effectiveness of deposit insurance, the role of relationships and other factors in influencing depositor We use minute-by-minute depositor withdrawal data to understand the role of social networks, the effectiveness of deposit insurance, the role of relationships and other factors in influencing depositor propensity to run. We employ methods from the epidemiology literature which examine how diseases spread to estimate transmission probabilities of depositors running, and the significant underlying factors. Our results suggest that social network effects are important but are mitigated by other factors, in particular the length and depth of the bankdepositor relationship. Depositors with longer relationships, and those who have availed of loans from a bank are less likely to run during a crisis, suggesting that cross-selling acts not just as a revenue generator but also as a complementary insurance mechanism for the bank. We further find that deposit insurance is only partially effective in preventing bank runs. Finally, we find long term effects of a bank crisis in that depositors who run do not return back to the bank. Our results help understand the underlying dynamics of bank runs and hold important policy implications. Show Context Citation Context Also, Lindengren, Garcia and Saal show that in the period between , countries experienced severe banking problems. A number of studies suggest that banks involved in mergers and acquisitions tend to reallocate their loan portfolio generating welfare effects for borrowers of the just-merged institutions. Gains from bank mergers may be offset by increases in market power and negative informational effects on the a Gains from bank mergers may be offset by increases in market power and negative informational effects on the availability of credit of borrowers that depend on relationship-based lending. On the other hand, other borrowers may benefit if bank mergers increase efficiency and credit capacity and they can extract some of the gains. We test these hypotheses employing a large sample of privately owned firms and analyze if their credit availability is affected by the involvement of one or more of their lenders in a merger or an acquisition. Following the literature on investment and financing constraints, we also test whether banking consolidation affects the investment-cash flow sensitivity of borrowers of banks that have merged. Finally, we focus on the effects of bank mergers and acquisitions on firms that should be more sensitive to disruptions in credit markets i. Interbank contagion at work: This article tests financial contagion due to interbank linkages. For identification, we exploit an idiosyncratic, sudden shock caused by a large-bank failure in conjunction with detailed data on interbank exposures. First, we find robust evidence that higher interbank exposure to the failed bank le First, we find robust evidence that higher interbank exposure to the failed bank leads to large deposit withdrawals. Second, the magnitude of contagion is higher for banks with weaker fundamentals. Third, interbank linkages among surviving banks further propagate the shock. Finally, we find results suggesting that there are real economic effects. These results suggest that interbank linkages act as an important channel of contagion and hold important policy implications. This has resulted in a significant decline of trading in the interbank money markets. In this paper, we empirically addres We study the credit supply effects of the unexpected freeze of the European interbank market, using exhaustive Portuguese loan-level data. We find that banks that rely more on interbank borrowing before the crisis decrease their credit supply more during the crisis. The credit supply reduction is st The credit supply reduction is stronger for firms that are smaller, with weaker banking relationships. Small firms cannot compensate the credit crunch with other sources of debt. Furthermore, the impact of illiquidity on the credit crunch is stronger for less solvent banks. Finally, we find no overall positive effects of central bank liquidity but instead higher hoarding of liquidity. The main channel through which a banking crisis may affect the real economy relates to the ability of the private sector to access the credit needed to fund investment and consumption. Hence, a key question at the heart of the current financial crisis is whether and how the sudden dry-up in bank liquidity impacts the availability of credit. We thank two referees, the Editor, and Victoria Ivashina for helpful comments and suggestions. We would The benefits of banking relationships: Mimeographed document by James Habyarimana , " Four Ugandan banks, including three domestic banks, were closed between September and May because of imprudent banking practices. This paper uses a unique bank-firm matched data set to estimate the effect of losing a banking relationship on firm performance. Employing a fixed effects diffe This result is robust to reverse causation; for a fairly well identified subset of firms, I find no evidence of firm decline causing banking failure. I investigate two potential explanations of this result: I find evidence for both views for mutually exclusive sub-samples. Insider firms experience the sharpest decline in employment relative to all affected firms. The insider effect persists even after controlling for the level of outstanding debt to failed banks. I interpret this as evidence of the looting view. In the set of potential non-looting firms, I find that older affected firms have larger declines in employment relative to younger affected firms. In addition, affected firms that do not produce hard information have the largest declines in employment relative to other affected firms. Moreover, affected firms that produce hard information have the same growth rate as unaffected firms. Finally, affected firms are more likely to report being credit constrained in the post crisis period. I interpret this as evidence for the information view. Resolving Large Financial Intermediaries: Scott Frame, Robert A. Eisenbeis , " This paper examines the policy issues with respect to resolving the possible failure of Fannie Mae or Freddie Mac housing enterprises. We compare and contrast these issues with those raised in the context of large bank failures and also identify important differences in the extant supervisory auth We compare and contrast these issues with those raised in the context of large bank failures and also identify important differences in the extant supervisory authorities. Based on these discussions, we offer a number of policy suggestions designed to minimize the cost of resolution and protect taxpayers from loss should a large bank or housing enterprise fail. Kane , " The views in this paper are solely the responsibility of the authors and should not be interpreted as reflecting the views of the Federal Reserve Bank of San Francisco or the

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Bank distress appears to have no greater effect on small borrowers than on large borrowers, although even small firms may react to bank distress by borrowing from multiple banks, raising borrowing costs and destroying some relationship benefits.

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Banks are moving both residential and commercial loans off their balance sheets at a faster pace and at higher prices than at any time since the beginning of the financial crisis.