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Banks' Lending Behaviour under a Repressed Financial Regulatory Environment: in the Context of Myanmar

1. Introduction

In an ideal world, banking operations should ensure that there is a match between business strategy and loan assessment behaviour (Berger and Udell, 2004). However, in reality, banks are confined within a highly institutionalised environment which shapes their lending behaviour. Banks operate between two spectra in terms of regulatory environment, with policies based either on financial repression or liberalisation. Repressive policies are more common in the banking sector than capital markets. According to McKinnon (1973), financial repression is defined by various policies whereby the state influences credit allocation in channelling financial resources to priority areas identified by the government and micromanaging banks' lending behaviour through interest-rate caps, collateral requirements and capital controls. Financial liberalisation, on the other hand, is regarded as an efficient means of fostering competition and inviting growth impulses from abroad (Bartolini and Drazen, 1997). After a series of decisions supporting financial liberalisation which took place from the 1970s to the 1990s, this type of policy has been intensively studied by scholars. However, there is still no consensus on whether it has positive or negative impacts.

The high degree of autonomy given to banks in terms of risk management prior to 2008 led to a subprime mortgage crisis in the United States and had a domino effect on other developed economies. Therefore, not only in the United States but also among European countries, policy makers are designing regulations that could reduce the autonomy of banks in terms of risk management and decrease risk-taking behaviour. These governments have made policy interventions in their banking sectors which could be identified as repressive policies, for example, lowering nominal interest rates. Nevertheless, none of these governments has identified the interventions as being financially repressive. They are commonly justified as macro-prudential regulations. On the other hand, regulatory authorities in Myanmar are increasing banks' independence in the area of providing loans to facilitate better financial resource allocations. However, we are yet to understand to what extent regulations need to be tightened or loosened up to reach optimal risk-taking behaviour. Moreover, we are not fully aware of whether macro level policy measures alone can control banks' risk-taking behaviours in complicated loan assessment processes. Prior studies which have analysed the impact of financial liberalisation and repression on banks' lending in both developed and developing countries have used aggregate level data such as changes in banking policies and credit volumes. However, micro level data on banks' lending behaviours would provide a complete picture of how banks respond to changes in macro level policies (Hübler et al., 2008). This will allow policy makers to identify opportunities and risks to draw better targeted policy recommendations.

Myanmar is one of the last countries with a repressive financial system. Its current fragile and inefficient financial system underwent reforms in 1963, 1990 and 2010 after its independence from the British government in 1948. Along with political reforms, economic reforms always took place in Myanmar. The first banking sector liberalisation actually began in 1990 when private banks were given licenses to increase competition within industry. After the 2003 financial crisis that only affected the country, further repressive measures were introduced to maintain safety and stability in the banking sector. Again, after the historic general election in 2010, further economic reform began and financial liberalisation was part of the process by default. Despite these reforms, the challenges in the banking industry remain the same. In other words, there is a need to examine the effectiveness of macro level financial policies on banks in Myanmar. This has led to the main research question for

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2
3 this paper: How do banks assess loan applications under a repressed financial regulatory environment
4 which promotes risk aversion?
5

6 **2. Literature Review on Myanmar's Banking System and Financial Repression**

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8 Than (2014) argued that academic research on Myanmar's economic and financial sector were mainly
9 confined to dissertations and seminar papers that were rarely published. In recent years, due to
10 political and economic reforms, a number of international organisations have paid exorbitant prices
11 for macroeconomic overviews, assessments of market conditions and investment climate along with
12 sectoral and subsector analyses. They have been presented at business events for investment but they
13 are not available in the public domain. Organisations such as the World Bank, International Finance
14 Corporations (IFC), Asian Development Bank (ADB), Price Water House Coopers (PwC) and the
15 Organization for Economic Cooperation and Development (OECD) have partnered with local
16 organisations to identify areas for improvement and policy points requiring attention in the banking
17 and finance sector.
18
19

