



Risks Emerged in Lending Industrial Enterprises by Banks and Ways to Reduce Them

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Abstract

Investment loans of commercial banks are an important source of financing the costs of modernization, technical and technological re-equipment of industrial enterprises. However, in order to increase the use of investment loans by commercial banks of industrial enterprises, banks need project managers who adequately assess investment projects, accurate risk assessment at each stage of investment projects, and banks have sufficient resources and industrial enterprises will be able to repay investment loans in a timely and complete manner. The article identifies potential risks in lending to industrial enterprises of commercial banks of the Republic of Uzbekistan, and develops scientific proposals to reduce them.

Keywords: *Commercial Bank; Risks; Origin of Risks; Types of Risks; Risk Management; Credit; Investment Credit; Industrial Enterprise; Reserve; Interest; Resource; Supply*

Introduction

According to the Decree of the President of the Republic of Uzbekistan No. PF-60 dated January 28, 2022, in the new Development Strategy of Uzbekistan for 2022-2026, the financial condition of borrowers, project viability, cash flow and risk analysis of project implementation, risk management in corporate governance are of particular importance for the implementation of each investment project [1].

Also, in accordance with the Decree of the President of the Republic of Uzbekistan No. PF-5992 of May 12, 2020, in the Strategy of Banking Reform of the Republic of Uzbekistan for 2020 - 2025

Achieving a moderate increase in the volume of loans from commercial banks is defined as one of the priorities of the country's banking system reform and the development of a mechanism for rapid corrective action to address the problems of banks early, before the risks occur, including by the banks themselves [2].

The above-mentioned circumstances make it necessary for commercial banks to apply the issue of possible risks in lending to industrial enterprises and their mitigation on a scientific basis.

The origin of the word risk is indicated in the ancient Latin and Greek alphabets, and the word risk means "shortening" in Latin, "sorting", in Greek - "danger". In some literatures, the word risk is also referred to as risk or risk. The term "risk" is common in the practice of European countries. For example,

the Greeks have the word "ridsicon", which means rock, peak, in Italian, the word "risiko" means danger, the word "risicare" means threat, the skillful transition from rock. The word "risdoe" in French means threat, to go around a rock. Economic dictionaries have shown that risk-risk comes in the sense of going towards risk in the hope of harm or loss, the probability of risk, or the prospect of success [3].

Literature Review

Research by Uerta de Soto has shown that lower interest rates on investment loans from commercial banks will turn previously unprofitable investment projects into profitable investment projects and as a result of financing investment projects through loans not secured with voluntary funds by banks occurs failure of investment projects and non-repayment of loans [4].

According to T. Belikov, the starting point for the analysis of investment projects in lending to industrial enterprises by credit managers in banks is not to increase the participation of banks in the investment project and, consequently, increase profitability:

- Analysis and minimization of risks associated with the implementation of the investment project;
- Analysis of the quality of investment project initiators (analysis of the borrower and guarantor organization and the group of entrepreneurial enterprises in general) and noted that the main contributors to this are the tools of financial analysis [5].

According to J. Sinki, one of the important functions of the employees of the credit department of banks is to properly assess the effectiveness of the activities and management of the borrowing company [6].

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According to V. Kayukov and A. Kayukov, in order to improve the mechanism of providing industrial enterprises with bank loans, it is necessary to strengthen the resource base of commercial banks, to ensure the balance of assets and liabilities of banks in terms of volume and maturity [7].

According to P. Knyazev, the risk management department of credit organizations has a special place in lending to investment projects. The risk assessment of the long-term lending process places certain extended requirements on forecasting. In this regard, he believes that an important role in the implementation of investment decisions in the activities of commercial banks is the management of technical, commercial, economic and political risks that can affect the investment project in the first phase of construction and in the second phase of production [8].

According to Mahmudova, the risks in the activities of banks, the size of the loan portfolio, its composition, the share of interest payments, the share of repayable loans in the principal at risk are in line with such indicators [9].

According to B. Sattarov, the division of loans into risk aspects, the development of ways to minimize them, the protection of bank interests can be the basis for reducing credit risks. The main reasons for the emergence of credit risks may be due to the fact that loans are allocated to one sector, one network, and do not comply with the risk pertaining to one borrower. Dividing loans by risk level can indicate how much of the loan is in the normal risk or high risk zone [10].

Analysis and Discussion of Results

Risk is a situation in which business entities have a negative result or disadvantage in production, commercial, financial and other activities and lose interest.

