Comparative Research on Romanian SMEs Crediting

Florin - Mihai MAGDA, PhD candidate
"Babes - Bolyai" University, Cluj - Napoca, Romania, florin.magda28@yahoo.com

Adina Elena DANULETIU, PhD
"1 Decembrie 1918" University, Alba Iulia, Romania, adina.danuletiu@gmail.com

Abstract: In an efficient market economy, economic growth and welfare is based on the existence of a powerful SME sector. As proven in the context of the nowadays crisis, a powerful and well-developed SME sector can successfully cope with economic challenges and can adapt more easily to a negative economic context, insuring, in the same time, the premises for the economic recovery and the population welfare. Therefore, one of the most important concerns for the developing countries is the development of the SME segment, which obviously supposes the accumulation of capital. Considering the post-revolutionary economic history of Romania, the shift from a centrally planned economy to the market economy, and afterwards the financial crisis that has started in 2008, at present the SME segment is being developed especially through loans granted by the commercial banks, taken into account the low absorption rate of European funds and the insignificant and incoherent governmental financing programs.

Therefore, this paper is important and actual as it synthetically and relatively simply presents the way in which Romanian commercial banks determine which SMEs may be financed, after performing a quantitative / financial analysis of the applicants in order to correctly determine the credit risk as a result of assessing and interpreting the main economic and financial indexes. We will also present the actual macro-economical stage (crediting terms, credit risk, credit demand, etc), as well as the main similarities and differences occurring in the SMEs crediting process at the Romanian commercial banks.

Keywords: credit, financial analysis, financial indexes, risk.

JEL codes: E51, G21, G32, G33

1. Introduction

Generally, SMEs financing has been generating numerous debates starting from the general economic background, the stability of the legislation and of the NBR regulations, the lack of credit demand in Romania, and ending with tough eligibility conditions of the Romania-based commercial bank.

Considering all these aspects, according to the data provided by NBR (NBR, Poll on crediting non-financial companies and population, February 2014), but also starting from the data provided by the representatives of the main commercial banks, we may notice the following aspects concerning the context and the stability of crediting conditions in our country:

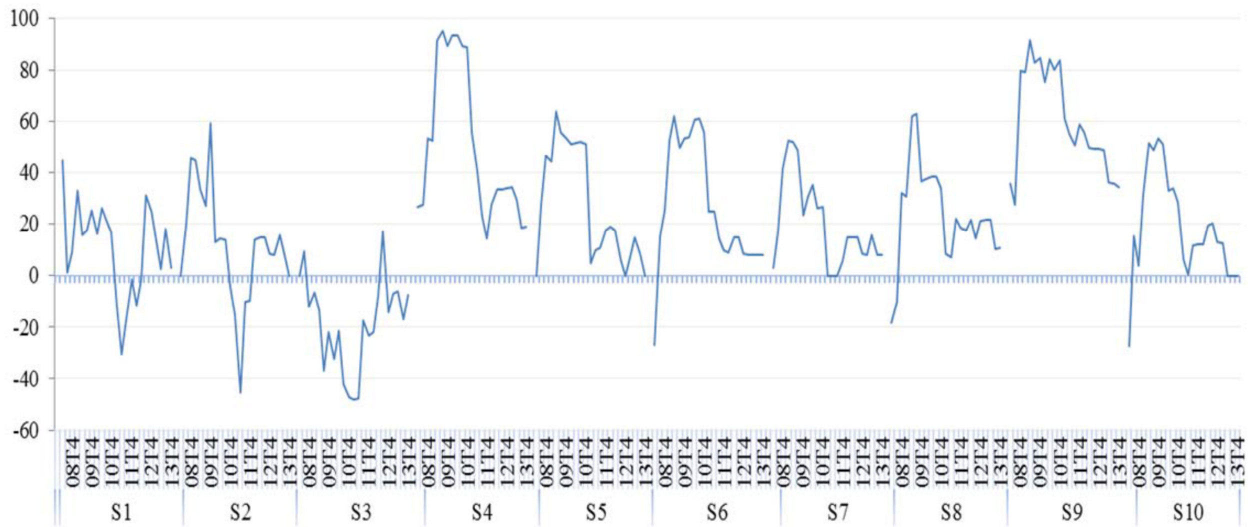
- crediting standards were relatively constant in the last part of 2013 and they even marked the end of the continuous tightening of the crediting process. This is more clearly seen starting with 2014, when the commercial banks' strategy has become, for the first time since the beginning of the crisis, much more aggressive on this segment, in order to determine an increase both in the market share as well as in incomes;

