Loan Products Included in the Offer of Commercial Banks

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Abstract. *A bank loan is the main form of economical credit. It is for corporate activities – for medium and big companies and for retail activities – for small companies and individuals.*

The conditions for credit mainly depend on the quality of customers, it means their ability to perform a profitable activity and to be able to pay back the credits.

For reasons which are mainly connected to marketing, bank practice has developed a large range of credit names, trying to emphasize some of the parts of the products or to take profit of some competition advantages in relation with customers' products. We are trying to include the offer of bank loans in a typology which takes into account the law, the bank field rules and the main technical features of the offered products.

Keywords: loan products; short term credit; long and medium term credit; commercial banks; risk.

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JEL Codes: G21.
REL Codes: 11C, 11E.

A bank loan, as the main form of economical credit, it is based on bank deposit, loans taken from the money market, especially from other banks, loans taken from the financial market and bank's own funds. A bank loan is mainly a short term credit because the resources are also on short term and they come from the money market. The medium and long term credit has as main source the loans taken from the financial market.

A credit is addressed to corporate activities – medium and big companies and retail activities – small companies and individuals. It depends mainly on the quality of the customers, it means their ability to perform a profitable activity and to be able to pay the given loans. Banks give loans only on the base of real guarantees or future income assignment of the beneficiaries, as well as the amounts of money in their bank accounts or personal guarantees. Loans are given for the goal established through the contract and the use of the loan for other goals entitles the bank to stop the credit and to start recovering the given amounts in advance. The contract of credit and the contracts of guarantee have a law value and that means the bank can make use of them against the debtor without any other law trial.

As in practice, for reasons which are mainly connected to marketing, we encounter a very large range of credit names, we are trying to include the offers of bank credits in a typology which takes into account the law, the bank field rules and the main technical features of the offered products. Thus, we can find:

1. Short term credits

Global operation loan

The global operation loan is the main type of credit used by companies for their economical activities. This type of credit has been named in different ways, at least since 1990 to present, according to the orientation of money authorities. In 1990 the name of *production credit* was used and it showed very well the goal of the credit, it means the financing of service supplying and production activities. As the term was considered to be old, in 1995 it was renamed as *global operation loan* and had the same economical meaning, but it was considered more adequately for the new market. Starting 2000 the name of *revolving credit* was preferred, a type of loan used in western countries, which allowed the customer to renew its credit to the level initially approved, thus the company had permanently available the same amount of credit till the due date. The substance of the credit has not changed, but the form of giving and paying back; the classic system has been abandoned in favor of a modern form of credit which allowed that the amount develop according to the cash flow fluctuation of the company, giving and repaying multiple amounts of money during the period of credit, but within the limit of the approved level. The term of revolving credit was largely accepted by the bank community, because it showed quite well the feature of the credit which gave the possibility of using a higher volume of credits than the approved one, but it had to be paid back when the reserves were in the approved limit. This form of credit was a step forward in the field of loan offering advantages mainly for companies, but also for banks as, by operating a higher volume of credits, within the limits of a contract, they could benefit from a higher volume of interests and bank charges for their payment operations. In 2000 this term was also changed into *credit line,* which was considered to be more adequate to the activity of loan and which represented a revolving credit. The crediting mechanism was the current account, which, through its crediting-debiting operation, reflected whether the existing credit (debit sold) or the money reserves (credit sold). Starting 2007, the central bank has introduced the term of *limit of credit*, with the same meaning and mechanism of operation but with a less representative name. Further on we will be using the term of global operation credit, which shows better the substance of this type of credit.

Global operation credit can be given either for the current supplying, production, sale activities or for other sub activities, projects, contracts which, through their nature, are performed and emphasized distinctively. The loan is given for a period up to 12 months and can be renewed, upon the customer's request, on the base of an analysis similar to the one performed when opening the credit line. The credit can be increased or decreased during this period of 12 months if the customer's business activity is better or weaker than the parameters taken into consideration when the credit was approved.

Global operation credits can be given to companies which have adequate financial performances (categories A or B) and which have a good sense of duty. These credits can also be given to companies included in the performance categories C or D, but only for export activities and when these activities have considerable percentage and permanent status in their turnover.

