

BANK COUNSELING PRIORITIES FOR ACCESSING BANK LOANS FOR SME's

Daniela HARANGUS, Raluca VOICA

„TIBISCUS” UNIVERSITY OF TIMIȘOARA, FACULTY OF ECONOMICS

Abstract:

The strategy of the banks in general, regarding investments of loans, is mainly directed towards support of the private sector of small and medium enterprises. In the current context of the global financial crisis, it will be very difficult for most of the small and medium enterprises to find the necessary money for financing the continuity of their activities. The portfolios of the Romanian banks include a series of products specially designed for small and medium enterprises, credit lines destined for retechnologisation, development and current payment of salaries or suppliers. Some banks offer the possibility of obtaining loans destined to the co-financing of European programs.

Key words: bank counseling, accessing bank loans, small and medium enterprises

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The globalization of the World Economy compelled the Romanian bank entities to apply a series of banking rules also applying in the European Union, regarding loan granting. The globalization of the banking sector is both geographical - at regional, continental and planetary level, resulting national, regional, and international and global banks, and structural.

The main and one of the most important bank operations is granting a loan. That is why in any financial bank Institution the regulation of the lending activity is done according to well established principles and lending rules.

The way the bank assigns the funds that administrates can resolutely influence the economic development at local or national level. On the other hand, any bank assumes risks at a certain extent when granting loans and somehow all banks currently record losses in the loan portfolio when debtors do not honor their liabilities. However, whatever the assumed risk levels may be, losses in the loan portfolio can be minimized if lending operations are organized and managed with professionalism.

From this point of view, the most important bank mastership is that of controlling the quality of the loan portfolio for any faulty management of the loan quality may lead to bank bankruptcy. According to the Currency Control Department, the main causes of bank bankruptcy in the U.S. in the 80's refer to:

- inattentiveness in formulating lending rules;
- presence of too generous lending conditions and lack of clear directives;
- violation of internal lending rules by the personnel of the bank;
- risky loan concentration on certain fields;
- excessive growth of loan portfolio value, over the reasonable possibilities of the bank to cover the risks;
- faulty or inexistent systems for detecting loans with problems;
- lack of information on treasury flows of the clients;
- preferential loan (under market conditions).

In order to overcome the systematic deficiencies and the procedures of this kind that lead to growth of losses at loan portfolio level, banks must develop and implement performant lending policies. Such policies should be linked to its strategic objectives and follow the efficiency principle (that of profitability) of the capital invested in loans,

based on its interests and market tendencies. After the evaluation carried out by specific departments, the bank establishes - if considered necessary – exposure limits for branch banks, areas and sectors of activity or types of loans. In order for a bank lending policy to be considered useful and not just an academic exercise, it must meet correct formulation conditions and complete content.

A lending policy can be appraised as being correct if for its elaboration was given priority to the achieving of the following objectives:

- selection of secure loans with maximum reimbursement probability;
- selection of profitable investments for the resources available at the bank;
- encouraging expansion of loans that correspond to the needs of the market on which the bank operates;

Lending policies vary over time and depend on the economic cycle. They must be updated and become adaptable to changes of economic and competitive environment.

Any granted bank loan represents an anticipation of future receipts. From this perspective (flow of receipts), any loan bears the risk that such receipts are partially carried out or not carried out at all. Such risk is also called the debtor's insolvency risk and it is essential in banking activity because the main feature of a bank is loan granting. The fair assessment of loan risk is therefore of major importance for the bank.

In order to minimize risk exposure, a banking entity takes into consideration the following important elements in the lending process, illustrated in Figure 1:

1. selection of the loan applicant;
2. evaluation of the loan application;
3. reimbursement of the loan;
4. interests and charged commissions;
5. loan guarantees.

