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Facing financial insolvency in banks

By

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Abstract

Banks are exposed occasionally to a financial crisis, which negatively affects their economic activity and makes it one of the reasons for the decline and deterioration of the economy. The risk is also considered from a financial point of view as a direct expected damage to the banking activity due to the occurrence of economic, natural, political and human events, which result in effective losses that may lead to the bank's discontinuity in carrying out its activity and its exit from the market and may eventually lead to the liquidation of the bank, and the risk can be released in the sense. The financial stringency is related to the financial confusion of the institution, especially the banking institutions, which makes it unable to fulfill its obligations towards others, and the aggravation of the situation may lead to the bankruptcy of the bank .In light of this, the process of dealing with financial insolvency is carried out in several ways, including statistical, mathematical and scientific methods, as each has an approach to facing potential financial insolvency and the expected result from it and correcting it on the third hand. It is a comprehensive continuous process in which employees at all levels participate and which has multiple effects on the performance of the bank .The research presented a detailed presentation on financial stringency in economic units, financial distress, its concept, stages, causes and manifestations, financial stringency for a sample of commercial banks, and methods of dealing with financial insolvency in them.

The problems of the study

Banks face different challenges, including the economic environment, others related to the sector in which they operate, and others related to their financial performance. As a result, banks may face financial insolvency that it is necessary to face.

The financial insolvency has become a threat to the banks in Iraq and weakens their financial position, which exposes them to financial failure for several consecutive times and then permanently stop practicing their activities and business and shareholders. Therefore, it is necessary to find mechanisms to confront financial insolvency and to restructure debts in banks and an inappropriate environment for banks, which led to the weakness of their abilities to withstand shocks and crises, including insolvency, and the research problem can be determined by the following question:

Are commercial banks in Iraq able to effectively face financial insolvency and judge their continuity?

Second, the importance of the study

Great importance must be given to the financial insolvency that may affect economic units and take them out of the market and make them unable to carry out their

activities at the present time. Then the importance is by standing on all cases and developments in terms of concept, causes and manifestations that may lead these units to this hard situation. In addition. It threatens the parties surrounding these units, such as creditors, investors, government units and others (Pandya & Al Janahi, 2021; Poma, Al Shawwa, & Rau, 2021).

The importance of the research stems from the importance of facing the financial insolvency of a sample of commercial banks in Iraq, especially with the challenges faced by independent commercial banks by their inability to meet their obligations and the exposure of some of them to bankruptcy and flow. So a modern scientific restructuring was adopted that contributes to addressing this failure (Wismiarsi et al., 2020).

Third: Objectives of the study

The current research aims to identify the role of facing financial insolvency for a sample of commercial banks in Iraq. It also aims to clarify the importance, objectives, challenges and requirements for success in the sample banks, discussing the reality and indicators of banks' performance and economic justifications, and identifying financial insolvency by identifying significant investments and the negative effects of it and its stages and the reasons that lead to it and try to find appropriate solutions to treat it.

Fourth: the study variables

The study is based on the variable (financial insolvency)

Financial insolvency is the inability of the economic unit or financial institution to pay its due costs and recover the rights of its shareholders, also known as the lack of financial liquidity.

Fifth: The limits of the study

1 .Spatial boundaries are represented by the private commercial banks listed in the Iraqi stock market.

2 .Temporal limits are published financial statements of the Iraqi Commercial Bank listed in the Iraq Stock Exchange for the years from 2016 to 2020, which amount to 5 years, will be based on the temporal limits. Some of these limits are not followed, which requires research.

Sixth: Research Hypothesis

The Raising the efficiency of the research sample banks and increasing their ability to withstand shocks and address financial crises, including financial insolvency in commercial banks, the research sample in the face of financial insolvency increases the endurance strength of financial institutions, including insolvency.

Seventh: Research Methodology

1 .The research adopted the (inductive) method in the theoretical aspect of the study.

2 .On the practical side, the descriptive analytical approach was adopted in choosing the hypotheses of the study by studying and analyzing the relationship between the main variables by collecting data related to the subject of the study.

