

**BANKER AND CORPORATE
CUSTOMER**

R. K. TALWAR

1974

BANKER AND CORPORATE CUSTOMER

R. K. TALWAR

1974

Published by

THE A. D. SHROFF MEMORIAL TRUST

235 Dr. D. N. ROAD,

BOMBAY - 400 001.

THE A. D. SHROFF MEMORIAL TRUST

(Registered under the Bombay Public Trust Act, 1950).

BOARD OF TRUSTEES

N. A. Palkhivala (Chairman)

B. M. Ghia, Jaykrishna Harvallabhdas, Sir Cowasji Jehangir, Bart., Tulsidas Kilachand, J. H. Tarapore, K. M. D. Thackersey.

Honorary Secretary: M. R. Pai

OBJECTIVES

- (i) Publication of one or more books in English, Hindi, and regional languages annually on some of the great builders of Indian economy aimed primarily at educating the younger generation in high standards of building the national economy as practised by those great entrepreneurs and placing the example of their lives for emulation by India's youth.
- (ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.
- (iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.
- (iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce, Bombay.
- (v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them; and
- (vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the Trust Fund shall be utilised for all or any of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

INTRODUCTION

The annual public lectures of the A. D. Shroff Memorial Trust have been delivered by professional men who are experts in the vital fields of banking, industrial finance and insurance. These lectures constitute a significant contribution to enlarging the frontiers of public knowledge. There could be no more fitting tribute to the late Mr. A. D. Shroff, who was himself a distinguished economist in the forefront of economic activity in this country.

For the year 1974, the Trust had the privilege of arranging a talk by Mr. R. K. Talwar, a distinguished banker by profession and the Chairman of the State Bank of India. His theme is the emerging trends in banks' relations with the corporate customer.

The publication of the text of this absorbing and highly pragmatic lecture will enrich public thought on this very topical subject.

N. A. Palkhivala

Chairman

Bombay

The A. D. Shroff Memorial Trust

June 27, 1974



A. D. SHROFF
(1899 - 1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff :

"In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

Published by M. R. Pai on behalf of The A.D. Shroff Memorial Trust, 235, Dr. Dadabhai Naoroji Road, Bombay 400 001, and Printed by Michael Andrades at The Bombay Chronicle Press, Horniman Circle, Bombay 400 001.

BANKER AND CORPORATE CUSTOMER

By

R. K. TALWAR *

I consider it an honour to have been invited to deliver the A. D. Shroff Memorial Lecture this year, and I must express my deep gratitude for it to the Memorial Trust, and specially to its illustrious Chairman, Mr. N. A. Palkhivala. I did not have the good fortune of meeting Mr. A. D. Shroff, as it was not until 1966 that my career brought me to this great city. Even from a distance, however, I had known of his reputation as a distinguished economist, business executive of high integrity, and, above all, as a warm hearted person, held in esteem even by those who did not feel as strongly as he did for the cause of free enterprise within the framework of planning. How far did he go in championing this cause? Not as far as the *laissez faire* philosophy of the early 19th century. In fact, the manifesto of the Forum of Free Enterprise which Mr. Shroff founded in 1956, made this abundantly clear. The incompatibility of that system with the planning era is axiomatic. The fact that Mr. Shroff served as a member of the National Planning Committee of the Indian National Congress in 1938, and was one of the eight

* Mr. R. K. Talwar is the Chairman of the State Bank of India, (formerly Imperial Bank of India). Joining as Probationary Assistant in 1943, he became its Chairman in 1969. He is a member of the Board of Governors, Indian Institute of Management, Ahmedabad, and Member, Governing Board for the National Institute of Bank Management.

authors of the Bombay Plan of 1944, which envisaged a variety of controls, should testify to his willingness to circumscribe the freedom of enterprise for the larger social good. His crusade was only against what he regarded as pointless and hurtful encroachment of that freedom. Yet, somehow or the other, Mr. Shroff's name got linked with that outmoded and discredited doctrine, which I think is sad.

