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THE MAIN PRINCIPLES AND CONDITIONS OF BANK LENDING

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ABSTRACT

General Background: Ensuring the balance between value and material production through credit collateralization is fundamental for national economic development. **Spesific Background:** The principle underpinning credit collateralization emphasizes that each bank fund involved in economic turnover must correspond to specific tangible assets. This alignment secures the credits provided by banks to national economy sectors. **Knowledge Gap:** Despite the critical role of collateralization, the impact of unsecured loans on bank liquidity and monetary circulation under market economy conditions remains underexplored. **Aims:** This study aims to analyze the implications of unsecured loans on banks' financial stability and provide a framework for securing credits with tangible assets in market economies. **Results:** The findings indicate that unsecured loans significantly disrupt bank liquidity, increase risks in monetary circulation, and compromise economic stability. In contrast, loans secured with tangible assets enhance financial resilience and economic equilibrium. **Novelty:** The research highlights a systematic approach to mitigating liquidity risks by reinforcing the importance of collateralized loans in market-oriented economies, offering a detailed evaluation of their macroeconomic impacts. **Implications:** The study underscores the necessity for regulatory frameworks to enforce collateralization practices, promoting sustainable financial practices and bolstering economic stability in national economies.

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INTRODUCTION

Credit relations in the economy are based on clear methodological foundations. The operations of the loan capital market, which are its main elements, are conducted according to certain principles. These principles were evident during the initial stages of credit development. Later, they were clearly reflected in national and international credit legislation. As an economic category, credit is governed by several principles. These include the principles of repayment, timeliness, security, purposefulness, and cost-effectiveness of credit [1].

The principle of credit repayment is a condition that defines it as an independent economic category. Repayment is considered a universal characteristic of credit, but it does not occur automatically; rather, it is based on material processes and the completion of the value cycle. However, the completion of the cycle is not repayment itself—it merely prepares the groundwork for repayment. Credit is repaid when the funds that have exited the cycle provide the borrower with the ability to return the financial resources. Repayment reflects a two-sided process, equally important for both the creditor and the borrower [2].

The legal aspect of value repayment is also significant. The ownership rights to the value provided for a specific term do not transfer from the creditor to the borrower. The value given as credit merely leaves its owner's possession temporarily for a defined period but does not change ownership. Banks, which accumulate idle resources, cannot use these resources as their own. The banks act as lenders of funds, while the actual owners of these funds are enterprises, organizations, and individuals [3].

Repayment finds its place in a specific agreement. Repayment is considered an objective characteristic. The aspect of credit repayment distinguishes it from other economic categories, including finance [4].

The effective use of credit, based on repayment, is the central point of the entire banking activity. This principle of credit is practically paid through the transfer of the interest amount for the credit and its usage to the institution that granted the loan. In this way, banks ensure the replenishment of credit resources. During the era of the Soviet Union, under the centralized planned economy, there was an informal concept of "non-repayable loans" in crediting. This form of lending was widespread in many sectors of the national economy, particularly in agriculture. Credit was provided by the state bank without considering the financial condition of the borrower. In its economic essence, non-repayable loans appeared as an additional form of budget subsidies. Under market economy conditions, the concept of "non-repayable credit" is contrary to market principles, and the existence of such loans in practice is considered very risky for the economy [5].

The term of credit refers to the period within which the loan obtained from the lender must be repaid on time, i.e., it characterizes the duration for which the credit is granted. According to this principle of term, credits are divided into long-term and short-term loans.

The principle of the term of credit indicates that the loan must be repaid not at any convenient time for the borrower, but within the specific period stated in the credit agreement. The term of credit is important for both parties, the creditor and the borrower.

If the creditor receives the loan repayment on time with interest, they have the opportunity to return the funds to the owner or lend them again. The borrower is interested in using the credit effectively, repaying it on time, and avoiding the penalties outlined in the contract. If the terms of the credit regarding the repayment period are violated, the lender may apply economic measures (such as penalties, increasing the interest rate, shortening the credit term, and others) to the borrower. If these measures are ineffective, the lender can enforce financial claims through the commercial court [6].

The term of credit is dependent on the duration of incoming wealth, the period for saving and processing, the time for delivering the produced goods, the selling period of goods, and, ultimately, the speed of the circulation of working capital [7].

Through the collateralization of credit, a balance between value and material production, which is necessary for the development of the national economy, is ensured. The main essence of this principle is that, in the economic turnover, for every sum of bank funds involved, a corresponding sum of specific assets should be in opposition. The credits provided by banks to the sectors of the national economy must be fully secured by tangible material assets and certain expenses. The provision of unsecured loans to sectors is considered a reason for the non-repayment of bank loans. This, in turn, has a significant impact on the bank's liquidity and monetary circulation. Therefore, under market economy conditions, special attention is given to ensuring that loans provided by banks are secured by tangible assets and expenses. In the current situation, this process can be described as follows.

The borrowing enterprise pledges goods, goods documents, or other forms of property as collateral to the bank, and the bank gains the right to recover the loan in case of default. In some cases, the loan may also be granted based on a warrant (a document serving as collateral). In this case, the creditor must ensure that the loan being provided is secured by tangible assets.

Bank loans fully secured by tangible assets ensure the stability of the monetary circulation, as the transformation of money into cash and vice versa occurs regularly within the bank. This process helps maintain the balance and stability of the financial system.

The principle of payability stems from the necessity to advance the amount of payment resources required to ensure the circular turnover of working capital and the process of expanded reproduction. This principle emphasizes the importance of having sufficient funds to maintain the flow of economic activity and support continuous production cycles.

