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# Economic Efficiency of Lending to Entrepreneurial Entities by Commercial Banks

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***Abstract*:** *In this article, one of the important issues of commercial banking credit policy is, without a doubt, the identification of factors affecting asset portfolios and the assessment of their impact. The level of improvement of the system for assessing the creditworthiness of clients of commercial banks to ensure the effectiveness of the management of the loan portfolio.*

***Key words:*** *Credit, efficiency, commercial banklai, lending, risk, small business entity.*

It should be noted that in countries with high inflation rates, the possibility of lowering the interest rates of commercial bank loans is limited. This is because, firstly, commercial banks take into account the inflation rate when setting interest rates on loans, and secondly, the central bank cannot lower its refinancing rate in conditions of high inflation rates.

An effective management strategy is widely used in the management of the credit portfolio of commercial banks. This strategy includes:

- formation of the optimal composition of the loan portfolio by the levels of risk and profitability;
- ensure compliance of the state of the credit portfolio with the current state of the national economy;
- monitoring on the quality of the loan portfolio.

The process of managing a loan portfolio is directly related to the formation of a loan portfolio, which allows strategic and tactical management of a commercial bank. This is explained, Firstly, by the fact that commercial bank loans are an important source of financing the activities of business entities, and secondly, by the high share of interest income from loans in the gross income of commercial banks.

The lower limit on the profitability of the loan portfolio is determined by the sum of the costs of carrying out credit operations and the interest paid to the resources involved. Therefore, in maintaining a low and stable level of credit valuation, the cost of credit operations and the cost of the resources involved plays an important role.

Liquidity of the portfolio plays an important role in the management of the credit portfolio of commercial banks.

The liquidity of a loan portfolio is determined, first of all, by the quality of the loan portfolio. That is, timely and complete repayment of loans serves to increase the bank's liquidity level, while ensuring the quality of the loan portfolio.

Commercial banks are one of the main issues of credit policy and are the management of the loan portfolio.

The liquidity of a loan portfolio directly affects the financial stability of a commercial bank. This effect is manifested in the following directions:

- an increase in the amount of problematic loans leads to an increase in the amount of interest-bearing expenses (Reserve deductions intended to cover losses from loans are taken to the cost of the full bank);
- failure to return loans on time unclassified loans will lead to tarkby's deterioration;
- the amount of expired interest accrued on loans with the status of not growing interest is deducted from the balance sheet of commercial banks, and as a result, the amount of interest income is reduced.

It is worth noting that the effectiveness of the management of the credit portfolio of commercial banks is strongly influenced by the degree of diversification of the credit portfolio. A low level of diversification of the loan portfolio increases the likelihood of an increase in the level of credit risk.

In conditions of deepening specialization of the activities of commercial banks, ensuring the level of diversification of the loan portfolio becomes a complex issue. Because, in such conditions, the bulk of loans issued by a commercial bank will accumulate in one area or network.

In the credit policy of commercial banks, credit risk management plays an important role. Currently, the assessment and management requirements developed by the Basel Committee in credit risk management are widely used in international banking practice.

A new approach called the “standardized approach” to credit risk assessment was proposed by the Basel Committee in 2004 (Table 1).

**Standardized approach to credit risk assessment [1]**

**Table 1.**

| **Credit rating** | **AAA AA -** | **A+ A -** | **VVV+ VV-** | **Below VV** | **Unrated** |
|---|---|---|---|---|---|
| **Risk level** | 20% | 50% | 100% | 150% | 100% |

Table 1 data shows that according to a standardized approach, the level of credit risk is determined depending on the credit rating of the client who received the loan: the higher the client's credit rating, the lower the credit risk level.

From the data presented in Table 1, it can be seen that according to the standardized approach, loans with a risk level of 150% appeared. That is, the risk level of loans to customers with a credit rating below VV is 150 percent.

From the data of Table 1.1, it can be seen that the risk level of a loan issued to a client who does not have a credit rating is set at 100%.

