

THE IMPACT OF SOFT LOANS ON THE ACTIVITIES OF BUSINESS ENTITIES

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Abstract

The article examines the essence of soft loans, their types, criteria for getting soft loans, the importance of soft loans on business entities in implementing projects. Also, regulatory legal documents on the allocation of preferential loans in our country, loans allocated to young people and women within the framework of preferential programs in recent years have been covered.

Keywords: Commercial banks, soft loans, preferential lending, central bank, business entities, credit.

Introduction

A soft loan is a type of loan that is provided by a lender to a borrower on terms that are more favorable than market terms (for example, for a longer period or at a lower interest rate). In some cases, a soft loan can also be provided without interest. Soft loans can usually be repaid in periodic (same or increasing) or annuity payments, including capital (principal) debt and accrued interest. Some soft loans are offered not only because of their low interest rate, but also because of the presence of a grace period during which the borrower is allowed to not pay the principal amount. In some cases, during this grace period, borrowers are charged only interest on the loan, not the principal amount. A concessional loan is a type of loan that is interest-free or below market interest rates, also known as “soft financing” or “concessional financing.” Concessional loans have lenient terms, such as extended grace periods and interest holidays, where only interest or service charges are payable. They are usually granted for longer terms than traditional bank loans (in some cases up to 50 years). Concessional loans are often provided to developing countries at market rates by transnational development banks (such as the Asian Development Fund), branches of the World Bank, or federal governments (or state agencies).

The Decree of the President of the Republic of Uzbekistan No. PF-5992 dated May 12, 2020 “On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020-2025” recognizes the creation of equal competitive conditions in the financial market, lending only based on market requirements, reducing banks' dependence on state resources, improving the quality of credit portfolio and risk management, pursuing moderate growth in lending volumes, and implementing technological solutions for assessing financial risks as priority areas for reforming the country's banking system. This creates the need to improve the financing of production by business entities in our country through the soft credit mechanism.



In turn, a prerequisite for improving the soft credit mechanism allocated to business entities is the establishment of strong ties between participants [1].

The modern concept of government support for the activities of business entities in our country is based on the need to further increase the volume and quality of manufactured products, to ensure competitiveness with products manufactured in foreign countries. One of the main factors negatively affecting the development of business entities is the lack of financial resources for the purchase of raw materials, resources, equipment and technologies necessary for the organization of production. Reforming the activities of business entities has become an objective need for the country's economic development. At the current stage of our country's economic development, the main attention is paid to issues such as ensuring gender equality and increasing women's employment. Support for the activities of business entities by commercial banks on the basis of soft loans plays an important role in establishing their activities and producing competitive products.

Literature Review

The comprehensive integration of business entities into the economic system is a prerequisite for the transition to market relations, the basis for the effective restructuring of production, a way to solve employment problems and raise the standard of living of the population [2].

There is no doubt that without the development of the activities of business entities, it is impossible to form a middle class, which is a reliable foundation of a democratic society. It is advisable to develop measures of state financial support to mitigate the consequences of geopolitical tensions that have arisen in recent years and restore supply chains.

There are a number of requirements for signing a contract on soft loans, which are reflected in the scientific works of economists. For example, according to O. Lavrushin, the terms of the contract on soft loans do not fully protect the commercial bank from credit risk and stimulate the activities of loan recipients [3].

Y.A. According to Shkarupa, the credit mechanism is a set of actions of interrelated elements, a form of manifestation of the movement of loan capital [4].

A.Y. Rodnina views the credit mechanism from the point of view of the structural-functional approach and the interpretation of the circular circulation of credit and defines it as follows: the credit mechanism is the mutually agreed interests of the participants in credit relations, which are manifested in the form of a system of interactions and relationships that reflect both the goals of the movement of loan capital and the incentives and transformation of credit [5].

According to I. R. Toymuhamedov microloans may have preferential interest rates if they are issued from a bank's special preferential fund [6].

The results of scientific research conducted by I. Alimardonov showed that: the highly liquid collateral required by the republican banks is not available to the majority of small business entities; the interest rates of loans provided to small business entities by commercial banks of our republic at the expense of credit lines of foreign banks are high; the methodological foundations of lending to small business entities by banks and non-bank credit organizations have not been improved. In particular, the principles on which the methodological foundations of lending by banks are based, and their differences from the principles of lending to small



businesses by non-bank credit organizations, are not reflected in current legislative documents [7].