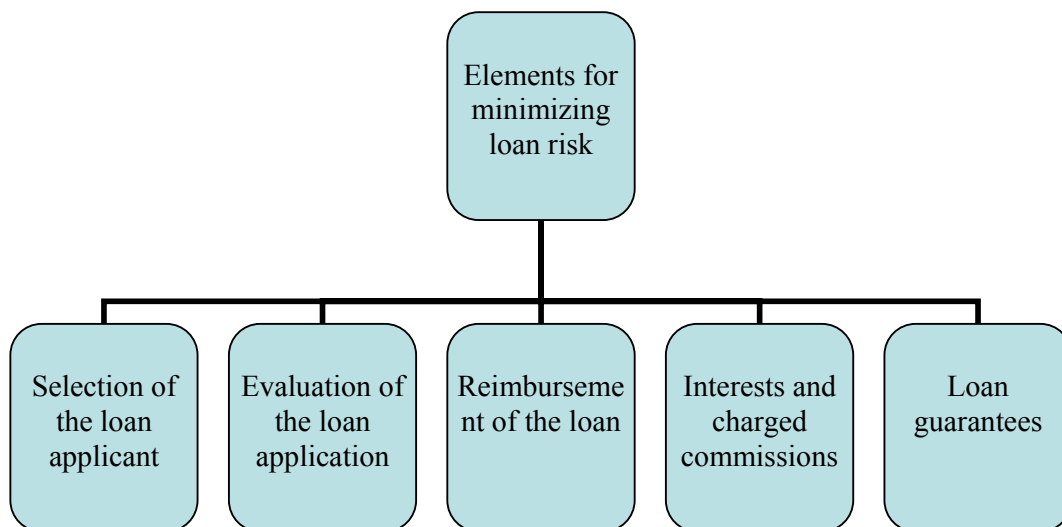


Figure 1. Elements for minimizing loan risk

As far as the loan applicant is concerned, in the context of the current global financial crisis, the banks have generally become more restrictive in terms of loan granting and risk management. The acceptance of a bank to grant a loan to a client actually reflects the bank's point of view towards the present and future reimbursement ability of the client. Therefore, an important step in granting bank loans is to have as much information as possible regarding the natural or legal person that applies for the

loan. The granting analysis is done differentially by the bank, taking into account the extent to which the bank can know the client.

The evaluation of the loan granting for a new client is different than the evaluation of an already existing client of the bank. If the loan applicant is already an existing client of the bank, with a certain history, the evaluation of the loan granting possibility is based on the previous behavior of the client, in his relations with the bank, regarding prior loans, debt service and the way the client respected the reimbursement graphic of the rates and paid the interests. If the client's behavior was a proper one, any renewal of a loan shall be done by taking into consideration both the client's previous behavior and his business plan objectives.

The evaluation of new clients is more difficult. In case the applicant is not an existing and permanent client of the bank, than it is necessary to obtain satisfactory information about the client's moral integrity and financial situation, which must correspond with the bank's requirements in order to avoid risks.

The evaluation is mainly concentrated on the following issues considered to be important:

- business field of the company, its concrete object of activity, relations with national and foreign partners;
- financial situation, way of honoring obligations and receipting debts;
- company management quality;
- present and future performances, company's prognosed flows.

In the last period, a revival of competitiveness was noticed on the banking market for acquiring a more consistent segment, implicitly in the sector of loan granting. In the future, such competitiveness will become more acerbic, as recently constituted banks and foreign banks will expand their network in the territory.

The target market for the medium banks starts to fully take shape, being the market of small and medium enterprises, as well as natural persons, to whom the bank tries to offer quality services, at competitive prices, specific to retail- banking.

The strategy of the banks in general, regarding investments of loans, is mainly directed towards support of the private sector of small and medium enterprises.

In general, the strategic objectives of the lending activity were anchored in the realities of the national economy. Short term and very short term loans have granting priority, becoming more and more diverse as market segments expand. Small and medium enterprises whose activity is export-oriented constitute a distinct segment for commercial banks, which are treated with priority and benefit of certain facilities.

For applying loan granting policies generated by the strategic objectives of commercial banks, established through activity programs, the banking field uses a series of technical methods:

- Allocation of resources for the loan granting activity in the form of lending limits deducted on operative units of the bank, on economic activity sectors, on types of credits;
- Definition of the reliability categories of loan applicants that may be accepted for loan granting, on types of activities and even on types of loans;
- Establishment of the interest level and commissions charged for granted loans, depending on the reliability category of the applicant;
- Establishment of the guarantee types (property, movable, personal) offered by the applicant, that may be accepted by the bank, on types of loans;
- Establishment of the necessary guarantee coverage percentage of the loan and related interest, on categories and types of loans.

In the current context of the global financial crisis, it will be very difficult for most of the small and medium enterprises to find the necessary money for financing the continuity of their activities. If a large company detains the necessary resources to resist

longer on the market despite difficulties, a small and medium enterprise that does not receive orders anymore and does not cash money will not be able to remain too long on the market. The major difficulties encountered by small and medium enterprises in this critical crisis period are:

- Decrease of the turnover;
- Sudden price increase of raw materials, energy and food;
- Problems in the loan and liquidity sector with significant decrease in demand for products and services;
- Significant variations of the exchange rate, inflation;
- Legislative instability, bureaucracy and many administrative barriers regarding the activity of small and medium enterprises;
- Fiscality and high para-fiscality;
- Financial blockage, court procedures difficult to apply and expensive to solve;
- Very limited absorption degree of EU funds;
- Excessive controls of local and central public administration of small and medium enterprises.

