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THE ROLE OF BANKS IN UTILIZATION OF THE EU FUNDS

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Key words: borrowings, financing, EU grants, development of enterprises.

Abstract

The favorable economic policy can trigger positive reactions from the business entities resulting in increasing the level of investments (capital, technological, information as well as in knowledge) and economy competitiveness. The level of investments depends, among others, on accessibility of investment funding. In most cases, enterprises fund the developmental investments with own as well as external sources. Use of the EU funds in business development reduces the costs of investment considerably because it is possible to obtain up to 50% grant-in-aid after completing the modernization project. Enterprises must, however, fund the investment project first to be able to apply for reimbursement of a part of the developmental expenditures. Until that time they use the support of commercial banks, which take active part in programming and utilization of funds allocated for Poland. This paper shows the role of banks in utilization of the EU funds allocated for development of Polish enterprises.

ROLA BANKÓW W WYKORZYSTANIU ŚRODKÓW UNIJNYCH

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Słowa kluczowe: kredyty, finansowanie, dotacje unijne, rozwój przedsiębiorstw.

Abstrakt

Sprzyjająca polityka gospodarcza może wywoływać pozytywne reakcje podmiotów gospodarczych, skutkujące zwiększaniem inwestycji (kapitałowych, technologicznych, informacyjnych oraz w wiedzę) i podwyższeniem konkurencyjności gospodarki. Poziom inwestycji zależy m.in. od dostępności środków inwestycyjnych. Przedsiębiorstwa finansują inwestycje rozwojowe najczęściej środkami własnymi oraz obcymi. Wykorzystanie środków unijnych w rozwoju firm znaczne obniża koszty inwestycji, ponieważ istnieje możliwość uzyskania do 50% dotacji po zakończeniu projektu modernizacyjnego. Przedsiębiorstwa, by móc ubiegać się o zwrot części nakładów rozwojowych, muszą najpierw inwestycję sfinansować. Do tego czasu korzystają ze wsparcia banków komercyjnych, które biorą aktywny udział w programowaniu i wykorzystaniu przeznaczonych dla Polski kapitałów. W artykule ukazano rolę banków w wykorzystaniu środków unijnych zaplanowanych na rozwój przedsiębiorstw w Polsce.

Introduction

Polish enterprises are now subject of tempestuous socioeconomic transformations. As a consequence of the globalization typical threats resulting from participation in the international markets appeared, competition in the local market changed into competition in the global market while opportunities for more rapid development also appeared. Insufficient knowledge on the competitive international market as well as lack of sufficient capital for radical technical and technological transformations, necessary to compete in the global market, are among the major threats. Those threats are compensated for with the public aid from the EU and Polish budget in the form of grants supporting the universal development of enterprises. The procedures for acquiring such grants require the businessmen the thorough analysis of marketing, financial and economic situation and also planning of investment tasks. Banks have an essential role to play in the process of application for the EU funds by enterprises.

The aim of research is to show the role of banks in utilization of the EU funds in Poland. The hypothesis was formulated that without participation of banks the enterprises would not be able to use the EU funds on innovative development efficiently. The verification of the research problem was conducted on the basis of the analysis of the EU projects; funding by PKO Bank Polski SA in Warsaw during the years 2004–2007. The comparative materials obtained from the bank headquarters were processed by means of the statistical methods. The types and quality of bank products, number as well as amounts of originated loans were investigated.