Research Methodology

This article uses such research methods as induction and deduction, systematic and comparative analysis, economic and statistical methods to implement scientific findings and proposals to support the activities of business entities using soft loans in our country.

Analysis and Results

Soft loans allow financing the activities of business entities at a preferential rate. The rate of these loans is tied to the key rate of the Central Bank, and this type of loan can lead to an increase in the volume of problem loans for banks. The greater the difference between the soft and market rates, the greater the tendency of business entities to use this type of loan. State support helps business entities solve such problems as opening and expanding production, modernizing facilities and introducing new technologies, increasing profits and increasing profitability. At the same time, soft loans are allocated from the state budget to achieve a specific goal. Such stimulation of the activities of business entities helps to create new jobs, increase tax revenues, increase competitiveness, introduce innovations, develop infrastructure and ultimately contribute to the overall economic growth of the country.

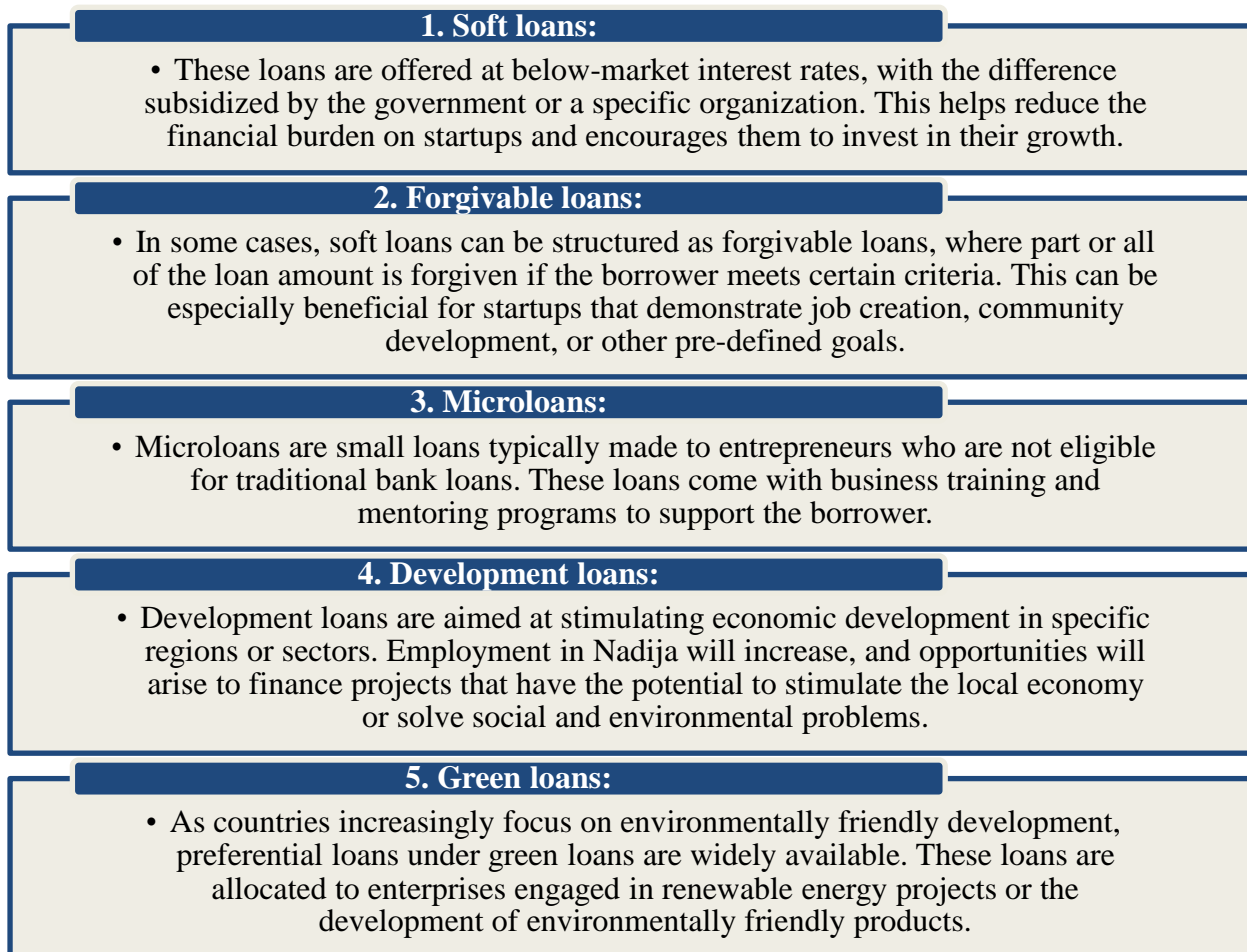
The issue of government support for business entities is particularly relevant during the crisis. During the COVID pandemic, in the practice of some countries, industrial enterprises were allocated loans at an annual interest rate of 2%. The activities of business entities are also stimulated through other methods (in particular, grants for young entrepreneurs, subsidies for employment of the unemployed and youth, credit holidays, moratoriums on inspections of business activities). Soft loans are an important element of the credit market. They provide effective results in the short term as an anti-crisis measure and allow to assist affected sectors. However, the regulator does not consider incentives as an effective mechanism for long-term support of the national economy.