- most of the crediting terms remained unchanged at the end of 2013, but starting with 2014 they have slightly relaxed, especially due to the decrease of ROBOR, as well as due to the fact that a minimum level of the interest rate for main refinancing operations of NBR has been set, in order to stimulate crediting by lowering interest rates; cost reduction is also due to lowering reserve requirements that has led to an increase of liquidities on the market;

- after a slight increase at the end of 2013, and except for the first term of this year, credit demand seems to have truly recovered for the first time since 2008, and the increase forecasts for this year are only menaced by a possible instable political and military background;

- business risks (Figure 1), which contribute to the crediting decision, slightly increased at the end of 2013, however, in 2014, the crediting increase pace shall be maintained due to the other conditions that evolved positively.

Figure 1. Credit risk evolution according to activity domains (net percent (%)



S1 Agriculture, aquaculture
S2 Industry
S3 Energy
S4 Constructions
S5 Trade
S6 Tourism
S7 Transport, Communications
S8 Financial Brokerage
S9 Real Estate transactions
S10 Other services

Source: www.bnr.ro

Irrespectively of the more or less important modification of the standards, terms and credit-associated risks, in our opinion the commercial banks take the crediting decision by observing the same principles.

2. Theoretical approaches on the crediting process of the (Romania-based foreign and Romanian) banks

After studying the crediting process of several top Romania-based commercial banks, both Romanian as well as foreign banks, we are going to present the main similarities and differences occurring in the SMEs crediting process, as well as the financial indexes on which the crediting decision is made.

The similarities of the Romanian SMEs crediting processes are:

- company credit applications start with and comprise information included in the yearly financial statements as well as in the customer balance sheets. Usually, the bank requests the last two yearly financial statements[3] based on the data taken from the balance sheet for December, as well as the last balance sheet;

- the banks input the data in their own Scoring Application in order to obtain and synthetically calculate various indexes and sets of indexes. Indexes can be easily interpreted and they are decisively contributing to the company crediting decision (together with the qualitative analysis and the proposed guarantee structure. There are various algorithms on which the analysis is based, and, within the quantitative analysis, they usually represent about 60% of the total score (the qualitative analysis concerning especially the quality, the management experience and the company history and previous conduct in relation with the banks, the previously accessed financing represent about 40%).

- generally, the bank adds up the performances of the main financial / quantitative indexes (Table 1), and each index receives a mark (from 1 to 5, where 1 stands for the maximum and 5 for the minimum) depending on the internal regulations of the crediting bank.

- company financial performance assessing models consist of the qualitative part as well as of the quantitative part. In the credit report (credit application) one assesses the credit risk according to the above description. By multiplying the marks of a predefined set of criteria with certain risk ratios, the Scoring Application calculates a weighted result, which determines the inclusion in one of the five financial performance categories of a company, according to the NBR regulations. The marks for the analyzed criteria are based on a 1 to 5 scale. The marks are granted depending on the inclusion in the preset values / ranges, and thus the financial performance is automatically calculated and determined.

Liquidity indicators show the company's capacity to meet its short-term debts generally higher liquidity meaning a lower probability of default. Solvency indicators shows the company's ability to meet its long-term debt, generally the more leveraged hedge is higher the greater the likelihood of default of the company. Profitability indicators shows the company's ability to generate profit, and the more the capacity is higher the PD is less. Activity indicators shows the efficiency with which the company uses various font inputs having different effects on PD like in Table 1

The main differences in the SMEs bank crediting process consist in:

- use and approach of an analysis more or less complex, starting with differentiated customer segmentation (corporate or retail);

- approving authority, which in case of the Romanian majority shareholder banks is a local one, at the Subsidiary level (Transilvania Bank, CEC), while in case of multinational banks, it is centralized, which means that there is no local authority;

- response time, as an effect of the length and speed of the analysis and decision making process (Transilvania Bank is considered one of the most rapid banks, as compared to multinational banks where flows are longer and the response time is also longer);

[3] Financial statements of companies are regulated by the Order of the Minister of Public Finances no. 1752/2005 on the approval of the accounting regulations in accordance with the European Directives, published in the Official Journal of Romania no. 1080/2005.

