

Involvement of Banking in the Commonwealth of Independent States

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C O N N E X I O N S

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Chapter 1

The Role of Banks in the Process of the Restructuring of Joint-Stock Companies¹

The world has developed many forms and methods for the participation of banking institutions in the modernization, technical and technological development of joint-stock enterprises (companies with Government shareholders). Such participation allows for a raised level of competitiveness of the joint-stock companies, and a general efficiency of a social production:

- The creation of new jobs (positions).
- The improvement of the working environment.
- Redefining corporate culture (code of ethics).

As a prospective direction of the activity of banks in creating the conditions for the elimination of the consequences of the world financial crisis, their participation in restructuring the activity of strategically important joint-stock enterprises make a significant impact in the core of real sectors in the economies (i.e., services and manufacturing) of the majority of the Commonwealth of Independent States (CIS) countries. In particular, their potential impact can be in the creation of new jobs, the modernization of manufacturing processes, the production of goods for export, and the management of corporate marketing efforts.

Considering their status and historically developed image as reliable financial institutions, and taking into account capitalization and financial mediation, the CIS banking sector is much better prepared in the role of institutional investors, than the operating companies or investment institutes. The CIS banks can accompany the joint-stock enterprises through the whole process of preparation and realization of programs of restructuring, as well as providing good capitalization, qualified managers, and provide a high quality of institutional investor.

Starting this modernization processes, commercial banks should represent accurately the maintenance and volumes of forthcoming changes in organizational structure of the joint-stock enterprises' management, in the industrial-economic sphere of the given specific category of the company, in the structure of their property, and also in the structure of actives and assets and liabilities.

The great value in the process of modernization of the joint-stock enterprises is the correct choice of various forms of restructuring that can include restructuring of the structure of its share capital, restructuring of available debts or restructuring of actives at the companies disposal. Restructuring of the structure of the share capital of a joint-stock company should be directed on optimization of corporate relations between shareholders, and attaining parity between the quantities of ordinary actions as a part of their large packages that are in the property of separate co-owners of the enterprise. Restructure of debts available for the joint-stock enterprise should be in repayment, write-off, a delay, installments, converting, debt consolidation, and also in purchase or sale of promissory notes, an exchange of separate kinds of debts. Restructure of actives

¹This content is available online at <<http://cnx.org/content/m34191/1.2/>>.

at the enterprise should assume sales by bank of its superfluous actives, tenancy, transfer to pledge of a part of actives, property acquisition, parity change between real and financial actives, liquidation of unprofitable actives.

On the degree of influence on central direction of the business of a joint-stock enterprise, managers of the bank's investment divisions should not only be able to define the restructuring based on calculations for the long-term period of development of the enterprise, but also define financial re-structuring, assuming updating of the enterprise in the short-term period of time.

Proceeding from methods of restructurization used by banks, it is necessary to keep in mind differing, but closely interconnected, directions of restructurization for the joint-stock enterprises.

- Restructurization of the enterprise by changing the scale of their activity, either towards increasing or reduction.
- Restructurization of the enterprise by influence on the structure of the property and quality of the corporate monitoring in the joint-stock company.
- Restructurization of business by changing the internal organizational and industrial structure of the enterprise.

Considering a wide spectrum of forms and methods of restructurization of joint-stock enterprises, the activity of commercial banks in any given sphere of business should be based on market principles. In particular, timely research on the resources needed for the realization of the processes of restructurization of a joint-stock company. The rational distribution of resources, and most importantly, their use should be aimed at the principles of prompt repayment and recoument of debt. In this connection, the mechanism of participation of banks should lean towards targeted loans to meet the needs of restructurization of strategically important enterprises, or on weighed business plans and technical-economic calculations. The commercial structures specially created for this purpose, must wish to be engaged, in this difficult capital-intensive and risky process on a professional basis.

The important starting stage of successful realization of programs of restructurization of strategically important enterprises is an active participation of banks in the research of necessary sources of financing. Thus the greatest effect can be yielded by the use of such sources.

- The budgetary funds provided for financing of investment projects, included in the state investment programs.
- Target means of off-budget funds functioning in the CIS countries.
- Privatization of objects of the state ownership, intended on post privatization support of the joint-stock enterprises.
- Grants of international financial institutions and means of interstate technical help.
- Investment resources of banks, insurance and other financial institutions, and also venture funds and other commercial structures.
- Own means of strategically important privatized enterprises involved at the expense of use of tools of joint-stock and debt financing, leasing, tolling, franchising and others.