From a startup perspective, concessional loans have several advantages. In particular, they are provided at lower interest rates than traditional bank loans and are more accessible to businesses with limited financial resources. Concessional loans also have longer terms, allowing startups to manage their cash flow more effectively in the early stages of their operations. Types of soft loans are given in picture 1.

Soft loans create uncertainty in the financial market and hinder healthy competition between companies. Soft loans are a cheap financing resource. The Central Bank can implement them to combat inflation when rates are the same for all participants. That is, in fact, the benefits of participants in the state program are paid by all other borrowers.

The gap between the rates on preferential loans and the Central Bank rate is growing due to the increase. In addition, due to the increase in the volume of soft loans, state costs for subsidizing them are also increasing, which creates additional problems in the context of a budget deficit. Soft loans create an anti-inflationary effect and imbalances in the economy.





Picture 1. Types of soft loans

The majority of soft loans are allocated to the mortgage market. The cancellation or sharp reduction of preferential lending to business entities can cause many problems for entire industries, which will lead to serious consequences. In this case, the costs of debt servicing of companies will increase and reduce the volume of their investments in development. The overall increase in costs will lead to an increase in the cost of goods and services for the final consumer, as a result of which the inflation rate will accelerate even further. The decrease in investment has a negative impact on the volume of production and the production of import-substituting goods throughout the country. In such conditions, it becomes necessary to develop the activities of business entities through soft loans. But on the other hand, preferential loans increase the demand for financial resources of other companies and the volume of production decreases. In this case, preferential loans do not serve as an engine for the development of the activities of business entities.

Soft loans create distortions in the financial market, that is, sectors that need to be developed by the government are financed, and resources are not directed to other areas where investments are needed. The competitiveness of business entities receiving soft loans increases. Soft loans can lead to the emergence of financial bubbles, as in the case of preferential mortgages, which led to an uncontrolled increase in the price of new housing.

Each country has its own criteria for obtaining preferential loans, which may include:

1. Creditworthiness and financial stability:

Commercial banks usually assess the creditworthiness of borrowers before granting a loan. A stable credit history and a history of paying off obligations within the specified period increase the chances of obtaining a preferential loan. However, startups often do not have a positive credit history. In such cases, commercial banks may focus on the company's business plan and projected cash flows.

2. Purpose and impact:

Concessional loans are often allocated for specific purposes, such as infrastructure development, education, or healthcare. Commercial banks assess the potential impact of the project on society or the economy and make a decision on granting a loan. Startups also have a strong focus on purpose, and if the company aligns with social or environmental goals (e.g., renewable energy, healthcare innovation), the chances of getting soft loans are higher. The company should highlight the positive impact of the startup on this area.

3. Sector and industry focus:

Some soft loans are targeted at specific sectors, such as agriculture, education, or housing. Commercial banks prioritize projects that contribute to national development.

4. Geographic considerations:

Soft loans are often provided by international financial institutions to underdeveloped regions or countries. They are aimed at addressing economic disparities. If the company's startup is being implemented in economically disadvantaged areas, it may attract regional soft loans.

5. Collateral and guarantees:

Soft loans, like conventional loans, require collateral or guarantees. However, the terms are much more lenient than commercial loans. Startups may not have large assets to provide collateral. In such cases, commercial banks may accept alternative forms of collateral.