20
21 One of the notable studies was conducted by IFC and the Consultative Group to Assist the Poor
22 (CGAP) (Duflos et al., 2013). Though it mainly focused on Myanmar's microfinance sector, it
23 observed that Myanmar's overall financial infrastructure was underdeveloped and no functioning
24 payment system was in place. Another report related to the financial sector was published by
25 Gesellschaft für Internationale Zusammenarbeit (GIZ). This report stated that, despite the current
26 reforms, the legal framework including the financial infrastructure of the banking industry lagged
27 behind international standards (GIZ, 2015). Similar conclusions were made in one of the ADB's
28 reports, written by Vikram Nehru (Nehru, 2015). The common theme mentioned by these authors was
29 the need for financial sector liberalisation for economic growth as Myanmar banks were too tightly
30 controlled by the government and more autonomy was needed. Despite of the financial sector reforms
31 already having taken place, the recommendations for the banking sector by these authors are still
32 comparable to the conclusions of those who analysed Myanmar's political economy before the reform
33 in 2010 (Turnell, 2009; Turnell, 2011; Mieno, 2013). This raises questions about the level of
34 effectiveness of these macro level policies on micro level institutions.
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38 Such recommendations were made because researchers believed that financial liberalisation would
39 ultimately accelerate economic growth through the promotion of financial sector development,
40 improvement of resource allocation efficiencies, positive technological progressions and financial
41 stability (Huang and Wang, 2011). Hence, in many developing countries, a pre-liberalisation period is
42 associated with financial repression and many researchers have attributed ultimate economic growth
43 to financial liberalisation (Shaw, 1973; Levine, 2004). Based on these theoretical underpinnings,
44 many countries embarked on reforms of their financial sectors during the 1970s, 1980s and the 1990s
45 (Amri and Kocher, 2012). There were 124 episodes of banking crises from 1970 to 2007. Hence, not
46 all the countries that underwent liberalisation experienced positive impacts. Caprio and Klingebiel
47 (1996) reported that the banking crisis that Chile experienced was due to financial sector deregulation.
48 Similarly, Diaz-Alejandro (1985) and Lee et al. (2002) attributed financial liberalisation to the debt
49 crisis in Latin America and the 1997 Asian financial crisis respectively.
50
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52
53 On the other hand, Demetriades and Luintel (2001) found that financial repression actually had
54 positive impacts on South Korea's financial development. Likewise, Huang and Wang (2011) stated
55 that, although China had one of the most repressed financial systems, it was still able to enjoy
56 considerable economic growth. Unlike in other parts of the world, banks in Asia often receive more
57 government interventions (Narayanamurti and Batten, 2015). In general, the role of banks as
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3 commercial enterprises is limited. Banks are compelled to lean towards carrying out their
4 governments' economic policies and fulfilling certain strategic directions. Therefore, Asian financial
5 systems are generally more prone to financial repression than their Western counterparts. Hence,
6 before attempting to understand whether financial repression or liberalisation would facilitate
7 economic growth, one needs to understand the behaviour of economic actors within the institutional
8 environment and the implementations of macroeconomic policies by them at micro levels.
9

10
11 At an institutional level, in various respects, the Myanmar government struggles with coordination
12 between different parts of the government, or even between departments of the same ministry as a
13 result of the size of the bureaucracy resulting from the legacies of military and socialist economic
14 governance systems (Bissinger, 2014). These systems were put in place to control the economy and
15 centralisation was a key aspect of government administrations. In addition, the government had no
16 capacity to formulate and implement new policies. After political reform in 2010, the Myanmar
17 government has been receiving technical and financial support from international organisations for
18 both infrastructure and capacity building. However, the Myanmar banking sector is still facing similar
19 challenges to those experienced before the current economic reforms. For example, banks are still not
20 providing loans to businesses despite receiving grants from the government (Hammond, 2015; Htwe,
21 2015).
22
23

24
25 It was also reported that, due to the central bank's repressive financial policies, which aim to promote
26 financial stability by imposing barriers on lending by banks, the official in government banks would
27 ask borrowers to pay them five percent of the loan to ensure that they had ease of access to financing
28 (Kyaw, 2015).¹ This evidence indicates that the formal constraints imposed on institutions are not
29 always effective. The controls are not always compatible with the internal objectives of the economic
30 actors. Therefore, such policies do not always deliver the desired outcome but rather, they may create
31 new rules for the economic games being played by the actors involved. In other words, policy makers
32 should move away from a one-dimensional view of policy making. They should make an effort to
33 understand the interplay between institutions by recognising that cultures, traditions, society's rules
34 and norms also play a role in shaping policy outcomes.
35
36

37 **3. Research Method**

38
39 It has been accepted that there are limited scholarly works in Myanmar due to the opacity of the
40 country's governance system, and even secondary data are not reliable and accurate (Pick and Thein,
41 2010). Than (2014) has claimed that there are significant gaps in the baseline data and that the
42 unreliability of statistics is a fact of life. Win (2013) has discussed her challenges in conducting
43 research into Myanmar's banking sector due to the lack of reliable data. She observed errors in
44 Myanmar's inflation data reported to the World Bank between 1995 and 2011. This was based on her
45 discussions with government employees about how the official data were calculated and reported
46 without standard formulae or proper calculations.
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49
50 As the purpose of the study was to analyse the banks' strategic formation in response to the demands
51 imposed on them by regulatory institutions in a highly bureaucratized and repressed financial
52 environment, the main method of data collection was interview. At the time of the study, which took
53 place between 2010 and 2014, four domestic banks out of a total of twenty-one banks controlled 79
54 percent of Myanmar's lending market (as of 2011 data), suggesting an oligopolistic competitive
55 situation. The data were collected from nine banks, representing 88 percent of the total assets of
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57 ¹ This information was collected from a local newspaper but it has been cross-checked with banks' customers
58 and local bankers.
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3 Myanmar's private banks. In addition, three government-owned banks were interviewed. Their asset
4 values were unknown to the public. Interviews took place only at the banks' main offices in Yangon
5 which is Myanmar's commercial city. Loan assessments and risk management occur only in these
6 offices as loan officers from different branches across the country would present their assessments of
7 loan applications to the credit committees at the main offices in Yangon for approval.
8