Eighth: Means of data collection

The researcher relied on the following sources to collect and analyze the data and information needed for her research:

1 -To find the theoretical side: the researcher relied on Arabic and foreign books, letters, theses,

periodicals and the international information network (the Internet).

2 -To accomplish the scientific aspect:

The researcher relied on the following:

B. Financial reports issued by banks, the research sample.

B. Personal interviews, where the opinions of a group of specialists in the Ministry of Finance and Banks and the Ministry of Higher Education and Scientific Research were taken advantage of.

Ninth: The study population and its sample

The study population is represented by the 33 private commercial banks listed in the stock market in Iraq.

Tenth: Previous studies:

1.Ramo and Al-Watar:(2010)

The use of financial analysis methods in predicting the failure of companies

This study aimed at a reliable means of predicting the possibilities of companies failing at least a year before it occurs through the application of one of the most important models for predicting the failure of companies, which is the Altman model, on a sample of Iraqi industrial joint stock companies listed on the Iraqi Stock Exchange. The subject of the study gained its importance from the issue of failure among many parties related to the economic unit. Yet, the problem lies in the lack of awareness of the administrations of economic units and investors of the risks of exposure to financial failure in the future, and the study reached several conclusions, the most important of which is the presence of a set of indicators that characterize each stage of failure that can be guided. The study concluded that most of the models developed to predict financial failure share a number of financial ratios that are based on the financial information published by those economic units.

The study concluded with several recommendations

a. The necessity of adopting the Altman model to predict the failure of Iraqi joint stock companies as a method of financial analysis approved for performance evaluation.

b. The necessity of studying the reasons for the poor performance of many Iraqi industrial companies and taking appropriate measures to avoid their failure and negative impact on the national economy.

c. The need for professional organizations to issue a standard about financial failure and its prediction to guide the management of the economic unit.

2. Al-Hamdani and Al-Qattan:(2013)

Using the Sherrod model to predict financial failure

This study aimed to identify the concept of financial decline and its stages and the reasons for going through these stages and reaching financial failure with its importance in avoiding failure on the one hand, and on the other hand reducing the costs of bankruptcy of economic units or rehabilitating their debts. The financial variables can assess the reality of the General Company for the Pharmaceutical Industry in Nineveh where which the study sample and the extent of its exposure to financial failure through knowing and studying the financial situation for several years predict the extent of its ability to continue providing its services, using one of the financial failure prediction models represented by the (Sherrod) model. A set of conclusions, the most prominent of which was that economic units that conduct a periodic examination of their internal and external environment are more capable to face the risks of financial decline and reduce its damage. The most difficult of these stages is the stage of actual collapse and total deterioration, and it is difficult to obtain additional financing for financial obligations which have led to greater difficulties that prevent the possibility of avoiding failure, and therefore the economic unit is closer to bankruptcy than to success, and all these

conclusions were made in order to apply the Sherrod model, as a tool for predicting the risks of financial failure.

The concept of financial insolvency and its manifestations

This topic includes the concept, stages, causes and types of financial insolvency and the main manifestations of troubled economic units.

First: the concept of financial insolvency

It can be known is the inability of economic sharpness to pay its obligations on time, and this will generate two effects, the first in the short term being its loss of freedom of choice and exploitation of opportunities and its inability to obtain cash discounts, the second in the long run will lead to the liquidation of some assets or investments at an untimely time appropriate, which causes it to have large losses such as bankruptcy and loss of suppliers, creditors and investors.

Financial insolvency can be seen as the inability of the economic unit to fulfill or pay its obligations on time, and financial insolvency can be classified by comparing current assets and current liabilities and the surplus between them(Touiti, 2014) known as Financial stringency:

It is the situation in which the liabilities of the economic unit are greater than its assets, and the financial insolvency takes two cases, real and technical, in which the assets are greater than the liabilities, while the real assets are less than the liabilities(Kadir, 2016).

Financial insolvency is the cash flow that is unable to pay the obligations resulting from the overuse of payment and indebtedness ratios in the economic unit in order to obtain a high profit(Hansen, 2012).