The following factors can be mentioned as unfavorable conditions and negative consequences:

- Lost income;
- Losses (loss of own funds);
- Absence of result (neither benefit nor harm);
- Incomplete receipt of income and profits;
- Failure to receive income or loss that is expected to be incurred in the future.

Behind the concept of risk is the risk of losing something you need as a result of various negative circumstances.

Hazards are man-made, natural, and mixed types, and can include environmental pollution, earthquakes, floods, or landslides that occur with or without human intervention. However, in terms of scope: if there are risks arising from the fulfillment of political, social, environmental and professional obligations, depending on the nature of the period, there are permanent (interest and currency risks) and temporary (risk of insolvency of the enterprise) risks.

In this analysis, we examined a set of different risks that commercial banks may face in lending to industrial enterprises, which differ from each other in time and space, as well as internal and external factors influencing the level of these risks and ways to minimize them.

We considered it necessary to consider the following main areas of banking risks when lending investment projects of industrial enterprises of commercial banks:

- Risk of investment project participants;
- Risk of completing an investment project;
- Infrastructure risk in an investment project;
- Risk of contracts during the investment period of the investment project;
- The risk of untimely and incomplete financing of the investment project;
- Risk of not providing the raw material base of the investment project;
- Risk of non-fulfillment of sales targets in the investment project;
- Risk of overdue investment project over the investment period.

1. The risk of participants group in an investment project.

The main content of this risk is the low level of financial literacy of the top managers of the project organization (borrower) participating in the project (borrower), the lack of experience in implementing investment projects and the lack of business acumen.

To reduce these risks in an investment project:

- Involvement of highly qualified specialists in the project team by the borrower to implement investment projects. Determining the skills of these specialists and recruiting them to the group before taking a loan in cooperation with the bank;
- Involvement of independent financial and technical specialists in the implementation of the investment project.

2. Risk of completing an investment project.

This type of risk is the emphasis on the main risks, ie technological, construction, infrastructure and administrative risks, which arise from the fact that industrial facilities are not completed in time, the installation of new equipment is not completed and commissioned.

In order to reduce these risks in the investment project:

- Financing of commercial banks is carried out only after obtaining full loan documents (including project estimates, licenses) from the borrower under the investment project.
- Upon prior agreement with the bank, the borrower must select a general contractor, equipment supplier, and selected production technology for the investment project.

3. Infrastructure risk in the investment project.

It is necessary to specify in this type of risk: non-fulfillment of technical conditions in the investment projects of industrial enterprises due to the import of natural gas, electricity, water, sewage, heating systems on the territory of the enterprise, failure to agree in advance on the limits of gas, electricity and water supply; as well as the absence of a highway, the fact that the facilities for the development of part of the railway line are not included in the territory, the dependence of the enterprise on the main suppliers of heat and electricity, the presence of a separate substation on the territory of the enterprise.

It requires special attention to the above infrastructure risks when considering each investment project by commercial banks.

To reduce these risks in an investment project should be included:

- Availability of own resource bases of the participant of the investment project, state support of the project at the district, city and republican level;
- Before financing the investment project, prepare and submit to the bank the relevant permits for connection to the engineering network and the allocation of limits;
- The budget of the investment project infrastructure costs (laying separate asphalt on the territory of the enterprise, construction of a railway, construction of separate heating boilers, power substations).

4. Risk of contracts during the investment period of the investment project.

This type of risk is the risk that may arise in the investment projects of industrial enterprises under the terms of contracts concluded by the enterprise with other organizations (supply of equipment, commissioning of construction facilities on a turnkey basis, etc.).

In order to reduce these risks in the investment project it must be entered following provisions:

- Establishing in the contracts a guarantee of fulfillment of obligations by the seller in favor of the buyer and a guarantee of refund of advance payments;
- Choosing the type of letter of credit that is secure under the contract;

- Application of the mechanism of implementation of 100% payment after delivery of the contract to reduce the risks;
- If possible, pay 10-15% of the contract amount after the equipment is delivered and fully commissioned

5. The risk of untimely and incomplete financing of the investment project.

Financing of the project by a source of several financial institutions, increase in the initial cost of the project, prolongation of the project investment period, improper planning of the need for working capital under the project may be the main reasons for this type of risk.

To reduce these risks in an investment project:

- Accurate calculation of budget indicators for capital construction;
- Defining specific indicators and objectives for financing each financial institution;
- Concluding contracts with general contractors and subcontractors at clearly defined values (fixed price);
- Failure of commercial banks to implement the project with the participant of the investment project at the expense of the last financial resources of the participant (borrower).