9
10 An interpretative qualitative approach was adopted because it provided multiple realities and allowed
11 the researcher to develop a deeper understanding of the situation (Myers, 1997; Son et al., 2006). This
12 was a relevant approach for the study because the research event was emergent rather than prefigured
13 (Creswell, 2013). The data collection involved a variety of methods including semi-structured
14 interviews and documentation reviews. However, the main method of data collection was semi-
15 structured in-depth interviews. In the initial stages, interviews were conducted with businesses and the
16 public as a fact-finding process about the background of the banks and Myanmar's financial sector
17 development. The second stage of interviews covered detailed issues relating to the processes,
18 practices and discussion of the challenges that banks encountered in the context of loan provision to
19 businesses under the stringent regulations. It allowed the researcher to uncover complex
20 organisational-institutional interplay and how banks achieved profitability while maintaining a façade
21 of convergence to institutional pressures. In other words, it enabled the research to uncover human
22 action within the specific context of its occurrence (Patton, 2014). By presenting interview data from
23 communication with only the senior management not only was a more accurate representation of
24 strategic responses of banks to institutional pressures in loan assessments provided, but also the
25 likelihood of biased results was mitigated as the participants were highly knowledgeable (Eisenhardt
26 and Graebner, 2007). The interview lengths ranged from two to three hours and a total of 23 hours of
27 interviews were transcribed.
28
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30

31 Several steps were taken to improve the reliability of the data collection. First of all, an interview
32 guide was used to ensure that there was a consistent framework and relevant themes were covered
33 despite the focus of some interviewees on certain questions. Secondly, two researchers were present
34 during each interview to enhance the reliability of the interview materials and conclusions drawn from
35 them. Thirdly, all the participants were given an assurance of anonymity to encourage open and
36 honest answers to the questions. After the transcription, NVIVO was used to assist in the qualitative
37 data analysis process. This study uses pseudonyms for banks in Myanmar for the purpose of
38 confidentiality. In this paper, for confidentiality, private banks are represented with the letter 'P',
39 government banks with letter 'G' and semi-government banks with letter 'S'.
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43 **4. Findings**

44
45 This section provides the background of the study as the context is particularly relevant in case-
46 centred research where it becomes the basis on which various aspects of the case are analysed (Roller
47 and Lavrakas, 2015). Afterwards, findings from the interviews will be presented.
48

49 **4.1. Myanmar's Financial System**

50
51 Myanmar's financial institutions have been operating under regulations which were passed in 1990,
52 namely the Central Bank of Myanmar Law, Financial Institutions of Myanmar Law, and the Myanmar
53 Agricultural and Rural Development Bank Law. Under these laws, there were 23 local banks,
54 consisting of 4 state banks and 19 other banks, of which 4 received a license to operate in 2010.
55 Although foreign banks were represented by local offices, they did not conduct any banking activity
56 as of 2014. The non-bank financial institutions consisted of a state-owned insurance enterprise, a
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state-owned small loan enterprise, a privately owned leasing company and one securities company. The Myanmar Securities Exchange Centre (MSEC) was launched in April 1996, a joint venture between the Ministry of Finance and Revenue and the Japanese Daiwa Institute of Research. However, there were only two listed companies, namely the Forest Products Joint Venture Corporation and the Myanmar Citizens Bank Ltd. Thus, there was no mature capital market for banks and other private sectors for financing businesses. As a result, the development of the banking sector had become particularly important for the mobilisation and allocation of financial resources and thus, for economic development.

In 2003, despite banks being scrutinised at all levels, Myanmar's financial system experienced a liquidity crisis due to the collapse of informal finance companies, which pay 3-4% per month on speculative investments such as real estate and construction. This was followed by another trigger for bank runs. Then, the Myanmar government enacted the Law to Control Money and Property Obtained by Illegal Means. This caused panic among depositors but the government was able to halt it. However, stability did not last long, with the rumour linked to the Asia Wealth Bank and their losses in foreign investments spreading among the public. Many of the borrowers had to sell off their business properties to pay off these debts. The crisis led to the closure of three leading private banks, Asia Wealth Bank, May Flower Bank and Myanmar Universal Bank. These banks engaged in providing speculative loans to industries with high risks. Though Yoma Bank's license to operate as a financial institution was not revoked, the government limited its rights to provide financial services. The 2003 financial crisis in Myanmar occurred not because of weaknesses in regulation of the banks alone since the laws and rules were already stringent prior to the crisis. It occurred because of people's lack of trust and the banks' connectedness to political affiliates. Therefore, as banks developed and retained public trust depending on their forms of affiliation with politicians, they were also sensitive to any rumour related to their political affiliates.