- approving rates, as an effect of the appetite and flexibility showed by each bank entity (usually, Romanian majority shareholder banks are much more flexible than the multinational ones).

Irrespectively of the similarities and differences of the financing process, the standard flow of the company crediting activity may be synthetically presented in Figure 2.

Table 1 – The main Financial Indexes introduced in Scoring Application and their impact on the Probability of Default (PD)

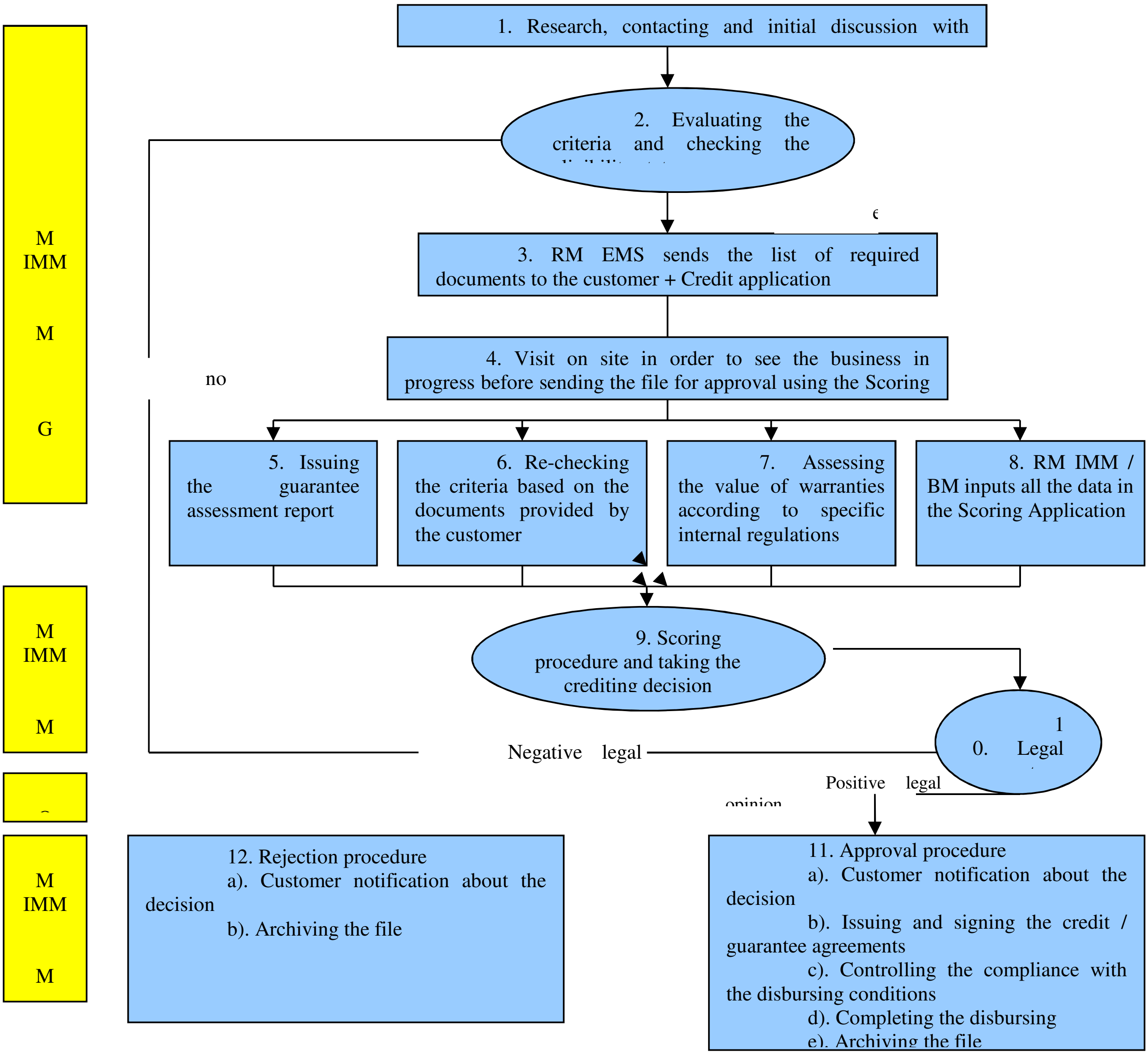
Ratio	Definition	Notation	Expected impact
	Liquidity ratios		
Current ratio	$\frac{\text{current assets}}{\text{current liabilities}}$	r1	-
Quick ratio	$\frac{\text{cash + ST}^{\text{I}}\text{ receivables}}{\text{current liabilities}}$	r2	-
Cash ratio	$\frac{\text{working capital}}{\text{assets}}$	r19	-
Working capital	$\frac{\text{financial assets}}{\text{current liabilities}}$	r15	-
Capitalisation ratio	$\frac{\text{fixed assets}}{\text{long-term liabilities}}$	r10	-
	Solvency ratios		
Leverage I	$\frac{\text{debt}}{\text{equity}}$	r3	+
Leverage II	$\frac{\text{LT}^{\text{II}}\text{ debt + LT}^{\text{II}}\text{ bonds}}{\text{equity}}$	r4	+
Leverage III	$\frac{\text{debt}}{\text{assets}}$	r14	+

