Meaning of bank crises

Literature, Russian Literature

The bank crises represents a situation where a bank gets in a financial distress due to most of depositors loosing confidence in the bank and undertaking to make excess deposit claims. According to Gupta (2002) this panic and withdrawal ofmoneyby a lot of bank dept holders is caused by the fear that, the bank may be closed down by any of the chartering agencies. Most banks are forced to take the money they had previously invested in loans in order to meet the debit claims. The result is that, the bank's financial capability goes down and if proper measures are not implemented to save the situation, the bank may end up closing down.

From the year 1980, the crises experienced in the banking sectors have become more severe and frequent with the IMF country members experiencing three quarter of the crises. George (2006) posited that, among the financial form of crises experienced recently, the banking sector experienced the greatest impact at its core, which had Turkey being the most affected in 2000, Mexico suffering the crisis in 1998, and Korea in the year 2004.

Financial liberalization has been the major preceding factor for the banking crises. It has also been noted that, the developing countries are more prone to banking crisis than the developed countries. Where the outward capital flows are too much due to the debit claims, the crises in question are bound to be severe and could even lead to a bank closing down (James, 2006).

Causes of Bank Crises

Most banks have experienced the crises due to various factors ranging from the effects of the nature of macroeconomic shocks in the organization, to the

specific characteristic and management of the bank. Matias (2006) posited that, in considering the characteristic and managerial factors, inefficient management in the running of a bank can so easily lead to a financial crises. The organizationalleadershipof a bank needs to be run by people who are skilled enough to lay strategies which would ensure that the organization has a lot of cash which is to be invested in loans and that, the cash at hand is able to serve the withdrawal demands of the bank clients.

The management should also be keen to employ qualified personnel who possess good customer care relations so as to attract more customers as well as to ensure that, the terms of transactions are fare and attractive. Poor management in a bank leads to inefficient services and this leads to most customers moving out for better services in other institutions. The result is that, the financial capability of a bank goes down.

According to Enrica (2007) making of lending decisions which are inefficient has also contributed to bank crises in many countries. When money is lend out in projects that cannot bring in good capital returns, the growth of the bank slows down leading to loss in the long run considering the other expenses incurred in the running of the organization.

The macroeconomic factors which leads to crises in a bank include a situation where a bank gets involved in poor terms of trade which may not earn any profits for the institution but rather leads to a slow growth rate. Depreciation of currency value has been one of the factors leading to bank crises. When currency in a country where a specific bank operates depreciates in value, the bank suffers the effect in the international currency markets and most banks end up experiencing losses in their operation.

Calvo (2004) stated that, when the real exchange rates appreciate, banks also get to suffer the consequences because it would mean that, the bank retains less income after the exchange takes place. Most banks do not have the tool to measure the standards of currency exchange and often get involved in exchange rates which are unfavorable thus leading to losses.

A bank whose growth has slowed down due to poor policies of investment is caught up in a situation where the income outflow is more than the income flowing in, leading to the organization making loses. Property and stock market crises have a lot of effect on the financial capacity of a bank.

The stock market and the property market are one of the major places in which banks invest their incomes, this are the places where most of the income flows for the banks are realized. When there are a crises therefore, the capital income for the bank goes down drastically, leading to shortage of cash within the institutions (Johnson, 2007). Lastly, when the capital outflow of a bank exceeds the income returns, there is bound to be a shortage of funds to run the organization as well as the investment funds. The result is that, the bank finds itself in shortage of funds to run the institution hence the crises.

Policies Implemented to Deal with Bank Crises.

With the increase of the number of bank crises reported in the banks all over, various policies have been formulated in order to deal with the situation. Zachary (2003) reported that, the experience from the London Bank and the East Asian banks have called for caution that organizations need to clearly understand the involved risks in implementing and designing

policies on macroeconomic as well as to make sure that there is proper soundness in the financial sector.

The legislations policies on finances have been improved, policies are also adopted to ensure effective regulation and supervision in the financial institutions, strategies have been reviewed in banks which are troubled and the last resort lender facilities are revisited. All this are measures which are put in place to manage the situations facing the bank crisis (Matias, 2006).

Various macroeconomic policies have been put in place in order to ensure that banks facing the crises are able to get back to the normal business operations as well as to ensure that, those banks in crises are in a position to recover back to the normal working conditions. Efforts have been invested to ensure that, with the financial marketsglobalization, the macroeconomic policies implemented are perfect to both the international lenders as well the domestic agents. Calvo (2004) expressed that, it has been realized that poor policies would lead to volatile capital outflows and abrupt reversals are also expected to be high. This would lead to critical consequences for the management of macroeconomics. Adoption of restrained monetary and fiscal policies has been essential in ensuring that bank crisis are dealt with. With the capital mobility increasing, a prompt monetary and fiscal action is adopted to correct the external and internal imbalances and to ensure that the banking sector is enhanced.

James (2006) stated that, a proper framework has been set up to support liberalization in the financial sector by having a good policy to supervise and regulate the financial institutions. Policies to ensure that there is proper supervisory and prudential regulatory system have helped so many banks to

improve their financial conditions. This has helped to avoid deficient management and to ensure that there is cautious management as well as to avoid the risks of lending or getting into bad contracts which would lead to risks of losing incomes.

