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RISK FACTORS IN THE INVESTMENT LENDING BY BANKS

In the case of attracting the third-party capital, the most commonly used financial instruments are bank loans and leasing, rarely debt securities issued by companies. On the other hand, financing through venture capital becomes an increasingly common form of enterprise development through investment.

Investment loans in the traditional sense are intended to finance expenses which primary purpose is to create new or increase existing fixed assets [1,p.234]. Therefore, they contain first of all the tangible investments expressed in the purchase of real estate, tangible fixed assets, reconstruction or modernization of the technological line as well as the construction of a new production complex. However, you should pay attention to other objectives of investment loans. At this time they also serve to finance intangible assets (covering the costs of research and development, the acquisition of patents, licenses, software) as well as the purchase of financial instruments (shares or shares in other companies) [2, p. 164].

A specific form of investment loans is represented by bridge loans intended for the implementation of the first stage, provided that the next stages will be financed from other sources [3, p. 240].

The main feature of an investment loan is its purposefulness, which means that it is provided to finance the purpose clearly stated in the loan application. Proper use of the investment loan is under the strict control of the bank, which is due to several reasons. The main reason is to evaluate the creditworthiness of the company based on assumptions about the investment project. A change in the entity of the investment object causes the presented calculation of the investment efficiency to become irrelevant. After all, others may be both the operating costs associated with the investment and the profit generated by it.

It should be noted that this refers both to significant changes (for example, changes to the factory design, expansion of hotel construction, etc.) and not to significant changes (for example, the purchase of another model of production line for manufacturing the same product). After all, the effect of these changes in each case will affect the predicted profitability of the project, and thus the potential ability of the company to repay the investment loan. Another important prerequisite is the legal securing of a loan. In investment loans legal security is usually the subject of investment. The Bank by granting a loan evaluates the possibility of realization of the subject of crediting in case the client does not fulfill the obligation to repay the loan with interest. It also takes into account the possible selling price of the investment item in separate lending periods. On this basis it determines the borrower's own share which should ensure the interests of the bank in case of loss of value of the subject of credit after the loan. Changing the subject of a credit by the company makes these assumptions obsolete. As a result the bank does not have a properly rated creditworthiness of the client, and also misjudges the subject of investment. Therefore, any use of a loan without knowledge of the bank is a material breach of the loan agreement, which in practice leads either to suspension of the loan (if it is made by grants) or to the denial of the loan agreement and the payment of the entire amount provided.

Another feature of investment loans is the period over which credit agreements are entered into. Investment loans are typically medium to long-term. In economic practice the investment loan period is close to the amortization period of the investment object and ranges from 5 to 15 years. Banks prefer to limit the term of credit when granting a loan, as this reduces the risk of their participation. However, they pay attention to the fact that the surplus received from the investment allows to repay the loan with interest. In doing so, they adopt the version of financial forecast that will be most effective for saving money. The maximum term of credit depends largely on the economic situation in the country. In the period of strong economic growth the banks tend to continue lending (even up to 20-25 years), in times of economic instability and crisis in the financial markets, investment loans are as limited as possible, both in terms of the crediting period and general availability.

One more specific element of investment lending is the establishment of a grace period to repay the loan. The grace period allows the investment company to begin repaying the loan only when the investment brings in a financial surplus (or at least is projected to generate such a surplus). This is very important for the proper financing of the investment. Unfortunately, in business practice companies often forget to adapt the loan repayment to the projected cash flows. As a result, they repay the first installment of the loan not with the proceeds of the investment but with the funds remaining from the bank loan. These are the funds that have not been used to finance the part of the investment costs, which can affect the potential for return on investment.

Characteristic of the investment project is also its delivery in tranches. This applies to the first stage of financing complex, multi-stage projects. The reason for lending tranches is the desire of the lender to control the use of the investment loan. The Bank issues the next tranche of the loan provided that the previous tranche is properly used. Proper use is the allocation of funds to finance the investment costs provided for different stages of the investment. Therefore, it is especially important to put in the business plan the proper cost sequence. In practice, a poorly prepared investment schedule is not uncommon. It is reflected in the fact that this stage of the investment cannot be completed without completing the actions defined in the next stage. On the other hand their execution is conditioned by purchases, the funds for which are not issued by the bank due to the incompleteness of the previous stage. This creates a closed circle. In this case there is a need to amend the loan agreement which however will depend on the consent of the bank. Very often such situation leads to the loss of confidence in the company that makes the investment. Therefore the proper planning of the schedule of realization of investment expenses is very important at the stage of preparation of the investment.