As of 2010, Myanmar did not have consumer protection agencies and neither did it have deposit insurance schemes for depositors until 2012. The banks in the country all operated under the Central Bank of Myanmar (CBM) which was, in turn, governed by the CBM law enacted in 1990. CBM also acted as a lender of last resort. Myanmar's official banking regulations and guidelines for banks were relatively simple. After the 2003 financial crisis, Myanmar's banking system became more repressive. As of 2014, banks were required to follow the guidelines below for lending. There are also other restrictions but I will only be presenting the guidelines that directly affected banks' lending.

Table 1: Repressive Lending Policies

Guidelines	Implementations
Lending Limit to an individual borrower	To limit risk exposure, the CBM limited banks so that loans to a single borrower accounted for not more than 30% of a bank's total loan portfolio
Interest rate ceilings	The CBM controlled the minimum and maximum interest rates that could be lent and paid on deposits. For instance, banks could not pay less than 3% below the CBM rate on deposits and could not charge more than 6% above the CBM rate on loans. CBM also limited commitment charge of 1% on lines of credit

Loan to value ratios	Banks could not lend more than 50% of the value of the collateral
Loan Maturity	Banks were only allowed to provide loans with one year maturity. However, they could be renewable depending on the borrowers' circumstances.
No overdraft and factoring facilities	Banks were not allowed to provide overdrafts without collateral.

5.2. Interview Themes

Findings regarding the behaviour of banks in the context of different repressive policies were coded. The responses of interviewees were identified with pseudonyms along with their ownership structures. Similarly to other ASEAN countries such as Indonesia, Thailand and Malaysia (Backman, 2001), concentration of firm ownership exists in Myanmar as well. This is because banks are set up either as family-owned businesses to fund their own investments or they share ownership with the government to carry out their specific strategic directions. Hence, it is worth mentioning the affiliations of the banks when analysing the data.

Convergent Behaviour in the Context of Financial Repression

Collateral Requirements

'Collateral requirements' was one of the themes mentioned quite repeatedly by the interviewees. The representatives from the banks described how they are constrained with the collateral requirements imposed by the CBM. Hence, at the time of interview, they were not able to lend as much as they could before the 2003 financial crisis. The bank representatives mentioned that, although they believed that such collateral requirements restricted them from extending credit to reliable individuals, they needed to adhere to such requirements.

Even if we know that the applicant is trustworthy and his serviceability is high, without collaterals, he would not get loans. This is not our policy. It is the Central Bank's policy.

P-B

Collateral became more important after the 2003 financial crisis. The banks changed their internal policies on credit allocation policies for different sectors. The CBM made a law stating that banks must not provide unsecured lending. The only acceptable collateral is in the form of privately-owned land and buildings. In many instances, banks mentioned that they further restrict the types of land and building that they accept as collateral. There are different types of land such as freehold land, grant land, farmland, agricultural land, permit licensed land and vacant land. In Myanmar, land disputes are common. This applies to all types of land except freehold and grant land. The latter could also be problematic at times if those grants have been given by the military government. Its legacy of land grabbing of agricultural and vacant land for industrial developments is still causing land disputes between grant and licence holders of the land and farmers. Currently, Myanmar's land laws provide little legal protection for every party involved in the process. As a result, banks have been taking as many precautionary measures as they can to assess the documents provided by a loan applicant.

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3 Representatives mentioned that they would check the property deeds submitted by applicants with the
4 Settlement and Land Records Department under the Ministry of Agriculture and Irrigation.
5

6 Moreover, one of the other complications has been the transfer of ownership when land and buildings
7 are purchased. Due to the increasing real estate prices as a result of investors' speculations in
8 Myanmar, especially in the capital's central business districts, purchasers often choose not to transfer
9 ownership to avoid paying high stamp duty:
10

11 *Most of the time, borrowers come to us with deeds which are not under their names. We require them*
12 *to change the name on the deed. I am sure you know about this. If they refuse to do so, they will need*
13 *to bring guarantors.*
14

15
16 S-E
17

18 *We look at the type of buildings built in the collateralised real estate; the location and marketability*
19 *affect the borrowers' requested amount of loan. If the borrower has no collaterals, guarantors should*
20 *be there with their deposits account or assets should be collateralised. These guarantors must be*
21 *close relatives, preferably, parents.*
22

