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REASONS FOR THE INCAPABILITY OF BANKS IN BOSNIA AND HERZEGOVINA TO COLLECT PAST DUE RECEIVABLES

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Abstract
The basic idea of research is order to answer questions about the number and characteristics of problems with claims collection and risk management of claims collection. Research was done at thirty-two commercial banks in B&H (twenty-three having head office in FB&H and nine in RS). The current economic crisis and recession are affecting most countries and their economies; they wish to overcome it as soon as possible and with the fewest consequences. Problems with uncollected claims arise at the beginnings of a crisis; they announce the crisis and deepen it strongly. From this point of view, it can be said that uncollected claims are, at the same time, the cause and the consequence of economic crisis and stagnation. Uncollected claims issues exist in every country, in all economic systems and at any given time. The only variable is their extent and intensity. In Bosnia and Herzegovina, these problems are more visible than in other countries for many reasons and circumstances because there are no appropriate mechanisms for their removal. Moreover, the government authorities are not making an effort to implement certain measures to change and improve the present situation. The most obvious example of this are companies that exist, function and do business although they have not paid notes payable for months (or

years); they are illiquid and because of them creditors cannot collect their claims. In this way, banking is also threatened. In some cases even instruments for ensuring collection of claims are of no use, and what is more, the legal system does not function properly so uncollected claims cannot even be collected by court proceedings. The reasons why banks in B&H cannot collect past due receivables are not only the consequence of economic crisis but are also caused by other reasons and different circumstances. The basic problem is that uncollected claims are not managed efficiently, that the legal state does not function, that the laws are not enforced, that legal regulations are not appropriate and that there are illiquid companies on the market as well as those which otherwise would not operate in a developed economy.

Key words: risks of claims collection, instruments for collection of claims and instruments for ensuring collection of claims, risk management of claims collection.

1. INTRODUCTION

Concerning the number of companies that have been forced into liquidation and the ones liquidated, it could be concluded that the illiquidity problem in B&H is not a great issue as it might seem, especially if one takes into account the data on outstanding liabilities and uncollected claims. Such conditions in companies affect the state of the banking system so the inability to collect accounts receivables also puts banks into a difficult situation, their liquidity and successful business activities are threatened.

This unveils the inefficiency of the legal system and market economy because there are illiquid companies among business entities which would not exist or operate on a market in countries with a developed market economy. The problem lies in illiquid, but also liquid companies (and government bodies) that tolerate this situation, which could lead to the conclusion that they are not aware of the magnitude of the illiquidity problem that can cause an overall financial, economic and social collapse.

It is obvious that illiquid subjects are trying to survive in any possible way, while it is also understandable that they are sometimes helped by liquid companies which offer them goods on credit or deferred payment with the goal of overcoming the crisis, or because liquid companies cannot otherwise sell their products and services to those who are capable of paying for them. However, it is not unreasonable that banks and other creditors, or even government bodies, act in the same way in order to meet trade unions' demands, to deal with unemployment issues and for other reasons.

It is not praiseworthy that this is done massively and unselectively, even for companies that are illiquid on the long run and those that experience liquidity issues from time to time, and those illiquid for a short period of time. This is what is wrong and not reasonable and what needs to worry the government authorities because, in this way, they only show the lack of authority and competence.

The problem will not be easily solved because private sector and private ownership are still not dominant in B&H, and what is more, this predominance is still held by the state, public and not private ownership, which is a relatively great direct and indirect influence the state has in the economy. Furthermore, the issue becomes more serious because the combination of public and private ownership creates objective circumstances for financing illegal activities or transferring public capital into private within the "grey economy".

Only in this way one can understand the behaviour of managers in companies that are not privately owned; their lack of interest and irresponsibility for their company's success,[1] their ignorance, unsatisfactory awareness and education about the importance of risk management of claims collection, and the possibility of reduction of collection risk if these risks are handled efficiently.

The situation is completely different in private companies because their managers are mostly owners or are directly supervised by the owner, so they are more interested in the company's well-being, its assets and resources, and they concern themselves with claims collection more than managers in public and state-owned companies.