For this purpose, the portfolios of the Romanian banks include a series of products specially designed for small and medium enterprises, credit lines destined for retechnologisation, development and current payment of salaries or suppliers. Some banks offer the possibility of obtaining loans destined to the co-financing of European programs. Although the conditions of accessing a funding have become a little more restrictive due to diminishing the risk intervention in the loan granting activity, companies continue to benefit from loan counseling from the banks. The effects of the Crisis are already visible in Romania; therefore a set of principles of socially responsible loan granting must be taken into consideration. Irresponsible lending procedures may generate system problems. The best example is that of the United States where an extreme forcing of the lending system took place, without taking into account the reimbursement ability of long term loans for a wide category of applicants, thing that led to a generalized crisis.

As far as the Romanian financial banking system is concerned, the National Bank is the entity that should intervene, being concerned with the problem of the responsibility of loan at the level of the whole banking system.

In financial consulting, the bank adviser's objectives totally correspond to the interests of the client. The adviser must provide the loan applicant professional advice, relevant to his needs. First of all, the bank adviser must make some calculations regarding the particular financial situation of each applicant, calculations that generate specific elements that require specific solutions. A responsible lending solution must take into account other factors besides the indebtedness degree, such as the relevance of the loan cost or the reimbursement period. Each applicant should be treated separately. Advisers should transparently discuss with the client offering various lending solutions. A complete analysis of each aspect that an application and loan granting case requires must be done by the adviser. In case such requirement is not met, it is possible that the bank records losses that will subsequently be covered, either from the profit or from their own equity.

The steps followed by the bank in banking counseling for granting loans are:

- Have an informative discussion, get documentation about the client;
- Necessary documentation regarding the substantiation of the lending decision;
- Loan negotiation;
- Loan approval;
- Evaluate the use of loan;
- Verify observance of loan destination, of guarantees existence and conservation;
- Payment of interests and total reimbursement of the loan.

All these steps are actually priorities in the bank lending and counseling process.

In order to perform the analysis of the possibility of loan granting by the bank entity, the loan application should be accompanied by the necessary documentation that can prove the legitimacy of the operation, and the necessity and opportunity of contracting the loan.

Based on the documents presented by the client to the bank entities, the reliability evaluation of the applicant is done. In this stage of the lending process the bank proceeds to the analysis of the documentation for loan granting. The necessity of analyzing the financial-economic situation of the client is generated by the bank's need of being acquainted with all factors necessary to the substantiation of the loan granting decision.

In such analysis, the establishment of the reliability of the loan applicant has a very important place. Banks in general should be ensured of the client's reliability, which actually defines its ability to support debt service, respectively to reimburse the loan at maturity date and to pay interest thereon, as well as to bring the proof of warranties. The determination of the applicant's ability to return the loan is essentially a matter of economic analysis. The financial analysis concerns both the history of the company, as well as its perspectives that are object of the requested loan. In the bank literature, it is outlined and confirmed to a certain extent by practice, the idea that the analysis should cover five basic features called "5M", namely:

- Men – meaning that everything connected to the human potential, professional and managerial competence should be investigated;
- Money – all financial issues, especially own equities, solvency, liquidity, profitability;
- Merchandise – quantity, quality and evaluation method of the stocks;
- Materials – refers to the technological level, reliability, performances and evaluations of fixed assets;
- Market – refers to market position, distribution of products and services, trade diagnosis in general.

The future analysis must demonstrate the company's need of funds; in its dynamics it should permit the evaluation of the loan application reality and it should highlight the real possibilities of loan reimbursement and the payment of relative commissions and interests.

To make the analysis of the financial-economic situation of a client that applies for a bank loan, the following types of analysis are considered to be relevant for the bank:

- Analysis of the accounting situations, in process;
- EBITDA analysis (Earning Before Interest Taxes Depreciation and Amortization – the sum of the amounts from the profit account with the amounts from the amortization account);
- Analysis of the indicators;
- Analysis of the profitability threshold;
- Analysis of the provisions through flows of funds and liquidities.

To be mentioned the fact that when the assets of a trading company are analyzed, expressly its fixed assets, the emphasis should be placed on two aspects, namely: which is the real value that can be realized by their purchase and which is the maximum estimated time for immediate liquidity change.