In the loan investment one of the basic requirements for businesses is to own a certain amount of equity. For the bank it is a kind of a guarantee of the safety of financing investment. The greater the company's share in financing the investment the lower the bank's risk. High self-interest represented at the stage of applying for a loan is also of psychological importance. The greater is the equity stake the higher is the risk of the investor. The credit decision maker sometimes subconsciously draws his attention to this regularity and is more likely to involve the bank in financing the investment project. It should be noted that banks require the involvement of their own share in the first place before issuing a tranche of the loan. Therefore, the company should have the equity already at the initial stage of realization of the investment.

The last of the most important elements that distinguish an investment loan from other credit risks of the bank is the company's creditworthiness procedure. The creditworthiness of a company is determined on the basis of the financial statements. From a banker's point of view the essence of the analysis is to confirm the ability to repay the loan from the financial surplus. However, in the case of an investment loan it is not the current solvency, but the projected that is fundamental.

The second prerequisite for the bank's involvement in financing the investment is a positive assessment of the business plan of the investment project. An investment business plan is a description of an investment project that contains a complex of technical, economic, trade, as well as financial and organizational aspects of the investment. It should be emphasized that not only the financial statements are subject to assessment, but above all the reality of the assumptions made during the analysis. For these reasons the detailed information is required to allow a decision-making bank employee to verify these assumptions. When discussing business plan issues, one more element should be noted. A business plan is a kind of business card of a company that wants to take an investment loan. If this document is carefully designed, comprehensively and objectively demonstrates all significant aspects of the investment and is well and knowledgeably presented by the investor, the decision-maker becomes credible to future investors. This is almost as important as a positive outlook for the financial performance of an investment.

In business practice it often happens that entrepreneurs finance an investment with a current loan of current account. In most cases this is due to the reluctance of the company to prepare a business plan, make financial forecasts, create material guarantees for the loan or fulfill other additional conditions set by the bank when applying for an investment loan. This is a conditionally forbidden practice that often has very serious negative consequences for the company. A current account loan is a special purpose loan to finance a company's current needs (typically increase in trade turnover). Therefore, when using a loan on an account to finance investments, it violates the objectives of financing which can lead to the termination of the loan agreement by the bank. Even if the bank does not notice this fact (in the case of high turnover enterprises it is difficult to distinguish from which funds is the turnover financed and from which the fixed assets increase) it does have certain financial consequences. The realization of the investment as a rule in the first period leads to a deterioration of the financial performance of the company. As a result, the bank may not renew the current account loan after the initial crediting period has expired or significantly reduce the current account debt limit.

When deciding on the financing of an investment through the bank loan, the investor should pay attention to other risk factors specific to this form of financing.

One of the main types of risk is the risk of changes in the value of received capital. This risk comes from two prerequisites. The first of these has a market character and is a consequence of a change in the market interest rate.

Another risk element associated with the accrual of interest on an investment loan that may affect the cost of capital to finance an investment is the volatility formula used in the loan agreement. The potential borrower should pay attention to the conditions that must be fulfilled to change the interest rates. Any record that makes a change in the interest rate depends on the decision of the bank, but does not specify when exactly this decision can be made (and under what conditions), is a significant risk for the borrower. For these reasons it is important to make sure that there is the clause in the contract that causes the interest rate to change automatically if on a strictly specified date (for example, the last day of the month or the quarter) the market rate will be different from the set base rate. In this case, the new base rate will be set at the market level on the last day of the current interest accrual period and will be effective for the next interest accrual period.

The interest rate on the loan is not the only component of the cost of financing the investment. All kinds of banking commissions and fees can play an important role in this area. The most commonly used the investment loan commissions are: the commission for consideration of the loan application, preparatory, for providing funds at the disposal of the borrower, for unused loan amount, for early repayment of the loan in addition to the contract. Before signing the contract the company should be familiar with the size of each commission and know the mechanism of its recovery, as different banks use different practices.

In addition to traditional credit commissions financing investment in credit can also generate other costs such as the investment object valuation fee, which is particularly significant in the case of tranche-funded construction investments. Another expense associated with an investment loan may be an inspection fee for the bank representative to monitor the progress of the investment. At the stage of signing the contract certain attention should be paid to the size of collection and frequency of visits.

Another issue that is particularly important in the investment loan is the issue of banking fees. It is important for the borrower that all commission amounts are clearly stated in the contract. The borrower does not have to agree with the clause in the contract according to which the size of the commission depends on the tariff of commissions and fees which is in effect at the bank.

Summing up the question of the cost of financing an investment through the investment loan and their impact on the weighted average cost of capital one important element should be addressed. The interest rate used in the analysis should not be the interest rate on the loan, but the real interest rate which takes into account all elements of financing costs. They represent an important value item that reduces the economic efficiency of the investment made.

References

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