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(Research Article)

The challenges of commercial banks for financing project: In case of small-medium enterprises

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Abstract

Small-medium enterprises (SMEs) are crucial for creating job opportunities, generating profit, and supporting social stability in low-income nations, contributing dynamically to private sector development. However, accessing financial resources remains a significant challenge for SME development, primarily due to inadequate financing from commercial banks. This often leaves new startups struggling to obtain credit due to a lack of credit history, marking them as high-risk prospects. Commercial banks face numerous challenges in lending to SMEs, including risk identification, managing operational costs, lending decision quality, and controlling bad loans. This research paper explores the role of commercial bank loans in the economy and examines the specific challenges that Uzbekistan's commercial banks encounter when financing SMEs.

Keywords: Commercial Bank; Credit; Challenges; Lending Manager; Risks; Small-Medium Enterprises; Economic Growth; Financing Projects.

1. Introduction

In the past decade, banks have played a significant role in supporting and helping Small-medium enterprises (SMEs) around world gain great access to financing projects. Therefore, banks work to grow up access of SMEs to financial resources in developing countries by provide loan for their projects. Small-medium enterprises (SMEs) are always a significant part of any economy during development. Most times SMEs are the supply chain for the bigger corporates and hence adequate resource of SMEs in the country is main key impact on the GDP growth. As we know that bank has dominated characteristic in most of countries economy, they are the key resources of financing for SMEs' project.

In economy of Uzbekistan, development of SMEs area is becoming a significant increasing and has effect factor in economic growth and employment, also to stimulate domestic demand and industry sector. In beginning of the 2024, SMEs' produced as a share of GDP reaching 58.6 percent and also total employment shared about 80 percent in economy of Uzbekistan. SMEs credit, which amounted to 39.7 percent of total bank loans. Also, SMEs play the key role in country economy and developing, have the capacity to generate income growth, exports and significantly job opportunities. The Government of Uzbekistan has assumed leadership in focusing its SME sector to increase its employment generation and contribution to gross domestic product. The government recognized forward and backward linkages and value addition between the SME sectors, as well as between the recently liberalized agricultural and horticultural subsectors and processing, also transport sectors. In this context, timely access to bank credit would be a force multiplier to SMEs to realize their potential.

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Mainly, the dynamic development of SMEs segment increased the demand of loan to financing of SMEs' project. Since small enterprises are significant sector in economy of Uzbekistan; it is vital support to increase their resilience. So, one of the main ways to increase their request loan is to promote SMEs with stable financing, importantly by banks. The main obstacle to the development of SMEs' sector is the lack of financing support by commercial banks. SMEs met issues increased difficulty in obtaining credit because of a lack credit history that leading to them being perceived as high risks.

Much research paper showed that commercial banks loan prudent for SMEs, also it is historically loan process and activities are mostly interested from banks. Furthermore, there are a lot of challenges and problems for banks to decide loan in the SME sector. Such as we can say according gathered data problems include identify main risks, managing project risks, avoid huge operational costs, lending decision quality and cost, difficulty controlling SME's bad loans and other.

2. Literature review

There are some studies which have made contributions to the literature of financing SMEs. Banks will have to deal with more difficulties due to such a small decline in loan quality. The root of poor loan quality comes from mechanism of information processing. Kim et al. (2021) argue that these problems start from the stage of loan application and then expand at the stages of loan approval, monitoring, control when there is no existence of the guidelines in risk assessment strategy on credit, regarding credit processing policies or procedures, these guidelines are weak or incomplete.

We found during the research that the most of SMEs do not use annual reports, annual file accounting, and main statistics figures. So, it makes challenges to managers during deciding loan because they really do not abut capable of small enterprises. Also, liability and net income does not readily available. On the other hand, SME has different financial behavior, it is a little easy to identify risks and manage them if we compare with customers loan. Lending managers investigated on every aspect of the SMEs during gathered information. Sometimes business plan of SME is not appropriate, so much risky. The evidence that business plan or project concern of SMEs, epically comprehensiveness is the main significant direct effect variable which investigation particular.