Financial insolvency occurs when there is a waiver of assets or property in favor of creditors or as a result of a loss situation for creditors after they have carried out failed operations or their property is placed under the protection of the state, in order to reorganize the economic unit by making a settlement between the unit and its creditors(Polsiri & Jiraporn, 2012).

The financial insolvency is the situation in which the liabilities of the economic unit are more than its assets and revenues, that is, the capital is less than zero or the assets and revenues of the economic unit are unable to pay its obligations(Amjadian & Pardegi, 2012).

It is a term that indicates that the revenues of the economic unit are unable to cover its expenses. This includes the cost of funds, especially the cost of debts that are represented in installments, interests, or repaying the debt at its specified due dates, as well as the lack of compatibility between investment decisions and financing decisions, and a gap between them Which exposes economic sharpness to financial risks(Sharifi, 2016).

It was known that the economic unit is unable to fulfill its obligations towards others, or the failure to provide its services, sell its products, and obtain the appropriate return(Al-Murshidi, 2018).

It can be included that the concept of financial insolvency is the insufficiency of cash expenditures, which leads to the failure to raise financial obligations and debts, and for the

economic unit to reach the maximum degree of bankruptcy, and the owners' rights become in danger due to large and continuous losses.

Second: The stages of financial insolvency

The so-called insolvent projects are those whose income is not sufficient to cover the expenses. It also means those projects in which the rate of return on investments at their book cost is less than the cost of capital, and the insolvent project if it is unable to meet its due obligations despite the increase in its assets over its liabilities, which is known as the crisis of liquidity, whether in the short or long term, and that financial insolvency begins with the emergence of problems and obstacles and ends with the liquidation of the economic unit, as follows:

1 -The stage of feeling the emergence of the problem (the appearance of the symptom): this stage is represented by the emergence of symptoms and problems related to the performance of the economic unit, which result from the inability of the economic unit to pay its obligations and invest its money, and these obstacles occur due to the bankruptcy of customers or due to embezzlement(Nahoud, 2015).

It is noted that this stage can be controlled and treated easily and successfully and bypassed successfully for the benefit of the economic unit if it is discovered early.

2 -The stage of liquidity deficit: It is the stage in which the assets of the economic unit are unable to convert assets into cash, and this stage arises as a result of a financial stumbling process, and this stage can be addressed by borrowing(Al-Zubaidi, 2017).

It is noted that there is a possibility of controlling this stage by borrowing in a balanced manner to cover the immediate cash needs, in order to be able to cross this stage in a safe and sound manner, and then repay the loans gradually.

3 -The stage of financial insolvency: This stage results from the inability of the economic unit to provide the appropriate liquidity to pay its debts. Also, if this stage is discovered early. It is also addressed by taking the necessary measures represented by changing management, adjusting financial policies or issuing additional shares(Matar, 2010).