While thinking of a subject for today's speech I toyed with the idea of discussing the whole spectrum of banking — its structure, obligations and potential. I overcame that temptation, not that I fought shy of it, and decided to deal instead with a facet which I regard as currently topical and important. My subject, therefore, is 'Banker and Corporate Customer'. By corporate customer I mean the large-scale or medium-scale industrial or commercial borrower, in private, public or joint sector. My effort is to portray a picture of the emerging relationship between the two, and if it is not true to today's reality in all detail, it is at least true to the picture that I visualise as a professional banker. The subject has another significance. It is a coincidence that Mr. A. D. Shroff had guided the deliberations of an official committee on a very similar theme some eleven years before his passing away. It was the first organised effort at assessing the ability of the banking system to meet a given situation. I am referring to the Committee on Finance for the Private Sector, set up by the Reserve Bank of India on 5th October, 1953, to

examine how increased finance could be made available to the Private Sector, particularly by banks. This committee of seven members, with Mr. Shroff as Chairman, submitted its report in April 1954. The problem then was how to achieve the targets for industrial investment, described as 'modest', set out in the First Plan. As far as short-term capital was concerned, however, little difficulty was being experienced by large-scale industry in obtaining it. A particular question before the Committee was whether the banks would be able to supply an additional amount of Rs. 158 crores, as envisaged in the Plan, from their resources, the bank deposits being of the order of Rs. 850 crores. The borrowing customers were essentially those engaged in commerce, claiming nearly half of the banks' resources, one-third being claimed by industry, mainly textile and jute mills and sugar factories. The Imperial Bank's nationalisation was still a year away and naturally there were no claimants from what is now called the priority sector — agriculture, small-scale industry and exports. The monetary authorities' main concern was to ensure that credit was directed into lines which had priority in the programme of development and was not utilised for speculative purposes. They sought to influence the lending policy of commercial banks through suasion and advice.

The 20 years since then have seen a sea change and I need not discuss the Shroff Committee's recommendations or the reasoning behind them, except to pay a tribute to the deep insight into the

needs of economic development that it revealed. Today the banks' deposits total Rs. 10,000 crores and more than half of the total credit goes to the large and medium industry. Industrialisation has proceeded apace. Though the economy's growth rate may leave much to be desired, the quantities and variety of goods and services produced are such as might have seemed too ambitious two decades ago. At the same time, the problem of paucity of resources continue to dog us, if in a somewhat different garb. It is perhaps a characteristic of a developing economy that investment in both private and public sectors should keep running ahead of the real savings. Expenditure also runs ahead of income. The gulf becomes wider whenever exigencies, such as drought, or war with a neighbouring country, or an occurrence abroad such as a spurt in crude oil prices, eat into those savings and upset the income-expenditure budgets.

I believe that I am not committing a breach of the Official Secrets Act when I say that our Governments, both Central and State, have been running budgetary deficits, which have assumed larger proportions in recent years. I have no views to offer on fiscal management, nor on monetary management for that matter, but what is relevant for my purpose is that in addition to the Government's deficit financing, net bank credit to the private sector is also responsible for increasing the money supply, or at least this is the view that has prevailed. Under the circumstances, the Reserve Bank has to act and improvise a variety of restraints

on bank lendings, and banks become susceptible to those, particularly, when they have to turn to the lender of the last resort. This year's restraints were remarkable for the elements of both novelty and severity, and their compliance by banks perhaps involved a degree of harshness too. The purpose of these restraints, as I understand it, is not to forbid expansion of credit altogether, but only to check it, ensuring at the same time that the genuine productive needs are met. That at least is the genuine effort, claims on genuineness of productive need alone being sometimes in dispute.

As far as large industrial borrowers are concerned, they are no doubt our valued customers, but they had their heyday. I am afraid they must now reconcile themselves to the existing socio-economic priorities, despite their continuing importance and claim for the solicitude they once had. Another lesson that corporate borrowers must learn in their current relationship with bankers is that bank credit is no substitute for capital. Bank credit takes the form of primarily short-term working funds and to some extent of term loans. Capital must come from real resources available for the creation of productive assets. The days when bank credit could be taken professedly as short-term loans and utilised for capital assets are past.

I think it will be appropriate at this stage to look back at the changing pattern of the relationship between the banker and the corporate customer. There was a time when the identity of an individual borrowing company carried little

weight with the banker. What counted was the managing agency house behind it. It will be uncharitable not to recognise in retrospect that they propelled such growth of industry as ensued, and the banker provided funds at the behest of the managing agency with a sense of delight and pride. Those were the good old days when resources were plentiful if only because the developmental process was slow. Bankers used to watch out for avenues of deploying funds, their concern being primarily with the safety of loaned funds. In this respect, guarantees by managing agencies constituted as good a security as any other. Some attempts were no doubt made to elevate the banker's role to a more enlightened participation in industrialisation, following the example of German banks, and one such attempt was the Tata Industrial Bank in 1917. These ideas, however, being far in advance of the times, the experiment did not meet with heartening success. When the pace of industrialisation did pick up, the banker stuck to his traditional role of lending against security, and the guarantee of management; if he felt impelled to evince greater interest in the proper running of the industry, this too he left in good faith to the nursing care of the managing agent.