Banks assess the creditworthiness of credit/loan applicants based on two basic criteria: their financial capacity or ability to repay a loan and their willingness to repay the loan. Mainly, for loan profitable to the SMEs, bank managers need to treat every business project, they need to focus on risks and profile, SME ability to afford and support loan to suitable site of sector. Business environments of SMEs and associated decisions are complex. Furthermore, as more changes occur, the more complicated project becomes to finance by bank managers. Changes and the processes related to managing risks differ among organizations, as there is no one size fits all. So, managing SMEs' projects remotely can be associated with complex risks.

According to Brajovic B. (2020), suggests that framing the discussion of how banks approach the challenge of serving SMEs, a standard banking value chain framework will be used. This framework consists of five discrete stages and one cross-cutting task. The five stages of this banking value chain is (1) understanding the market, (2) developing products and services, (3) acquiring and screening clients, (4) serving clients, (5) managing information and knowledge. Cutting across each of these five stages are the permanent and critical task of risk assessment. At each stage of the value chain, there are actions and considerations particularly relevant to the SME sector.

The general principles for Credit Reporting of financing SMEs' project in the banks were issued by the World Bank in September, 2022. Since then, the World Bank and the International Committee on Credit Reporting (ICCR) have been leading efforts towards the implementation of the General Principles worldwide. Among those efforts, the World Bank and the ICCR are developing more detailed guidance for specific credit reporting of financing SME project and other activities in bank.

This report identifies 5 key topics for analyzing credit reporting systems:

- data;
- data processing;
- governance arrangements and risk management;
- legal and regulatory environment;
- cross-border data flows,

Large and foreign banks are generally not interested in investing in SMEs, while on the other hand; small banks which are focused on a specific niche are more motivated to overcome the problems which arise within SMEs. Torre et al. (2010) have shown that there are no sufficiently plausible arguments for this claim, and that banks find SMEs to be highly profitable clients. In addition, regardless of the size of the bank, the practice has shown that they are striving to maintain long-term relationships with the SME segment, especially in emerging markets.

Small-medium sized enterprise sector's growth and its impact on the society, risks assessment equally calls for attentions and strategies to this sector by bank. SMEs' project risk management of bank is considered a suitable model for SMEs, to adopt and implement (Keane, S., 2009). There are several approaches that financing SMEs' project, bank can choose to process risk assessment and reduce loss exposures. Kliem et.al (2017) prefers that a four-step process: 1) risk identification, 2) risk analysis, 3) risk mitigation and 4) risk follow-up. In compare to SME's strategic risk assessment scheme in the bank, there are two highlights in risk assessment of financing SMEs' project that make this approach more suitable for SMEs' project which the step of planning and identifying risks.

Banks have strong incentive to use their own money for the projects where returns are certain and attempt to borrow money for riskier projects. Banks and other lenders have developed measures to safeguard against losses. First, they gather information that can inform them on the chances of the borrower failing to repay the loan. Such information is typically associated with the characteristics of the borrower (Sugrue Ward, 2013). Banks are increasingly taking the view that lending decisions should be based on the cash flow, business plan and prospects, thus adopting an income based approach (Fletcher, 2015). Second, in order to align the risk bearing function of lender and borrower, they can demand the borrower to make part of the investment (Myers Majluf, 1984; Shapiro 1990). Third, in order to shift the risk from the bank to the borrower, they can ask for collateral (Bergström Lennander, 1997; Anderson, 1999) or ensure that the financial standing of the borrower is solid enough to repay the loan should the project fail (Altman, 1983; Beaulieu, 2006).

3. Research methodology

Most researches conduct is qualitative and quantitative, those using primary alternatives to all researchers. It is important to mention that which approach is most appropriate and more effectively conducting really depend on research problems and objectives. So, this chapter of the paper represented the survey of the information and data collection. On the hand, this provides necessary investigation breadth to our research study, also ensure different factors to be considered and analyzed to the relationship between commercial banks and financing projects of SMEs.