Credit activity of banks

The economic function of banks is the mediation in the transforming loans obtained from business entities (which do not have the potential and knowledge in the field of own savings optimal allocation) into bank credit/loans and other capital investments generating profit. Providing mediation services between business entities is favorable economically and socially as assuring financial as well as economic order and safety. Banks, facilitating the flows of capital between entities, do this with concern and feeling of responsibility for the money deposited by the society. Banks have the skill of assessing and selecting the optimal structure of assets that is maintaining the proportions between highly liquid assets and long – term assets with lower liquidity, but generating higher profits. The Central Bank takes care for the safety of deposits and the depositaries confidence in the commercial banks and monetary system and, as the last financial authority, it is the warrantor in case of simultaneous withdrawal of deposits from the commercial banks during the self-propelling panic (BEGG et al. 2000, p. 128). The European monetary system is stabilized additionally by the Directive 2006/48/EC of European Parliament and Council from June 2006. The directive regulates the level and structure of own funds in banks, it standardizes the legislative principles in the field of monetary system safety in the Member States as well as harmonizes the mutual recognition of permits and systems of precautionary supervision (PYKA 2008, p. 141). Reduction of credit activity risk results from combining different forms of financial mediation into financial conglomerates. At the same time the problem of *crossborder infection* appears (it can have the economic or psychological basis) for the countries, in which the sector of financial services is dominated by foreign financial conglomerates (IWANICZ--DROZDOWSKA 2007, p. 98). The results of research encompassing 602 European banks during the years 1996–2002 show that credit risk could be reduced by increased diversification of products being under control in relation to the bank risk, and that the relationship between the level of commissions and bank fees and the protection against the risk of capital loss was weak (LEPETIT et al. 2008, p. 2334). The relations between the European and the American supervision of the financial system also gain increasing importance. The common monetary policy in all EU Member States also mitigates the economic fluctuations (SOBOL 2005, p. 235).

Commercial activity of banks involves utilization of specialized knowledge and experience to purchase a diversified portfolio of assets (BEGG et al. 2000, p. 108). Commercial banks are organizations oriented on profit generated as the difference between the costs of capital borrowed (the costs of opening and maintaining the accounts and deposits and involved in charges on the borrowed capital) and the incomes obtained from the margin on sales of long-, medium- and short-term credits[1]. Banks are subject to comprehensive economic appraisal based on classical methods of profitability, financial liquidity and solvency assessment as well as the analysis of the risk-adjusted profitability (RAROC). The RAROC is the measure of the effectiveness of transaction exposed to risk (PYKA 2008 p. 127). Transactions burdened with the higher risk require higher capital protection and the other way round. To meet the needs of the banks, the investment projects are evaluated by means of simple – statistical methods (return period, rate of return, break-even point, financial liquidity, etc.) as well as complex – dynamic methods (discount), involving computation of the Net Present Value (NPV), Net Present Value Ratio

[1] A simplification was made represented by dismissing other than loans to enterprises sources of bank income.

(NPVR), Internal Rate of Return (IRR) as well as Modified Internal Rate of Return (MIRR) (WIND 2008, p. 221–230). Banks consider two enterprise risk measures – Earning at Risk (EaR) as well as Cash flow at Risk (CfaR) (JAJUGA, JAJUGA 2007, p. 337).

Bank credit risk is also essential for the business entity applying for investment project capital support[2]. The credit risk results from evaluation (standing) of the previous activity of the enterprise as well as the rating of the planned project based on the marketing, financial and economic analysis of the credit period and the transaction amount, legal protection and currency risk (WIATR 2008, p. 202). The enterprise that takes a development decision involving use of external capital, also assumes the risk of increase in operational costs, resulting in the increase of marginal cost and prices of the goods produced. The Weighted Average Cost of Capital (WACC) at company level results from the formula (JAJUGA, JAJUGA 2007, p. 336):

$$\mathrm{WACC} = w_d\, k_d\, (1 - T) + w_d\, k_d + w_p\, k_p + w_e\, k_e,$$

where:
w_d – the share of external capital,
w_p – the share of capital from privileged actions,
w_e – the share of own capital,
k_d – the cost of external capital,
k_p – the cost of capital from privileged actions,
k_e – the cost of own capital,
T – rate of income tax paid by the company.

There are fixed and variable interest rate loans. Fixed interest means, that it will remain the same during the entire payoff period independent of the fluctuations in the market interest rates. The banks very rarely agree to such an option, because of excessively long payoff period. They establish the fixed interest rate for a period shorter than loan maturity. In case of the variable interest rate loan the amounts of installments change with the interest rates. Those interest rates are:

– for the PLN – Warsaw Interbank Offered Rate (WIBOR) monthly, 3-months and 6-months;

– for the indexed currencies – London Interbank Offered Rate (LIBOR) monthly, 3-months and 6-months.