One of the main difficulties in the way of participation of banks in the processes of restructuring of joint-stock companies in the CIS countries is the acute shortage of long-term financial resources at the majority of commercial banks. In this connection, the role of such tools as securities of commercial banks and the strategically important enterprises, allowing the mobilization of free financial resources of participants of the share market having their surplus increases, but not capable or unwillingness to develop their potential at the expense of own participation in investment business increases. However, for the escalation of scales of issue activity of banks and joint-stock companies, and also the attraction of resources of foreign and internal investors, state bodies and economic departments of the CIS countries should create a favorable mode of the activity, allowing compensation for the risks connected with restructuring of activity of domestic commodity producers.

In due time, prepared and qualitatively carried out with participation of banks, restructuring of various parties of their business has the capability to provide securities of the given enterprises to foreign markets

of capital and to involve foreign investments for their innovative development, which will be positively reflected in the growth of investment appeal of securities markets formed in the CIS countries. Thus, the process of participation of banks in restructuring the strategically important joint-stock enterprises should be considered, as an obligatory stage on the path to the formation of the competitive market in the CIS countries, capable of providing a modulation of capitals and innovative development of most enterprises of real sector of economy. The given problem is not only especially economic, but is also of sociopolitical value, since it opens prospects for the creation in the CIS of new workplaces and the increase of a standard of life of the population of these countries.

*CHAPTER 1. THE ROLE OF BANKS IN THE PROCESS OF THE
RESTRUCTURING OF JOINT-STOCK COMPANIES*

Chapter 2

Increase of Efficiency in the use of Securities in Eliminating the Consequences of the World Financial Crisis¹

An essential requirement for the banking sector, in the realization of the conditions to eliminate the consequences of the world financial crisis, is that commercial banks must evolve their approach to the use of available financial resources, in particular the evolution of an efficient policy for mobilization of financial resources through the security markets. In this connection, further successful functioning of commercial banks in the Commonwealth of Independent States (CIS) countries becomes almost impossible without skillful use of huge potential of the securities, capable of making a positive impact on strengthening the structure of their capital, the expansion of their resource and client base, the increase of level of liquidity, and profitableness of the bank business.

Under conditions in which there is insufficient capitalization at the majority of banks of their own circulating assets, the securities market becomes one of few real solutions to the problem. It is important to research into means for development of a bank business and innovative development of enterprises. On the other hand, recent events have convincingly demonstrated that, during the post crisis period, banking institutes should not only learn how to use the huge potential of securities, but they must also take an active part in the restoration of trust of both large institutional investors and skilled investment intermediaries.

The world financial crisis has forced many banks to reconsider their business strategies, by emphasizing the search of alternative sources of expansion, strengthening their resource base with the increase of level of capitalization, and the ability to get through the struggle for available managed financial resources and savings by individuals. The effective help in increasing the level of capitalization of bank institutes was rendered by the governments of many countries of the world.

To the internal factors influencing increase of level capital adequacy of bank business in the country, it is necessary to carry such factors as:

- A real rate of inflation.
- Features of an investment policy spent by the state.
- The character of regulation of issue activity of banks.
- The degrees of their interest in expansion of scales of additional release and placing of stocks.

Thus, the constantly growing capital of commercial banks, and the potentials of its basic functions that play the important role in maintaining sustainable development of banking establishment, has demanded the

¹This content is available online at <<http://cnx.org/content/m34192/1.2/>>.

formation of an accurately expressed emission policy directed to escalating the level of its capital intensity and maintaining the necessary level of capital adequacy of banks. However, a condition for the increase in investment appeal of securities provided by the banks should become the radical re-structuring of various parties of bank business, the introduction of effective methods of corporate governance directed on maximization of profit and reduction of risk, carrying out weighed dividend policies and the constant training of bank personnel to the expansion of a spectrum and improvement of quality of services rendered to clients, and also a permanent work on ensuring the transparency of the bank business as a whole.