During addressing to directions for managing non-performing loans in commercial banks, mainly the primary data collected. We used to collect information primary and secondary data for conducting this paper, it is necessary to say that all secondary sources are gathered figures, statistics and facts collected to get information, such our secondary data gathered from various literature, it may include electronic sites, books, different journal, research paper which done by other people before and banks' annual reports, published internal papers and policies.

In this research also intended to prepare interview schedule and conducted face to face interviews. Interviews were conducted with bank staffs who decide to give loan for SMEs' project. Therefore, questions investigated on risk assessment goals for SMEs, techniques and process. Addressing to where the risks appear and challenges arise during implement project also identified the main risks of financing SMEs' project in the bank.

We must inform that the research performance statistics are limited. Nevertheless, the research paper can obtain financial data from commercial banks of Uzbekistan, lending managers' reports and significant information. So, it was some limitations during conducting current paper such as to find specific historical information, data, time limitation, some cost issues, the size of subject area, also data confident.

4. Data analysis and results

In the conditions of the market economy, the main support of economic development is the loans provided by commercial banks. Commercial banks operating in Uzbekistan are the most important element of the country's economy. The operation of the banking system on the basis of reliability and profitability is an important factor of economic development. Banks are financial institutions that collect temporarily idle funds and lend to individuals, firms, and governments to finance consumption, investment, and capital expenditures, thereby promoting economic growth.

Table 1 The macroeconomic indicators of commercial banks in Uzbekistan

Indicators/Years	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
GDP, (bln. UZS)	177	199	303	408	524	580	735	888
Total assets of commercial banks, (bln. UZS)	65	84	167	214	273	366	445	557
Total credits,	43	53	111	167	212	277	326	390
(bln. UZS)								
Share of credits to GDP, (in percent)	24	27	37	41	40.4	48	45	44
Share of credits in bank assets, (in percent)	66	64	66	78	78	77	73	70
Total deposits,	36	45	60	70	90	115	156	217

According to table 1, in 2022, compared to the previous year, the volume of credits directed at the economy increased by 19.6% and reached 390.1 bln. UZS as of January 1, 2023 and the level of loans compared to GDP reached 43.9 percent in Uzbekistan. We can say that the ratio of banking system loans to GDP shows that the importance of the banking system is increasing for the real economy. Loans of commercial banks are one of the sources of financing current and investment expenses of economic entities and play an important role in ensuring the stable development of the economy. In the next example, we will consider the role of commercial bank loans in ensuring the stable development of the country's economy. Many papers showed that banks are facing more challenges and difficulties due to a small decline financing in loan quality.

The bank should determine which loans to allocate and which not to allocate, how much to allocate from each type of loan, to which customers to allocate loans and under what conditions these loans are allocated. The main goal of commercial banking policy should be to ensure optimal relations between allocated loans, attracted deposits and other liabilities and private capital. Only then, the bank will achieve its main goal of increasing profits and operate on the basis of high profitability.