Research on professional qualifications of managers shows a lower level of education in private companies, which might imply poor education on managing payment risks, while the situation with uncollected claims in private and state-owned companies reveals the opposite, uncollected claims being fewer in private than in public and state-owned companies.

Relatively large and uncollected claims also exist in private companies, and some managers even approve goods delivery to buyers even when they are not entirely sure the goods will be paid on time, and sometimes they do this without payment or instruments for ensuring collection of claims.

In most cases those are their long-term buyers who they want to help, buyers that are already in debt with them so the managers hope these deliveries will help them overcome the crisis and they will collect claims later. In other cases, they are urged to do this because they cannot find a satisfactory number of buyers who want to pay for goods in cash or by a secure payment instrument.

[1] They only have the moral responsibility towards the supervisory board, that is, towards government bodies that name the members of supervisory boards

2. BANKS AND BANKING OPERATIONS

Banks are financial intermediaries between clients who have surplus financial assets and those who lack financial assets, operating in a way that they take money from the ones with surplus assets and approve loans to those having fewer financial assets. Banks pay interests to clients from whom they take the money and collect interests from approved loans, and collects the difference in the rates as profit. Besides these basic functions, banks provide other financial services, including payment transactions. For a bank to be successful, security, liquidity and profitability are of great importance, and these three segments are interrelated, mutually conditioned and interdependent.

Security is based on a bank's stability, its liquidity consistence, and its insurance that people who invest in it will not lose the investment and that they will profit with accrued interest. This can be achieved only by banks that do business successfully, which are liquid and profitable. The security of savings deposits in banks is increased by states directly or through competent authorities and agencies, which furthermore guarantees payment of a certain amount of savings deposit in cases of liquidation. [2]

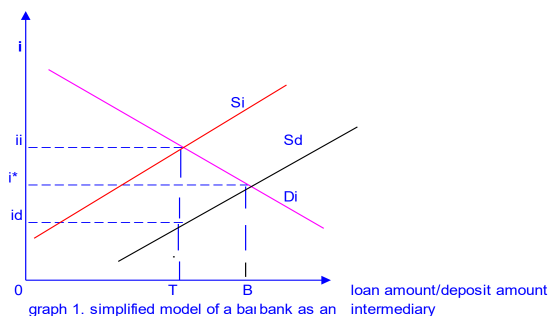
Liquidity implies that banks can meet their own and their clients' liabilities. As an authorised organization for handling payment transactions, a bank carries out its clients' payment transactions, which includes meeting clients' liabilities and their claims collection.

A bank does this by using assets on clients' accounts, and in some cases a bank will be urged to meet its client's liabilities even when the client does not have enough resources as it is the case with bank guarantees, which are issued as claims collection insurance, or with irrevocable credit payments, and other payment and instruments for ensuring collection of claims. This means that, in some cases, a bank will meet its client's liabilities when the client has no available resources on their account, while problems may arise when the client has the necessary resources but the bank cannot meet the client's liabilities because it is illiquid. That is why liquidity of banks is essential, and it is connected with security of savings, deposits and investments, meeting the bank's and client's liabilities and ensuring claims collection, and with the bank's profitability. Banks cannot be successful and profitable if they are not secure and liquid, security and liquidity depend on the quality of banking, economic and social system. In an unstable environment, unreliable economic and social systems, banks and other companies are not secure.

Taking into account the importance of banks for a monetary system of a state, for economy and payment transactions, banking operations are controlled by legal regulations. Moreover, banks are supervised, regulated and directed by a central bank or an independent banking agency, and in some cases they are monitored by both institutions. The main role of banks is to intermediate, and this model of

[2] In Bosnia and Herzegovina, savings deposits are secured by the Agency for deposit insurance

intermediation between a client with surplus resources and a client with fewer assets can be illustrated by the following grap.



graph 1. simplified model of a bai bank as an intermediary

Si: credit offer curve

Sd: deposit offer curve
Di: credit demand curve
OT: credit amount demanded by client
OB: credit amount demanded by clients at an interest rate not including banking operations costs
i*: interest rate not including banking operations costs
ii: credit interest rates
id: deposit interest rate

Bank interest (as an expense of banking intermediation) is the difference between credit interest rate (ii) and deposit interest rate (id). The graph shows that the credit offer curve and deposit offer curve are cost sensitive. If a bank is willing to pay greater price for deposited money (higher interest rate on deposits), it will be able to accumulate more deposits. If it is willing to offer credits at lower interest rate, the bank will be able to offer more credits. The model is simplified because interest rate is not the only factor that affects the amount of money banks can offer through credits.

