

BANK'S LOANS AND THEIR DETERMINANTS

^aPETR RICHTER

*Czech University of Life Sciences Prague, Faculty of Economics and Management, Kamycka 129, 165 21 Prague 6 - Suchbátka
email: "prichter@pef.czu.cz"*

The information in this document originates from a concept No. 201011110018 "The Financing of Small and Medium Businesses & The Roles of European Union Funds", provided by the Internal Grant Agency (IGA).

Abstract: Bank loans belong among important sources of financing the enterprise. The credit offerings in the Czech Republic have undergone their characteristic development changes since the time of the country's transformation to the market economy in 1989. The development of financing through credit may be divided into several consecutive stages beginning with the year 1990. In this initial stage, the economy was then financed via loans provided by domestic banks and in those times of the emerging capitalism, the demand for them was tremendous. Such frantic growth was however the beginning of the later problems after 1997 within the frame of the banking sector. The next stages connected themselves directly to the initial stage, and despite existing problems, the demand for credit has been on the rise from the long-term point of view. The reasons for such growth may be primarily allocated to the households, which rapidly changed their lifestyles. Among the very important aspects belong the qualitative changes in the configuration of the credit policy, the worldwide growth of economy, and the completed restructuring of the economy. This credit boom had lasted from the beginning of 2001 until 2008, when the banking sector started experiencing the impacts of a financial crisis in the United States.

Keywords: Bank loan, credit, interest rate, entrepreneur, financial resource, transition mechanism.

1 Introduction

The bank loan may be considered as a financial resource granted to the debtor by the creditor. The cost of the bank loan is represented by the level of the interest rate, which is determined by the discount rate, PRIBOR (Prague Interbank Offered Rate), risk level, maturity, and amount of the borrowed capital. The bank loans are primarily provided by commercial banks, the fact of which fulfils their main function as financial providers. The bank loans supply and demand meet with the financial market, where the banking institutions render credit products to the applicants (companies, household consumers, etc.). In addition to the internal factors of the individual banks and the development of the external environment, the volume and structure of the rendered credit depends on the Czech National Bank (central bank of the Czech Republic) via its monetary policy, which is realized through the inflation targeting. The central bank enforces such through the credit channel of the transition mechanism. Mishkin F. S. [1996] states that the efficiency of the credit channel is closely connected to the type of monetary policy, ability of the central bank to affect the short-term interest rates, character of the banking sector, own stability of the relationship between the interest rates and credit aggregates, and many others. Mishkin F. S. [1996] and Bermanke B. and Gertler M. [1995] assign to a key factor the size of the entities entering this process, when much greater influence on the small and mid-sized enterprises is handled by the performed changes and such enterprises not being capable of substituting the loans for the other types of financing, and even any smaller changes affect them significantly. Čechura L. [2004] reminds that such fact is primarily based on the asymmetric information in the process of rendering credit. The asymmetric information means that the economic entities on one side of the market have much better information than the entities on the other side.

2 Methodology

The submitted project deals with the issue of bank loans and with their determinants. The paper delimits the approaches of selected authors and evaluates the development of credit offerings.

The paper is based on the applicable professional literature and studies. The data originate from the Czech National Bank and the Czech Statistical Office. The foundation of the paper is the descriptive method for the obtained data, in comparison with the approaches of the selected authors engaged in the issue at hand.

3 Outcomes

3.1 Role of Bank Loans in Economy

The banking sector belongs to the industries with fast dynamics of their growth. The efficiency and stability of this sector is the foundation stone allowing the economic growth. Nevertheless, the relationship of the banking sector and other spheres is closely connected. The developed economy needs the advanced banking system and vice versa ([Revenda Z. [1999]). From the analysis of Tůma Z. [2005] and Pašaličová R. and Stiller V. [2002], which compares the credit offerings with the level of the growth domestic product achieved, it is evident that the sector of banking services is very important for the economy of the Czech Republic and significantly affects its future state. Due to rehabilitation of the commercial banks performed after the banking crisis in 1997, the Czech Republic banking sector is now considered as being highly stable. This characteristic emerged fully under the financial crisis during 2008 and 2009. As mentioned above, the credit offerings are affected by the approaches of the central bank, which realizes them through the transition mechanism. Arlt J., et al. [1998] describes the transition mechanism of monetary policy as a chain of economic ties, which allow the changes in configuration of monetary-political tools to result in undesirable changes in inflation, or alternatively in desirable changes of the growth domestic product and employment rates. This transition is however possible only under the adequate reaction of the commercial banks, which may not be always realized.