Object credit

An object credit refers to a loan given for orders, final product stocks which are for sale, including unfinished products within the period of credit. This type of credit is typical to building and manufacturing companies, which operate on base of a contract concluded before the production process starts or to companies which acquires stocks of goods in order to sell them later. For a bank this type of credit is more attractive than the global operation one, as the sale of the products is assured and thus the credit repayment is assured.

Credits for financing temporary stocks

This category includes: (a) credits for *temporary expenses and stocks* of raw materials, materials which exceed the needs following to some factors (supplying in advance from suppliers, supplying with best lots of goods, production shut down, difficulties with shipping the goods to house or abroad customers; and (b) credits for *temporary expenses and stocks* of raw materials and products (animal and vegetable agricultural products, agricultural food, other stocks for a longer period than a quarter of a year but no longer than 12 months). These stocks are typical to companies which perform temporary business activities in the food and agricultural industry.

Treasury credits

This category also known as loans for temporary needs, are given to cover the deficit of cash due to a failure in receiving goods or services, to supply some temporary requests of financing, including for the use of some opportunities offered by the market. Treasury credits are given for a period of maximum

30 days. Credits for *account facilities* are of the same nature as well as credits for overdraft, which are given up to 30 days in order to cover the difference of cash flow following to an unpredictable situation.

Discount loan

A discount loan is given on the base of some payment instruments, also called commercial securities, which can become guarantees given to the bank up to the receipts of those securities or one can guarantee in favor of a bank that it will recover their nominal value as beneficiary. In the same way one can do with the cheque, which is either remitted for the bank or guaranteed in favor of the bank. A trade paper, a promissory note and a cheque are loan securities which entitle one to have access to open currency or to tenor. These kinds of loans cannot be given to the companies which have been included in the Data Bank of the Payment Central with incidents in the last six months or the companies whose right to use them has been suspended for a period of 12 months.

The account loan is more risky than other types of loans, as the payment instruments received as guarantee do not assure their settlement and there are risks of failure of payment by the debtor, who is also helped by the period between the issuing and the remittance (which is sometimes quite long) as well as the postdated cheques. There are very important the situations encountered in our bank system, where the loans given on the base of postdated cheques were refused to be paid because of lack of money, and made the banks which offered them to lose money and to try to recover it in the court.

The factoring

Factoring is the operation performed on the base of a contract through which the factor (the bank) takes debts from the customer or it is appointed adherent through the payment of some invoices resulted following to some trade operation, in exchange to a commission. In fact, there is a financing commission, which should remunerate the bank for offering the amount to the customer in advance and a commission of administration which should remunerate the bank for its effort of recovering the money. Unlike discount, in the case of factoring we do not encounter trade papers.

According to the moment of financing the customer, there are two types of factoring:

- *Old line factoring*, when the factor pays the invoices when overtaking them.
- *Maturity factoring*, when the factor pays the debts of the adherent the moment they become exigible. In this second case, the factor does not receive the financing commission, but it is remunerated for the operation of discount.

Services of insolvency and currency risk evaluation are of a great importance in financing the exports. The insurance against the insolvency risk is made by subrogating the factor for the adherent, so that the importer will be considered valid and the payment will be made to the factor. For the currency risk, there must be added a margin to the cost of operation.

The cost of these services is between 0.5 and 3% of the invoice for the administration of the bookkeeping and for the help with the management, and the payment in advance of invoices means a 1.5-3% higher interest than the bank interest.

To make use of the factor offers a series of advantages: it gives you the possibility to use the trade paper or the letter of credit when making the payment, to avoid the misunderstanding which can come out when using a foreign language or not knowing the laws in force or the custom in the importer's country.

Old line factoring assures the adherent a financial reserve earlier than the payment date of the loans given to importers, offering the possibility to place another order without the risk of insolvency of its debtors. Besides it offers the possibility of getting some payment facilities, so for an exporter it is a way of promoting the exports.