In our opinion, a standardized approach leads to a decrease in the level of credit risk in the activities of commercial banks. Because, any commercial bank will try to give a loan to a client with a high credit rating. Because, firstly, there will be a high probability of timely and complete return of loans to customers with a high credit rating, and secondly, a decrease in loans with a low credit risk level will make it possible to increase the level of adequacy of the regulatory capital of a commercial bank. Because, the adequacy of the regulatory capital of commercial banks is determined by dividing the regulatory capital by the risky sum of the bank's assets.

It is worth noting that in ensuring the adequacy of the capital of commercial banks, it is of paramount practical importance to ensure the proportionality between the growth rate of regulatory capital and the growth rate of the risky sum of bank assets. In addition, it is also important to ensure that the capital structure complies with the requirements of the Basel standard in ensuring the adequacy of banks ' capital. For example, the inclusion of a devaluation Reserve as part of the capital of commercial banks is not possible under the requirements of the Basel standard. The deterioration of macroeconomic conjuncture leads to a decrease in the volume of production of goods and services, or to a failure to sell the goods produced. Both cases increase the likelihood of non-return of loans issued by commercial banks to companies.

The monetary policy implemented by the central bank has a strong influence on the practice of managing the credit portfolio of commercial banks. This effect is evident in the following areas:

1. An increase in the refinancing rate of the central bank will lead to an increase in the interest rates of commercial bank loans. As a result of this, the likelihood of non-return of commercial bank loans increases. Because, the interest rates of loans are the cost of the loan. The higher the credit valuation, the higher the likelihood that it will not return.

The central bank's reduction in the refinancing rate will lead to a decrease in the interest rate of commercial bank loans.

2. The central bank's increase in mandatory reserve rates reduces the possibility of commercial banks lending, while leading to a decrease in the liquidity of banks.

3. An increase in the central bank's refinancing rate reduces the ability of commercial banks to take advantage of the central bank's refinancing loans. This creates a negative impact on their liquidity, resulting in a decrease in banks ' ability to make loans.

The change in Budget-Tax Policy is one of the important external factors affecting the practice of managing the credit portfolio of commercial banks. In particular, an increase in budget costs leads to a decrease in interest rates of commercial bank loans.

Also, the change in tax policy affects the financial position of customers of commercial banks, and as a result, the impact on the repayment process of commercial bank loans occurs.

The increase in the deficit of the state budget creates a negative impact on the practice of managing the credit portfolio of commercial banks. This effect is manifested in the following directions:

- an increase in the amount of the state budget deficit forces the government to cover part of the deficit at the expense of loans from the Central Bank, and as a result, the supply of resources in the National loan capital market decreases, and the interest rates of loans increase;
- an increase in the deficit of the state budget will lead to an increase in inflation rates, and as a result, interest rates of loans from commercial banks will rise;
- the deficit of the state budget leads to a decrease in the amount of loans guaranteed by the government.

Within the factors affecting the practice of managing the credit portfolio of banks, the credit risk management system plays an important role. In transnational banks, the credit risk management system has been improved, allowing this system to prevent the deepening of credit risk.

The level of improvement of the credit solvency assessment system of clients of commercial banks plays an important role in ensuring the effectiveness of the management of the loan portfolio.

In international banking practice, two methods are mainly used when assessing the creditworthiness of clients of commercial banks:

- method of financial coefficients;
- method of assessing cash flow.

It is characteristic that in banking practice of developed countries, great attention is paid to the use of the method of assessing the flow of money when assessing the creditworthiness of customers. This method determines a customer's eligibility for credit payment by dividing their total cash flow into total debt obligations.

Foreign experience in the lending of small business entities by banks and its practical significance

The terms of preferential loans to small business entities in Germany are as follows:

- the loan amount is 1.0 million. amounts up to Euro;
- the annual interest rate of the loan is 5 percent;
- the loan is issued for a period of up to 20 years and should allow to expand the activities of a small business entity, to finance not more than 50% of the costs of technical and technological rearmament;
- interest is not charged within the first two years of the term of the loan agreement [2].

Lending to small business entities based on factoring from Western European countries in the UK, France and Italy is relatively well developed. This is explained by the fact that these countries are large world factoring markets. 22% of factoring operations carried out in World factoring markets are in the UK, 15% in France and 14% in Italy [3].

