Kobycheva O. S., Yaroshenko A. S.

SCHEMES AND TOOLS OF COMMERCIAL BANKS' PARTICIPATION IN PROJECT FINANCE

This article explores characteristics of participating commercial banks in project finance transactions. Defined functions and tools of commercial banks in project finance transactions.

Keywords: commercial banks, project financing, securitization.

Study of experience of project finance allows to single out the most commonly applied schemes of project finance as a tool to raise additional investment resources.

An investment project, as a rule, is financed in three major forms: lending form, shared form and combined. Parties to the investment project most often act not only as creditors but its immediate participants as well. Within the framework of implementing the standard schemes of project finance, credit support may be provided by investment funds, dedicated financial companies, international financial organizations, specialized agencies of international credits, insurance and leasing companies, private investors - natural persons and others. Thus, project finance unites financial, fund and trade mechanisms, or in other words it unites banking, investment and consulting [1]. It is, however, acknowledged that the key role in project finance is played by commercial banks.

Analysis of last publications. Some aspects of project financing were reflected in scientific researches of such domestic economises as T.A.Vasylieva, B.S.Irniazov, V.Yu.Katasonov, S.M.Kozmenko, T.P.Kurylenko, S.V.Leonov, A.A.Peresada, I.V.Salo, V.V.Sheremet. As for the foreign researchers, works by G.Winter, S.Gatti, J. Delmon, L.Lang, P.Lynch, P. Rose, F.Fabozzi, J. Finnerti and others focused on problems of project finance.

Previously unsolved parts of problem. Irrespective of considerable number of scientific researches concerning banks' participation in project finance, the problem is still unsolved completely. A range of questions related to role and functions of commercial banks in credit support of investment project require further research.

This research aims at defining the role of commercial banks and their function in credit support of investment projects, systemization of schemes and tools of banks participation in project finance.

Major findings of the research. Upon conditions of market economy, role of commercial banks steadily grows, as they act as financial initiators and organizers of investment project implementation, moreover, it is the commercial banks that play the crucial role in investment resource leveraging acting as financial guarantors of

investment measures taken. It is also worth highlighting that while implementation of project finance schemes funds may be leveraged both within any financial institutions and beyond such institutions. For purposes of financing a certain investment project, commercial banks may unite their capitals through banking syndicate.

Thus, commercial banks have an opportunity of direct access to world financial market for large-scale involvement of foreign capital for implementation of high-risk projects, moreover, they can immediately participate in development of pilot projects, investment programs implemented with foreign capital, and they also function as one of financial agents of government in order to ensure effective and reliable dispose of foreign investment into national economy.

In this aspect, banks are a key link regulating a mechanism of interaction between companies and investors (both corporate and individual) with effective policy of locating investment into real sector of economy, notably both with internal and external sources.

Here it is worth stressing that the role of commercial banks in credit support of investment projects is not restricted to lending, as it bears multi-aspect character (Fig.l.).

As the Figure 1 shows, bank functions while project financing are much more diversified than those of a common creditor, as it can act as a guarantor, counsel, organizer of project syndicate, broker, investor (through participation not only in capital but in corporate management as well) etc, and it can fulfill a wide range of tasks within the scope of project management.

Based on the Fig. 1, the following bank functions while project financing can be defined:

- *Leveraging function* that implies selection of the most effective sources and methods of investment leverage, as well as raising financial resource in the domestic and foreign markets for their further investment into the national economy;
- *Expert function* implies election and expertise of investment projects, development of methods and criteria of their appraisal in terms of their investment potential, and in some cases, election of banks to co-finance the project;
- *Stimulating function* that is realized through development and implementation of a range of measures targeted at realization of effective schemes of syndicate lending, where the bank acts as a major lender;
- *Payment function* that characterizes arrangement of financial resources, establishment of correspondent relations, as well as payment and cash services and international settlements;
- *Supervising function* that implies ensuring effective application of funds involved, as well as control of their intended use, issue of guarantee letters, and control of projects payback and timely fulfillment of assumed obligations by borrowers.

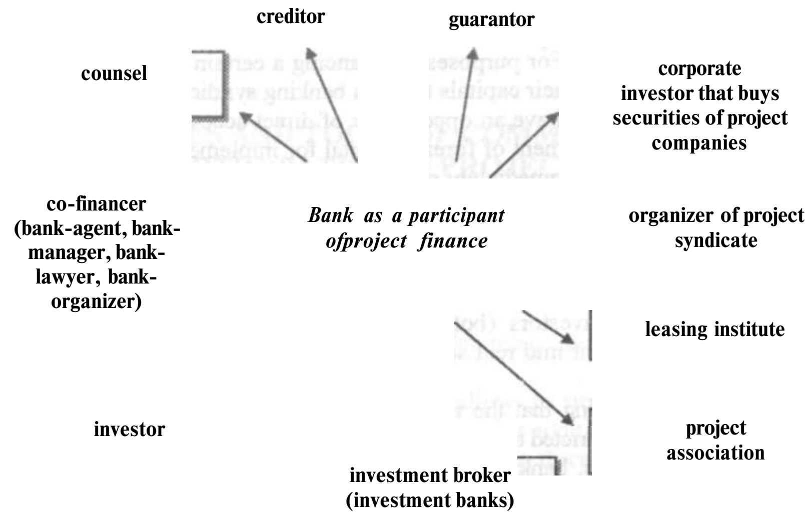

Fig. 1. Role of Commercial Banks in Credit Support of Investment Projects [2]

Thus, the peculiarity of banks participation in project financing lies not only in their investment of money into the project but also immediate participation in the investment project through acquisition of the borrower's stock of shares or through introduction of its representative to the board of directors who performs direct control over intended use of funds, which, in its turn, is another guarantee of credit reimbursement [3].