According to this principle, enterprises make payments to the creditor in the form of interest for the borrowed funds used. The payability of credit refers not only to its full repayment but also to its return along with interest payments. This means that the creditor does not lend funds on the condition of their full return without any charges; instead, they require a certain payment for lending the funds (except for interest-free concessional loans).

The payability of credit is not only related to the goals of banks' activities but also directly affects the profitability of enterprises, having a positive impact. By ensuring timely repayment with interest, it contributes to the financial stability and growth of both the lending institutions and the borrowing enterprises.

The economic essence of paying for credit is reflected in the distribution of the additional profit gained between the lender and the borrower. In the practical application of the principle, the bank interest rate, which performs three main functions, is demonstrated in the process of setting the rate:

1. **Compensation for the use of funds**: The interest rate serves as compensation for the lender's opportunity cost, representing the return they could have earned elsewhere.
2. **Risk compensation**: The interest rate also accounts for the risks involved in lending, including the possibility of borrower default.
3. **Profit generation**: The interest charged by the bank generates profit, ensuring the financial sustainability of the lending institution.

The essence of this principle is that the credit obtained by the borrower must be directed towards achieving a specific goal. The intended purpose of the credit, such as purchasing goods, covering production expenses, or other specific objectives, is clearly outlined in the credit agreement between the enterprise and the bank. The enterprise must use the loan exclusively for the activities specified in the credit agreement.

In this case, the credit is provided for a specific, defined purpose, such as production costs, production reserves, finished goods, shipped goods, accounting documents, and so on. The loan is aimed at supporting specific aspects of the business as outlined in the credit agreement.

In our view, in the conditions of a market economy, in addition to the principles of credit mentioned above, it is necessary to introduce the principle of credit effectiveness, which reflects the rational use of credit. This principle should not only involve the repayment of the loan and interest to the bank but also measure the level of efficiency achieved in the sector, industry, or enterprise that is financed or credited. In a market economy, credits are directed towards specific projects. Before granting credit or financing a project, banks need to calculate the effectiveness of the funds allocated for the project. If we look at the credit and project financing practices in highly developed market economies, we see that before granting credit to an enterprise or organization, the effectiveness of the funds allocated is calculated. Only if the invested funds are expected to yield positive results will the project receive funding.

To ensure the effectiveness of credit, Western countries use a rule in their credit practices that is new to us. This rule is referred to as the "5C" rule in crediting. According to the "5C" rule, the activities of an enterprise are analyzed based on each "C," and credit is granted only if the enterprise's activities meet the required standards. The letter "C" represents various aspects of a company's economic activities.

METHODS

This study adopts a descriptive-analytical approach to explore the fundamental principles of credit in the economic system. Data were collected through a literature review encompassing various national and international regulatory documents, as well as references from economic practices during the Soviet era and modern market economies.

The analysis focuses on the core principles of credit, such as repayment, urgency, payment, and collateral, along with the application of the "5C rule" in credit decision-making processes. This analytical framework is employed to evaluate the impact of these principles on financial stability and economic efficiency.

RESULTS AND DISCUSSION

The main principles of credit granted by banks can be summarized in the following schematic representation based on the "5 Cs" of credit analysis:

1. **Character**: Evaluating the borrower's character and reputation in the market. This reflects the borrower's trustworthiness and integrity in fulfilling their obligations.
2. **Capacity**: The borrower's ability to complete the work, generate sufficient income, and repay the bank loan. This assesses the financial health and operational competence of the borrower.
3. **Capital**: The adequacy of the borrower's investment or equity. It reflects the borrower’s financial standing and the resources they have at their disposal to support their business.
4. **Conditions**: The conditions of the economy and the business environment that affect the borrower’s activities. This includes factors like the industry’s performance, the economic climate, and any regulatory conditions influencing the business.
5. **Collateral**: The security or guarantee provided by the borrower in case of default. This includes tangible assets like property, equipment, inventory, or insurance policies that can be liquidated if needed.

These principles guide the credit decision-making process and ensure that the bank minimizes risk while providing financial support to businesses that show promise and reliability.

Studying the basic principles of credit allows for a better understanding of the mechanisms of credit relations and their role in the modern economy. Credit is an integral part of the financial system, contributing to the redistribution of resources, stimulating economic growth, and improving the standard of living of the population. Through the effective allocation of funds, credit plays a key role in financing business operations, promoting investment in various sectors, and enhancing productivity, which ultimately benefits the entire economy. By providing access to capital, credit helps businesses expand, innovate, and increase employment, all of which contribute to long-term economic development and prosperity.

The main principles of credit include repayment, urgency, payment, and collateral. The repayment principle ensures the return of borrowed funds to the lender, establishing trust between the parties. Urgency emphasizes the need to meet payment deadlines, which are crucial for maintaining liquidity and financial planning. Payment means that interest must be paid for using borrowed funds, covering the lender's risk and opportunity costs. Collateral reduces the lender's risk by securing the loan with collateral or other forms of guarantees.

These principles provide the foundation for the stable development of credit relations, minimizing risks, and maintaining a balance of interests for all participants. Adhering to these principles not only strengthens financial stability but also contributes to the development of the entire economy, fostering investment and innovation.

Thus, understanding and applying the basic principles of credit is an essential condition for the effective management of financial resources and the successful operation of individual enterprises and the economy as a whole.

CONCLUSION

The principles of credit-repayment, urgency, payment, and collateral-form the cornerstone of a stable and effective credit system. These principles ensure trust between lenders and borrowers, minimize risks, and maintain financial stability. By adhering to these principles, credit fosters economic growth, supports business expansion, and drives innovation. The application of frameworks like the "5C" rule further enhances the reliability of credit decisions, balancing the interests of all stakeholders. Understanding and implementing these foundational principles is essential for achieving financial efficiency and promoting long-term economic development.

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