Source: author’s compilation

Ratio	Definition	Notation	Expected impact
	Solvency ratios		
Debt payback period	$\frac{\text{LT}^{\text{II}}\text{ debt} + \text{ST}^{\text{I}}\text{ debt}}{\text{operating profit+interest expenses+depreciation}}$	r9	+
Interest coverage	$\frac{\text{operating profit + interest expenses}}{\text{interest expenses}}$	r5	-
Cash-flow I	$\frac{\text{net profit + depreciation}}{\text{(debt-reserves)/365}}$	r6	-
Cash-flow II	$\frac{\text{net profit + depreciation}}{\text{debt/365}}$	r13	-
No credit interval	$\frac{\text{money + ST}^{\text{I}}\text{ payables + LT}^{\text{II}}\text{ payables)}}{\text{operating expenses}}$	r16	-
Retained earnings	$\frac{\text{retained earnings}}{\text{assets}}$	r17	-
	Profitability ratios		
Gross profit margin	$\frac{\text{operating profit}}{\text{sales}}$	r7	-
Return on assets	$\frac{\text{operating profit}}{\text{assets}}$	r8	-
Return on equity	$\frac{\text{net profit}}{\text{equity}}$	r20	-
Net profit margin	$\frac{\text{net profit}}{\text{sales}}$	r21	-
	Activity ratios		
Average receivable collection period	$\frac{\text{receivables}}{\text{sales/365}}$	r11	+
Inventory ratio	$\frac{\text{inventories}}{\text{sales/365}}$	r12	+
Sales turnover	$\frac{\text{sales}}{\text{assets}}$	r18	-
Payables ratio	$\frac{\text{ST}^{\text{I}}\text{ payables}}{\text{sales/365}}$	r22	+

Source: Petr Jakubik and Patr Teply, Scoring as an indicator of Financial Stability, 2007

Figure 2 - Standard flow of company crediting activity.



Note: RM PJ = Relationship Manager Medium and Micro Enterprises
BM = Branch Manager
OAC = Credit Approval Officer
LO = Legal Officer

Source: author's compilation

3. Practical approach, case study regarding crediting a SME by two important banks in Romania: a foreign capital European bank and a Romanian bank

The research and correct interpretation of the financial statements is the most important stage for a bank in order to clearly understand the financial status of a company. Also, the financial analysis provides valuable information based on which a correct and informed crediting decision can be taken.

One can find below an example of our research concerning the complex crediting process performed by two important banks in Romania: a subsidiary of a foreign multi-national banking group and one of the biggest private Romanian banks.

For this case study we selected a company having a RON 10.7 m turnover as of December 2010 (EUR 2.4 m), generically called “X” ltd. The main premises of the analysis process are the turnover and the group exposure. According to the amount of turnover, the “X” ltd company is considered to be:

- a medium SME, by the international bank, therefore it requires a more complex analysis, identical with the one performed in case of corporate companies;

- a corporate company, by the Romanian bank, thus requiring an analysis specific to this category, using the specific application of this bank.