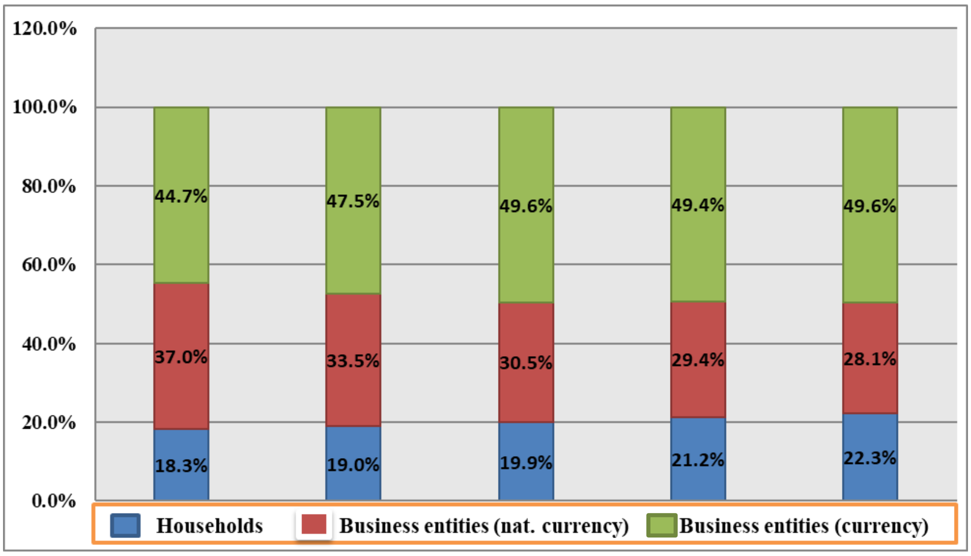

Figure 1 The structure of credit portfolio in commercial banks of Uzbekistan, (%)

The increase in the volume of lending is related to the increase in the risk of non-return of the loan. In order to prevent such risks, in order to determine the creditworthiness of customers, financial indicators (financial statements), collateral, project being loaned (business plan, technical economic basis) must be analyzed; conduct stress tests and regularly use modern scoring methods. In evaluating the creditworthiness of a SME, the lending officer has to evaluate the firm's ability to respond to changing conditions and develop and implement effective strategies. For this purpose, the customer's business plan, as part of the strategic planning, can be used in two-ways. First, it is an indicator of the ability of management to communicate the strategy of the firm to external parties. The firm strategy should be clear and consistent in order to persuade external parties, such as banks, who make commitments to the firm's future success.

The past financial performance of a SME is an important factor to estimate its ability to repay a loan (Gibson, 2013). Past profitability shows the firms past operational success and thus provides tangible representations of the competence of the SME. Indicators for a company's past performance are found in quantitative measures based on accounting information. A firm's generated profit or loss is provided through external accounting information. The main purpose of external accounting information is to provide useful data to potential investors, creditors and other users to make rational financial decisions.

According data analysis, the most important variables to supporting credit request is part performance of the borrowing SMEs, which really tell to manager about SMEs' history, profitability, past project result and others. We need to say that 22 lending managers focus on the past performance of the SME to decide loan, in this case with mean 3.75 and 27.5 percent respondents linked to this significance. The second significant factor to give loan is competence within the business project, with mean 4.22 and 21 responses by lending managers.

