

**PROGRAMME ON PROJECT APPRAISAL AND RISK ANALYSIS
MANAGEMENT FOR BANKERS**

PETRONAS MANAGEMENT TRAINING INSTITUTE, BANGI, 7 JANUARY 1991

Tan Sri Ahmad Sarji, President, The Harvard Club of Malaysia; Distinguished guests; Ladies and gentlemen.

For decades Harvard University has been renowned for its excellence in the field of studies involving business and the management of business. Today, thanks to the initiative of the Harvard Club of Malaysia, in collaboration with the Harvard Institute for International Development and the Institute of Bankers Malaysia, a selected number of nonHarvard graduates will be able to participate in and benefit from the famous Harvard case-study method of teaching. I would like to extend a warm welcome to the participants from our ASEAN neighbours, Indonesia, Singapore and Thailand. I hope you will enjoy not just this course but also your stay in Malaysia. By the end of this programme, I am sure all the participants will emerge better equipped with the latest techniques as well as become "hands-on" competent on the PC in project appraisal and risk analysis management. The corporate sector and the financial world is becoming increasingly competitive and complex and technologically more sophisticated, and so technical competence in project appraisal and risk management are essential to the efficient conduct of modern business. I applaud this move to provide high-quality technical training in this area and hope that this Harvard training programme will not be the last.

Ladies and gentlemen,

2. Talking about economic advancement, I am glad to say that Malaysia had recorded yet another year of excellent economic performance in 1990. Despite the challenges and uncertainties in the world economy caused by the crisis in the Gulf, Malaysia managed to retain economic stability and a largely inflation free growth.

3. It may be assumed that as a net oil exporter, Malaysia should of course be able to do this. But in reality, Malaysia like other countries in the region and elsewhere, faced inflationary pressures that could negate the gains from higher oil prices. Malaysia warded off inflation by refusing to increase retail petrol prices in step with the rise in crude oil prices, which at one time exceeded US\$40/-. Had Malaysia raised fuel prices, the cost of transport and other goods would have gone up. As is well known, once goods and services increase in price due to whatever reason it almost never returns to original levels even when the causes are removed. Because Malaysia continued to retail petrol at roughly the prices prevailing when crude was below US\$20/there was no increase in the cost of goods and services. Thus when crude came down to more reasonable levels there was no problem with prices remaining at a high level.

4. The price paid for this strategy was loss of revenue for the government and the smuggling out of petroleum products. But this is considered a small price to

pay for containing inflationary pressures.

Ladies and gentlemen,

5. The outlook in the immediate term remains favourable for Malaysia. Even when the expected slowdown in world trade and growth is factored in, the Malaysian economy can reasonably be expected to continue to coast along to record another creditable performance in 1991. Having managed the initial disruption of the Gulf crisis, Malaysia can now enjoy the yield from better prices for crude. More importantly, domestic sources of growth, particularly private investment outlays and consumption spending have been expanding strongly since 1988 and should have enough built-in momentum to carry the economy through in the next 1 to 2 years.

6. In this regard, the sustained surge in investment interest has been particularly encouraging, with over \$21 billion ringgit worth of projects already approved by MIDA during the first nine months of 1990. Equally encouraging have been the indicators on consumer spending, which continued to register strong double-digit growth.

7. The surge in domestic economic activity and continuing favourable economic expectations have inevitably given rise to some areas of concern. First, there is the fear of inflation, in particular, the build-up of inflationary expectations, which - if left unchecked - could become self-fulfilling. As a government, we have begun to use fiscal measures to ease the situation. But in the final analysis, what we need to do is to be more productive if we want to consume more. That is really the only way to combat inflation - i.e. higher production with higher productivity. Second, because of continuing economic growth, our labour market has become much tighter, leading to pockets of shortages and some wage pressures.

8. Increases in wages are not bad for the economy. Indeed they promote greater consumer spending and generally contribute to wealth creation. But wage increases without commensurate or improved productivity will almost certainly result in a wage-price spiral in which of course the increases in wages become meaningless. Workers and management must always bear this in mind. Inflation as a reason for wage increases is suicidal but wage increases because of increases in productivity should not be resisted by management. The government would like to see Malaysian wages rise with increasing productivity.

Ladies and Gentlemen,

9. Apart from the threat of inflation, the buoyant economy has also created a third problem in that our infrastructure facilities have shown early signs of strains in keeping pace with the ever increasing demands of a rapidly growing economy. In some of the more densely developed industrial areas, such as the Klang Valley, infrastructural constraints have become more visible. To cope, the government will need more funds than can be reasonably expected from the usual revenue sources. Excessive borrowing to finance infrastructure will land the government in tight financial situations later on.