The approvals / rejections concerning the credit facilities required by “X” ltd company are the results of a complex process based on the concise analysis and interpretation of the following indexes (Figures 3,4 and5):

- profitability ratios (for the international bank: EBITDA and EBIT Margin, Pre-Tax Margin; for the Romanian bank: Gross Profit Margin, Operating Profit Margin, Pre Tax Profit Margin) resulting from the analysis of profit and loss account;

- efficiency ratios: operating cycle, deficit to be financed (financial gap – for the international bank, and working capital requirement – for the Romanian Bank)

- Liquidity ratios & Working capital;

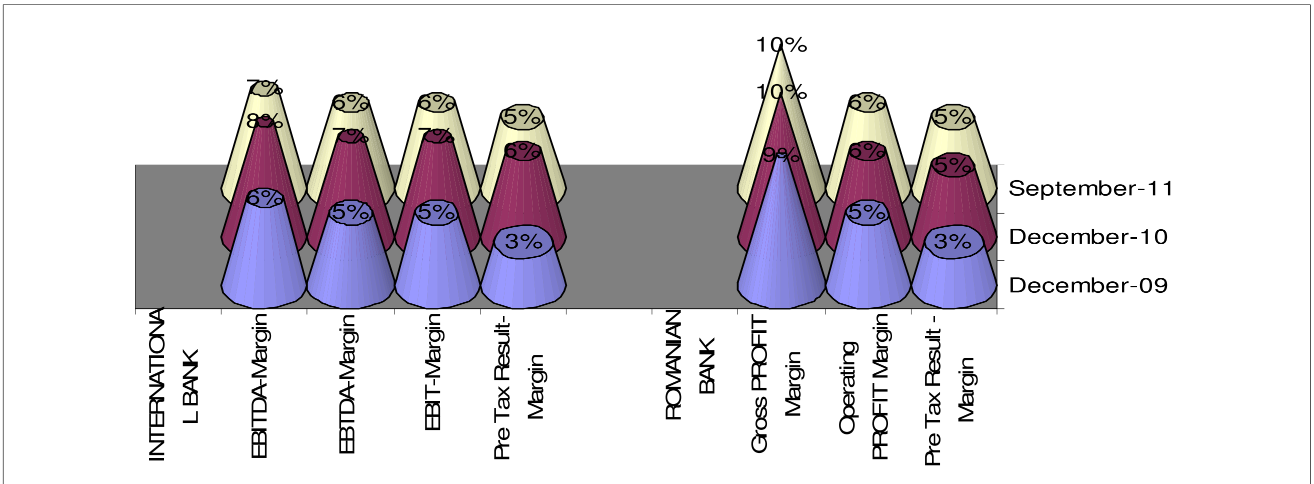
- cash flow analysis – operating activities / investment activities

Remark: - besides the quantitative indexes, which are the most important, the qualitative indexes are also used, but they are more subjective and quite different between the two banks;

- calculation of quantitative indicators can be found above in Table 1.

Figures 3, 4 and 5 present the results of the financial analysis of the “X” ltd company using the analysis models specific for each of the two banks.

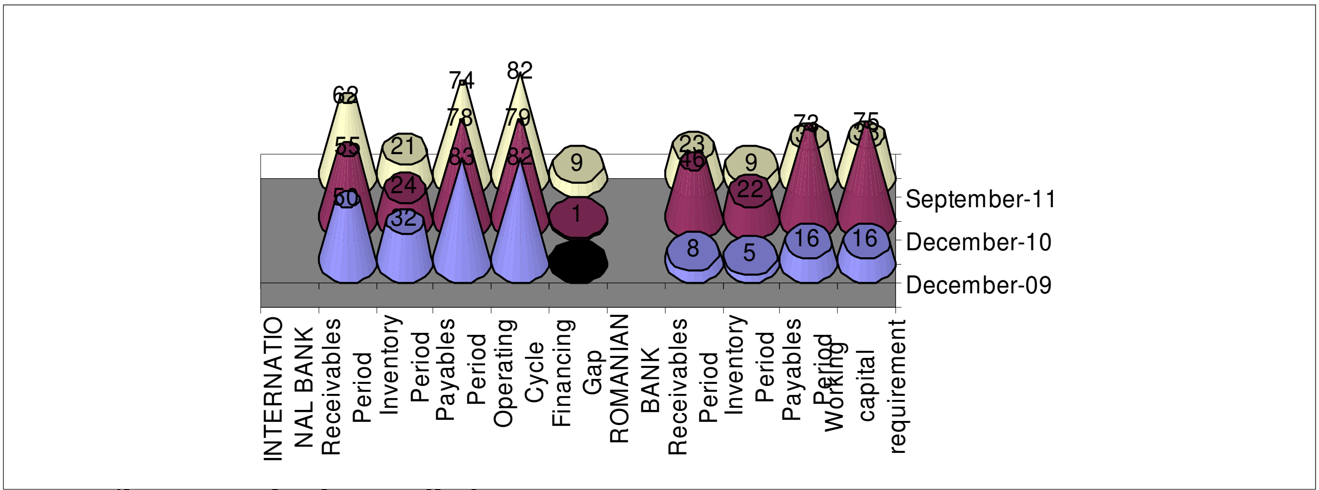
Figure 3 – The results obtained from an international bank and Romanian bank for profitability indicators of the "X" ltd



