

THE MECHANISM OF PROJECT CREDITING

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The structure of the mechanism of crediting of investment projects is investigated. Its objects, subjects, methods, the tools, providing subsystems are studied. Stages and the basic requirements to the process of design crediting are listed. Ways of its organization, the basic management stages are considered.

Project crediting is a complex process depending on a great number of factors and participants. Investment credit as a form of special project financing acts as a form of bank credit (as a rule, a long-term one) created for investment purposes.

The content of the mechanism of project crediting can be considered both in a broad sense - as a part of the whole credit system, the main element of which is investment credit and in a narrow sense - as the aggregate of organizational and economic methods of submitting and returning investment bank loans.

Credit is a basic notion that makes the economic basis of credit mechanism together with the ways, forms and methods of the organization of credit relations. The essence of credit is revealed through its functions. Therefore, credit mechanism should provide practical implementation of credit functions. On the other hand, credit mechanism itself is a working system, and any system consists of the interrelated elements. In relation to this we understand the mechanism of project crediting as the aggregate of elements and their relations that provide the process of interaction of investment crediting subjects in the process of influencing the objects of investment crediting aimed at the implementation of economic interests.

The basic elements of the mechanism of project crediting are subjects, objects and credit security. The conditions of crediting are the demands to the basic elements of mechanism. It means that a bank cannot give credit to any client. There are always many people willing to get a credit, but it is necessary to choose those whom it is possible to submit and be sure that the loan will be returned in time and the loan interest will be paid. That is why the bank evaluates the solvency of the borrower, balance li-

quidity, examines investment project, the market of the producer of goods, the level of account management, previous experience of any operations with it.

The same is true about the crediting object. Not any requirement can be the object of investment crediting, but only the one connected with its investment projects and caused by the necessity to develop the production and circulation of the product.

Security as the third basic element of credit mechanism should be complete and of good quality. Even if the bank submits a credit on trust, a blank credit, it should be sure that it will be returned in time.

Crediting shows the interests of the both sides of a credit deal. The aim of project crediting is creating the prerequisites for developing the economy of the borrower, its competitiveness and profitability, production continuity and circulation. However client's interests cannot become the key and dominating factor of conducting credit operations. It is also necessary to fulfill the interest of another side - creditor bank.

The content of elements, their correlation and unity in crediting mechanism determine crediting principals that are of great importance as reflect the essence and functions of credit as well as the requirements of objective economic laws in the sphere of credit relations: recurrency, urgency, payment, security, purposeful use.

Credit process is accomplished on the basis of crediting principals (the aims and time limits of submitting the borrowed funds, payment order, control of the use of loans by the borrower).

Nowadays modern banks use a number of organizational and economic methods of submitting and paying off the loans. The aggregate

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of these methods as private actions on the organization of credit process, its regulation in accordance to crediting principals is called the mechanism of crediting in a narrow sense.

While examining this process as applied to crediting the investment projects, it is necessary to distinguish three phases or stages of project crediting: informational (pre-investing), crediting (investing) and operational (monitoring and paying off credit) (see the figure).

Informational stage contains consulting activity - the evaluation of project and its risks, determining crediting structure and etc. The main task of the informational stage is selecting the viable project for future crediting. The choice of project needs complex approach because at this stage it is possible to make mistakes that later lead to the loss of invested funds. Consequently, it is necessary to accomplish deep analysis of investment projects. As a rule, three levels of pre-investing analysis are distinguished²: the analysis of possibilities; preliminary technical and economic substantiation; final technical and economic substantiation.

The key moment in decision making about the participation in project crediting is the evaluation of its financial position and economic efficiency

based on the use of the methods of evaluating the investment projects.

Crediting stage in a narrow (practical) sense includes the agreement between the participants about risk distribution, holdings schemes, specifying the timelines and methods of submitting and paying off credits, control over fulfilling the conditions of credit agreement.