Consume credit

Consume credit is a credit given to individuals in order to buy goods or services in the commercial network. In general this is a short and medium term credit. Initially it arose from the possibility offered by a trader to buy goods, especially food, and to pay for them when salaries are paid. Consume credit offers advantages for both parties: the buyers have the possibility to get the goods he needs without having the amount of money needed for this purpose, and the traders promote the products. At the beginning the consume credit was in the way of a trade credit where the risk of non-payment was under seller's responsibility, but in time it has turned into a bank credit. There is a large variety of consume credits which can be changed according to more and more varied offers of goods and according to consumers' preferences closely depending on their income, it means their life standard. The most wanted types of consume credits are the following: non-nominal credits, deck credits, card credits, credits through debit cards for overdraft, car credits, credits for long use products, house credits and credits on mortgage.

Consume credit (except the house credit and credit on mortgage) has a minimum and a maximum limit (about 500 – 20.000 RON), which varies from a bank to another, a period of up to four – five years and a variable interest plus commissions. This credit can be taken in RON or in another foreign currency. The size of the credit is given depending on the value of the goods which are to be bought and on the income made by the person (and its family) who takes the loan. The guarantee is the transfer of the income made out of salaries and, if the case, the endorsers' revenues.

Consume credit also has a social component, as it finances the people's going up desires of consume through a later repayment thus becoming the engine of retail activities. The more advanced a society is the higher the amount of consume credits among non government credits is. But there is a limit where one can extend the consume credit determined by the level of people's debts according to the income made by them, which varies from a country to another and it is between 50% and 70%, depending on the country's monetary policy.

Non-nominal credits

A non-nominal credit (also known as credit for personal needs) is the most used form of the consume credit, being used to cover the present requests of the person (and its family) who takes the loan. As a rule, this is a credit which must be guaranteed by personal income and possibly by other endorsers.

On the market there are also non-nominal credits for long use goods, but they operate as long and medium term credits.

Credit through credit cards

A credit through credit cards is a classic short term credit which is given according to the banks' standards. This is a type of revolving credit, it means a credit line of a certain value (also called limit of credit) from which one can make payments within its limits and which has to be monthly renewed. The owner of the card is obliged to pay a third of the credit balance at the end of the month and also to cover the interest and the commissions, then he renews the limit of credit. The risk of a failure of payment is higher for a credit card than for the other short term credits, as the interest is also higher. Yet the credit through a credit card has become a common one and it is now the most favorite way of paying goods.

Credits through debit cards for overdraft

An overdraft credit for individuals is specific for a debit card and it is a line of credit which depends on the operation of this card. Mainly the payment can be made through the debit card only within the limit of the amount of the card account. For a salary card, the bank offers a credit facility, it means that, without money in the account, one can make payments from the credit line within the limit of an amount of the salary and this amount should be paid back from the first salary received together with its interest and commissions. The guarantee is offered by an employer who undertakes to retain the amount from the salary in case the overdraft credit is not paid back.

2. Long/medium-term loans

Development loans

Development loans are the ones which are given for new investments in production facilities and equipment, infrastructure work, water plant management, city construction management and others which can be the base for economical development. Investments are of great values which are to be made in several years and have a long term economical effect. Investments are made on the base of some technical economical documents which should contain the description of its efficiency apart from the technical one.

Loans are approved on the base of these documents, approved by the beneficiary's management board and they must have the expertise of the technical and economical department of banks, and if they do not have this kind of specialists, they have to get the advice of a specialist. A bank analysis is focused on the economical efficiency of the investment which should show the possibility of credit reimbursement and should make the beneficiary increase its profitability. Credits are given to make up the investor's funds, but it is the main financing source (about 60% - 70%). The period of credit is of about 15 – 25 years, depending on the nature and the efficiency of the investment.

For investments of great values, the credit is given by a bank pool, it means a group of banks which is formed to take part with a certain percentage to the financing in order to share the risk of credit. Financing is assured through one of the banks which represents the whole group – the agent bank – and which monitors the credit till the reimbursement is complete. The guarantee is the investment, and if it is considered necessary, because of the long term of the credit, one can ask for other bank or state guarantees.