Economic growth can also influence the amount of banking activities. In the conditions of economic growth, subjects have a greater need for financing sources which directly leads to the increase of credit activities of banks, while in conditions of stagnation or negative tendencies in the economy, credit activities of banks are reduced. Besides the simplified economic model, a bank as a business company can be described by a balance model:[3]

assets = liabilities + equity

[3] Rose P.S. Menadžment komercijalnih banaka, Mate, Zagreb, 2005. op. cit. pp 117- 146

In its everyday operations, a bank pays deposits to those who invested their resources (depositors), offers credits to clients and meets their other immediate liabilities, so it is in constant need for a certain amount of liquid resources. Liquid resources in banks represent the money and assets that can be turned into money in a short period of time and with no value loss. For the purpose of their liquidity, banks form liquidity reserves which can be primary and secondary. Primary reserve includes cash, deposits in other banks and in a central bank, and every bank is obliged to have these. Banks do not have any yield on these reserves, or the yield is very limited, so the reserves are reduced as much as possible, but banks also keep a certain amount of reserves in order to have liquid assets that are needed to operate and meet legal regulations.

If for any reason a bank cannot provide liquid resources from its primary reserves, it supplies liquid resources by borrowing on the money market or taking resources from its secondary reserves, which include short-term debt securities (most often government bonds, bank bills and similar) and term deposits in banks that a bank can have in its assets.

Secondary reserves enable banks to gain profit, but less than the profit made by investing. The basic characteristic of secondary reserves is the fact they can easily be transferred into cash with no loss of value, and the amount of assets in secondary reserves mostly depends on the liquidity of the market where the bank does business and operates.

If the liquidity of the market is high and if the bank can buy sufficient amount of liquid resources on the money market at a reasonably low price, it will have a smaller amount of assets in its secondary reserves. On the contrary, it will have more assets in secondary reserves.

Commercial banks implement their business plans and achieve financial results by performing the following activities[4]:

- Accepting deposits and other money resources from the public with repayment – this is also a basic advantage banks have in comparison to non-bank financial institutions.
- Granting credits, including consumer and mortgage loans, factoring and forfaiting.
- Providing means of payment in the form of electronic money.
- Financial leasing
- Payment operations services
- Issuing and managing means of payment (credit cards, traveller's cheques, bank drafts)
- Issuing guarantees and other warranties
- Trading for themselves or for a client:
- By instruments of money market (cheques, bills of exchange, deposit certificates, etc.)

[4] Leko, V. , Financijske institucije i tržišta I, Ekonomski fakultet, Zagreb 2002. p 131.

- By foreign currencies
- By financial, futures and options contracts
- By foreign exchange and interest rate instruments
- By transferrable securities
- ▪ Participating in stock issuance and services related to the issuance
- ▪ Counselling in operations within capital structures, industrial strategies and related activities; counselling connected to mergers and acquisitions of companies
- Intermediation in money trade
- Managing portfolio and counselling
- Keeping and managing securities
- Credit services
- Keeping and managing services, and similar (or equal) to the above, it is regulated by the Law on banks of the Federation of B&H.[5]

Vital functions of contemporary banking institutions are shown in the following illustration:[6]