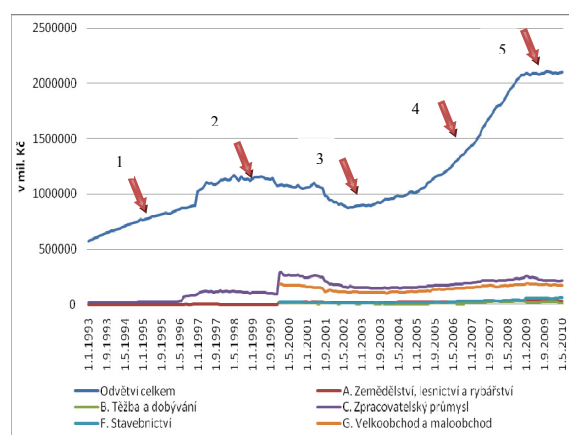
According to Kalouda F. [2009], the bank loans are rated as traditional financial resources. These are the foreign resources, which are characterized by high flexibility and relatively easy process of their obtaining. Because the state tries to support the economy, the process of developing the alternative financial resources continues, especially of their new types (more details by Dvořák I. and Procházka P. [1998]). In spite of these facts, the bank loans remain the important tool in the management of entrepreneurial finances.

3.2 Determinants of Credit offerings

The determinants of credit offerings represent the key factors that determine both, the supply side (i.e. financial institutions), and the demand side (i.e. entrepreneurs). There is no possibility to summarize these determinants easily, but it is necessary to assign them into the context of the market situation, out of which their effects and power result.

The financing through the bank loans had undergone its specific development from the historical point of view in the Czech Republic. Many authors, headed by Buchtková A. [1999] and Pašaličová R. and Stiller V. [2002], sectionalize this development into several stages. The graph below depicts the development from the beginning of 1993 until the middle of 2010 for all industries and for the selected sub-industries, according to the availability of the pertinent data.

Development of Credit offerings in Companies and Industry (1993 – 2010) [Millions of CZK]



LEGEND:

Odvětví celkem	⇒	Industry Total
A. Zemědělství, lesnictví a rybnářství	⇒	A. Agriculture, Forestry and Fishery
B. Těžba a dobývání	⇒	B. Mining and Exploitation Resources
C. Zpracovatelský průmysl	⇒	C. Processing Industry
F. Stavebnictví	⇒	F. Construction
G. Velkoobchod a maloobchod	⇒	G. Wholesale and Retail

Source: Czech National Bank

It is evident from the graph above that the dynamics of the development of credit offerings in companies is significant as a whole. The monitored period may be divided into five stages, which had acquired their attributes of characteristic development. The first stage represents the period from 1993 to 1997, which was the time of the initial market economy, privatization and advancement of private enterprise. The problem of the Czech Republic companies was their weak competitiveness given by a low capital. Because of the needs to develop the economy, the companies were seeking options for their financing. The key resource than became the bank loans. Such fact was the result of the impossibility to find the other types of resources and of the very friendly credit policy enforced by commercial banks. It was very easy then to obtain the resources for the development of business activities, which later surfaced with the banking entities. The main determinant of that time was the business policy of the banks and the need for the capital to develop the enterprise.

The second stage represents the period from 1997 to 2001, which was the time of the stagnation of the credit offerings. This was primarily due to the banking crisis in 1997. Hampl M. and Matoušek R. [2000] describe as main factors the existence of collaterals, over-crediting, permanent low efficiency of the company sector, and subsiding transformation of the Czech Republic economy. It is evident that due to the subsequent tightening of credit policy by banks, there happened an attenuation of the rapid growth of the credit offerings, which subsequently resulted in the slowdown of the economy.

The third stage represents the period from 2001 to 2003, when the volume of the granted bank loans dropped down rapidly. This was the result of both, the further tightening of the commercial policy by banks, and the reflection of the worldwide slowdown of economy, which gradually transferred here from the United States. Other factors may be the inflow of foreign capital and the development of alternative methods of financing.

The fourth stage represents the period of prosperity from 2002 to 2008, to wit from the viewpoint of the credit offerings, as well as from the viewpoint of the economy. Overall, the demand for bank loans was being pulled primarily by residential construction, purchases of new equipment, and expansion of productions. Due to the positive development of the economy and its outlook, the credit policy loosened and the confidence in the economy went up. Simultaneously, further development of

alternative resources realized, together with the support of new financial tools headed by the venture capital and business angels, which may be assigned a significant role especially from the viewpoint of future development.

The fifth stage represents the period from 2008 to the end of the period being monitored. It was the times connected to the rapid drop of the demand for loans, which was the result of the full-blown financial crisis, which transformed into the worldwide economic slowdown. The financial crisis had started appearing in the United States already in 2007 due to the price bubble at the real estate market and due to the related securities (stocks) with low market value, which were being wrongly considered as high-quality investment instruments.