Banks have adopted the best banking practices and intermediation in the financial sector to ensure that there is better guidance and information on liabilities which are contingent and not in conformity with the balance sheets, good safeguards, limits of various forms of risks in the insurance sector, as well as a public disclosure that is comprehensive (Zachary, 2003).

Policies for capital flow management have also been formulated where surges on the inflows of capital have proved to be very beneficial in easing of the external constraints to the recipient countries and this has helped in keeping the domestic rates interest down, this in return helps to increase growth and encourage higher investment. Researchers such as Johnson (2007) have proved that, a situation offering a lot of capital inflows may lead to economic management which is complicated, create policy concerns and instability.

The problems which can be caused by this large capital inflows include deficits on current accounts, consumption levels that are unsustainable, monetary control that is weaker, and upward pressure on inflation. There is also the problem of vulnerability reversal flows. The policies adopted are meant to deal with all these issues.

According to Enrica (2007) a policy has also been put in place to ensure that capital flows and the integration problem has been put under control. A

careful supervised and well capitalized financial sector including making people aware about the scope of contagion has helped to minimize the bad effects that have been realized in the past. Proper monetary and fiscal policies have also been put in place to minimize this problem.

The central banks in various countries have also undertaken to put various policies in action being the key decision makers and policy makers, due to the fact that, the decisions made by the central bank in various countries really affect the success orfailureof a financial institution. The central banks have therefore adopted policies which have helped in promoting of the monetary stability, which is to ensure that there is a domestic form of stability (Gupta, 2002). The move by the central bank also tries to ensure stability in the mode of exchange rates as this has been one of the factors leading to most of the banks crises in many countries.

Policies have been implemented to ensure that the financial sector is sound, this has been after a realization that for any bank to attain monetary stability or even a good exchange rate system, the soundness of the financial institution is very essential. A fiscal policy to be adopted by the central bank also needs to be prudent to ensure success of the banking sector. The central bank put in place policies to ensure that, capital inflow which is not favorable is avoided as this has been a major problem in the banking sector, and especially in exchange rate settings that are fixed. This in return helps to strengthen the fiscal incomes and banks are therefore able to improve on their financial strengths (Matias, 2006).

Role of International Financial Institutions

The international financial institutions have played positive roles in the growth and development of the banking sector though there are still critics that they bring in risk of investment. Firstly, this institutions have helped in the importation of informationtechnologywhich has been adopted by many banks to improve efficiency in the banking services. The international institutions have also helped in funding the local banks to re capitalize the banks which are already in crises so as to improve the conditions and ensure that banking operations are stable.

According to Enrica (2007) the international institutions have ensured that the there havens in a local country are safe and can be used as an alternative to reduce the flow of domestic funds in offshore years when there is a financial crises. Most of the international institutions are wealthy with deep pockets and this ensures that there is a continuous lending which follows the adverse shocks which most of the times lead to the weakening of the banking sectors at the local levels. This international institutions have however been criticized for bringing a high competition rate to the local banks leading to weakening of the local financial institutions.

Leading Indicators of bank Crises

Due to the crises which have faced the banking sector for a long period of time, researchers have come up with indicators which may help to send early signals of a bank that is bound to collapse. The Word Bank and the IMF have come up with two models of indicating the financial position of a bank.

George (2006) posited that, there is the qualitative response approach as well as the signaling approach. The signaling approach compares two

periods of time when there is an experience of tranquility and on identified periods of crises. From this point, the indicators are selected on their behavior changes between the normal operations of the bank and times of crises so as to detect whether they can be relied on to give signals on a bank crisis that is bound to occur. A threshold alarm is then set so that if the indicator pass the point that is set, then it can be clear that there is an impending crisis and presents the point at which a balance can be maintained to avoid the situation.

The qualitative approach has the macro vs. micro approach . Zachary (2003) posited that, the micro method of approach deals with concentrating on an individuals data on the balance sheet so as to look at possibilities for an individual institution failing, this model looks into issues of traditional supervisory measures to make a conclusion on the financial situations of a bank. The macroeconomic approach is used most of the time and focuses on this method of institutional variables to ultimately predict and explain any systematic bank crises. This system has been applied in many countries especially those who have had a problem of crisis.

Banks Prone to Crises in Developed and Emerging Markets

According to Calvo (2004) banks in both the developed and the emerging markets have been prone to crises due to factors of poor financial policies which lead to economic instabilities in a country. The economic theory in most of the countries has been lane on guiding of the makers of policies, this in turn brings about a crises in the foreign exchange rates a factor that contributes to a lot of bank crisis. Banks placed i such countries face that crisis.

Where the management policy in a domestic level is poor, this leads to difficulties in the supervisory and regulatory management of the banks and finally causing bank crisis. The bank of England has been one of the banks faced by this problem where the excessive borrowing by the private banks was the major reason which caused the recent crisis in the bank.

The free mobility on capital has lead to very high rates of borrowing a factor which has affected several banks such as the Bank of Finland. According to Matias (2006) this makes the investors to lose confidence in a bank due to the high chances of vulnerability of a bank which is caused by the regime of free mobility character due to changes on behaviors of the investors.

The crises experienced in the banking sectors are mainly caused by poor macroeconomic policies adopted as well as poor regulatory and supervisory management. Banks should adopt the best practices as well as make use of the leading indicators to predict the future so that they can avoid risks of getting into crises.

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