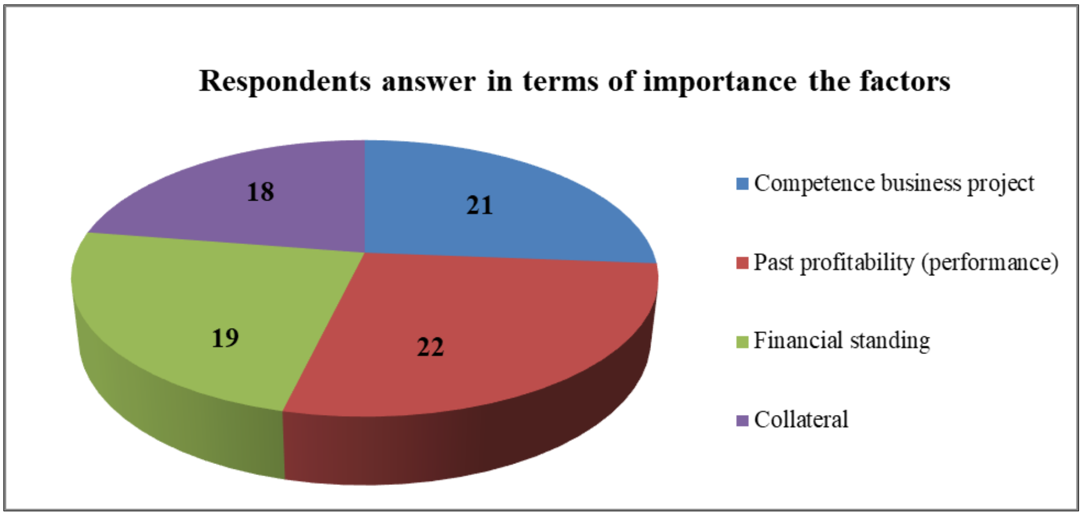

Figure 2 The most significant factors for supporting SMEs by commercial banks

We can see above results of the lending manager's approach to aggregate the importance factors for supporting SMEs' loan. The last importance factor is financial standing of the SME. We cay that SMEs with enough financial standing can enable their extensive sources, mostly financial resources to repay back loan of the bank and also fee regardless of the project outcome individually. But, only 22.5 per cent managers investigate on the financing standing during deciding loan for the existing project. Mainly, collateral is one of the main factors to manager for avoiding any loses.

Many researchers' paper approached to examine the relationship between banks' loans and household sector. Therefore, reviewed papers placed significant focus on identify and discuss variety type of risks in banks. According to our analysis identified those risks in commercial banks during financing SMEs: 1) interest rate risk, 2) raw material prices risk, 3) supply chain risks, and 4) management and employees risks, 5) credit risks, and 6) operational risks.

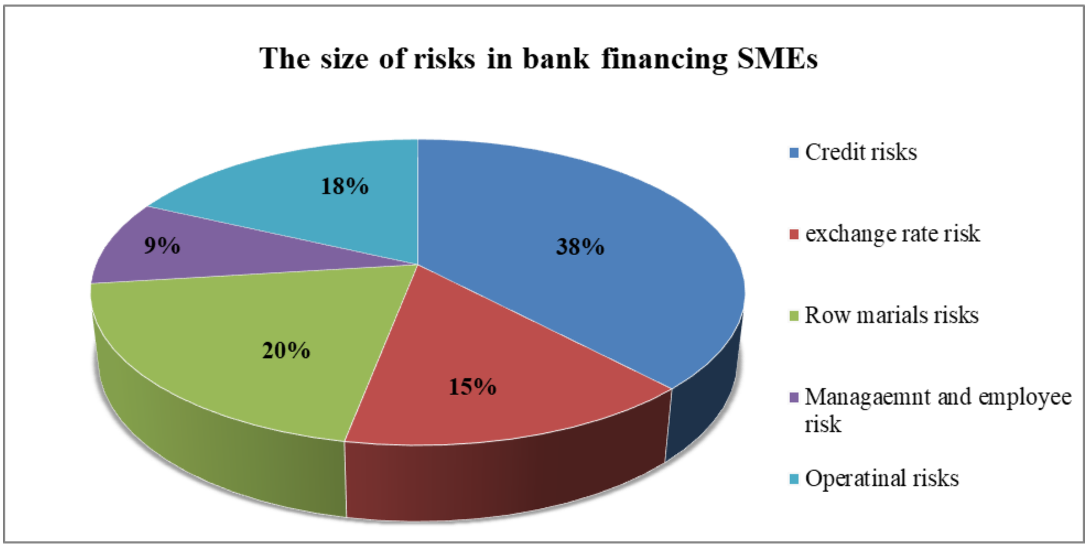

Figure 3 The most significant risks of SMEs faced in commercial banks

The main risk according to respondent answer is management and employees risk. Knowledge of project manager may also constitute a challenge for SMEs' project in the bank. Lending managers individually looked to management and employee risks during project implementation. One of manager mentioned that SMEs' project is viewed highly dependent on external finance, bank loans and accordingly, a loan is usually the main source of financing available. This, however, involves the risk that interest rates on the loans may change (i.e. interest rate risk).

According to data analysis, we found that the three important factors increase during years positively. Our collecting data indicate these three factors supporting SME to repay loan for the bank, also all data estimate indicators have helped to reduce loses and enable to lending managers control all risks properly. We can see during three years which 2021-2023, changing significant SME's factors during holding project.