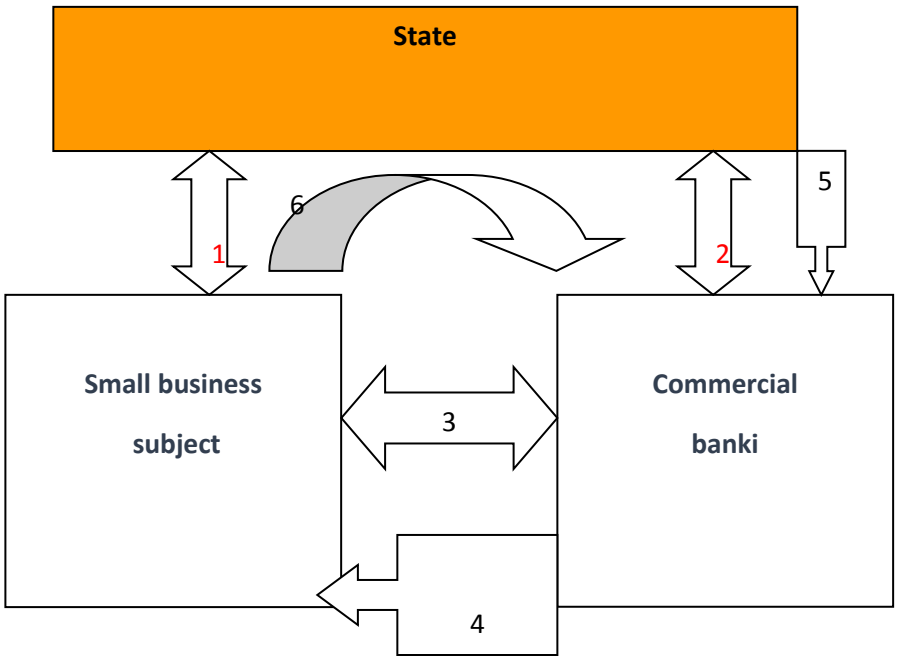
In developing countries, the method of lending to small business entities is widely used (Figure 1).

In Fig.:

1. contract concluded between a state and a small business entity;
2. contract between the state and the Commercial Bank;
3. contract concluded between a small business entity and a commercial bank;

4. Commercial Bank gives credit;
5. the state pays the Commercial Bank the difference between the market rate of the loan and the preferential rate;
6. a small business entity pays the principal loan amount and percentage of the loan.

**Figure 1. The procedure for lending small business entities using the method of bonification**




*Compiled by the author on the basis of an analysis of the experience of Germany and France.*

From the data of Figure 1, it can be seen that the lending of small business entities in the method of bonification is based on three-way concluded credit agreements.

The advantage of this method is manifested in the following:

- because the credit risk for a commercial bank decreases, the difference between interest rates will be paid to the commercial bank by the state;
- for a small business entity, the burden of payment on the loan is reduced;
- the state will be able to meet the demand of small business entities for loans.

In the practice of Western European countries, preferential lending covers 40 percent of the costs of small enterprises. To create a new firm, loans are issued for 15 years. For modernization will be issued for 10 years. State institutions provide preferential interest-rate loans not only in small enterprises, but also to associations of small enterprises[4].

For agricultural producers, it is considered very important that the interest rates of commercial bank loans are low and stable. However, commercial banks do not always have the opportunity to issue loans at low and stable rates. Because, the change in inflation rates, the increased cost of resources, reduces the possibility of providing cheap loans. Now, however, credit resources in progressive countries are very cheap.

The balance of loans made to agricultural producers in the volume of" Paribas " bankningkredit deposits had a downward trend in 2015-2019. This is considered a negative situation in terms of improving the lending of small business entities.

From the data presented in Table 2, it can be seen that Bank of America's loan castings and including loans to small business entities decreased in 2019 compared to 2015. This is explained by the presence of problems associated with a deterioration in the quality of the loan portfolio of this bank. If at the end of 2018, the amount of reserve deductions intended to cover the losses incurred by the Bank of America from loans amounted to 2231 million. In 2019, this figure amounted to 3043 million US dollars. the dollar was. This is a sign that during this period, the quality of his loan portfolio has seriously deteriorated.

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Table 2 data shows that in the total volume of loans issued by Bank of America in 2015-2019, the balance of loans issued to small business entities remained at a stable level.