The economic and industrial scene has now become transformed. Managing agency houses have disappeared, or at least their old garb has, which I do not say wistfully despite my admiration for the role they once played. Happily, a new class of entrepreneurs has come to the surface, and

their base is being broadened. Independent companies, unconnected with any house, are being formed. Public sector companies have also made headway. Top-management has been, or at least is being, divorced from ownership. The accent is on professionalisation. Above all, with the nationalisation of the big commercial banks, the outlook of bankers has changed.

Professionalisation of top-management is, of course, to be welcomed in the larger interests of the country, but let us not pretend that all corporate customers have taken to it in the right spirit. There is first of all the problem of different perceptions of the goal of the corporate enterprise between the owner and the manager. We have to reach a stage where both decide on the common goal. This is as true of the public sector company as the private enterprise.

From the banker's point of view the problem is that the professional manager may not stick it out in times of difficulty. He may discover fresh woods and new pastures elsewhere. The managing agency houses are not there to initiate a rescue operation. Their association no doubt continues in a different form, that of consultants without managerial and financial responsibility, and I am not looking down on it. The result, however, is that when a company falls on evil days, it does not have many sure sources of assistance. The banker, when approached in such circumstances, may find himself embarrassed because of the qualitative change in the risk.

It is this climate that has reduced the importance of security, without eliminating it, in credit decision-making. After all, why were the guarantees of managing agency houses important? Not very much because of the value of the assets they flaunted. The importance lay in their **bona fides** of which the guarantees were an earnest. They inspired confidence that they would make the necessary changes in management to improve its quality and ensure the provision of any other necessary inputs to pull a company out of a morass. Since the managing agents are no longer there to take over charge of the steering when necessary, it is the banker who has to satisfy himself that it is in the hands of a skipper of integrity and competence, that the affairs of the company are moving in the promised direction, and that if a storm comes there are reasonable chances of it being weathered. The emphasis has thus shifted towards good management, a good substitute for which, alas, still remains to be invented.

If the consideration of security has only been demoted, and not dispensed with altogether, it is for a good reason. It serves as a sort of insurance against a possible loss to the banker, but it is no longer the **raison d'être** for lending. Let me illustrate. A structural unit requires additional finance. It has enough security to offer in terms of large stocks of iron and steel, on the basis of which we would until recently have had no qualms in sanctioning the additional finance. Now, however, we make enquiries about its book debts. On

finding these to be too high in comparison with those of other units in the very same business, we get a smell which is not refreshing. We may still lend as a temporary measure, but bring our influence to bear on improving the asset management. As a corollary to this change in outlook, our appraisal skill has been updated and is more detailed. The end-use of funds has assumed new importance. It has to be acceptable to us. That entails calling for budgets and cash-flow statements. We also lay down conditions in regard to utilisation of bank credit. After lending, where a banker was once satisfied with a simple stock statement, he would now like to have additional operational data.

The emerging discipline as it exists, or as it should, calls for a new look at the nature of the banker's involvement in the customer's operations. It is often asked whether a banker should go into the affairs of the customer in such great detail when he is giving a short-term advance repayable on demand. The plea that the overdraft, or cash credit advance, is highly liquid, being repayable on demand, is a myth. Even a first rate customer, in a highly profitable industry, can rarely if ever, repay on demand a cash credit advance. As a matter of fact, every company seems to bank on endless resort to bank finance. No new company issue is advertised, without a substantial provision for bank finance to meet its working capital needs and its clearance by the Controller of Capital Issues indicates that such an arrangement has his tacit and general approval.

Availability of bank finance on a more or less permanent footing is taken for granted from the very beginning. How then can we regard cash credit lending as short-term lending? It is so in theory, not in practice. The point I am making is that the distinction between long-term lending and the so-called short-term lending is somewhat academic in the context of high dependence on bank borrowings. A banker is, therefore, as much interested as any other term lender in the borrowing customer's quality of management, financial planning and viability of operations, irrespective of whether the customer belongs to the public sector, private sector or joint sector.