Bank participation through its representative in management of project implementation gives a possibility to determine much more indirect factors that contribute to more realistic estimation of project implementation. Moreover, on-going monitoring and administrative control allows for tracking the company's financiáis flows that significantly reduces a chance of unintended use of funds. The process of implementation of domestic schemes for project financing also applies, beside a contractual agreement, implicit long-term agreements, which is stipulated with high risks of counteragents. Use of such agreements is an additional factor motivating a borrower to fulfill its obligations.

Bank as a participant of project finance has a unique opportunity to revise some terms of credit agreement while project implementation. Terms of a concluded agreement in common bank practice are mandatory and are not subject to further revision. However, considering that project finance bears long-term character and, accordingly, extremely high uncertainty of economic environment, the bank may revise some terms of cooperation

within the framework of project finance, but only subject to weighty arguments and sufficient amount of confirming analytical information.

In the majority of project finance schemes banks cover large part of expenses incurred due to the project. Amount of funds lent for project financing can be calculated with the consideration of repayment of expenses for construction and floating capital, if financing of company is envisaged. In case a project initiator before its referral to the relevant body has already spent some money for the project, this circumstance is viewed by the bank as positive, as it increases this company's interest in implementation of such project and reduces risks [2].

In case of project finance, standard rate of indebtedness reimbursement, which is calculated as ratio of estimated net earnings from the project to planned repayments usually totals 2 (though in some industrial countries it reduced to 1.3 due to capital surplus). Repayment may apply a method of set interest, when a fixed share of cash is allocated to repay the indebtedness. Norm of set interest often depends on standard rate of indebtedness reimbursement [2].

Obligations (credits, bonded loans), which entitle the bank to be preferred while recovery of company's assets in case of its wind-up, in international practice are called as principal debt [4]. While project financing they represent the principal sum of project financing amounting, in general, to more than half of total resources involved.

Under project financing, banks are to give credits without any security, when all risks related to this financial transaction are distributed among the project participants.

According to the international practice of project finance schemes, senior loans are given by the leader of project syndicate or organizer of this kind of agreement. For this finance operation, banks normally do not require any security and give credits for 'fixed' contracts; however, they are very responsible in bid selection of project participants engaged m construction, products delivery and services supply. In special cases, participation of governmental authorities in the project in a form of concession agreement or cheap loans is a kind of guarantee against project risks for investors. If project syndicate is organized by any international financial institution joining the World Bank group, then loan does not exceed 30-35% of project investment [3].

Another argument for banks to give unsecured loans under project financing is the fact that, beside the security, there are other methods to even risks. An example of possible method to reduce risks is agreement concluded between independent creditors that distribute credit risks among them. However, it is worth stressing that such scheme of risk distribution is mainly specific to syndicated interbank loans.

At the first stage of project financing, bank is often forced to provide the so called standby investment credits, which are given if needed, in case the actual costs exceed the estimated. If such projects are implemented in the emerging countries, such credits are usually given by local commercial banks instead of permits of governmental authorities not to secure the credit risks.

Furthermore, subordination-based finance is also quite often applied within the framework of project financing. Subordinated debt is an obligation of company with lower status if compared to its other debt obligations [4]. This debt is formed with obligations under the involved capital (credits and loans) to cover the necessary costs in the part that remained after principal financing [6].

Project finance as a system of bank financing of investment projects assumes active participation of bank capital in the production process, supervision of production and marketing, setting volumes, prices and forms of goods marketing based on market needs and optimal rates of economy growth.

Bank project finance reflects interaction between bank and industrial capital, advantages of which are used in priority spheres of economy development, allows for:

- provision of the investment process with the required resources, avoiding, however, additional costs related to pay the interests that increase expenses for project implementation;
- creation of conditions for effective implementation of project, formation of market outlet, setting volumes of sales and analyzing pricing factors based on market needs and affordability;
- active use of bank-provided funds in middle-term and long-term deposits with the consideration of bank interest in final results of project implementation;
- creation of conditions to form income receivable, possibility of re-investment, strengthening of own capital of the company initiating the project finance;
- formation of income gained from joint activity targeted at project implementation, which contribute to better working capital turnover, creation of new value, saturation of market with goods and solution of social problems.

References

Project Financing in Project Management: methodological guidance / Rybak A.I., Burdiugov A.F., Butyrska T.A., Vaniushkin A.S. Ukrainian Academy of State Administration under the President of Ukraine at Odesa Institute. - 2002.

Vasylieva T.A. Bank investment in the market of innovations: monography. / T.A. Vasylieva. - Sumy: publishing house of Sumy State University, 2007.-513 p.

Boichenko Yu. Project Financing / Yu. Boichenko // Investment in Russia. - 1998. -No.3. - P. 38-43.

Shenaev V.N. Project Financing. Foreign Expertise and Possibilities to Use It in Russia / V.N. Shenaev, B.S. Imiazov. - Moscow: Konsaltbankir JSC, 1996. - 105 p.

Katasonov V.Yu. Project Financing: Global Experience and Perspectives for Russia / V.Yu. Katasonov, D.S. Morozov, M.V. Petrov. - Moscow: ANK1L, 2001. - 312 p.

Nevitt Peter K. Project Financing. Fifth edition. Published by Euromoney, London. - 1995. - 405 pp.