Company, which tries to obtain an investment loan should have existed in the market for at least one year, although it happens that banks fund the

[2] The considerations were limited to credit risk connected with the development of enterprises.

investment projects of younger enterprises. The enterprise must also have at least 20% of own means for the project to receive the loan funding. This represents a serious barrier for enterprises, particularly during the initial period of their activity. The loan is usually originated for a specific purpose only, and it is not possible to change it. The banks usually require presentation of the project feasibility study. Creditworthiness of the borrower is analyzed in detail; every bank conducts it according to its own methodology. The current market situation in a given business sector as well as the incomes of the future periods (the business plan forms the basis of their assessment) also influence the creditworthiness. The bank analyzes both the potential of firm in positioning itself in market, and the risk involved; moreover it estimates the possible incomes. During evaluation of the enterprise the financial documents such as the: balance sheet, profit and loss statement as well as the tax declarations are analyzed. Also profitability, financial liquidity, rotation of receivables, liabilities, stocks and the change in those indicators over the period set by the bank are analyzed. During the investment loan originating procedure, the banks conduct in depth studies on the capacity of the enterprise to repay the loan from its current earnings, considering the additional revenues from the investment planned to the limited extent only. This is a major obstacle in obtaining the funds and it is a symptom of high caution and distance in the banks; approach to the investment projects that are the subject of their lending. Thus, creditworthiness is the other barrier for developing enterprises seeking funds for investments. Low creditworthiness is often the result of tax policy assumed by the enterprise, which is based on inflating the costs to benefit from the shield effect.

Using the external capital to increase the return on equity (obtaining the financial leverage effect) depends on the relation between the interest rates on the external capital and the increase in the operational profitability of assets (PIASECKI 2001, p. 467). According to ADAMEK (2006, pp. 18–19) short-term loans are of major importance in the debt structure of the SMEs, which results from the:

– borrowing mentality of the enterprise owner;

– linking of that form of capital needs funding with the SME trade cycle and investments process;

– limiting the time during which the enterprise is under the control authority of the lending institution;

– minimization of conflict areas between pursuance of the owner of the business entity to maintenance of previous independence level and rights of the external capital owner during the loan maturity period;

– higher risk of loss of the financial balance during the current business activity, than is the case for a large enterprise;

– short-term loan function of compensating for the lack of rational policy and financial planning.

According to PKPP Lewiatan, the main obstacles hindering use of bank loans are: the level of collateral required, costs of borrowing the capital and aversion of banks to originating loans for SMEs (Fig. 1).

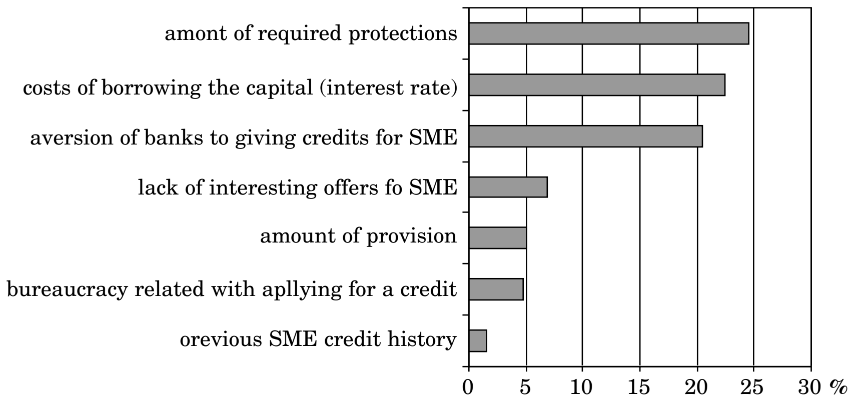

Fig. 1. Main barriers to using bank loans by enterprises
Source: prepared on the basis of: *Monitoring kondycji sektora MSP 2007*, PKPP Lewiatan.

The central bank Lombard credit rate determines to a significant extent the level of costs for the investment capital borrowed by enterprises from commercial banks. Table 1 presents a significantly more favorable situation in Poland in 2007 than in 2000 as the interest rate in case of Lombard credit decreased from 23 to 6.5% and it is about 1.5 percent points higher than the average interest rate in the EU and about 2% higher than in the Czech Republic, Denmark and Sweden. The lowest interest rate (0.4%) was recorded in Japan in 2006.