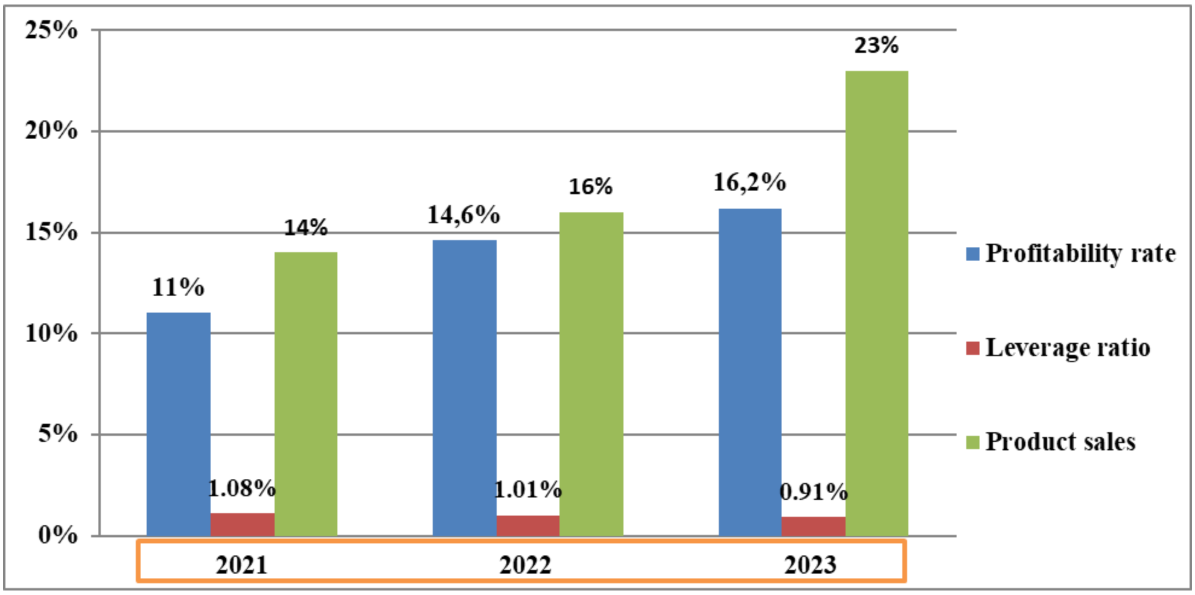

Figure 4 The significant factors for decision making by lending managers for financing SMEs

Data analysis indicated that credit managers who deciding loan for SMEs' project, has limited implemented capabilities and understanding risks of bank project relatively. As a results, lending officer tend to be focused on the reducing risks and eliminate actual risks for SMEs' project. We need to mention that a strategic approach for assessing SME's risks also including the use of controlling and diversification.

5. **Conclusion and recommendation**

Researches stated that SMEs credit analysis always require a specific approach different than bigger company within large scale. SMEs' project risks can be assessed numerically and are prioritized. Several risk factors and related attributes were identified and categorized. This empowers project managers or lending manager to make proper decisions about whether to take on or abandon respective giving loan or project changes. We found that lending managers are facing a relatively risks for the SMEs' project, all these risks lead to project events and activities.

We investigated deeply to analyze into lending managers' decision making for SME's project. All data analysis represented that for the lending manager the main key indicators for supporting credit request are past financial performance of the SME, collateral ordering level, also mainly the business project competence. Also, there many variables can influence to managers decisions and effect in SME's project performance, we can say training with lending managers, bank internal policies or guidelines, maybe referral system of management and others.

There is sometimes misunderstanding or disconnection between bank managers and SMEs' project managers. They have different understanding the importance of the risks during financing projects, financial stability both two sides, and also has similar the role of understanding risk assessment for bank financing project by credit managers.

We can suggest according to findings, commercial banks need to focus on specific measures to decide loans for SMEs sector, it helps to safeguard against loses from bank financing SMEs' project. Also, lending managers collect information which can enable them chance of the SME failing to repay bank loan. These information is always associated about SMEs characteristics, it may include such as financial condition, past performance, implemented projects and others.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

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