In order to restore the trust of potential investors, commercial banks of the CIS should master the methods of modern investment business, the organization of advertising and marketing programs, and also in communicating with the mass media. With that end in view, the CIS countries' short-term prospect on the institute of market-makers should be extended at the expense of potential use of known international investment institutes, which are capable of engaging on a professional basis in forming their image, and demand for different kinds of bank securities.

One more effective form of maintenance of financial stability and increase level of capital adequacy of commercial banks during the post crisis period is activity on introduction in bank practice of the CIS the procedures of merge or acquisitions (M&A) of joint-stock bank institutes. Merging procedures allow their participants, being in one structure, to function independently, dividing spheres of influence and keeping identical powers on management of bank business. However, process absorption in an attached bank requires fundamental re-structuring up to the change of a profile of its activity since it passes under a complete control of the leading bank. Successful realization in practice of procedures of merge and acquisition promotes more effective utilization by banks of potential of a share issue for the purposes of strengthening of their capital base and increase of stability of national bank systems.

Along with expansion of scales of use of tools of the joint-stock financing, many banks have expanded a spectrum and have increased scales of release and placing of debt securities. Their issue promoted mobilization of extra financial assets for needs of innovative development of clients of banks and to settlement of problems of non-payments that was positively reflected in growth of their image among participants of the market. Advantage of debt securities to investors is that they express the obligation of the emitter to return the laid-down capital enclosed means in the appointed term having provided the guaranteed level of their profitableness. In this connection, investors do not bear such risk level as in a case of an investment of means in share securities. The given circumstance has gained an important value for restoration of trust of participants of the market to securities in the conditions of elimination of consequences of the world financial crisis. The central place among the debt securities which are issued by banks is occupied with the bank certificates the advantage of which for banks is in simplicity of the organization of release since they do not demand release of the issue prospectus and can be emitted in process of occurrence of means on settlement accounts of their clients. Besides, they are capable to support effectively resource bases of commercial banks since the average rest on accounts of banks usually is at the constant level. For owners of bank certificates (from among clients of commercial banks) the advantage of using them is in simplicity of use and reliability of extraction of incomes. Besides, they can carry out for investors additional functions as the effective tool, capable to confirm their solvency, and also in the form of donation or inheritance means.

Further means on the perspective use of potential are bank bonds which also have a number of the important advantages to banks in comparison with actions and other kinds of share securities. So, in comparison with stocks their advantage to banks is that their release does not threaten owners of banks with washing out of actions and control loss over a banking establishment. The main advantage of bank bonds to investors is the higher level of reliability of an investment acts in the absence of risk of a non-return of the enclosed placed investment as in a case with actions, and also giving to many banks possibility to use their additional services of banks. In the post crisis period, a great popularity was received by so-called coupon bonds, intermediate term and long-term bank bonds, and also the bonds converted at will of their owners in the stocks of the joint-stock enterprises. Release by banks of coupon bonds has involved interest of small investors as they have allowed them to compensate inflationary costs and to fill the shortage of turnaround money resources. Issue of intermediate term bank bonds has involved interest of the average private and large conservative investors having free financial resources, but not wishing to incur the big investment risks

connected with possession by bank actions. Their release is favorable to commercial banks themselves since they will allow the access to investment resources, the demand for which grows constantly from the side of various categories of subjects of managing.

In the conditions of elimination of consequences of the world financial crisis, the major criterion of efficiency of use of potential of securities was an activation of their investment activity. The commercial banks which are not possessing competitive investment strategy and do not have strong experts in this area have lost chances of a sustainable development as they become incapable to sustain struggle in the market of bank services. If before the crisis the main investment activity of banks was a credit activity, now it is gradually becoming the ability to build and put into practices the weighed investment policies at the expense of skillful use of investment potential of securities. Moving of the centre of gravity from credit activity to the investment is caused by the world tendency to large scale of bank activity. The given tendency is connected with a problem of reduction of bank margin because of constant reduction of level of depository rates and impossibility of unbalanced increase of rates for credits. At the heart of qualitatively new relation of banks to investment management there lays the fundamental ability of securities, at the correct account of their investment qualities to bring to their owners a higher and stable profit, different in its long-term character.