An extremely important step in loan granting flow is the preliminary verification of the documents presented by the applicant, in order to prove their legitimacy and to create a starting point for the appreciation of client reliability and, further on, in the negotiations of the terms observed for the loan. For this purpose, the bank adviser together with the legal adviser of the operative unit of the commercial bank verifies,

from a formal and legal point of view, if the documents submitted by the client are current, complete and authentic, and if such documents contain all the necessary information to make a competent and objective analysis. During the evaluation process of the documentation and the establishing of the loan granting opportunity, the bank adviser also makes use of: the circuit of payments and receipts through the available accounts in a certain period, the use of other non credit products or banking services provided by the bank, the debt service from previous periods.

Based on all this information gathered by the bank adviser and based on the loan documentation, the bank proceeds to:

- The elaboration of the loan report that shall include all information with regard to the financial economic situation and legal status of the loan applicant, that shall be signed by the bank adviser;
- The elaboration of the loan file that includes the loan application, financial situations of the economic agent, loan report, evaluation reports of the guarantees, opinion note of the evaluator, opinion note of the legal adviser.

After the evaluation, a score is made according to the table below, and the interval classification is done according to the recorded level of the performance indicators carried out as follows:

Table 1.

Performance margins for granting score

INDICATORS	20	15	10	5
General liquidity	> 2	1.5-2	1.4-1	<1
Patrimonial solvency	> 2	1.5-2	1.4-1	< 1
Gross profit rate	> 10 %	9.9% - 5%	4.9 % - 1%	< 1
Financial profitability rate	> 5%	4.9% - 3%	2.9- 1 %	< 1
Indebtness degree	0-0.3	0.4-0.6	0.7-1	< 1

Source: Internal rules for legal person lending, no. 1.1.39, Transilvania Bank

After summing up the granted points based on the total score obtained, and on the value intervals predetermined by rules, the bank client, and implicitly the loan is then placed in one of the performance categories, as follows:

Table 2.

Score obtained on the basis of performance indicators

GROUP	SCORE	FEATURES
A	85-100	standard
B	70-84	in observation
C	50-69	under standard
D	25-49	questionable
E	< 25	loss

The clients that, according to the calculated score, are included in the first two categories have the advantage of an easier access in obtaining the loan, especially if the other conditions requested by loan granting rules of the referred commercial bank are fulfilled.

After evaluating the situation of the economic agent, the bank adviser formulates his conclusions that shall outline the lending terms of the client and which concern the volume of the loan, the granting period, grace period, guarantees, interest, rate amount, reimbursement period.

In the stage of approval and granting of the loan, the whole loan documentation is submitted for approval to the SME loan analyst, and the loan agreement is concluded. As far as the loan approval is concerned, it should be highlighted that at the Romanian commercial banks the approval decision for loans is primarily a collective decision taken within a Risk Committee, according with the competencies determined by laws and regulations.

After receiving the decision that confirms the approval of the loan, guarantee and loan agreements are being prepared, meeting all terms according to which the loan was approved. The loan agreement represents a bilateral convention by which the bank entity undertakes – in exchange of a remuneration – to provide a person with money funds, for a certain period and for a predetermined amount. Moreover, the loan agreement is considered to be an onerous agreement, by which each party seeks to obtain a benefit, and all rights and liabilities of the contracting parties are set, respectively of the bank and borrower.

Throughout the entire lending period, the bank shall continuously monitorize the way in which the client uses the loan, if the loan is used for the purposes for which it was requested and if the agreement dispositions are being observed. The bank adviser is bond to verify the use of the loan according to the approved destination. Careful and responsible monitoring of the use of loans also assumes periodical transportations of the bank adviser to the headquarters of the economic agent where financial economic analysis, based on the last balance, is performed, the effective control of the guarantees and the investigation of possible contributions.

Reimbursement of the loan is done at determined dates provided by the reimbursement graphic, annex of the agreement, having as support either amounts in the disposable accounts of the credited client, or amounts representing cash deposits. For any delay in reimbursing due rates, the bank shall calculate increased interests according to the clauses of the loan agreement. The bank adviser is the official of the bank that keeps a continuous connection with the loan and that is responsible, according to laws, for the loan in the conditions in which it was approved.

Currently, a priority for bank counseling of the Romanian banks is the immediate promotion of certain products and services in order to support its clients in company strategies, on one hand, and on the other hand to consolidate its position gained on the Romanian banking market and withstand competition that lately became a lot more acerbic.

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