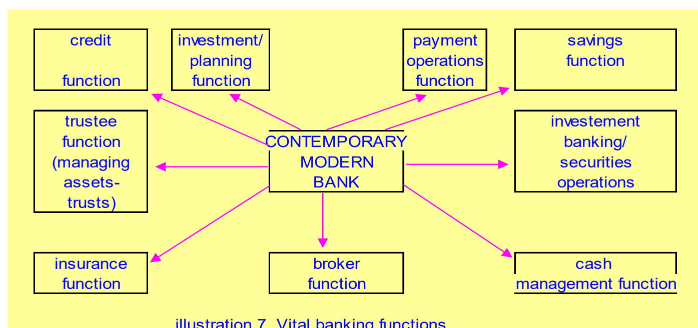


illustration 7. Vital banking functions

3. MANAGING ASSETS AND LIABILITIES OF A BANK

From the point of view of assets and liabilities management, the management is concerned with net interest income, that is, the bank's profit; stockholders are interested in capital's market value, that is, in the bank's stock price, and the supervisor's interest lies in the management of capital.[7]

Development of capital market and the rising number of non-bank financial institutions have influenced the redefining of the role of banks and the

[5] Official Gazette of the Federation of BiH, number 39/98, 32/00
[6] Rose P.S. Menadžment komercijalnih banaka, Mate, 200. p 7.
[7] This is stated and ordered by the Basel III. Management of capital includes strict control over liquidity and adequacy of capital, and adequacy means that a bank's capital can cover potential losses which can arise as a consequence of risks in banking operations

way they do business, and securitization and derivatives operations are seen as innovations.[8]

New non-standard operations that have appeared in commercial banks have increased the number of off-balance sheet items and non-interest income.[9]

From the point of view of risk management it is important to state that banks whose clients have high quality risk management are exposed to risk to a lesser extent. [10]

Banking operations in the FB&H are regulated by the Law on Banks and by the decisions made by the Banking Agency of FB&H. In accordance with the decision on “Minimal standards for managing credit risk and classification of bank assets in FB&H”, a bank is obliged to classify assets that are exposed to credit risk into adequate categories, at least once in every three months:

Percentage of reduction of risky claims under BiH regulations		
Categories	Days of delay	% of reduction
A	0	2
B	to 90	5 to 15
C	90 to 180	16 to 40
D	180 to 270	41 to 60
E	more than 270	100

A bank determines procedures for practical implementation for each individual category. In category A the percentage of reduction is 2% (except those labeled as 100% secure), in category B this percentage is from 5% to 15% if the client delays payment up to 90 days. In the third category (C) the reduction of risky claims is from 16% to 40% (for the delay period from 90 to 180 days), and in the forth category (D) the reduction is from 41% to 60%, from 180 to 270 days of delay. In category E the reduction is 100% (for delays longer than 270 days).

Evaluation of disputable claims, as well as their accounting treatment, is regulated by the revised International Accounting Standard (IAS 39. and 37.), which has been implemented since January 1st 2013. Under earlier legal regulations and adequate IAS standards, accounting treatment included an obligation of making provisions of the same amount as the disputable claim, as a counterpart to the amount treated as the provision expenditure. Also, there were reductions of claims from a less risky category and debits from riskier ones (the same amount of claims transferred from category A to category B).

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[8] In these activities the USA market is much more developed than the EU market

[9] Sinkey J. F.,Jr. Commercial Bank Financial Management in the Financial-Services Industry, sixth edition, University of Georgia, 2002. op.cit. 1 pp 467-508

[10] Sinkey J. F.,Jr. Commercial Bank Financial Management in the Financial-Services Industry, sixth edition, University of Georgia, 2002. op.cit. pp 467-508

By implementing the new regulations (IAS 39.) provisions are no longer recorded for the amount of risky (disputable) claims, instead, the regulation introduces a correction of value of risky claims and expenditure of the reduction of claims on a bank's assets.

This novelty in accounting treatment will result in the reduction of a bank's assets and liabilities for the amounts of earlier recorded provisions, which will contribute to a more realistic illustration of the extent of bank's assets.[11] The novelty (based on IAS 39) is also the fact that a bank's disputable claims remain in assets even after a write-off of 100%, as opposed to the former regulations under which such claims were recorded off-balance sheet.

The decision on capital adequacy leads to the structure of warranty capital being defined, as well as capital adequacy, which commercial banks must ensure to cover possible losses, losses that may arise as a consequence of business risk exposure. Capital adequacy ratio is a measure of the amount of a bank's liable capital expressed as a percentage of its risk-weighted asset, and the minimum amount is legally regulated.