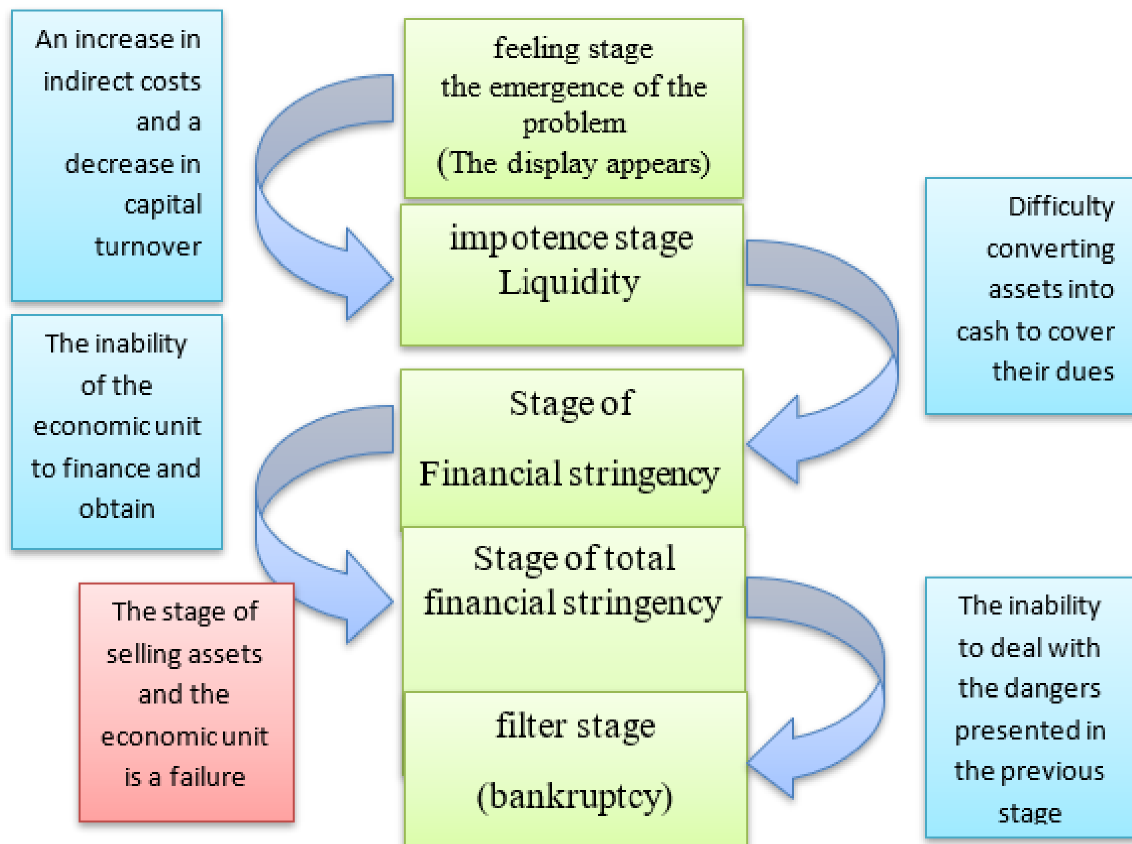
It can be included that this stage can be successfully addressed if the defect is discovered in a timely manner through changing departments, amending the financial policy or issuing additional shares.

4 -The stage of total insolvency: It is the stage resulting from the inability of the economic unit to deal with the apparent errors in the previous stage (insolvency), and that this stage in which the liabilities are greater than the assets and then the economic unit is unable to obtain new liquidity, which It leads her to admit failure(Kadir, 2016).

It is noted that this stage is the most dangerous stage experienced by the economic unit. Also, it can only be addressed through the transition to the fifth stage due to the cumulative deterioration of the previous stages and the inability to address it and the accumulation of debts.

5 -The stage of liquidation (bankruptcy): It is the final stage that the economic unit reaches, as this stage is manifested by a judicial (legal) procedure in order to protect the rights of all parties related to the unit, and then the economic unit will fail(Al-Atrushi, 2013).

It can be included that this step is important for the purpose of preserving the rights of all shareholders after the failure of the economic unit has been proven and its inability to rise again, and as in Scheme (1) these stages:



Scheme (1) *stages of financial insolvency*

Third: The causes of financial insolvency

The reasons for the difficulty of the economic unit, according to the opinions of interested and researchers, differ from one economic unit to another according to the conditions of the surrounding environment, including:

1 .Internal causes

A. Administrative reasons: Administrative reasons are in the first that lead to the difficulty of economic units, because the weakness of the administration and its inefficiency and the failure to provide appropriate support to employees, as well as the selection of people who are not qualified to take up important positions, this will be a major reason for the failure of many units, and the weakness of plans The strategy set by the management makes it unable to solve the existing financial, organizational, commercial and human problems(Al-Maliki, 2014).

Marketing reasons: Among the most important marketing reasons that lead to financial insolvency in the economic unit are(Al-Janabi, 2013):

a. High marketing costs

b. Organizational problems and obstacles related to marketing research.

c. Dusmping the market with foreign goods and products.