Table 1

Interest rate of Lombard credit of central banks in selected countries (in %)

Country	2000	2001	2002	2003	2004	2005	2006	2007
European Union	5.75	4.25	3.75	3.00	3.00	3.25	4.50	5.00
Czech Republic	7.50	5.75	3.75	3.00	3.50	3.00	3.50	4.50
Denmark	5.40	3.60	2.95	2.15	2.15	2.40	3.75	4.25
Poland	23.00	15.50	8.75	6.75	8.00	6.00	5.50	6.50
Sweden	4.75	4.50	4.50	3.50	2.75	2.25	3.75	4.75
Hungary	13.75	11.25	9.50	13.50	10.50	7.00	9.00	8.50
Great Britain	6.00	4.00	4.00	3.75	4.75	4.50	5.00	5.50
USA	6.50	1.75	1.25	1.00	2.25	4.25	5.25	–
Japan	0.50	0.10	0.10	0.10	0.10	0.10	0.40	–

Source: prepared on the basis of: http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/, 2008, (–) – no data.

Bank lending and investments of enterprises in Poland

The influence of interest rate on the development of enterprises is correlated with the investments in the economy. The investment outlays in enterprises in 2000–2006 are presented in Table 2. The data indicate that the years 2000–2003 were characterized by a decrease in replacement investments by 23.5% (from PLN 97.8 to 74.8 billion). The reaction of micro-enterprises was the weakest as they reduced the level of investments PLN 2.1 billion (they were influenced by the market contraction the least – 17.2 %). Small enterprises decreased the level of investments the most, by as much as 27.7% (i.e. by PLN 3.3 billions), medium sized enterprises by PLN 5.4 billion (24.9%), and large enterprises by over PLN 10.3 billion (19.8%). The investors; activation occurred in 2004 (Poland accession to the EU) and since that time the investment outlays in enterprises have increased. The data also indicate that investment outlays exceeded the level of 2000 by PLN 12.9 billion only in 2006, when they amounted PLN 110.7 billion. The structure of the bank loans share in funding the developmental projects of enterprises and current activity is also presented in Table 2. It can be concluded that the year 2000 was characterized by a high share of credits in the investment outlays (investments – PLN 97.8 billion and total originated loans – PLN 117.4 billions). Since then the funding of current activities has increased as the number of loans originated increased by PLN 3.8 billion while the investment outlays decreased by PLN 20.3 billions in 2001. That trend develops until 2004 and then the investments increase by PLN 9.1 billions while the amount of loans decreased by PLN 5.1 billion. As of that year the development outlays of enterprises as well as the amount of bank loans have increased steadily.

Table 2

The investment outlays in enterprises by sector and loans originated by banks in Poland during the years 2000–2006 (billions PLN)

Item	2000	2001	2002	2003	2004	2005	2006
0–9 (micro-)	12.2	10.3	10.0	10.1	10.1	11.4	11.4
10–49	11.9	8.3	7.6	7.6	9.5	9.4	12.2
50–249	21.7	15.9	15.5	15.3	18.3	19.9	25.1
Over 250	52.0	43.0	42.4	41.7	46.0	50.4	62.0
Investments (general)	97.8	77.5	75.6	74.8	83.9	91.1	110.7
Loans originated by banks	117.4	121.2	121.9	124.8	119.7	122.9	139.7

Source: prepared on the basis of the report „Przedsiębiorczość w Polsce 2007", www.mg.gov.pl and www.nbp.pl, 2008.

PKO Bank Polski in creating better utilization of EU funds

During the years 2004–2007, PKO Bank Polski SA originated loans exceeding PLN 3.0 billion to more than 2000 enterprises (representing more than 33% of all loans originated by the banking system in Poland to support the EU projects' financing). The bank supports utilization of the EU funds with the bank product called the European Program, which helps the beneficiary at every stage of the process of applying for the EU aid funds. It proposes the enterprise preparation of the grant application, applying, project evaluation and signing the grant agreement as well as lodging the request for payment and disbursement of the funds. The bank also helps the contractors of the beneficiary (contractors, subcontractors and suppliers of services, works and goods) that is the final recipients of the grant funds. The European Program creates the conditions that enable the beneficiary meeting the requirements of the refinancing contract, that is:

– securing of the sources of funding;

– performance of the full content of the project according to the schedule of works and expenditures;

– implementation of the project (all its stages) and its completing within the time defined in the refinancing contract and the schedule of works and expenditures;

– making all project payments as non-cash payments using the banking account;

– documentary evidence of expenses in required format for the given undertaking;

– documentary evidence of appropriate project tasks performance (works, goods and services);

– satisfying the other documentary requirements, e.g. specified in the managing authority guidelines such as presenting the expert appraisal proving that the device possesses the required characteristics/parameters.