The post crisis period requires from the CIS countries reorientation to the qualitatively new strategy of the movement to the market, based on creation of accurately expressed corporate basis of the organization of the enterprises of key economic branches of national economies. This has demanded the creation of the integrated corporate structures in the form of financial and industrial groups, the holding companies and other associations of conglomeratic type created by integration of both the industrial and financial capital and functioning on the basis of share capital issue, through its consolidation, an exchange of shares and other forms of modern financial engineering. An active role in creation and functioning of the specified highly integrated corporate structures should have commercial banks, capable to act on it and as the most reliable emitters, and as the largest investors, and as professional operators.

Considering the ways of activation of potential of investment activity of commercial banks, it is necessary to notice that dynamics of rates of its growth depends not only on property and level structure of institutional developments of the share market, but also on the developed mentality and behavior of economically active part of the population making a basis of a class of small and average investors in the CIS countries. With the nature of this category of carriers of the behavioral finance, banks should allocate characteristics of such parameters as the degree of risk accepted by the population, its business activity, influence of the religious factor and tradition of corporate ethics, propensity to savings, and also psychology of acceptance of investment decisions.

It is necessary for the commercial banks of the CIS countries to use more in the investment activity such financial tools widely approved in world practice as cumulative actions, converted or design bonds, opening of savings and investment accounts payments which are not fixed in advance, and occur on principles of distribution of the profit received from their use between banks and clients.

The important place in business of the realization of the potential of securities belongs to activities of commercial banks on the increase of efficiency of realization of their intermediary operations in the share market. Actualization of this direction of activity of banks of the CIS countries is caused by the majority of categories of the basic participants of the developed and formed securities markets have no experience of the reference with this financial tool. It is more than that, many of them do not consider working with them, as the primary activity or the main object of enterprise efforts. In this connection, it is more favorable to them to seek the help of professional participants of the share market for which this activity is the basic function, well familiar, and the basic source of reception of the income.

Commercial banks, on the contrary, have a wide experience on issuing their own securities and investment operations in which they are engaged for maintenance of due level of capitalization, and also maintenance of profitableness and liquidity of bank business. Besides, it should be remembered that rendering of intermediary services demands presence of the whole complex of necessary conditions, including the access to the information on a condition of various segments of the share market, constantly updated bases analytical data, and also the qualified experts in the field of the share industry. The majority of investment institutes operating in the CIS countries owing to the youth and the limited financial possibilities cannot give

such spectrum to the basic participants of a securities market of and to provide such quality of services as commercial banks do. Considering the above-stated, it is possible to assert that commercial banks of the CIS countries have all possibilities for use in the interests of a more potential of the intermediary operations connected with service of life cycle of securities.

The basic advantages of the commercial banks acting in a role of intermediaries, for emitters from among the enterprises of the CIS countries, are connected by that they are capable not only to assist in designing of idea of release, working out of business plans of release and placing of securities, their registration and placing, but also they are able to carry out a wide range of accompanying services, including traditional bank maintenance.

The main advantages of the commercial banks acting in a role of financial intermediaries to investors is their good knowledge of a conjuncture developing on various sites of the financial market, predisposition to an objective estimation of investment potential of various types of securities, and also their independence is at acceptance of investment decisions in interests of the clients.

Interest of commercial banks in use of results of the professional work on a securities market is caused by the possibility to derive additional profit for the primary activity in the financial market and to raise the image in the opinion of participants of this market.

Index of Keywords and Terms

Keywords are listed by the section with that keyword (page numbers are in parentheses). Keywords do not necessarily appear in the text of the page. They are merely associated with that section. *Ex.* apples, § 1.1 (1) **Terms** are referenced by the page they appear on. *Ex.* apples, 1

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|----------|--|------------------|-----------------------|
| B | bank, § 2(5) | investor, § 2(5) | |
| | banks, § 1(1) | | |
| | business, § 2(5) | | |
| C | CIS, § 1(1), § 2(5) | J | joint-stock, § 1(1) |
| | client, § 2(5) | M | market, § 2(5) |
| | commercial, § 2(5) | P | privatization, § 1(1) |
| | Commonwealth of Independent States, § 2(5) | | processes, § 1(1) |
| | company, § 1(1), § 2(5) | R | restructure, § 1(1) |
| | crisis, § 2(5) | S | securities, § 2(5) |
| G | government, § 1(1) | | shareholder, § 1(1) |
| I | international, § 1(1) | | shares, § 1(1) |
| | investment, § 2(5) | | stock, § 2(5) |

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