When it comes to risk management methods, banks are ordered to implement the Basel Agreement on capital ("Basel II" or "EU Capital Requirement Directive"), which serves to enforce higher standards of bank protection and to develop greater sensitivity to risks in business, and also to establish a more adequate system of limitation of specific risk exposure, as well as a system of capital adequacy of commercial banks. In this way banks make their own models for evaluating risks, and for that they need to establish internal database and gather data on clients, past events and future plans.

4. RESEARCH ON UNCOLLECTED CLAIMS IN BANKS IN B&H

At the end of last year, there were thirty-two commercial banks in B&H, twenty-three having head office in FB&H and nine in RS[12]. Among them, twenty-three banks are members of the insurance programme implemented by the Deposit Insurance Agency.

Research was done in order to answer questions about the number and characteristics of problems with claims collection and risk management of claims collection. It has been found that there are uncollected claims in all banks; that citizens who were granted loans did not meet their liabilities. Moreover, private and state-owned companies (public and non-privatized) did not meet their liabilities on time and the structure of uncollected claims is different across banks.

[11] The size of a bank is most commonly measured by the size of its assets
[12] One of the banks ("Bobar Banka") is in the process of insolvency and liquidation

Uncollected claims from private companies amount from 11% to 34% of the total number of uncollected claims; among non-privatized companies uncollected claims range from 16% to 40%, while among the public the percentage is from 14% to 54%.

Because the respondents in banks were not authorized (were not allowed or did not want) to reveal exact information on the amount of past due receivables, the questions were adjusted for the answers they could provide. Consequently, 70% of respondents stated that the amount of uncollected claims in their banks was "large/unbearable", and only 30% of respondents stated that the number of uncollected claims was "small/bearable".

It has also been established that there are significant differences in certain banks in the maturity of past due receivables. The greatest number of total claims are past due up to 30 days (38%); 16% of uncollected claims are past due up to 60 days; 14% are past due up to 90 days; 20% are past due up to 180 days, and 12 % are past due a year or more.

Of the total number of uncollected claims (on December 31st 2014) the greatest number of those were not taken to court (63%), and only 11% were written off. The largest number of past due receivables from the public was collected from debtors (67% as an average for all banks), 18% from guarantors, 9% by collection and insurance instruments, and 7% were not collected at all.

The greatest percentage of collected claims after maturity date were collected by compensation (27% on average), and the smallest number of them were settled by court proceedings (only 4% on average). Some banks collected only 9% of past due receivables by compensation, while in the same way others collected 43% of the total number of claims after maturity date.

Sixteen percent (16%) of claims were collected by cession and assumption of debt after maturity date, 11% of claims were collected by assignment and assumption of contractual liability, 14% of claims were collected by collateral promise, and 7% of claims were not collected at all after maturity date.

Considering the structure of uncollected claims, it can be concluded that non-privatized companies owe 36% of past due receivables, private companies owe 44% and the public owe 11% of past due receivables.

As far as collection instruments and instruments for ensuring collection of claims are concerned, banks used drafts, mortgages, warranties, term deposits, and in some cases more than one instrument.

In all banks a draft was used as collection instrument and instruments for ensuring collection of claims in 17% of cases; mortgage was used in 32% cases; warranty in 15% and term deposits in 11% of cases, while in 15% of cases more instruments were used.

When it comes to grading the quality of collection instruments and instruments for ensuring collection of claims , none of the respondents graded the draft with a “five” or “four”; one respondent gave the instrument a “three”, two respondents graded the draft with a “two”, and nine respondents with the grade “one” (16 points).

Mortgage was graded a “five”, it was given two rates of “four”, six rates of “three”, two rates of “two” and one rate of “one” (36 points), while warranty was graded a “five”, five rates of “four”, one rate of “three” and two rates of “two” (36 points).

Term deposit was graded with the highest rate and all the respondents graded it a “five” (60 points) so it is undoubtedly the best rated instrument.

