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PREGLEDNI NAUČNI RAD / OVERVIEW SCIENTIFIC PAPER

MAKING UNCERTAIN BUSINESS DECISIONS IN THE BANKING SECTOR

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Abstract: *The time in which we live today imposes new business rules that must be followed in order to survive in the market. Therefore, the essence of today's management in all sectors, including banking, is flexibility. Clients who use the bank's services have the following key products at their disposal: loans, guarantees and deposits. The subject of analysis in this paper will be the approval of loans to business users. Analyzing business users, banks analyze the entire spectrum of different financial indicators. This information, in the form of quantitative and qualitative data, is the basis for assessing the creditworthiness of the client in order to minimize credit risk. Based on the analysis of financial indicators and overall operations of a legal entity, a detailed report on solvency, liquidity, profitability, activities, repayment capacity of a particular client can be obtained. The main goal of the research is to show the analysis process that happens in the background when approving a loan to a business user. The paper will present banking risks as well as the types of financial indicators on the basis of which business decisions are made. On the basis of the case study method, it will be shown how and in what way banks approach the process of approving loans to business persons, which methods they use to protect themselves and to prevent the emergence of banking risk. The results of the research point to the need to use financial indicators during the loan approval process, because in this way banking risk is prevented, and subjective assessment methods cannot meet such a demanding task.*

Keywords: *decisions, finance, bank, credit.*

JEL classification*: G20, G21.*

INTRODUCTION

Making a decision on issuing a loan to a business user is not an easy process for the bank. The bank, in the process of issuing loans, must use instruments that are available from the field of financial management. These are instruments in the form of financial indicators, such as financial indicators of liquidity, solvency, indebted-

ness, profitability, etc. These indicators are calculated based on the analysis of financial statements, namely based on the vertical and horizontal analysis of the balance sheet and income statement. By comparing the positions found in these reports, you can get relevant information about how a company operates, what its obligations are, etc. The optimal approach involves observing the situation in the company in several previous years, i.e. analysis of the balance sheet and income from several different years, in order to obtain adequate information about the movement of certain coefficients over the years. Such comprehensive analyzes enable the reduction of banking risk, that is, indicate that a certain company may have problems with repaying loans, and be an alarm for the bank not to place its funds in those organizations that are risky for them. On the basis of the above, it can be concluded that it is very important that scientific methods are applied in this context, and that they can provide answers to questions that, by subjective assessment, cannot be answered. In the continuation of the work, through the literature review and the case study method, this will be discussed more.

LITERATURE REVIEW

In the past, how and in what way banks grant loans to business users was discussed. Financial institutions are key to allocating capital to its most productive purposes. Of the many functions of commercial banks, lending has the most direct impact on real economic growth. The banking system acts as an intermediary that directs financial resources from savers to entrepreneurs who organize production processes that contribute to the real result (International Capital Market Association, 2024). But the role of banks is not limited to the production side. Retailers, for example, have less need for bank credit to finance the distribution of final goods. Similarly, consumers need the bank's help in procuring durable goods for repayment. In credit calculations, banks are involved in every stage of the circular flow of goods and services, from their initial production through distribution to final consumption (Akpansung & Babalola, 2012). Research on bank loan growth has attracted the attention of academics and policy makers, especially after the global financial crisis, due to the effects of the credit boom cycle on the economy. Despite credit expansion exposing systemic risks to banks, making them vulnerable to financial crises, bank credit growth remains the main driver of domestic investment, output and consumption, thereby strengthening macroeconomic stability, especially in bank-based developing economies. In addition, the growth of domestic credit reduces the incentive for the private sector to borrow from external sources, which negatively affects the exchange rate and the inflation rate, creating pressure for macroeconomic instability. Therefore, policy makers usually adopt policies to stimulate domestic credit growth, such as public bailouts, deposit insurance or general guarantees, capital injections and nationalization of troubled banks (Albaity, Mallek, Hanifa, & Al –Tamimi, 2022).

