

**THE MAJOR REASONS FOR EMERGENCE OF BAD DEBTS IN  
BANKS OF UKRAINE AT THE PRESENT STAGE OF ECONOMIC  
DEVELOPMENT**

**Abstract.** The given paper analyzes the main reasons for emergence of bad\problem debts in banks of Ukraine at the present stage of economic development. It was determined the principal causes of problem debts emergence in banks of Ukraine that lie within three factors: macroeconomic causes; the causes, depending on the banking institutions; the causes, depending on the borrower. It was proved that the subjective reasons can and have to be influenced in order to improve the efficiency of the banking business, to minimize credit risk and to prevent occurrence of problem loans.

**Keywords:** bank lending activities, loan portfolio, criminal and non-criminal fraud, objective and subjective reasons, bad\problem debts.

**I. Introduction.** A difficult way to move the country out of the economic crisis involves many processes and actions. The reality of the banking business in Ukraine forces managers to make difficult management decisions in order to stay afloat. Without understanding the causes of the crisis in the banking sector, moving forward is long and difficult. The recovery of loan debt, not repaid by the borrower on time, is traditionally a pressing issue for most banking institutions. This is a complex process caused by a wide variety of factors, which are both objective and subjective.

A thorough analysis of the reasons of bad\problem debts is necessary. The analysis is important to avoid failed steps in the future, and to be able to respond

appropriately to the consequences of the committed errors and mistakes that led to the extremely high volume of bad debts in domestic banks.

In the period of crisis, this problem is particularly urgent for the country's economy. Therefore, the increased interest on the part of leading scientists is reasonable. By studying the reasons of bad debts in banks, an amount of domestic scientists and researchers (Baranovsky O. I., Vasyurenko O. V., Vladychyn U. V., Dyadechko L. M., Ivasiv B. S., Kovalenko V. V., Matviyenko V. P., Moroz A. M., Polyak N. P., Savluk M. T., Stoyko O. Y) were engaged in this problem of study.

**II. Statement of the problem.** The problems with credit repayment do not arise suddenly. A number of reasons at macro level and at the level of individual entities precede them. At the same time, having an impact in some way on macroeconomic processes is a complex task. Therefore, managing link in the banking business has to adapt to the conditions that dictates nowadays.

At the level of bank institutions, the main reason for the growth of bad debts was the lack of an effective and well-functioning risk management system of banks. In other words, this system could meet the challenges of the global financial crisis. Therefore, the aim of this research is to analyze the reasons of emergence and growth rate of overdue debts, searching the ways to improve the risk management system, which occupies a key position towards the reduction of troubled banks portfolios.

**III. Results.** After Ukraine gained the status of an independent state and the emergence of such entities as commercial private banks, a new service of crediting appeared. It is clear that for the average citizen, as well as for legal entities lending has opened a lot of opportunities to get any benefit from the purchase of household appliances, cars, apartments (for individuals) to the opportunity to develop its business (for the legal entity). Moreover, the entire world uses credits.

But nobody paid attention to the lack of experience of credit activity in the domestic banks, to the difference in the level of interest rates, when rates on credits in national banks are ten times higher than in foreign banking institutions.

Opaque (to the borrower) diagram of the formation of the loan rates, the availability of large expenditures, associated with the loan (one-off fee, notaries'

payment, insurance, and so on) and high interest rates did not reduce the desire of borrowers to try an interesting novelty – credits.

Financial illiteracy of some borrowers became the first reason in the process of bad\problem debts. Because no one can resist the well-known truth – a banker is someone, who lends you an umbrella when the sun is shining and who asks for it back when it starts to rain.

Moreover, the first steps in the loan process (concerning bad\problem debts) were made not only by borrowers, but also by most banks. The aggressive policy of banking institutions regarding capture the maximum share of the credit market has provoked a situation when the rate of consumption of credit resources has significantly exceeded the growth rate of income of the borrowers, which resulted in a reduction requirement regarding the financial condition of the borrower [1]. For example, consumer loans were granted even without proof of borrower's income.

Thus crediting, as one of the main functions of bank institution, defined problems in almost all phases of the loan process: from the preparation stage and the stage of granting credit to the stage of monitoring and control of credit resources.