6. Risk of not providing the raw material base of the investment project.

The lack of sufficient raw material base and the rising prices for raw materials, dependence of the enterprise on large suppliers of raw materials should be mentioned as the main reasons for this type of risk

To reduce these risks in an investment project should be taken into account:

- Availability of the borrower's own raw material base;
- Existence of long-term contracts for the rapid purchase of raw materials;
- The profitability of the project is high even in the supply of raw materials from foreign suppliers at high prices by foreign organizations.

7. Risk of non-fulfillment of sales targets in the investment project.

This risk is mainly due to the fact that in the analysis of large investment projects by commercial banks, first of all, the project initiator (borrower) requires joint agreements with other organizations for the sale of products produced under the project, pre-purchase contracts.

When the production site is leased, it is necessary to have a long-term (for a period not less than the project period) lease agreement with the lessor.

To reduce these risks in an investment project:

- Carrying out competition forecasts taking into account the capacities launched by competitors;

- Concluding contracts with potential buyers for the sale of products, signing joint agreements;
- Analysis of the amount of underutilized production capacity in the industrial sector and the reasons for their incomplete commissioning.

8. Risk of expiration of the investment project over the investment period.

Violation of delivery times by product suppliers, delivery of poor quality equipment, failure of the contracting organization to carry out the construction work on time, difficulties in the process of connecting completed facilities to engineering systems can be cited as the main reasons for the occurrence of this risk.

To reduce these risks in an investment project should be considered:

- Conclusion of a turnkey contract with the general contractor for the investment project;
- Availability of complete design and pre-project documents for the investment project, as well as various permits;
- In the contracts of the seller and the supplier to include in the contract the obligations of the seller to accept the terms of full commissioning of production equipment and to pay part of the payment after the completion of the installation of equipment.

Conclusions and Suggestions

Banks should have sufficient resources to increase the use of investment loans by commercial banks of industrial enterprises, and industrial enterprises should be able to repay investment loans in a timely and complete manner.

Expansion of promising investment projects and lending to small businesses and private entrepreneurship is a prerequisite for sustainable development of the country's economy.

To study the risks with the 100% level by commercial banks in lending to industrial enterprises can be divided into the following 3 main sections (with answers to questions), allows the bank to minimize the risks in the allocation of credit:

1. The first section. This is undoubtedly a borrowing organization. What kind of organization is this organization, what kind of activities is it carrying out, are there any professionals in this organization, are there any positive achievements during its previous activities.
2. The second section. Information about the project itself. Whether all the steps of this project have been developed, whether the product to be produced is unique or the demand for this product is high, whether there are opportunities to store this product, whether it is possible to identify and reduce all risks in the project, whether the borrower has a stake in the project.
3. The third section. What kind of support is provided to the investment project. Whether it is possible to sell the secured property when the loan becomes a problem, whether the sale process will go smoothly, whether the project envisages the risk of the borrower or the involvement of a third party in the project.

If at least 2 of the 3 main sections discussed above have a clear answer, then the risks of this project can be reduced.

If the commercial bank is a new organization that is not familiar with the activities of the borrower, then a well-designed project and a well-supplied supply are needed to reduce the risk in financing an investment project.

If at the beginning of the project the ability to accurately calculate is limited, then it is possible to finance the project only by reducing the risks under the strong supply, which is a high share of the project in the project with good experience and credit history and a strong secondary source of credit.

In our opinion, the following measures should be taken to reduce the risks that arise in improving the practice of lending to industrial enterprises of commercial banks of the country and their reduction:

1. In order to reduce the risks of investment loans provided by commercial banks to industrial enterprises, it is necessary to first attract qualified specialists from abroad, if necessary, an in-depth and comprehensive analysis (*correct determination of the correct investment term, the optimal interest rate, loan term, repayment schedule of the loan principal and interest*) of the investment project; second, it is necessary to reduce the share of interbank loans in the volume of resources (because they are an expensive resource).

2. In order to reduce the level of reserve allocations to cover loan losses by improving the quality of loans to industrial enterprises by commercial banks:

Firstly, the structure of classified loans should be improved by ensuring a high and stable level of the share of standard and substandard loans;

Secondly, it is necessary to improve the system of assessing the creditworthiness of industrial enterprises through the introduction of financial ratios and cash flow assessment methods, which are widely used in banking practice in developed countries;

Thirdly, it is necessary to increase the share of insurance policies of insolvent insurance companies in the collateral for loans to industrial enterprises.

3. In order to reduce the risks of investment loans issued by commercial banks to industrial enterprises, to fully establish a system of full insurance of assets involved in the general investment project by the borrower during the investment period, as well as risks arising in the process of construction and installation.

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