On the first stage of credit process - *developing the strategy of credit operations* - each bank confidentially forms the strategy of its development taking into account the results of the conducted economic analysis, market situation, the condition of economics and its separate branches, the results of studying the situation in the market of bank products and services, evaluation of its current activity and the rating of bank-competitors. The document every year regulating bank activity in the sphere of crediting is the Memorandum about credit policy. It is based on the main directions of bank credit policy, strategic plan of its development for the nearest perspective and determines: the aim of credit policy for the current year; the main principals of forming the credit portfolio of the bank; credit organization, providing the liquidity of credit portfolio of the

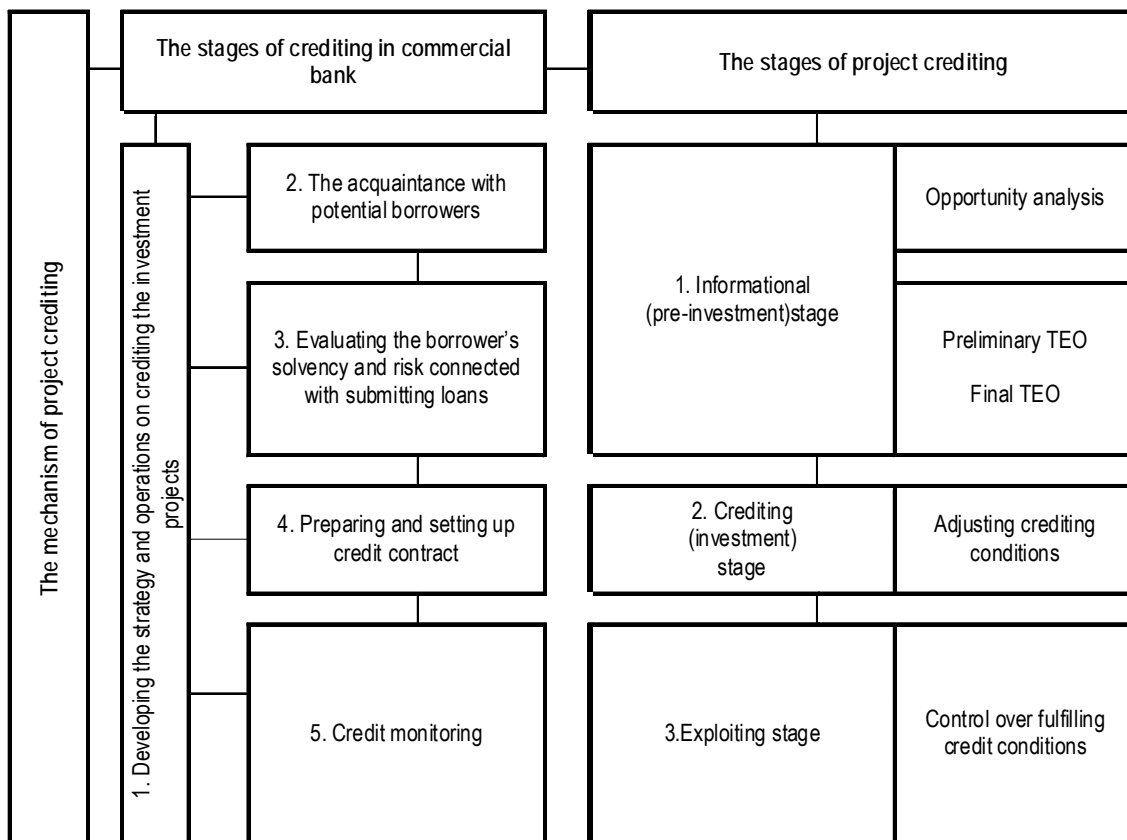


Fig. The stages of the mechanism of project crediting in commercial bank

bank and decreasing credit risks; interest rate policy on the loans.

On the second stage - *acquaintance with potential borrower* - it is examined:

- ◆ The sphere of client's activity;
- ◆ The state of affairs in business at the moment of asking for a loan and in perspective; its main supplies, buyers;
- ◆ The legal status of borrower;
- ◆ The aim, type, timeline, and form of credit;
- ◆ The correspondence of client's requirements to the current credit policy of the bank;
- ◆ The sources of paying off the loan and its interest.

The third stage - *the evaluation of borrower's solvency and risk connected with submitting loans* - assumes the examination of the reputation of borrower, his credit history, the ability of a client to pay the loan in time, secured liabilities and the quality of a loan.