In our study, we formulated and examined the reasons of bad\problem debt at every stage of the loan process.

The initial stages of the credit process, namely the preparation of grant and loan are extremely important, because it is the basis for the strong financial results of the credit activity of the banking institutions and the opportunity to avoid problems with loan defaults. Nevertheless, as practice shows, the domestic banking institutions need to move to improve almost all procedures and processes accompanying the issuance of credit resources. Banking products, system analysis of the financial condition of the borrower, the analysis of the adequacy and accurate assessment of the collateral for the loan require refining.

The lack of a thoroughly developed regulations and banking products, including standardized conditions, process maps, forms of documents and forms of management reporting as well as the lack of a clear allocation of responsibilities and

control of procedures creates the ability to make situational decisions by the credit workers, and leads to:

- increasing the level of operational risks;
- increasing the time required for operations;
- increasing the likelihood of errors;
- occurrence of fraud and abuse.

Thus, there is a potential problem of loans at the initial stage of the credit process [2].

The insufficient control of the credit portfolio concentration causes an increase in credit risk. Moreover, the abovementioned insufficient control leads to losses and significantly reduces the quality of the loan portfolios of the banking institutions at the period of financial decline.

The immaturity of the system of financial condition analysis of the borrower and his creditworthiness results in a lack of understanding of the following information that is required by a bank to give a loan: a condition of the borrower's business; risks inherent in the industry in which the borrower operates and the development prospects of the business.

The imperfect scoring models, the ratings of the borrowers, risk maps and other methods identifying and evaluating the creditworthiness of the borrower sometimes do not give the opportunity to define the objective financial condition of the borrower and its changes over time.

However, it should be noted that the difficulty in determining the actual financial condition of the borrower is not always associated with imperfect schemes approved by the banks. The situation is complicated by the fact that the data provided by the borrower itself may carry part, and sometimes purely formal information. This is due primarily to the fact that the borrower is trying to optimize the tax base. Therefore, accounts payable that does not actually exist, may be indicated in the balance sheet, the overstocks can be too high. That is, the financial statements of the borrower can be radically different from the status quo. Thus, it is extremely difficult

for the bank worker to determine the actual financial condition of the borrower, if the latter will not provide adequate explanation.

There are also facts of criminal fraud, when the borrower is not going to repay the loan and intentionally provides such information, which does not correspond to the real state of things.

Non-criminal fraud, unfortunately, also takes place in the conduct of banking business. For example, trying to get a loan, the borrower provides financial statements that do not reflect the real situation in the business, with the hope that the situation will improve and the loan will be repaid. However, as practice shows, hopes for the best, as a rule, are not justified, and a bank gets problem credit that would incur losses.

The moral and ethical qualities of the bank employees also play an important role in the minimization of credit risks and, as a consequence, in the event of bad loans. There are some cases when bank employees are interested in decision to issue the loan. In addition, there are regular cases of incompetence or negligence of bank employees that lead to errors in the process of lending operations. The inability to collect, organize and analyze information may lead to carelessness in making important decisions regarding the financial condition of the borrower. All these reasons lead to a possible deterioration in the loan portfolio of the bank [3].

Another reason of such a high level of bad\problem debts in Ukrainian banks is, in our opinion, the low level of organizational work with mortgaged property. The quality of the mortgaged property has not paid enough attention due to the intense competition among banks. The lack of internal regulations in work with mortgage property and accreditation of experts of mortgage property resulted in unreliable evaluation of secured assets, which increased the risk of loan default.

Not rare were cases when the same subject of pledge was laid several times. As pledge granted property rights to deferred income, liabilities for collateral in the future [4].

The second stage of the credit process, that is, the control and monitoring of the implementation of borrower's obligations, is accompanied by the element of risk, as

lack of control over quality of the loan portfolio, which may result in delayed response to the occurrence of arrears.

Usually banks do not pay sufficient attention to the establishment of the automated system of information storage in loan servicing. In our opinion, such electronic information storage system for supporting loans is indispensable assistant in analyzing the quality of the loan portfolio and making effective management decisions.