D. Inaccuracy and failure to determine the expected sales volume and profits.

E. Lack of interest in economic feasibility studies.

F. The small size of the financial market.

B. Financial reasons: The financial reasons are the high rate of borrowing, delay in repaying liabilities, insufficient capital, provisions for depreciation for capital assets, inability to purchase primary resources, poor financial management, lack of liquidity, high costs and manipulations in the investment cost. These reasons lead to a clear imbalance in the financial ratios of the unit economic and major disturbances, and then to accumulated losses borne by

the unit, which may negatively affect the economic unit and the results of its work. Therefore, the combination of these reasons leads the unit to catastrophic results represented by the inability to pay obligations, which exposes it to financial insolvency (Ammar, 2010).

c. Productive and technical reasons: These methods, which lead the economic unit to financial insolvency, are represented in the following: relying on unsophisticated and low-quality technologies and means, the inability of the economic unit to keep pace with development, the intensity of competition and errors in preparing the technical feasibility study and defects in materials(Kadir, 2016).

2 .External reasons: The external causes are the circumstances surrounding the economic unit that affect it and lead it to financial insolvency, including: the obstacles and obstacles represented by the delay of the economic unit in implementing its time programs on their specified dates, as well as the obstacles represented by government departments dealing with import, tax and customs agencies, technological progress and rapid development And the extent of its impact on the market, as well as the inflationary trends that affect the local and global economy through the prices of raw materials, raw materials, prices of goods and services, fluctuations in exchange rates and their relationship to the financing structure of the economic unit (Behbood, Lu, & Zhang, 2011)as in figure (2).