10. To overcome this financial constraint and yet provide the required infrastructure on time, the government will use privatisation to the maximum. This way government money will be expanded only on infrastructure with no possible commercial potentials, as for example rural roads, schools and clinics. Industrial estates, ports, airports, toll ways etc, will be built and operated by private enterprise and will be paid for largely by those who use them directly. Our experience has convinced us that privatisation pays and we intend to resort to it as much as possible. We do not see why a car owner in a remote small town should pay for highways and city by-passes which he will hardly ever use. Certainly if the financing of these infrastructure is by public funds, as for example higher petrol tax, the small town car owner will share the burden equally without equally sharing the benefits. Privatisation is therefore a more equitable approach towards providing infrastructure rapidly without diverting funds needed for normal development. Borrowing will have the same effect of spreading the burden without spreading the benefits equitably.

11. Despite the problems which are a consequence of rapid growth, I am confident that the Malaysian economy will be able to march forward with confidence. The banking sector has so far played its role well in financing the growth process. As the credit situation tightens, the banker's role in funding Malaysia's next phase of growth towards a broad-based industrialised economy becomes more critical. Experience in the 1980s have taught bankers to be wary of character lending or collateral lending. Many are finding a need to go back to basics -hence, the quest for expertise and the upgrading of skills. In particular, this calls for effective management in risk analysis and project appraisal.

12. The government is torn between a desire to be liberal and the need to control banking in order to protect the industry and the people. As is well-known, banks just cannot be allowed to go bankrupt as other businesses can. The collapse of even a small bank has such wide implications and effect on the economy of a nation that government is forced to intervene. Interventions cost a lot of money - public money. If the Government is to be responsible with regard to the performance of banks, then it must wield some authority. This is to ensure that banking prudence is not just a catchword but is actually practiced. Still this Government believes in minimal control, which of course means bankers must exercise self-control and be professional. Any move to upgrade banking skills and professionalism will therefore have the Governments unstinting support.

13. When, during the recession, many bank clients got into difficulties, the creation of Funds by the Government did not only help the client of the banks to recover but they also help the banks to recover their loans. In other words in rescuing the borrowers the Government is also rescuing the banks. Banks should therefore acknowledge this by being willing to forego such sources of profit as penalties and the interests on interest. Bankers should also accept that during bad times they themselves must suffer some losses.

14. This does not mean that bankers must be too forgiving towards their clients. The degree of forgiveness should match that of the Government towards the

banks. Nevertheless good bankers must have some foresight and not lend so much to so few people that their fate becomes tied completely to the fate of these clients.

15. Foresight is a scarce commodity. No one predicted the invasion of Kuwait for example. One or two did of course but they were regarded as quite mad when they foresaw such nonsense. But it does not require occult capabilities for bankers to reduce or spread their exposure. By acquiring certain skills they can reduce the role of instinct and gamble in their dealings. This is where expertise and experience in the techniques of project appraisal and risk management come in.

16. Despite the sustained upswing in the economy in the past four years, there is still a large overhang of problem loans, a legacy of the 1985/86 severe recession. The process of loan rehabilitation, whether with or without Government financial assistance, is still an area of major concern to the banking community. Yet the viability of many stalled projects should improve significantly with the economic upturn, despite the Gulf crisis. We badly need special skills at reviving many stalled projects, particularly the abandoned housing projects.

17. On the other hand being over-cautious with new ones are not good either. I believe bankers should always be prepared to "go the extra mile" in order to achieve an amiable and mutually beneficial solution to the projects placed before them. Foreclosure or bankruptcy proceedings, like a war, can never be the best solution for both parties, and can at times be even destructive to the economy as a whole. I would urge the banking community to constantly upgrade its appraisal skills and management techniques in loan rehabilitation and in the management of corporate turnaround in particular. The successful turnaround of stalled projects would help conserve the nation's scarce pool of entrepreneurs, restore productive capacity and in the final analysis help economic growth.

Ladies and Gentlemen,

18. Efforts should also be directed at promoting new industries, particularly those with innovative and new ideas. In business, success cannot always be attained simply by repeating what has been done successfully. Economies of nations will stagnate if there are no new ideas or approaches to business and products. On the other hand bankers are conservative people although they usually describe their attitude as prudent. They tend to be wary and unsupportive of new things. Consequently if bankers are to have their way, nothing new will enter the business scene and the economy will stagnate and even regress.

19. Clearly there is a need for bankers to be more adventurous and to provide venture capital for selected projects. The skills in the selection of such projects must be developed by every bank and they must keep close watch on the performance of the projects they finance. Such skills usually come through experience but experience is a costly teacher. It is important therefore for those who have had the experience to pass them on through the numerous techniques of teaching that have been developed by such business schools as the one at

Harvard.

20. Bankers cannot depend exclusively on collaterals and track records. On the other hand those people with innovative ideas and products must understand that knowing how to do or make things does not mean that a profitable business can result if the capital is available. If there are rich inventors, it is because somebody else took their inventions and marketed them. Left to themselves the inventors can only fiddle in their laboratories. Ford did not invent the car nor Ray Kroc the hamburger. They are basically successful marketeers. But in their own way they were innovators and banks must learn to recognise and support innovators.