In developing the new pattern of relationship with the corporate customer, the banker will ensure not only the safety of his funds, but will also fulfil his social responsibility, to set aside an increased portion of available credit for priority sectors and weaker sections of the society, and to see, as far as large houses are concerned, both in private and public sectors, that no more than the clearly established minimum needs are sought to be met. He will also safeguard the interests of the shareholders, which is incidental to safeguarding his own. The assumption of this function by the banker may look somewhat far-fetched but I don't think it is. There need be no misgivings or clash of interests over this, since the aim of company managements also is to earn adequate return for the shareholders. Company managements whose dependence on bank finance is high should not look

askance at the banker's role as a benevolent Nosey Parker, and should, I think, willingly suffer him in the interest of business. I am happy to say that the response of corporate borrowers is by and large getting attuned to this philosophy, though I wish progress was faster. Not all respond readily. Some resist. Others are half-hearted. I referred earlier to our updated appraisal drill. Its objective is to identify the precise purpose for which funds are sought and to quantify the need; also to ensure that there is proper planning, and that for specified need appropriate type of finance will be raised. I would appeal for greater appreciation of the banker's new role and his stake in financial strength and profitability of operations.

The banker's interest does not and should not end with the decision to lend just because it has been taken after the most rigorous credit appraisal. He has to make sure that the borrowed funds are utilised for none other than the ostensible purpose. He would accordingly like to stipulate conditions governing future conduct of the company's financial operations. For instance, if the customer borrows funds for working capital, that, in fact, remains the purpose for which these will be put. This is where the rub comes. The follow-up watchfulness is objected to. In one case we insisted that the borrowing company should not invest in shares of other companies, or grant loans to them, or invest in fixed assets during the year beyond a given limit without the bank's consent. As should be obvious, the intention was that such investments

should come not from bank borrowing for working capital, but from other sources such as long-term loans or internal generation or additional equity. Our anxiety was that the company's liquidity should not suffer from diversion of working capital finance to long-term investment. In another case our condition was that the company should not declare dividends out of past reserves without our consent. If it did, it would do so only if the current year's profits were inadequate, in which event its net worth would decline and its liquidity would also suffer. These are, after all, matters of vital concern to the banker, once it is accepted that in the revised context he is entitled to look into the company's operations and financial picture, despite the security that may have been provided for the advance. In both cases, although we explained that a customer could always clear his proposal with us in advance and seek exemptions, the responses were resentful. The closer and continuous relationship that we wish to build will be strengthened if the corporate customer voluntarily gives us all the needed information. The next best thing he can do is to give it when asked.

A new phenomenon is the emergence of the joint sector, where the resources of both private and public sectors are pooled together and the enterprise is entrusted to professional management. Even here, dependence on bank finance is fairly large, and I see no reason why the banker's approach should be any different. On the contrary, I would say that the need for close relationship

between the banker and the customer is all the greater, since the banker has to see that diffusion in ownership does not throw up or accentuate managerial weaknesses. In respect of the public sector too, I would advocate the same approach. Government, as the owner of the corporate enterprises, should in fact welcome the closer involvement of the banker in the common interests of both.

I was most reluctant to cite difficulties of customers in support for the new pattern of banker-customer relationship that I am canvassing. It does happen, however, that in hard cases the virtue of the pattern is vividly illustrated. Traditionally, the banker would react to a problem situation with anxiety to recover his advance by the sale of security. He would say he has no role to play in revival, and God help that company. But in the new context of closer involvement of the banker and the customer it would be the banker's responsibility to detect danger signals in time, and prescribe remedial action. If the customer still ran into difficulties, the banker's first inclination would be and should be to see if the position cannot be retrieved. He should not run away from the heavy responsibility of rehabilitation and revival steps.

Problem accounts do disclose danger signals. In the case of a multi-unit company, book-keeping itself was found to be very much in arrears. Requests for additional funds were not supported by convincing data, and no forward planning was evident. Our analysis revealed that the company's

accounting system was outdated, and management information system was absent. After discussion it was agreed that the company should seek assistance from the management consultancy division of a reputed firm of chartered accountants. We are now endeavouring to have the consultants' report implemented. In a second case, that of a large company run almost wholly as a proprietary concern, we had to convince the management of the need to appoint well qualified professionals in high positions and delegate adequate powers to them. Following a consultants' study of all aspects of the company's operations, we sought implementation of many of the recommendations. Simultaneously we also granted the additional advance sought by the company.

In a few cases we have found it necessary to appoint our nominee on the board of directors. These nominees were not our officers, but acknowledged specialists who could provide the company with necessary expertise in the area of weakness. The easier way out in some of these cases would have been to seek intervention of a Government agency, or its takeover under the Industries (Development and Regulation) Act and pass the burden of rehabilitation to Government. We took the view that it would not be proper. I can say with pride that several of these companies have turned the corner and the need to invoke Government assistance has been averted. I cannot help reflecting that had this approach been evident amongst bankers, not excluding those from State Bank, some

years ago, and had the requisite degree of cooperation also been forthcoming from the customers' side, the history of many of today's sick units might possibly have been different. Even now, if the banker perceives his role as being far wider in scope, the burden which devolves on Government in assisting enterprises in distress, either through takeover of management or through nationalisation, could well be lightened.

