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PROBLEMS IN ATTRACTING COMMERCIAL BANKS' LOANS TO PRODUCTION AND THEIR SOLUTIONS

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Annotation: In this article basic problems in attracting commercial banks' loans to production and their solutions were discussed. On the other hand, special features of commercial banks today and their function were analyzed.

Key words: credit risk, commercial banks, cash management, creditworthy customers, profitable, non-performing loans, Bad debts, business organizations, E-banking.

Today, banking is one of the fastest growing systems in the economy of the Republic of Uzbekistan. However, this rapid growth threatens the quality of assets (including loans) and the ability of banks to manage credit risk, and the issue of improving the way commercial banks deal with problem loans remains relevant. Credit risk has been studied a lot across the development of banking as a popular topic in the industry. Nevertheless, as long as banks practice their core functions, which are credit activities, this issue never goes old. Banks offer many services but most of them are related to credit, for example, business loans, checking accounts, payment services, cash management. One of the financial services that contribute greatly to bank revenues is lending. Loans that banks lend out acts as financial solutions for their clients, and in return, the clients have the responsibility to pay principals and interests. In terms of creditworthy customers, who are capable of repaying their debts, banks will be profitable. However, this is not always the case since there are risks that customers cannot afford to full fill their loan obligations. These risks can shift performing loans to non-performing loans (NPLs), or worse, impairment losses. Bad debts, another term of NPLs, cause negative impacts on bank performance, profits and reputation. Even though banks are exposed to many types of risks, credit risk is considered to have the most influence on financial performance by far. Due to these reasons, risk controlling in credit activities is a critical issue in the banking industry which requires bank managers and experts to come up with solutions that can minimize credit risk and bad debts. Commercial Banks have changed their approach and now the target is small savers who have been induced with unsecured personal loans which were the domain of Savings and credit co- operative

societies. Currently, individuals and retail customers are being literally begged for Unsecured Loan business by commercial banks, the ones Commercial Banks were uncomfortable to do business with in the recent past[1].

In our society, credit level is not distributed evenly since there are people and organizations who have more money than they currently need while there are ones who have less. As a result, it leads to the existence of the money market and within the market, banks play an important role as financial intermediates between lenders and borrowers. They gather money that is littering in the economy and redistribute it in order to provide credit to business organizations and individuals that are in needs of financial supports. There are various types of banks: commercial banks, investment banks, central banks, online banks, saving banks, etc. However, the most common type that we interact with in our daily lives is commercial banking. Commercial banking can be categorized into wholesale and retail banking even though nowadays, most of medium to large sized lending institutions operate in both areas. If a commercial bank had credit activities with big clients, for example, large-sized corporations, other credit institutions, pension funds, it would be considered as a wholesale bank. On the other hand, customers of retail banks are relatively smaller. They are usually individuals, small and medium-sized companies, therefore, loans and deposits in retail banks are not as large in scale as in wholesale banks. Credit risk refers to unexpected events which lead to losses in assets' value, deductions of profit in compared with expected profit, or generation of additional expenses in order to complete a specific transaction. Credit risk occurs when counterparties are unable to repay loan's principals and interests in time, which is written in contracts. If losses were consequences of inefficient or error internal operating system, they would be called operational risk. On the other hand, market risk is created from external factors that reduce bank's assets value and create losses[2].

Banks typically offer five main services: payment services, deposit services, lending services, investment services and E-banking. We probably all have an idea of how these services work through our daily experiences. For example, deposit services mean customers save their money into bank accounts or lending services allow customers to borrow money from lending institutions. In this research, we will focus on credit risk matters in lending activities of banks only and exclude other types of services. According to Buzzell and Spasovski, when banks approve new loans, these loans can be categorized into four different types: consumer loans, real estate loans, government-sponsored loans and business loans. Consumer loans are accumulated by individuals with the intention to pay for personal needs. For instance, a person can borrow

money from a bank to purchase a new car or pay for his education. The real estate loans concept refers to loans used for acquiring physical properties such as office buildings, shops. On the other hand, government-sponsored loans are defined when borrowers are government entities. The last group of loans, business loans, is the target group of this research. Business loans, or so-called commercial loans, can be either short-term or longterm, which are carried out for the purpose of financing business entities. Some examples of business loans are line of credit, working capital loans and lease financing. The reason why banks give much attention to the lending activity, especially in periods of a stable economic environment, is that a substantial amount of banks income is earned on loans which contribute significantly to the financial performance of banks.

Typically, every bank has its own lending policy, which determines bank visions and strategies linked to credit activities. For a commercial bank, this policy acts as a guideline for employees and loan personnel in their daily jobs by setting a common mindset, a common goal among workers whenever they make decisions, handle transactions, negotiate and interact with customers. Though, components in a lending policy may vary from bank to bank, a lending policy needs to contain at least five elements: introduction, objectives, strategies, credit standards, lending authoritiaes and approvals. In another study to define basic components of a lending policy, Buzzell and Spasovski point out that a lending policy should cover the following sessions: - Lending organization[3]:

- Lending objectives
- Standards and criteria for loan
- Credit risk rating
- Loan authority
- Lending procedures

A good lending policy is a strong tool to manage credit risk because it forms a system to evaluate and analyze credit profiles of new and existing borrowers. Since loan personnel is affected by lending policy in granting or refusing loan applications, the board of directors should put effort into developing and reviewing this policy annually and make necessary adjustments. In banking activities, lending generates most of the profit, however, it also contains great potential risks. It can be said that lending and deposit-taking credit are also lending and taking risks. The basic characteristic of a bank is to pursuit benefits with acceptable and measurable risks. As it is mentioned previously, credit risk happens when customers could not repay their loans. Timothy W. Koch also said that “ Whenever a bank acquires an earning asset, it assumes the risk that the

borrower will default, that is, not repay the principal and interests on a timely basis."[4]. Credit risk is not limited only in loan products but it also exists in other credit products, for instance, letter of credit and guarantees – a contract in which a bank agrees to act on behalf of a client if that client fails to execute what he committed in business contracts, investment services or asset finance- the bank lend out real assets like land, properties, and equipment.

To sum up all given facts above it should be highlighted that credit risk can be reduced if a loan has collaterals backed behind it, so that if a loss event occurred, the lending bank could make up part of the loss by the collateral value. The related terms of collaterals are normally negotiated before the loan is issued. However, the terms are not fixed, during the term of the loan, the bank may require additional collaterals and revise initial terms if the credit became riskier. The disadvantage of collaterals is that many types of them are difficult to trade on the market. Fortunately, this disadvantage can be diminished when banks use asset-backed securities. Still, using ABS is not as common as other methods for credit risk management because risks are not always transferred out of banks. This is because ABSs' cash flow still depends on the ability to repay of the debtors whose loans are pledged as collaterals for the ABSs. Thus, if the debtors defaulted, originators, in this case is the lending banks, might have to pay to ABSs' buyers and still suffered losses. On the other hand, ABS still remains as a solution for banks to release their capital in order to make more loans.

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