23
24 P-A
25

26 It is common for land owners in Myanmar to have deeds which are not in their names. In many
27 instances, there are two types of contract exchanges: one which is used to register with the Settlement
28 and Land Records department and to pay stamp duty; and the other which is used to transfer the
29 ownership of the estate at the real market value of the purchase. Purchasers normally record the
30 purchase value as being lower than the actual market price to avoid paying high stamp duty as a result
31 of increasing real estate values. Permit licensed land in Myanmar was given by the government to
32 civil servants as part of its urban development programs. Similarly to other land purchases, transfer of
33 ownership was not formally recorded so as to avoid paying stamp duty and other forms of legal fees
34 associated with such purchases. However, unlike other types of land purchase, this permit licenced
35 land has sometimes been exchanged between multiple owners over time with the name of the original
36 recipient of the licence remaining unchanged. The process that banks have had to undertake in order
37 to get assurance that the documents submitted by the loan applicants are genuine takes a significant
38 amount of time. The conclusion is that, not only are the banks fulfilling the CBM's regulatory
39 requirements but they are also able to use these collateral checks as an instrument whereby the banks
40 and borrowers build trust.
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42

43 These were not the only challenges that banks have faced in terms of collateral requirements. There
44 are other legal issues which have prevented them from accepting other types of property such as
45 apartments and condominiums as collateral. The key issue has been that the apartment owners do not
46 always own the land located under their buildings. Hence, the owners are unable to use their
47 properties as collateral and apply for mortgages. The paucity of condominium law has meant that
48 bankers do not have the assurance that apartments are valuable and reliable collateral to fall back on
49 in case of borrowers defaulting. Unlike land and buildings, the values of apartments and
50 condominiums have been fluctuating greatly. Since 2011, the government allowed banks to accept
51 gold and commodities as collateral. However, the pricing risks and perishability of the commodities
52 have prevented banks from accepting them.
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56 Bank P-A also mentioned that they have concerns about not being able to pay money back to their
57 depositors. This is particularly important in Myanmar as most of the loanable funds are based on
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3 deposits unless they come from public limited companies. Nevertheless, since Myanmar's stock
4 exchange is under-developed, banks can only sell shares on their premises. Therefore, banks can face
5 possible liquidity challenges regardless of whether they are public or private limited companies.
6

7 *Borrowers' credibility and serviceability are determined mainly through the quality of collaterals. We*
8 *can't lose because these are our depositors' hard earned money. We have the obligation to pay back*
9 *our depositors.*
10

11 P-A
12

13 The banks also mentioned that the main reason for using collateral to decide whether to approve a
14 loan or not was because they could not rely on the financial statements provided by the loan
15 applicants. Hence, though banks mention that the need to ask for collaterals from borrowers as one of
16 the central bank requirements, there are some convergent values between banks and the regulators in
17 terms of conservatism in lending practices.
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20 **Interest Rates Caps, Loan Maturities, Loan Size and Government Influence on Credit** 21 **Allocation** 22

23 The second theme that was mostly coded in the interviews is 'Interest rates'. Unlike many other
24 countries where a central bank sets base rates with the interest rates determined by banks, lending and
25 deposit rates were regulated by CBM in Myanmar. As of 2010, CBM stated that banks could not
26 charge an interest rate of more than 17%. Since 2011, CBM dropped the maximum interest rate to
27 13% with a floor of 10%. Interests on deposits were provided at 8% per annum. Hence, since deposits
28 are the main source of loanable funds for banks, they are expensive sources of funds.
29
30

31 The shareholder-owned bank, P-A appeared not to lower the lending interest rate from 17%
32 (maximum interest rate as required by the CBM as of 2011) though other banks, such as P-B and P-C
33 set lower interest rates based on their preferences.
34

35 *The management sets lower interest rates for industrials and agricultural businesses and lend at the*
36 *rate of 15% and give priority to export sector.*
37

38 P-B
39

40 *The standard interest rate is 17%; however, if the production sector meets industrial criteria, they*
41 *would be charged at lower rate of 15%. We are not happy with how the interest rates are being*
42 *capped. For the bank, it seems too low. If you think about the inflation, it is double digit. If possible,*
43 *we would like to increase the interest rates.*
44
45

46 P-C
47

48 According to the bank executives, banks must not charge higher or lower interest rates than the rates
49 set by the central bank. Further interviews revealed that banks were more dissatisfied with the central
50 bank's interest rate limits than the collateral requirements. They believed that collateral requirements
51 were important in risk mitigation, whereas interest rates were imposed upon them without
52 considerations of the economic environment that banks had to operate in. The government has never
53 been transparent in providing actual figures on inflation to the general public. On official data,
54 Myanmar's inflation data has always been stated to be a single digit. Banks believe that inflation is
55 much higher than the official data provided by the government. Thus, they have claimed that they
56 should be allowed to set interest rates based on their risk perceptions and the actual inflation rate.
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3 The central bank also requires banks to provide loans at lower interest rates for industry as part of
4 their development plans. Banks have stated that they do not have a choice in selecting the types of
5 business that they would like to agree loans with. Private banks have mentioned that they do not get
6 industrial loan requests from their borrowers because these types of loan are made by the government
7 and semi-government banks. Therefore, through banks were to provide industrial loans at lower
8 interest rates, they did not have such customer base. Another issue with such businesses is that they
9 require long-term loans rather than short-term ones as their borrowing is used to finance capital assets.
10 After the 2003 financial crisis in Myanmar, banks have not been allowed to provide long-term loans.
11 All the loans provided by private banks have been short-term. Some interviewed banks believe that
12 this amounts to sound banking practice. There is an industry-wide belief that banks should not furnish
13 capital for customers to do businesses with and that their role should be to provide assistance only in
14 certain seasons and for specific purposes. Loans are routinely renewed, meaning that banks can
15 renegotiate and review terms of agreement if they have any doubts about borrowers. On the other
16 hand, even if businesses can renew short-term loans, they cannot use them for fixed capital purposes.