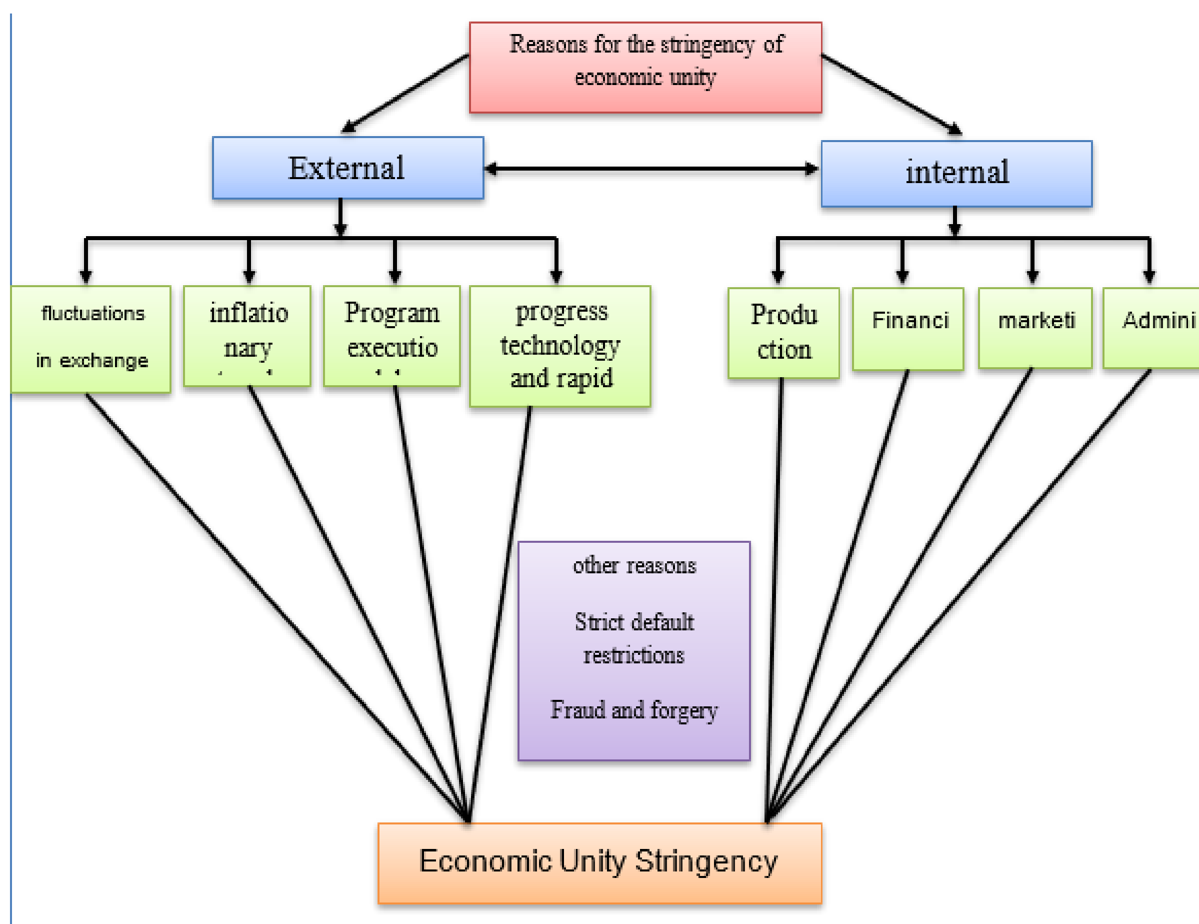


Figure (2) *(prepared* by *the researcher) Reasons for the insolvency of economic unity*

Through what was presented about the reasons for the difficulty of the economic unit, it is concluded that all these methods, whether internal or external or others, all lead to the failure of the economic unit, but the significant and important impact on it is mainly the weak management of the economic unit and the inefficiency of its strategic plans in facing the

challenges represented by technology And developments in the world, fluctuations in exchange rates and fraud, so the economic unit must strive seriously to raise the level of performance efficiency by formulating its strategic plans in a scientific and accurate manner and working to avoid extravagance of funds, in order to maintain liquidity and not harm the financial structure of the economic unit. As well as working to keep pace with technologies and rapid developments in order to maintain its place in the business market and avoid financial failure that leads to liquidation.

Fourth: Types of financial insolvency

The most important types of financial insolvency are:

1 -Business failure: It is the failure that occurs through a set of financial problems and obstacles experienced by the economic unit, which may lead to the termination of its work and its relationship to loss or liquidation, and this type of failure is sometimes determined by the financial analysis unit known as (Dun). & Brad Street)(Thamer, 2018).

2 -Economic failure: This type of failure is determined when the economic unit is unable to cover the costs involved, including the cost of capital financing(Ali Khalaf & Rashid, 2013).

3 -Administrative failure: This type of failure is represented by the weak ability and efficiency of the administrative system of the economic unit, which leads to the inability to control the results of its work, which leads it to negative results that make it unable to determine and estimate what will happen to it in the future, as well as the deterioration in profits. Hence, it cannot adjust its plans or adapt to its external environment(Ammar, 2010).

On this basis, financial insolvency is classified into the following:

A- Technical Insolvency:

In this case, the value of the current assets is greater than the value of the current liabilities, meaning that the economic unit can sell some of its current assets during the period of time to pay the liabilities related to them, and the problem lies in the monetary and not the financial position of the economic unit and it is called (hard flow) (Abu-Shehab, 2018).

B- Legal Insolvency:

In this case, the value of the current assets is less than the current liabilities, which drives the economic unit to sell part of its fixed assets, and the process requires a long time to fulfill its obligations, which drives the rights holders to demand liquidation or direct supervision over them(Abbas, 2018).

Fifth: The main manifestations of distressed economic units

The manifestations that indicate that the economic unit is heading towards financial insolvency can be clarified as follows(Ramo & Al-Watar, 2010):

1 .Weakness and lack of administrative and financial competencies in managing the activities of the economic unit.

2 .An imbalance in the financial position of the economic unit, such as an increase in high payments or reliance on short-term borrowing.

3 .Following the traditional methods by some units, i.e., not relying on advanced and modern technology, which makes the unit unable to compete in the market.

4 .The inability of the economic unit to identify profitable activities.

5 .Increasing the intensity of competition between imported products and local products, which leads to a decrease in sales.

6 .Delay in preparing final accounts.

7 .The continuous rise in the items of goods and debtors due to weak control over working capital.

8 .Delay in payment of dues to suppliers.

There are main manifestations of insolvent banks

Banks are characterized by important features

1 .Inadequate provision for regular and non-performing loans and contingent liabilities to meet the obligations and purposes for which they are created.

2 .Banks' violation of the controls and instructions issued by the central banks registered with them, especially the instructions related to the balance of currencies and the controls for granting credit and capital adequacy (in accordance with the Basel Agreement).