The subsequent transition into the other countries had a strong impact on the confidence in economy. Today we may say that the economic slowdown, except several reductions in the form of bankruptcies, was the result of the overall loss of confidence. This fact is also visible on the interest rates of the commercial banks, which were increasing them despite the drop in the PRIBOR (Prague Interbank Offered Rate) and the overall efforts of the central bank to shake up the growth of the credit offerings. Nevertheless, the bank loans remain the important and mostly the key resource of financing the enterprise, despite the further development of alternative resources.

It is evident from the text above that the determinants of credit offerings cannot be generalized. From the historical viewpoint, the determinants depend on the current economic and political situation. However, the key factor remains represented by the commercial policy of the banks that fully surfaced exactly during the economic slowdown, by the relatively low capital, by the inadequate options for substitution of the bank loans, and by the experiences of the company managements.

4 Conclusion

From the historical point of view, the bank loans belong to the important financial resources for the companies. This status is given by many factors. The important role in this is played by the central bank, which is fully autonomous and via its actions supports the growth of financing through credit. No less important factor is the status and development of the economic environment in the Czech Republic, which underwent significant changes directed from the traditional financing through credit to the financing using the risk capital, creation of clusters, technological platforms and others, which allow, in addition to the obtainment of financial resources, the transfer of the expertise that improves the quality of the competitiveness of the entire economy in the Czech Republic. The favorite preference of the bank loans may be particularly the result of friendly commercial policy of banks, stable related legislation, flexible options of financing through credit, variety of loan products, and limited possibilities for other types of financing. The entrepreneurs have relatively broad options for selecting the methods of financing; however, such often represent only the specialized resources in the form of additional tools allowing the diversification of risk and improvement of cash flow. These additional tools of financing may be the leasing, forfeiting, factoring, franchising, subsidies, bonds, etc. On the other hand, there is a group of own tools, which are important for the enterprise, but they are dependent only on the capabilities of a company to generate them in advance via its actions. These may be the reserves, write-offs, profits and various forms of funds. From the viewpoint of financing, in addition to the public loan support via easier obtainment and lower interest rates, the current trend is the development of new financial tools headed by the risk capital and business angels. The main benefit of these resources, as opposed to the bank loans, is their emphasis to enter the very risky projects with an option of fast return on investment, with transfer of knowledge, expertise and valuable contacts allowing faster development.

Literature:

1. Arlt J., et al. Definice měnového transmisního mechanismu v ČR a analýza vybraných základních vazeb. Praha: ČNB – Institut ekonomie, 1998.
2. Bernanke B. a Gertler M. *Inside the black box: The credit channel of monetary policy transmission*. New York: Journal of Economic Perspectives, 1995.
3. Buchtíková A. Bankovní úvěry a jejich vliv na vývoj sektorů a odvětví národního hospodářství ČR v roce 1995. Praha: ČNB – Institut ekonomie, 1997.
4. Buchtíková A. Empirická analýza financování podniků a úvěrových aktivit bank v ČR v letech 1995-1997. Praha: ČNB – Institut ekonomie, 1999.
5. Buchtíková A. Mikroekonomické aspekty transmisního mechanismu měnové politiky v úvěrovém kanálu. Praha: ČNB – Institut ekonomie, 2001.
6. Čechura L. Úvěrový trh, credit rationing a zemědělství. Praha: ČZU, 2004.
7. Dvořák I. a Procházka P. *Rizikový a rozvojový kapitál*. 1. Vydání. Praha: Management Press, 1998. ISBN 80-85943-74-3.
8. Hampl M. a Matoušek R. *Úvěrová kontrakce v ČR - její příčiny a důsledky*. Praha: ČNB – Institut ekonomie, 2000.
9. Izák V. Transmisní mechanismus měnové politiky – úvěrový kanál. Praha: ČNB – Institut ekonomie, 1998.
10. Kalouda F. *Finanční řízení podniku*. 1. Vydání. Plzeň: Aleš Čeněk, s.r.o., 2009. ISBN 978-80-7380-174-8.
11. Mishkin F. S. The channels of monetary transmission: Lessons for Monetary policy. Cambridge (Massachusetts): NBER, 1996.
12. Mishkin F. S. *Housing and the Monetary transmission mechanism*. Cambridge (Massachusetts): NBER, 2007.
13. Pašaličová R. a Stiller V. Vliv měnové politiky na vývoj bankovních úvěrů. *Finance a úvěr*, roč. 52, č. 6, 2002. ISSN 0015-1920.
14. Revenda Z. (1999): *Centrální bankovníctví*. 2. vyd. Praha: Management press. ISBN 80-85943-89-1.
15. TUMA Z. (2005): *Bankovní sektor v ČR a jeho regulace* [on-line]. 5. 10. 2005, [cit. 2008-4-20]. URL:<http://www.cnb.cz/m2export/sites/www.cnb.cz/cs/verejno_st/pro_media/konference_projevy/vystoupeni_projevy/download/tuma_20001_2_pariz.pdf>.

Primary Paper Section: A

Secondary Paper Section: AH, GA