21. Risk analysis should not be confined to quantitative and tangible factors only. Indeed, the borrower' s character should be of paramount importance. An entrepreneur who has the vision, dynamism and the spirit to fight against all odds should never be overlooked. This, unfortunately, is rarely included in the credit decision process.

22. Besides the borrower' s character, another important factor should be customer loyalty. People do not easily forget those who deny them aid in times of need. A banker once said that a good client is a rare precious asset; indeed, it is quite impossible to find one who does not already have his own banker. Often, the only way to get one is to steal one or alternatively, to "grow" one. In a young emerging nation like Malaysia, I am sure there is no shortage of enterprising people for the bankers to cultivate their own pool of loyal clients. Bankers have to learn to be more far-sighted. Professionalism and expertise would certainly help in the process.

Ladies and Gentlemen,

23. For its part, the Government has set aside \$250 million ringgit under the New Entrepreneurs Fund to provide low-cost financing opportunities to the new breed of indigenous entrepreneurs. As at the end of November 1990, only \$21 million ringgit have been approved under the scheme to finance 127 new projects. With the present economic upswing, there should be no shortage of fertile ground for new ventures. What is needed are bankers who have the foresight and vision as well as the skills to take the risk and nurture budding entrepreneurs from the cradle.

24. To me, the slow utilisation of the Fund reflects a shortage of this new breed of bankers rather than the lack of budding entrepreneurs. I would urge the banks to step up their efforts to help new enterprises get off the ground. Emerging small and medium size enterprises should be given the opportunity to start up and to grow -they represent vital links in the economic backbone of the country.

25. To this end, I note that regulatory restrictions have already been relaxed for some time to allow banks to invest, within prudent limits, in the shares of newly formed start-up manufacturing concerns. Such a form of equity financing allows the implementation of promising projects with long gestation periods without the

burden of having to meet early demands for repayment, as would be the situation in traditional lending.

Ladies and gentlemen,

26. The Government has recognised the important role that venture capital can play in expanding and diversifying an industrial base and has provided attractive tax incentives for venture capitalists. The market also rewards the venture capitalists for the risk they undertake by providing the opportunity for capital gains that would arise from the initial public offering of the shares of a successful company. But, before this can happen the Bankers must play their role and take reasonable risk, for which they must equip themselves with the skills of proper investment appraisal and risk analysis techniques. I believe the opportunities offered in this programme will go a long way in building expertise in a very exciting area of financing.

27. In this regard, the Government would also like to see the capital market deepen and broaden further in order to enhance the efficiency and risk-bearing capacity of the financial system. For some time now, concerted efforts have been directed at developing the corporate bond market to enable large corporations to raise funds directly from the capital market in a flexible manner and at lower cost.

28. Our first credit rating agency, Rating Agency Malaysia Berhad, which was incorporated in November 1990, should start operations this year. This rating agency is expected to boost investors' confidence in the Malaysian bond market and provide the necessary impetus to the corporate sector to raise long term funds directly from the market.

29. Concurrently, the government is also encouraging the development of a financial futures market, to allow for the more efficient management and distribution of risks. The availability of a wide range of hedging instruments can be expected to enhance the risk-bearing capacity of a market oriented economy. This would help increase capital formation, raise savings and promote economic growth. With the increasing sophistication of the capital market, the need for expertise in risk management and project appraisal will undoubtedly become more urgent in the coming years as the choice of financing and hedging instruments widens.

30. Lest it be thought that a sure recipe for success depends solely on professional skills and technical competence, I should emphasise that these are but necessary ingredients; and on their own, they are not sufficient. We need honesty and integrity in our bankers. Indeed, I would go so far as to say that the fruits of our labours in sustaining economic growth in the past three decades would come to naught, if there is a widespread absence of these fine human qualities in our bankers, businessmen and the people as a whole. The managers of our financial institutions in particular, as mobilisers and custodians of public savings and the channel to provide the oil for the wheels of our economy, are expected to display the highest integrity and sense of honesty in their

endeavours.

31. I am told that at the Harvard Business School today, all MBA students must take basic courses in Business Ethics. This is a good sign and augurs well for the future. It should not be accepted that honesty is essentially a moral choice, and morals and business do not mix. I believe that morals are an integral part of business.

32. Economists and game theorists do tell us that trust is enforced in the market place through retaliation and reputation. In fact, I would go further to say that those who engage in fair dealing will prosper. Ultimately, the caring society we are trying to foster in Malaysia is one where businessmen and entrepreneurs choose virtue and honesty because we want to believe in ourselves and want others to respect and believe in us.

33. Businessmen should keep their promises because it is the right thing to do, not because it is good business. Any society that is not built on trust cannot last. I can find no better way than conscience to explain why trust is the best basis for any business relationship. Fortunately, the environment we live in Malaysia honours honesty, whether or not it is profitable. Right is right and wrong is wrong. There can be no two ways about this.

34. On this note, ladies and gentlemen, I now have much pleasure in officially declaring this course on "Project Appraisal and Risk Analysis Management for Bankers" open.