6. Compliance with legal and regulatory documents:

The possibility of obtaining soft loans within the framework of legal and regulatory requirements has a positive impact on the company. Commercial banks ensure that borrowers comply with the instructions. Compliance of a startup with all relevant laws increases the chances of attracting soft loans.

The National Bank for Foreign Economic Activity of the Republic of Uzbekistan has formed a Special Fund for Preferential Lending (hereinafter referred to as the SPL) to issue preferential loans to manufacturing microfirms, small and medium-sized entrepreneurs, farm enterprises, and other small and private businesses. The Fund's resources are formed by deductions of up to 25 percent of the bank's profit.

The interest rate for using loans from the Fund is set at no more than 50 percent of the established refinancing rate of the Central Bank of the Republic of Uzbekistan on the day the loan is issued. The Fund's resources are primarily allocated to finance high-tech and innovative



projects in the field of small business and private entrepreneurship, manufacturing microfirms, small enterprises, farm enterprises located in remote and hard-to-reach areas, as well as in areas and cities with excess labor resources. Loans from the Fund are provided in an amount not exceeding 2,000 times the minimum wage and currently this amount 750 mln. soums. The terms of providing loans from the Fund depend on the payback period of the financed event, in particular:

loans for replenishment of working capital of small and private business entities, necessary for the purchase of raw materials and supplies, semi-finished products and other production stocks, are issued for a period of up to 1 year;

loans for replenishment of working capital for the organization of agricultural production of farms, as well as dehkan farms with the formation of a legal entity are issued for a period of at least 2 years;

loans for financing investment projects to all small and private business entities, including farms and dehkan farms with the formation of a legal entity, can be issued for a period of up to 5 years without the right of deferment.

Loans from the FLC are provided to borrowers for the organization, development and expansion of entrepreneurial activities related to the production of goods (except for tobacco growing and the production of alcoholic beverages), the performance of work, the provision of services (except for trade and public catering), not prohibited by current legislation, providing for:

construction, technical re-equipment and reconstruction of industrial buildings;

purchase of machinery, equipment, tooling, inventory, seeds, livestock and poultry;

purchase of raw materials and materials, including fodder, compound feed, veterinary drugs, chemical plant protection products, mineral fertilizers, fuels and lubricants and mechanized services for the processing of crop areas.

Loans from the Fund cannot be issued to repay previously received loans or any other debts, or to purchase personal property not used for production purposes. Microloans at the expense of FLC are provided on the same terms as those provided for microcrediting of individual entrepreneurs and dehkan farms operating without forming a legal entity, as well as farms, other small business entities operating with the formation of a legal entity, in national currency. To receive loans, it is necessary to provide the following documents to the bank (credit package):

credit application;

business plan with mandatory indication of the forecast of cash receipts to the borrower's bank account (cash flow);

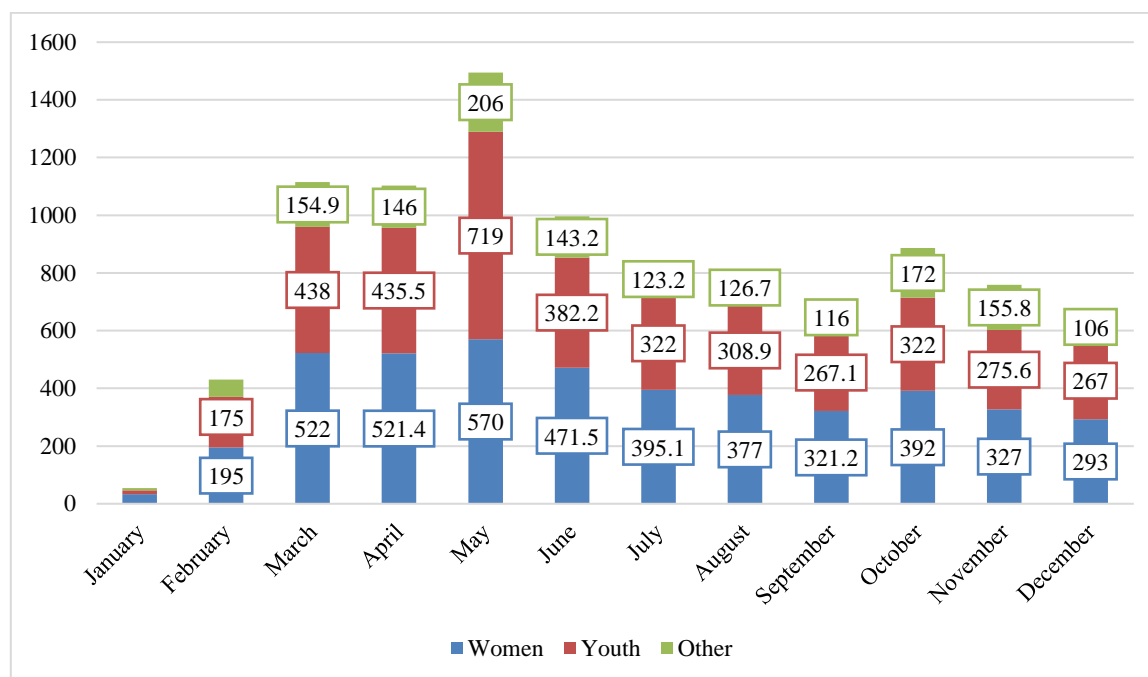
balance sheet (form No. 1) for the last reporting period, certified by the local (district) body of the state tax service, and a certificate of accounts receivable and accounts payable (form No. 2a), as well as reconciliation statements for debt over 90 days, a report on financial results (form No. 2) - with the exception of dehkan farms;