Credit on mortgage

Credits on mortgage are also long term credits given to buy dwellings (houses, flats, or land) which are based on the mortgage over the investment according to the Law of the loan on mortgage no. 190/1999. In Romania, the credit on mortgage has increased since 2003 and has developed rapidly because of the deficit between the dwellings and the possibilities of financing which had arisen. 70% of the investment is given as a credit, and the dwelling is on mortgage in favor of the credit bank till the reimbursement of the loan is completely paid back. The size of the credit depends on the income and the age of those who take the credit so that the credit could be reimbursed completely during the active period of their life. The credit period is up to 20-30 years, but these limits can be extended depending on the monetary policy. To finance these investments, there are mortgage banks which take long term credits from the capital market or ask other financing companies or investments funds to co-finance these investments, but the role of agent is played by the mortgage bank. The risk is that the debtor could fail to make the reimbursement during such a long period of time and the bank should be in charge with selling the real estate according to market conditions. The highest risk is the difficulty in anticipating the economical evolution on long terms, a very good example is the crisis of the subprime loans in the USA which made financing companies to lose a lot of money and some of these companies went bankrupt. After the events of September 11, 2001, the government encouraged the drop in interests which decreased from 7% to 1% in order to encourage constructions and to stimulate the economic growth, which led to an avalanche of mortgage credits. The problem was when interests went up again and made a lot of debtors fail to perform the payment of their installments which led to a deterioration of the portfolio of credits on mortgage (one of four credits became unprofitable). The failure of payments led to the collapse of dwelling demands and consequently the drop in price, thus the banks could not sell the dwellings taken from the debtors and lost about US$ 400 billion, some of them almost went bankrupt. This crisis has already started to arise in other countries too, for example in England.

Real estate credits

Credits for real estate investments are given to buy real estates or land for construction and they are guaranteed with those real estates or with the bought land or with other real estates or other land. These credits are medium or long term credits which are based on the deed of sale and on the investor's capacity to reimburse the loan. Real estate credits are also used to erect buildings having as a guarantee the erected building after it has been finished. Before the building is finished there are used other kinds of guarantees, as an unfinished and non operational building can not be considered as a guarantee.

Leasing credits

Leasing credits are medium term credits and are given to leasing companies for buying movables or real estates, which then can be leased or rented with the option to buy the product at a price previously established or to return it to the company at the end of the leasing period. The credit is given up to 85% of the goods value on the base of real guarantees (real estate guarantees) and on the base of the goods that are to be bought and other additional securities under the form of a transfer of debts of the amounts in the account, on the base of compensation from insurance companies. Although the leasing is a new activity, it has expanded quite fast on the base of financing from bank credits.

Nominal credits

This type of credit is given to buy new vehicles from authorized dealers or to buy second hand vehicles from second hand traders or individuals. Its particularity is that the buyer should have at least 25% of the funds as the credit is 75% of the goods value. The goods should be insured by the buyer and the insurance policy is transferred to the bank. Credits for other types of goods (domestic electronic and electric devices, computers, IT components, furniture) are given under the same conditions as for vehicles.

Forfaiting

Forfaiting is an operation of transferring the debts of a foreign business trade made on credit to a bank or to a special financing company. The bank pays for these debts on the spot and it will recover their value from the importing debtor. The operation looks like discounting, but there are several technical elements which are different. Firstly, forfaiting unlike discounting, does not give the bank the right to appeal the seller of the debts in case there are any incidents regarding the payment caused by the debtor. Secondly, the term of the operation makes the difference. Forfating applies not only to the short term debts, shorter than a year, but also to those of medium term, from 1 year to 7 years. But we have to notice that in Romania the operation rather works within the lower limit of the above mentioned period. The bonds used in the forfaiting can be bills of exchange, bills payable to order, letters of credit.

Forfaiting's advantages are: creating cash, respectively improving the cash flow by receiving immediately the value resulted from selling the bills of exchange, avoiding the risk of non-payment of the bills of exchange at the stated term – this risk being overtaken by the bank – and promoting the goods at selling on the base of a sure financing. The cost of financing has a fixed rate of interest, plus a commission established depending on the debtor's reliability, on the fact that the bills of exchange are or not guaranteed, on the estimated risk of operation, on the way of paying the forfaiting. Thus the determined discount reduces the nominal value paid to the exporter. Taking into account the risk overtaken by the bank, we can find here higher costs compared to discount operation.

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Regulamentul nr. 15/20/14.12.2006 privind tratamentul riscului de credit pentru instituțiile de credit și firmele de investiții potrivit abordării bazate pe modele interne de rating

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