If there is to be a meeting ground between the banker's interest in preserving the safety of his funds, and the corporate customer's interest in earning profits for the shareholders, there is need for coordination with the auditors as well. Their role is also the same. Yet, unfortunately, the auditor's role is often perceived as being limited to the statutory function of auditing the books and drawing up the annual accounts. As a matter of fact, the banker and the customer should jointly seek the auditor's assistance in looking into other aspects of the company's operations wherever thought necessary. In some cases our attempts to seek clarification from the auditors on specific items in the balance sheet, which we spotted as potential trouble spots, have failed. In one company the value of book debts seemed high in relation to the turnover. We wanted to know from the auditors how they had assessed the solvency of these assets. The company itself authorised the auditors to give us whatever information we sought. Yet the auditors did not oblige. I see a clear need for the banker, the customer and the auditor to come

together in the common endeavour of presenting a true picture of the company's affairs to the shareholders, and to the banker as well. Very often the banker's stake is far higher than that of the shareholders, and I trust his need for adequate information will not be challenged. In any case it is in the interest of the shareholders themselves that the company's banker is kept fully informed and in good time of major decisions, such as expansion and diversification which entail deployment of large funds.

Many of the small-scale units are outgrowing their defined limits and entering the medium-scale sector. In most such cases, however, the thinking of managements still lags behind in the small-scale stage. Our experience shows that the banker has a special responsibility in assisting in the transition process. Difficult decisions have to be taken in regard to broadbasing equity, engaging professionals and delegating authority. Small industrialists, however, are dismayed by the prospect of parting with immediate control and view the future with trepidation. The banker has to reassure the customer and help him grow bigger and faster on sound lines. Here again the need for a new relationship between the banker and the customer will be seen. It is with the aim primarily of assisting the small-scale units to grow bigger that we in the State Bank have set up a Merchant Banking Division, and if this much publicity for it is permissible, I trust they will take the fullest advantage of it.

I have earlier referred to the current credit restraint and also to the overdraft system. If I revert to these now, it is only to make the point that the budget of the banking system cannot be planned independently of the budgets of the customers. I would, therefore, like the corporate customer to keep the banker posted in respect of operational plans for the coming year. Having known of the customer's plan, the banker would take it into account in formulating his own budget. There could thus be a dovetailing of the customer's budget and the banker's budget and the latter's credit plan for the future. If this could be done for the banking industry as a whole, warning signals of any imbalance between the demand side and supply side of funds could well be detected in advance. Even then there is no guarantee that the budgets of the customers or of the bankers will not be upset by sudden changes in monetary policy, but the chances are that these may themselves influence monetary policy.

What I have pleaded for so far is a relationship of enlightened proximity between the bank and the corporate sector, in place of that between a money-lender and borrower. It will not, I hope, be construed as a diabolical plan on the part of the banker to have a finger in industry's pie. That would mean crediting us with too much ambition. There is certainly no ideology behind what I have said. Managing the banks is more than a full-time job for us. We do not have spare energy. We are not looking forward to participating in industry's

managerial functions, much less to taking them over. This reminds me of an aspect of Mr. Shroff's personality. When I was recently refreshing my memory of the Shroff Committee Report, an interesting recommendation caught my eye. This was that financial institutions like the Industrial Finance Corporation of India should have the option to convert the whole or a part of their loan into equity capital. It is amusing to reflect that when the same proposition came many years later from the Government, it was dubbed as a surreptitious design to take-over private industry. Let us champion a cause by all means, but let us also do it in the larger perspective as displayed by Mr. A. D. Shroff. •

All I have so far said is that with the present heavy dependence of companies on bank borrowings, it is not merely unavoidable but desirable for banks to go closer to the customer. If this suits the banker, it is no less in the interest of the company and ultimately of the shareholders. In this context may I also say that reduced reliance on bank borrowings will make for a stronger financial base and facilitate expansion on sound lines. The question may well be raised if the banker-customer relationship would not change in that event. I do not foresee a qualitative change, only relaxation of some of the terms and conditions. I am also hoping that many of our today's heavy borrowers will become tomorrow's heavy depositors, turning the table against banks and seeking to scrutinise closely our balance sheets.