The EU Guarantee Fund (Fundusz Poręczeń Unijnych) offers the SMEs the package consisting of 3 complimentary products and services: simple advisory services, bridge and co-finance loans, which are secured by the EU Guarantee Fund guaranty as well as project account. It offers the beneficiary the expert knowledge on project funding, help in establishing securities for the bank loan contracted and also the transparency of financial flows. The enterprise possessing neither sufficient own funds nor the sufficient securities to contract an investment loan can use the guarantee given by Bank Gospodarstwa Krajowego (bank servicing the public finance sector in Poland) within the frameworks of the EU Guarantee Fund. Those instruments allow contracting the investment loans by enterprises with short credit history or assets that are not sufficient as security for the bank. The accounting for the project as well as disbursement of the subsidy is done through the project account.

PKO BP offers the package for implementation of "soft" projects to foundations and associations that intend implementing training or advisory projects with the EU funds. The bridge loan offers the beneficiary the financial liquidity during the project implementation, i.e. from spending the funds until reimbursement of those funds. PKO Bank Polski offers the bridge investment loan to the enterprises with good financial standing and the contract for project refund servicing (Kredyt pod dotację UE – credit from EU subsidy). As the security for repayment of this loan PKO BP accepts the transfer of receivables from the refinancing contract and own blank bill of exchange. The bank also applies limitation concerning the documentation such as: accounting and securities, that is bank support in the process of correct and timely project implementation, including making the payments and settlements. The basic bank products and services are:

– dedicated project account facilitating management of the project financial flows and their monitoring, which is also the destination account to which all the subsidy funds are transferred;

– documentary letter of credit, which is a kind of settlement between parties to a trade contract minimizing the transaction risk, which allows timely delivery of goods and services;

– bank guarantee being a kind of trade transactions security;

– different clearing – securing operations (also fiscal);

– working capital credit;

– guarantees and securities with the EU Guarantee Fund resources as well as loans from the global subsidy provided by the European Investment Bank as a supplement to the European Program offer.

Analysis of bank products, which support the utilization of EU funds by enterprises, shows that the majority of Polish banks possess special offers related to the EU funding (Tab. 3). The presented banks (PKO SA, BOŚ, Fortis Bank, Kredyt Bank, BRE Bank, BPH), are offering programs that facilitate utilization of the EU funds, similar to those offered by PKO BP. The differences in amount of commission, fees for loan promise as well as credit costs are very small.

Table 3
Bank products (in selected banks) supporting the utilization of the EU funds by enterprises

Bank	Offer	Loan origination fee	Loan promise issuance fee	Credit cost (interest rate)
PKO SA	Kredyt Unia	from 1%	0.25–0.5 %	fixed 19.25%, variable 7.05%
BOŚ	European Offer	1%, minimum 100 PLN	0.2–1.0%, 100 PLN	fixed minimum 8.13%, variable from 8.13 to 8.63%
Fortis Bank	Subsidy loan	2%	negotiations	2–5% + WIBOR 1M
Kredyt Bank	EU Investments	0.5–4.0% without promise, 0.3–3.0% with promise	0.25–1%, minimum 200 PLN	variable from 8,28 to 10.28%
BRE Bank	BRE Union	minimum 1000 PLN, maximum 2%	from 0.1%, minimum 1000 PLN	WIBOR + 2–3%
BPH	Euro Express Loan	from 2%, minimum 300 PLN	0.25–0.50%	9.50%

Source: prepared on the basis of: www.bankier.pl, 2008 and telephone interviews with bank managers.

Summary and conclusions

The situation of Polish enterprises as concerns access to the developmental capital has improved significantly, which is confirmed by the dynamics of investment expenditures growth as well as the number of originated loans. Banks adapted their offer to the possibilities and needs of the economy, particularly in the area of the EU funds utilization. In addition to co-financing of the EU projects, their offers also include consulting in preparation of the EU projects from the idea, through preparation of the grant application, the application process, project evaluation, signing the refinancing contract and applying for payment. The formulated hypothesis, that without participation of banks the enterprises would not be able to use the EU funds effectively on innovative development was verified positively.

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