When considering this topic, it is necessary to start from the fact that banks have two basic products, namely: credits and deposits (Gospodnetić, 2017). The word credit comes from the Latin word "credo" which means "to believe". From this we find the theory of credit, which essentially represents a debtor-creditor relationship between two subjects - the lender and the recipient of the loan - based on trust. It follows that the basis of the loan is trust, which must exist between the lender and the recipient of the loan. The amount of the approved loan is called the principal. Since the principal is

given in the present moment and is returned in the future, the recipient of the loan pays the lender a certain compensation. This compensation is called interest (Zolak Poljašević & Berber, 2024). It is customary for the interest to be expressed as a percentage of the approved principal. This percentage is called the interest rate (Kodžoman, 2016). A large part of commercial loans consists of four different types of loans: asset-based loans, cash loans, trade finance agreements and leasing. All these loans are senior and secured; however, they differ in the type of collateral that backs them (or, to be precise, the net return on the sale of the collateral) (Ivashina, Laeven, & Moral-Benito, 2020). Bank loans are the most common source of external financing for many SMEs and entrepreneurs who often rely heavily on direct debt to meet their start-up, cash flow and investment needs. However, large companies, corporations, joint - stock companies also use banking lending services (Belanova, 2021).

Deposits represent the bank's liabilities, sources of funds, where the bank has an obligation to their owners, i.e. depositors. The bank must adjust the structure of its placements to the maturity of the financing sources (Radović & Zorić, 2015). Deposits are deposited (invested) funds with a bank or other person to secure or consolidate certain business activities and savings (Pirović, 2016).

How do banks decide which companies to lend to and how does that decision depend on their situation and the characteristics of their borrowers? Healthy, well-capitalized banks may feel more comfortable financing risky deals, due to their ability to absorb potential losses, compared to less healthy banks. The latter may be more sensitive to risk, taking into account their more limited capacity to absorb losses. Divergently, weaker banks may be more inclined to adopt more lenient credit standards, with the aim of increasing their revenues (Faccia, Hünnekes, & Köhler-Ulbrich, 2019).

The bank, as a lender, has a certain risk. Therefore, banking operations include certain banking risks that need to be borne, and this is one of the characteristics of modern operations. The bank, using scientific methods of financial management, tries to have a preventative effect on the occurrence of risks; that is, it wants to reduce them to a minimum.

Credit risk can be defined most simply as the possibility that the borrower or other contracting party will not fulfill their obligations in accordance with the agreed terms. As the Basel Committee points out, the goal of credit risk management is to maximize the yield of the credit portfolio while maintaining exposure to credit risk within acceptable parameters. Banks must manage the credit risk of the overall portfolio, as well as that which lies in individual loans or transactions (Dragosavac, 2012). Credit risk management is part of comprehensive management, but also part of the control system. Credit risk can be considered one of the biggest risks because it is associated with every active trade. Banks have generally pursued a risk management strategy that incorporates the principles of the risk management process including risk identification, monitoring and measurement. The goal of credit risk management is to maintain business efficiency and business continuity (Spuchlakova, Vlaškova, & Adamko, 2015). Credit risk management in financial institutions has become more important not only for the performance of financial transactions, but also for protection against the crisis that the industry is experiencing (Getahun, Anwen, & Bari, 2015). Credit risk is therefore defined as the possibility that the debtor of the bank or the other contractual party will not fulfill their obligations in accordance with the agreed terms.

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The objective of credit risk management is to maximize the bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks should manage the credit risk inherent in the entire portfolio, as well as the risk in individual loans or transactions. Banks should also consider the relationships between credit risk and other risks. Effective credit risk management is a crucial component of a comprehensive risk management approach and key to the long-term success of any banking organization.

Liquidity risk is the basic risk determined by the market conditions of a security or any other investment property. Liquidity itself is defined as the marketability of investment assets, that is, the ability to sell investment assets at expected prices. The smaller the possible deviations from the expected prices, the higher the liquidity risk and vice versa, the larger the possible deviations from the expected prices, the lower the liquidity (Puljiz, 2016). Liquidity risk generally does not cause a reduction in capital. The causality is exactly the opposite: the reduction of the company's capital (long-term loss) eventually leads to the insolvency of the company (ie, the loss of its liquidity). In the case of insolvent companies, the loss of their liquidity is the primary, immediate reason for the termination of their activity. Only in extreme cases where companies experience a liquidity crisis does the crisis affect their solvency – the company must sell off its assets at a loss or seek any available credit assistance, usually on less than favorable terms; this reduces its solvency, and subsequently its liquidity (Blahova, 2012). Liquidity crises are not a new phenomenon and banks have suffered from them throughout history. There are several types of liquidity, just as there are several indicators of liquidity, which will be discussed further below (Golubeva, Duljic, & Keminen, 2019).

Market risk is the risk that occurs during unfavorable market price movements. The bank can expect this type of risk as a result of undertaking speculative business or foreign exchange operations. Each component of risk includes general market risk and specific risk that arises due to the specific structure of a bank's portfolio (Tica, 2016).