17
18 *All of our loans are short-term. After one year, we reduce the collateral value by 10%, that is to*
19 *reduce the risk, then, we renew the loans.*

20
21
22
23 S-A

24
25 *You see, our inflation is pretty high. Then, our government told us that inflation is single digit, then,*
26 *they restricted our interest rates to 12% on deposit and 17% on lending. We cannot make profit at this*
27 *point. I don't care if they reduced the interest rates or not. We need the spreads to be much bigger.*
28 *So, we cannot provide more than fifty percent of the collateral values. If they [borrowers] want more*
29 *loans from us, give us more collaterals.*

30
31
32 P-D

33
34 Prior to the 2003 financial crisis, banks have had two instruments with which off-set stringent
35 regulatory restrictions: service charges and collateral values. Banks have been able to set their own
36 service charges. This means that if the CBM limits upper and lower interest rates for lending, banks
37 are able to vary their service charges depending on their perceived risk premiums. However, since the
38 crisis, banks have not been allowed to charge more than 1% on service and commitment charges.
39 Furthermore, loan sizes are limited to a maximum of fifty percent of the collateral values.
40 Consequently, to externalise and mitigate default risks, real estate collateral is the only instrument
41 available to them. When banks were asked about the types of flexibility they want from the central
42 bank, they stated that they would like to be able to set the rates on lending and deposits.

43
44
45 In theory, organisations in every country are managed rationally and centrally through national
46 economic plans. Some banks are under pressure from social-political institutions which force them to
47 lend to government-affiliated partners, sometimes without them fulfilling the set requirements:

48
49 *We sometimes are given orders from the government to give loans to certain borrowers, in such kind*
50 *of circumstances; we need to be flexible with our requirements*

51
52
53 P-B

54
55 Over the years, banks have been directed by the government to direct credit to certain industries. This
56 enhances the banks' roles in carrying out the government's political and economic policies.
57 Interviews with the banks demonstrated that the government economic policies are not always
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compatible with the internal objectives of banks, i.e. profit maximisation. However, conforming to such regulatory pressures gives banks the advantage of being protected by the government in case of losses. In times of need, banks are required to provide financial assistance to different development projects as required by the government. For instance, after Nargis Cyclone, which destroyed the Ayarwaddy Delta region, the regulators asked the Myanmar Livestock and Fisheries Development Bank (MLFDB) to provide loans to salt factories at a 16% interest rate with government guarantees. The Co-operative Bank, Sibin Tharyaryay Bank and MLFDB also provided loans to Shwe Than Lwin Company for the government's sustainability project in constructing Compressed Natural Gas (CNG) compatible cars. The compatibility of internal objectives and the government policies are determined by the formation of the banks in the first place. Many of the banks exist to supply loans to the government. Hence, interviewees at government and semi-government banks did not express any concerns about such pressures in the way that private banks did.

Varying Levels of Institutional Pressure

Despite the fact that all banks operate in the same economic and political environment, the levels and types of institutional pressure exerted differ from one bank to another. In private banks, collateral is considered to be the main requirement; however, the government-owned bank, G-A sometimes discarded this requirement:

We do not have governmental guarantee scheme; however, sometimes, we ignore collateral requirements by giving unsecured loans.

G-A

Even with government-affiliated banks, sometimes collateral is not required and loans are provided for start-up businesses. Furthermore, the interviewees at the banks stated that executive business networks can reduce the cost of information processing and asymmetry of information. In government banks, these bank executives are civil servants with more authority for approving loans than those in private banks:

When the board of directors brought the borrower to the bank, we give them the loans without collaterals because they are trusted by the directors.

S-E

Similar to the inconsistency of collateral requirements, in the context of loan maturities, government banks have more differing loan maturities compared to those at private and semi-government owned banks. For example, compared to private and semi-government banks, the G-A bank has much more flexibility in fixing the terms of a loan and is able to charge lower interest rates and give unsecured loans.