Reasonably good grades were given to the option “more than one instrument” which was graded with two rates of “five”, five rates of “four”, three rates of “three” and two rates of “two” (43 points).

It can be concluded from the structure of indebtedness that, on average, every fifth bank order was not settled on the maturity date (23%), that 19% of orders were paid after maturity date and that only 14% of cases were taken to court for past due receivables.

4.1. Reasons for uncollected claims are not only economic

The research has shown that banks granted credits to borrowers even in cases when they were not sure (or convinced) that the borrowers would be able to pay off regularly. This was especially the case in the period after privatization of banks, and it is possible that influential individuals purposely abused their power in such situations. This could not be confirmed nor denied by respondents, but almost all of them stated that there was a significant amount of uncollected claims from that period.

Banks granted almost a quarter of credits (24%) even in cases when those who approved the credits were aware that “there could be problems with collection” from debtors, and in 14% of cases credits were approved because there were no “more reliable borrowers”.

The functioning of legal state and judicial bodies can be rated on the basis of the amount of paid past due receivables by court proceedings. It was impossible to collect accurate data on the amount of money, so certain conclusions can be drawn from the following:

Only some of the banks collected 6% of claims by court proceedings, and some of them collected claims in this way in 28% of cases. Banks partially collected from 45% to 68% claims by court proceedings, while no claims were collected from 9% to 21% of cases.

The situation is almost identical with written-off claims so these data are only presented in a descriptive way and proportionally to the total number of claims.

According to respondents, 32% of written-off claims are “large/significant” and 69% are “small/insignificant”.

Banks, as authorized organizations for payment transactions, conduct payments for their clients via transaction accounts and have their clients’ bank accounts records.

These data are managed individually for each bank, and in a bank they are managed separately for each client and for each individual transaction account, and every company can have (and they do) more than one transaction account in different banks.

For this reason the research included the data related to active, blocked and closed accounts, from which one can draw conclusions about the state of the accounts. Furthermore, the accuracy of research results is supported by the data on the structure of transaction accounts provided by the official data of the Central Bank of B&H.

A proportionally large number of closed transaction accounts implies problems with companies’ business and the lack of resources, problems with bank failure, with work termination or liquidation, but it does not state to what extent uncollected claims and uncovered liabilities are a cause of this, or if the situation is a consequence of other circumstances. Companies whose accounts have been closed or blocked do not have to be in a bad financial situation and it does not mean that they do not have available money on transaction accounts in other banks.

5. CONCLUSION

Problems with uncollected claims in B&H are great, complicated and are not easily solvable. The basic problem is that uncollected claims are not managed efficiently, that the legal state does not function, that the laws are not enforced, that legal regulations are not appropriate and that there are illiquid companies on the market as well as those which otherwise would not operate in a developed economy, they would be excluded from the market, and would fail and reorganize or would be liquidated.

Another problem also arises because of the fact that there were no adequate models of instruments for ensuring collection of claims or that only one instrument was used prior to concluding sale contracts and establishing credit relations. Moreover, the greatest drawbacks definitely lie in a company’s environment, in the social and economic systems which are not functional or

sensitive to illiquid companies that cannot do business successfully, and these systems do not exclude such companies from the market.

It is not an insignificant issue that creditors neglect the function of risk management of claims collection and accept payment, or consider instruments for ensuring collection of claims as if they were completely safe and not risky, as if they were only a formality and have no value, as if they were a worthless piece of paper or a paper that gives rights but cannot be cashed.

Because of this it is extremely important to undertake reforms in this region and adopt practice from developed countries, use their experiences and develop economic and social systems which will help and stimulate successful entities and demotivate companies that are unsuccessful, and automatically (by law) open insolvency proceedings of entities that have been blocked longer than the prescribed period.

Research results have shown that banks granted credits even in cases when they were not sure debtors would be able to pay off, and this was especially done in the period right before and after the privatization of banks. So, it is not excluded that influential individuals purposely abused their power in such situations. According to research results, banks approved almost a fourth of credits (23%) even when those in charge of approving were aware “they could have problems” with the collection of claims from debtors, and in 12% of cases they did this because they had no “more reliable debtors”.

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