The fourth stage - *preparing and setting up a credit contract* - includes the following activities:

- ◆ Bank's legal department conducts the expertise of the text of credit contract and contracts of secured character and puts visa on them;
- ◆ The process of submitting a credit is accompanied by the order of the credit department of bank's accounters (to the operational department);
- ◆ On the basis of this order the accounting department of the bank gives number to the loan account opened to the borrower, the number on accounting the reserve of possible losses on the loan and reflects the credit line opened to the borrower or the overdraft limit,
- ◆ After giving the credit the specialist of credit department finally forms the credit file of the borrower for the future work with it in the final stage of credit process - credit monitoring.

The final fifth stage is - *credit monitoring*. It is targeted at paying off the main debt in time and paying the interest. In the process of control the employee of the bank should evaluate:

- ◆ The quality of credit - the change of financial statement of affairs of the client and his ability to pay off the credit;
- ◆ Keeping to the terms of credit contract (carrying out the credit commitments by the

client in accordance to the terms of transaction);

- ◆ The state of the mortgage, guarantees, warranties (are there any changes in the conditions influencing the cost of the loan or the possibility of the warrantor to undertake the liabilities);
- ◆ profitability (whether the credit operation continue to give profit).

Control should reveal the problem credits, i.e. the credits, where the problems with paying off interests and main debts can appear.

Security is the important part of bank project crediting and, as an independent process, includes the following procedures:

- ◆ the choice of mortgage objects;
- ◆ determining the market cost of mortgage objects by one of the traditional approaches: cost-is no-object approach, profitable or comparative;
- ◆ forming the system of monitoring the market cost of mortgage objects for the period of submitting bank investment credit.

Managerial regulations define the consequence of steps and procedures on decision-making on submitting bank credits and guaranteeing its return.

There is analytical and organizational work in the sphere of forming the information base, planning and regulating the directions of development, supervision and control, developing the activities on improving the whole crediting policy on different levels of managing project crediting.

The management of crediting investment projects will be successful only if the process of crediting is the comprehensive system that contains the elements of crediting mechanism³. Creating the interaction between these elements is the central task of bank managers that is implemented through the functions and tasks of its subdivisions.

At the same time the management of crediting investment projects should be accomplished taking into account the following peculiarities of project financing:

1. The object of investments - a certain investment project, but not the general industrial and economic activity of the company - recipient. A separate project company is often created for receiving and using project financing.
2. The source of returning the invested funds - profit from implementing investment project (separated from the financial results of the ac-

tivity of initiators and other participants of the project).

3. Various forms and sources of financing can be used in financing complex.

4. The main security for financing - the future cash flow. It is not necessary to apply the typical for banks instruments of guaranteeing, but they can be used on different project stages.

It is also possible to refer the following to the peculiarities of project crediting:

- ◆ project risks are distributed among a great number of participants;

- ◆ banks have the possibility to organize "off-balance" crediting of the founder;

- ◆ the cost of project crediting is rather high.

Creditors make the decision to use the mechanism of project crediting and participate in it on the basis of technical and economic viability of the project. But projects differ from each other by their characteristics that is why a creditor and a borrower can evaluate the project and ways of organizing project crediting differently. The following general approaches to implementing project crediting help to overcome them:

- ◆ giving grounds to project viability;

- ◆ the participation of safe and experienced partners in the project;

- ◆ accounting and distribution of all project risks;

- ◆ regulating the legal aspects and developing certain coordinated plans of activities;

- ◆ transparency - clear and comprehensive process of decision making;

- ◆ the system of open tenders - providing the access to information for potential investors;

- ◆ the participation of experts - recognized international technical experts having the corresponding experience should participate in the project, there should not be conflict interests among them;

- ◆ the participation of investors from the beginning of the process - involving potential investors from the start is necessary for taking into account their interests while structuring the project;

- ◆ the participation of the company organizing the project at the initial stage of financing;

- ◆ it is favourable to attract international credit institutes for increasing the loyalty to the project;

- ◆ guaranteeing the recurrency (in the form of insurance).

Consequently, the mechanism of project crediting is the aggregate of financial instruments that is expressed in organizing, planning and stimulating the use of credit resources. There are five interrelated elements in its structure: subjects, objects, methods, instruments, sub-systems.

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