We give short-term, medium-term and long-term loans. Short-term loans at 17% with maturity from one to three years, medium-term at 16.5% from three to four years and long-term loans at 16% with maturity over five years.

G-A

Such differences in regulatory requirements imposed on banks depending on their levels of governmental affiliation have led to different customer bases for banks. As the government banks have the privilege of providing loans with different maturity levels and interest rates, industrial loans

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3 which are used for capital asset financing have generally been provided by the government banks
4 rather than by the private banks. In other words, the government requires banks to provide industrial
5 loans at lower interest rates than commercial loans and private banks are not able to fulfil the
6 requirements due to the lack of such a customer base. In addition, private banks are more scrutinised
7 by the CBM compared to government-affiliated banks:
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10 *We have night meetings on Mondays and Fridays with the Central Bank. If the deposits are high, we*
11 *have to give some justifications. Other government banks are not required to attend these meetings.*
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13 P-A

14 Since 2003, in addition to abiding by the above guidelines, Myanmar banks have been required to
15 report their daily activities such as their liquidity, solvency and capital adequacy positions by banks'
16 senior executives by 6pm at the CBM. If they have higher deposits or loans than normal, they have to
17 provide justifications to support this. This procedure is termed 'Night School' by these bankers.
18 Government-owned and semi-government banks are exempt from such scrutiny. This demonstrates
19 government favouritism towards government-affiliated banks. This can also be interpreted as private
20 banks being perceived as taking more risks. Interviewees at private banks described the government
21 dealings with the semi-government owned bank named Myawaddy Bank as an example of preferential
22 treatment by the government. It is owned by the Union of Myanmar Economic Holdings Company
23 and widely known locally as 'U Paing'. The share capital of the bank is jointly owned by the
24 Directory of Procurement of Burma's Ministry of Defence and by various forces of cooperatives,
25 regimental associations and veteran organisations. The bank is exempt from imposing service and
26 commitment charges on loans. In addition, it is exempt from paying tax to the government. Hence,
27 operational costs for the bank are much lower compared to other private banks as a result of the tax
28 exemption and provision of loans to the bank's counterparts in different sectors.
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33 In a similar way, some of the government-affiliated banks can lend amounts which are much higher
34 than the CBM allows and no penalty is incurred by them.
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36 *You see, for certain businessmen, our given loan amounts are much higher than their collaterals*
37 *given to us.*
38

39 S-E

40 Thus, the ownership structure is the most important determinant for the extent to to which repressive
41 financial policies are exerted on the banks.
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44 ***Non-Conformity to Repressive Financial Policies***

45 The assumptions in institutional theory are challenged by rejecting the idea of bank conformity to
46 institutional pressures. The idea is that banks under different circumstances and situations approach
47 different strategies to achieve their desired outcomes or to avoid the need for conformity. Hence, in
48 this paper, the resistance of banks to regulatory pressures, in order to accommodate their efficiencies
49 or profitability rather than legitimacy through different strategic responses to institutional pressures,
50 will be presented.
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54 In analysing the interview data for strategic responses, extreme forms of divergence can be only
55 identified as 'avoidance'. Since banks cannot avoid institutional pressures by exiting the environment
56 in which rules and the expectations of the government are actively imposed, banks alter regulators'
57 demands in a manner which is, to some extent, acceptable. Hence, even though strategic responses
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3 can be coded as 'avoidance', their tactics neither escape the institutional environment nor loosen their
4 institutional attachments. In other words, banks try to conceal or disguise their non-conformities by
5 taking advantage of Myanmar's soaring property values. The regulatory restrictions on loanable funds
6 are only 50% of collateral value. Nevertheless, one of the banks' representatives, in interview, stated
7 that, depending on the trustworthiness of the borrowers and profitability of the business, banks
8 increase their loanable funds to up to 70% of the collateral value. This is effectively against the
9 regulatory criteria. Such forms of non-conformities are disguised by the banks by inflating the market
10 value of loan applicants' collateral.

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13 *[...] But we have this guideline that 20% of our total loans should not be for only one*
14 *business/company. Normally, we lend 50% of the wholesale value of collaterals to businesses; if the*
15 *prospect is good enough we increase to 60%. In the extreme cases, if the prospect is very good, we*
16 *increase it to 70% to 80%.*

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19 P-B

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21 *We look at how the borrower paid the interest rate before; if he was prompt in paying interests, then,*
22 *we renew for the next year, give loans up to 70% on the collateral values.*

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24 P-A

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26 This was considered by banks to be a common practice in the industry especially among private and
27 semi-government banks. These banks stated that government banks also engaged in similar activities.
28 They mentioned that the government property value appraisers may receive bribes from loan
29 applicants to overstate the value of their collateral to receive higher loans from the banks.
30 Trustworthiness of the borrower can also be another motive for banks to compromise regulatory
31 constraints such as high interest rate restrictions:

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33 *If the business is good and the borrower is trustworthy, we reduce the base amount on which the*
34 *interest rate is charged.*

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37 S-D

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39 Representatives also believed that, even if the borrowers default, banks are well protected when
40 liquidating such collateral at the market value. Furthermore, banks are able to disguise this on their
41 financial reports submitted to the CBM. They believe that real estate collateral carries the fewest risks
42 in Myanmar's economic environment. In summary, private banks are more likely to diverge from
43 institutional pressures when the prospect of the business and trustworthiness of the loan applicants are
44 above their minimum acceptable levels.