3 .Some customers in those banks exceeded the limits authorized to them and the guarantees provided by them.

4 .Non-compliance with the conditions and controls included in the credit approvals issued to some customers and permitting the use of these facilities before the prescribed conditions and controls are met.

5 .Continuing to work in those banks with approvals that have expired without renewing them.

6 .The lack of commitment by these banks to the necessity of matching the total loans and facilities authorized to their customers and the size of their financial resources invested in their activities.

7 .Banks granting new facilities to some customers in order to cover existing excesses.

8 .The suffering of these banks from the phenomenon of concentration (concentration risk), which is the concentration of a large part of the credit granted to a limited number of customers, as well as the concentration in bank investments (in sector or location), concentrations in deposits and concentrations of shareholders in bank shares.

9 .The failure of those banks to re-evaluate the assets that were owned by the banks in fulfillment of their debts(Al-Fotouh, 1994).

10 .Banks' lack of commitment to financial disclosure of all financial information in light of the rules and controls issued by central banks and international accounting standards with misleading events with incorrect information. This leads decision makers to take their decisions, and this is reflected in their actions. The value of that information prevents it from being available and more detailed and more Valid and available at the right time and also taking into account the return from it.

11. The failure of the auditors of troubled banks to exercise due diligence in expressing neutral technical opinions on the continuity of these banks and not expressing conservative technical opinions. It is noted that the successive losses of those banks and their impact are responsible for the continuity in the auditors' reports to the shareholders of those banks.

12. The troubled banks suffer from weak internal control systems or have multiple loopholes that are reflected on the management and are reflected in the increase in violations or the environment conducive to economic crime such as bribery or administrative corruption.

13. Weak institutional governance, which is one of the manifestations of the lack of separation between management and ownership and weakness in defining powers and responsibilities, in disclosure and transparency, in oversight, in setting future plans and following up on their implementation.

14. Lack of effective risk management departments.

15- Weak credit management, the absence of effective follow-up of bad debts, the absence of effective control over the granting and collection of credits, and the absence of a periodic review of the establishment of guarantees.

It is noted that all the manifestations that were presented above are indicative of the difficulty of the economic unit in performing its work correctly, and through which the economic unit tends to fail.

Conclusions

The following points will show the most important conclusions

1 -Poor management in the banks, the sample of the study, which exacerbated the crisis of financial insolvency in them.
2 -Not paying attention to liquidity, and neglecting profitability, since profitability is what refers to the financial position of private banks and trying to balance them.
3 -The percentage of private banks' dependence on external sources of financing is superior to their dependence on internal financing sources
1 -Working to follow modern methods and methods of financial analysis in order to predict financial insolvency
2 -There is no single scenario that all private commercial banks heading towards financial insolvency can follow, but this stage differs from one private bank to another, and this is due to several reasons. The most important are the causes of financial insolvency and the way that private commercial banks deal with them. So, it is important to decide whether the bank has reached a state of financial insolvency or not.

Recommendations

The study recommends the following:

1 -Continuously raising the capital and assets of private banks in order for the capital to reach their counterparts in the Arab countries, in addition to increasing and diversifying the assets of private banks. Also, they must redouble efforts and choose the best ways to achieve a balance between returns and risks for the purpose of achieving stability in the banking sector.
2 -Comprehensive supervision practices must be developed according to scientific standards, and the weakness of banking supervision leads to the bankruptcy of private commercial banks and the failure of the banking system.
3 -Working on using modern methods and systems for financial analysis to predict financial insolvency.
4- The necessary information must be provided to decision makers by providing a set of appropriate preventive measures, the application of which leads to the improvement and development of financial information, which are represented in the following:
a. Availability of financial systems with effective supervisory frameworks in private commercial banks
b. Commitment of private commercial banks to international accounting standards.
c. Developing the administrative skills of employees in private banks in financial analysis and interpretation of ratios to managers and subordinates at work.
d. Using financial analysis in the decision-making process and moving away from quick and improvised personal estimates in order to improve the quality of the decisions taken.
e. Attention to financial planning in private commercial banks.
And the. Reducing the granting of financial credit and rationalizing spending, to reduce costs to a minimum.

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