When analyzing the quality of the loan portfolio it is necessary to establish the relationship between the price of credit resources and the level of credit operations risk. For example, it is possible that some banking products include the share of problem debts. Established and automated management system, monitoring and analyzing of credit commitments will allow us to:

- analyze the efficiency (profitability) of the credit activity in the context of individual banking products, industries, taking into account the interest rate;
- keep records of problem loans in the context of individual banking products industries;
- determine the real level of profitability of individual banking products, taking into account the adjustment for the percentage of overdue loans;
- define the breakeven point of sales for each banking product, taking into account the level of interest rates and level of overdue debts;
- take prompt management decisions [5].

Therefore, effective organization of control stage and monitoring over the execution of the borrower's obligation to repay the loan, analysis of the current state of the credit portfolio quality with the use of electronic storage and systematization of information on credit agreements will minimize credit risks and prevent occurrence of problem loans in future.

The next group of reasons of bad\problem debts at the present stage of economic development is the attitude of the borrowers concerning the necessity to repay their obligations. Unfortunately, the mentality of the domestic borrowers, the

difficult economic situation in the country leads to high level of criminal and non-criminal fraud.

#### **IV. Conclusions.**

Therefore, understanding the causes of problem debts in the banks of Ukraine on the modern stage of economic development is extremely important and helps to avoid unsuccessful steps in future, and allows us to respond adequately to the consequences of mistakes and miscalculations. The problems with loans repayment do not arise suddenly. A number of reasons as on macro level and at the level of individual entities precede them.

The study made it possible to draw the following conclusions: reasons of bad debts can be divided into two groups: objective and subjective. The objective reasons are the reasons that occur *at the macroeconomic level*: the impact of the global financial and economic crisis, devaluation of the national currency, the level of political stability in the country, the imperfection of the legislative base. The subjective reasons are the reasons that occur *at the level of banking institution*:

- lack of experience (at the stage of granting, controlling and monitoring a credit, lack of control over the quality of the loan portfolio, lack of standardization of banking products and procedures, lack of concentration control, the immaturity of the system analysis of the financial condition of the borrower, moral and ethical qualities and incompetence of the bank's employees, low level organizational work with mortgaged property);

- the desire for a quick profit (oversaturation of credit resources, lending to speculative operations);

#### *at the level of the borrower:*

- criminal and non-criminal fraud.

Thus, the main causes of bad\problem debts in the banks of Ukraine lie within three factors: macroeconomic causes; causes that depend on banking institutions; the causes, which depend on the borrower.

All these groups of causes affect the level of problem debts. However, we must adjust to the objective group of macroeconomic causes and take it for granted.

The subjective group depends on the activities of banks and borrowers. They have to be influenced in order to improve the efficiency of the banking business, minimize credit risk and prevent the occurrence of problem loans.

## References

1. Каменецкий С. Кредитование малого и среднего бизнеса: причины возникновения проблемной задолженности и их профилактика. Практический опыт. [Электронный ресурс] – Режим доступа: <http://www.trainings.ua/article/2598.html>
2. Тенденции и перспективы развития рынка проблемных активов банков Украины. – [Электронный ресурс] – Режим доступа: [http://www.credit-rating.ua/img/st\\_img/Press-release/2011/09.06.2011/Final\\_Report\\_RU3005.pdf](http://www.credit-rating.ua/img/st_img/Press-release/2011/09.06.2011/Final_Report_RU3005.pdf)
3. Обзор украинского рынка проблемных активов в контексте развития профессиональных участников. [Электронный ресурс] – Режим доступа: <http://inventure.com.ua/analytics/investments/obzor-ukrainskogo-rynka-problemnyh-aktivov-v-kontekste-razvitiya-professionalnyh-uchastnikov>
4. Дяченко Л.М. Управління проблемними кредитами в банках України в умовах економічної кризи. / Дяченко Л.М. // Фінанси. Банківська справа. Науковий вісник ЧДІЕУ – 2011. - №3 (11)
5. Вовк В. Я. Кредитування і контроль : навч. посібн. / В. Я. Вовк, О. В. Хмеленко. – К.: Знання, 2008. – 463 с.