**Bank of America's share of credit castings and loans to small businesses in it [5]**

**Table 2**

| Specification | Years | | | | | Change from 2015 in 2019 |
|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | 2019 | |
| Loans-total, billion. US dollar | 926,2 | 907,8 | 928,2 | 881,4 | 903,0 | 97,5 |
| Including: | | | | | | |
| loans to small business entities, billion. US dollar | 13,3 | 12,6 | 13,3 | 13,4 | 12,9 | 97,0 |
| The share of loans issued to small business entities in total loans, % | 1,4 | 1,4 | 1,4 | 1,5 | 1,4 | - |

This is considered a positive case in terms of improving the lending practices of small businesses. But the fact that loans to small business entities in the total volume of loans issued by the Bank have a small margin indicates that lending to this area is not a priority of the lending activities of the Bank of America.

At its own expense, Graminbank established the Gramin capital fund, the activities of this fund expanded and became an independent venture fund specializing in financing projects of small business entities intended to introduce new technologies into production. Also, in addition to small business entities, Graminbank provides the following credit services:

- buying small business entities that are experiencing promising, but temporary financial difficulties at the expense of a loan;
- making investments in the authorized capital of small business entities at the expense of credit;
- providing loans to small business entities operating in areas where there is an opportunity to develop fisheries and livestock [6].

Financial support for the lending process of small and medium-sized businesses through Vneshekonombank is carried out in the following order:

- From the Russian state budget, Vneshekonombank is provided with resources to support the lending of small and medium-sized business entities;
- Vneshekonombank gives the obtained resources to the MSP Bank and reserves the right to control the loans issued;
- MSP bank loans small and medium-sized businesses through them by concluding a loan agreement with highly rated Russian banks and leasing and factoring companies [7].

The results of the analysis of the theoretical foundations of lending to small business entities have shown:

- the instability of the financial status of small business entities operating in the agrarian sector and the low level of solvency prevent them from increasing the level of access to the financial services of credit institutions, including microfinance services;
- the process of lending to small business entities should be financially supported by the state, and the main focus should be on the allocation of resources from the state budget and the bonification;
- factoring is a promising form of lending for small enterprises that have the opportunity to grow the real market potential - the volume of sales of goods, but lack working capital;
- when lending small business, it is necessary to provide a separate credit service for each segment of the market;
- in the field of financial services to small businesses, commercial banks lead, and in the structure of their financial services an important place is occupied by the issuance of term loans, leasing loans and their lending by opening a line of credit.

The results of the analysis of the theoretical foundations of credit policy of commercial banks have shown:

- an effective management strategy is widely used in the management of the credit portfolio of commercial banks, and this strategy includes:
- formation of the optimal composition of the loan portfolio by the levels of risk and profitability;
- ensure compliance of the state of the credit portfolio with the current state of the national economy;
- monitoring on the quality of the loan portfolio;
- the lower limit of the profitability of the loan portfolio is determined by the sum of the costs of carrying out credit operations and the interest paid to the resources involved;
- ensuring the level of diversification of the credit portfolio in conditions of deepening specialization of the activities of commercial banks becomes a complex issue;
- according to the standardized approach, the level of credit risk is determined depending on the credit rating of the client who received the loan: the higher the credit rating of the client, the lower the level of credit risk.

The results of the study of foreign experience in lending to small business entities by banks have shown: preferential loans to small business entities in Germany are issued on specific terms; in western European countries, lending to small business entities on the basis of factoring is relatively well developed, and this situation is explained by the fact that these countries are large world factoring markets; in developed countries, the method of lending to small businesses is widely used, and this

method has the following advantages: for a commercial bank, the credit risk decreases, since the difference between interest rates is paid by the state to the Commercial Bank; for a small business entity, the burden of payment on the loan decreases; the state will be able to meet the demand

**Conclusion.** The following problems associated with improving the lending policy of banks for small business entities operating in the territories of our Republic were identified: the high level of turnover of the cost in small business entities in the volume of revenue from the sale of products;

the low level of profitability of assets in small business entities; the low current liquidity level of small business entities; the presence of problems associated with financing the import of small business entities;the high levels of financial risks associated with lending small business entities.

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