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46 Compared to private banks, semi-government banks such as the Small and Medium Industrial
47 Development Bank (SMIDB) has received funding from international donors and the government to
48 lend to small businesses without collateral and at lower interest rates. However, in one of their annual
49 general meetings, a director of the bank stated that:

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52 *[...] we received government funding to lend to small businesses without collaterals and lower*
53 *interest rates. We cannot lend all the amount of money that is provided to us. It is too risky. So, we put*
54 *the money at other banks. We still get paid interest rates on our deposits.*

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56 The conditions for receiving these funds required the bank to provide loans at 0.25% above the
57 deposit rates and also without collateral. However, this did not match the bank's appetite for risk and
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3 their need to protect shareholders' expectations of profit maximisation. Hence, they have
4 compromised the regulatory requirements by balancing the expectations of both regulators and
5 shareholders.
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7 All in all, banks may diverge from institutional pressures to meet the demands of organisational
8 constituents to increase financial profitability and decrease the risks associated with their loan
9 portfolios; the evidence suggests that banks do not implement strong forms of resistance to these
10 pressures. They either choose to put on a façade of convergence or avoid any necessity to conform.
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12 **5. Discussion and Conclusions**

13 This paper provides new evidence on the controversial subject of financial repression and financial
14 liberalisation through analysis of micro level data on bank lending practices rather than using
15 aggregate macro level data. Bank level information offers an insight into the concerns of banks, the
16 challenges facing them and their loan assessment processes while operating under repressive financial
17 policies. This study is also unique in the sense that it is contributing to the limited academic literature
18 on Myanmar's financial system. It not only represents the last surviving case of a repressed financial
19 system but also an extreme example of the presence of governmental interventions and prudential
20 regulations. Hence, it has been used as an example to identify the efficacy of such policies. It has also
21 uncovered interesting findings.
22

23 First of all, the extent to which enforced repressive financial measures in banking differ, depending on
24 the political affiliations and ownership structures of banks, has been highlighted. Such practices divert
25 different types of loan applicants to private and government-affiliated banks. The latter would attract
26 those with politically-affiliated businesses and connected lending becomes more prevalent. Hence, the
27 results of macro level policies which focus on financial stability are not welfare-enhancing but rather
28 sacrifice overall welfare for the gain of a handful of beneficiaries. Secondly, though repressive
29 policies are enforced on banks to curb risk-taking behaviour among banks and maintain financial
30 stability, the banks in Myanmar themselves inherently demonstrate aversion to risk in the context of
31 lending. Similarly to James B. Forgan's note on good banking practices in 1898 (see Lamoreaux,
32 1996), the banks in Myanmar still maintain the belief that banks should not furnish businesses with
33 loans for fixed capital but only for working capital purposes. Hence, banks are not always concerned
34 about the central bank's conservative lending criteria, especially in terms of collateral requirements.
35 Banks' risk aversion was further augmented by a lack of financial and legal infrastructure in place.
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38 Thirdly, in Myanmar, financial repression does not always mean banks need to compromise their
39 efficiency in terms of profit maximisation to achieve legitimacy from the regulatory authorities. For
40 example, though there were restrictions on the maximum loan to value ratios that banks can provide to
41 borrowers, banks use the soaring property market to their advantage by inflating the market value of
42 real estate used as collateral to provide large loans to businesses. Banks are able to disguise their non-
43 conformities on their balance sheets. In terms of the strategic responses of banks to institutional
44 pressures, the evidence suggests that banks do not take strong measures to react to pressures and
45 regulations from the government but are more likely to undertake weak forms of resistance such as
46 disguise and avoidance. Banks do not consider such practices to be risky because of the soaring
47 property market in Myanmar. Such practices over-expose banks to the property sector and put all the
48 banks at risk if the real estate market were to collapse. Hence, the effectiveness of repressive financial
49 policies put in place by the government to maintain financial stability becomes doubtful. In other
50 words, different governmental policies create another different sets of rules in the lending game.
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Furthermore, this paper presents an argument which prior studies have failed to recognise, i.e. the successes and failures of financial liberalisation policies and governmental reforms could depend on the acceptability and adoptability of the actors within the financial system. Hence, policy makers should move away from a one-dimensional view of policy developments and make an effort to understand the interplay between institutions. By recognising that there are sets of rules and norms established within the financial system over time, the desired policy outcomes are achievable.

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