Source: author’s compilation

Indicators calculated from the two banks show good profitability and PD is small, so the company can be credited (recorded results from the two banks are identical for the same indicators)

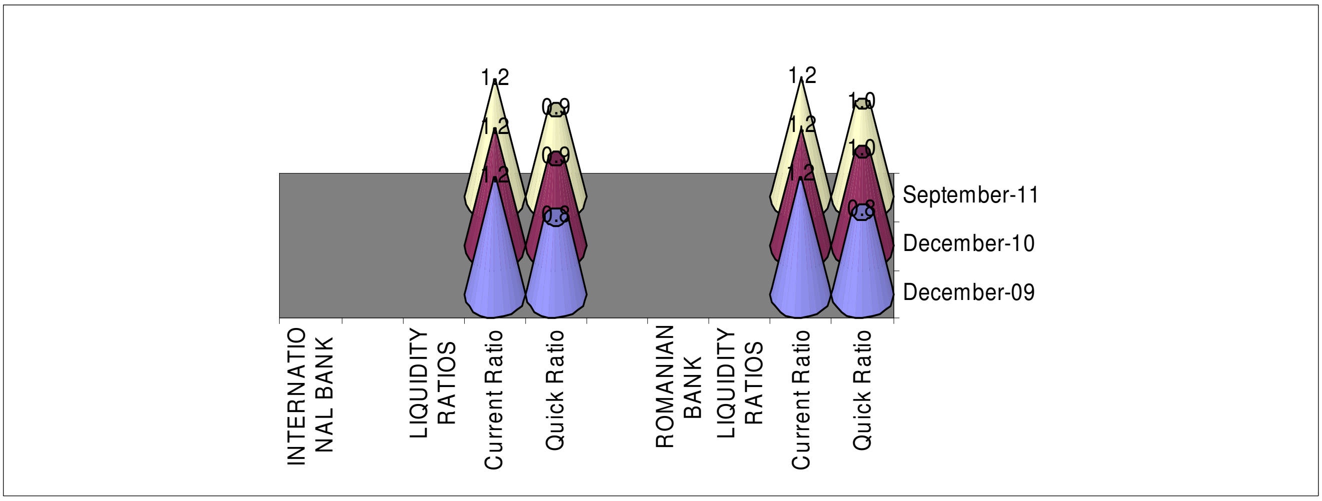
Figure 4 – The results obtained from an international bank and Romanian bank for activity indicators of the "X" ltd



Source: author's compilation

Activity indicators of the "X" indicates an efficient ltd company can be financed because PD is low (though we note that the results are different in the two banks are not identical because of its scoring program applied - for example the international bank it takes into account the scope of the company adjusting the results accordingly, while Romanian bank that does not happen)

Figure 5 – The results obtained from an international bank and Romanian bank for liquidity ratios of the "X" ltd



Source: author's compilation

Liquidity ratios indicate the firm on both banks very good liquidity, greater than one, the firm can thus honor Payable smoothly and therefore be credited (recorded results are the same on both banks)

4. Conclusions

Financing the economic units has become a real test in nowaday's economic conditions, so that the commercial banks continuously addapt the crediting policy and the types of credits in order to cope with the current economic challanges, aiming both at decreasing the provisions and make profitable investments with warranties as safe as possible.

The entire crediting process is governed by caution, beginning with the selection of customers (the economic areas with the lowest degree of risk are, consequently, the most desirable ones), continuing with the qualitative and quantitative anaysis of debtors in order to calculate the rating, the concern for structures of warranties adequated to the established risk degree, as well as the debitors' monitoring (regular financial analyses, customers analytics charts, inventories, etc., re-assessment of the real estate warranties).

He who shall find the most successful solution shall gain an important market share, both from the general Romanian banking market, but also from the SME banking market, considering that the decreasing pace of natural persons crediting also seems to come to an end.

5. Bibliography

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