one of the forms of security for loan repayment

Currently in the practice of national commercial banks if entrepreneur the age category from 18 to 30 years old and taking first-time credit the NBU of the Republic of Uzbekistan can provide a 14% annual soft loan in accordance with Presidential Decree No. 6260 dated July 13,



2021, to finance innovative, start-up and business projects developed on the basis of innovative ideas of young people. The loan term is 7 years, grace period is up to 3 years. The loan amount is equivalent to USD 100 thousand.



The dynamics of credit allocation within the family business development programs in 2023 (bln. soums) [8]

In particular, although the balance of soft loans increased by 5% during 2023 (6 trillion soums), reaching 145 trillion soums at the end of the year, their share in the total loans allocated decreased from 36% at the beginning of last year to 31% at the beginning of this year.

Within the framework of family entrepreneurship development programs, in order to widely involve the population in entrepreneurial activities and form additional sources of income, as well as provide financial support to small business entities, a total of more than 44 trillion soums of soft loans have been allocated over the past 6 years, creating the basis for about 1.9 million people to engage in income-generating activities.

In 2023, the implementation of the Programs continued, with the main focus on engaging youth and women in gainful employment, and based on the recommendations of the assistants of the governors, a total of more than 9.9 trillion soums of soft loans were allocated to more than 472 thousand projects.

At the expense of these preferential loans, 3.8 trillion soums were allocated to more than 174 thousand projects to support youth entrepreneurial initiatives and 4.6 trillion soums to more than 262 thousand projects of women.

Of the loans allocated under the programs, 369 billion soums (4 percent) went to legal entities and individual entrepreneurs, and 9.5 trillion soums (96 percent) to self-employed individuals.

Conclusion and Suggestions

Soft loans give business organizations the opportunity to finance their operations at a discounted rate. The rate of these loans is linked to the Central Bank's main rate, and they have the potential to push banks to issue more problem loans. The more the soft and market rates diverge, the more likely it is that commercial organizations will take out this kind of loan. Support from the state enables businesses to address issues including starting and growing their operations, updating their buildings, using new technology, and boosting profitability. Soft loans are simultaneously taken out of the state budget in order to accomplish a particular objective. Increased tax revenues, increased competitiveness, the introduction of technologies, the development of infrastructure, and the creation of new employment are all benefits of this kind of business entity stimulation.

Within the framework of the programs, all processes are fully digitized using an electronic signature:

- applying for a loan, analyzing the borrower's scoring, making recommendations by assistants of the governor, formalizing loan documents, ordering products, monitoring and identifying the applicant on the oilakredit.uz platform;
- formalizing documents for purchasing products and equipment and ordering services is carried out through the "marketplace" electronic trading platform (smart-market.uz), which is based on a free competition and competitive environment.

During a crisis, the question of government assistance for commercial companies is especially pertinent. In certain nations, industrial businesses were given loans at a 2% annual interest rate during the COVID epidemic. Other strategies are also used to encourage business activity (e.g., scholarships for young entrepreneurs, youth and unemployment employment subsidies, credit vacations, and a moratorium on company activity inspections). One significant component of the credit sector is soft loans.

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