Operational risk is the risk of loss due to inadequate or failed internal processes, people and systems or external events, including legal risk. Operational risk can be viewed in a narrower and broader sense (Matić, 2008).

Strategic risk is the possibility of negative effects on the bank's financial result or capital due to the absence of appropriate policies and strategies, and their inadequate implementation, as well as due to changes in the environment in which the bank operates or the lack of appropriate response of the bank to these changes (Kovačević, 2016).

Strategic risk is the possibility of negative effects on the bank's financial result or capital due to the absence of appropriate policies and strategies, and their inadequate implementation, as well as due to changes in the environment in which the bank operates or the lack of appropriate response of the bank to those changes (Prga, Vrdoljak, & Šverko, 2009).

In order to avoid and minimize all these aforementioned risks, it is necessary to work on it, through the analysis of financial statements with the help of financial indicators. Financial indicators represent a ratio or mathematical relationship between two quantities. Financial ratios are used to compare different figures from financial statements in order to obtain information about the overall performance of a company.

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While calculating a ratio is a simple arithmetic operation, interpreting it is more complex. In this sense, interpretation is what makes financial indicators a useful tool for market participants, not calculation itself. Ratio analysis is defined as the systematic use of ratios to interpret financial statements so that a firm's strengths and weaknesses, as well as its historical performance and current financial position, can be determined. The information needed for ratio analysis is derived from financial statements, and some ratios often link accounts from different financial statements, such as the balance sheet and the income statement. Financial ratios can be interpreted as hints, indicators, or red flags regarding significant relationships between variables used to evaluate a company's performance. Some of the most important questions to answer are whether all resources were used efficiently, whether the profitability of the business met or even exceeded expectations, and whether financing choices were made rationally. Creating shareholder value ultimately requires positive results in all these areas that will lead to favorable cash flow patterns that exceed the company's cost of capital (Kharatyan, Nunes, & Lopez, 2004).

Calculation of financial indicators can lead to favorable behavior of subordinates due to the objectivity and reduced uncertainty of such measures. Financial indicators are considered "lagging" indicators in the sense that they are the result of other earlier actions, mostly quantitative in nature. Kaplan and Norton (Harvard Business Review, 2008). they create balanced scorecards (BSC), where one of the groups of indicators are financial indicators. The BSC method is widely used around the world to assess business performance. Analysis of financial indicators, obtaining additional information and knowledge about the financial status of the organization are used in decision-making, but eliminating deficiencies creates conditions for improving the performance of the organization and its results can be evaluated with financial indicators (Kotane & Kuzmina-Merlino, 2012). Processes that existentially threaten the functioning of individual companies and the economy as a whole relate to the inability to regularly settle obligations (liquidity crisis), the inability to pay debts (solvency crisis), the inability to achieve the necessary level of profit. (crisis of profitability), and the inability to remain competitive on the market (crisis of competitiveness). All these processes are closely related and very important, and liquidity is most often put in the foreground (Jovanović, Todorović, & Grbić, 2017).

The most important financial indicators are indicators of liquidity, solvency, profitability, activity and investment. Liquidity indicators measure the company's ability to meet short-term obligations. The most commonly used liquidity indicators are the current liquidity ratio, the accelerated liquidity ratio, the current liquidity ratio, and the financial stability ratio (Janus, 2010).

Indebtedness indicators can be classified into static indicators and dynamic indebtedness indicators. The balance sheet, as a source of data, imposes a static approach to determining indebtedness, tying it to a certain period of time (Rovčanin, 2004). The approach to financial leverage through the income statement enables a dynamic approach to the consideration of financial leverage. Indebtedness indicators include: indebtedness ratio, self-financing ratio, interest coverage ratio, etc.

Profitability refers to the yield in relation to the total assets employed or to the principal or to the total income (Bolčić, 2016). Types of profitability indicators are: gross profit margin, operating margin, net profit margin, return on total assets and re-

turn on equity ROE. The assessment of profitability is very complex, and is based on several criteria (Lalić, Jovičić, & Lukić, 2021).

Activity indicators are also known as turnover ratios; the general rule says that it is better for the turnover ratio to be as large as possible, i.e. that the bonding time of the total and individual types of property is as short as possible (Janus, 2010). Activity indicators measure the efficiency with which a company uses its own resources and the speed with which assets circulate in the business process. In addition, if the turnover ratio is known, then it is possible to calculate the average days of tying up funds, i.e. average duration of turnover. This group of indicators includes turnover ratio of total assets, receivables ratio, supplier turnover ratio, inventory turnover ratio, etc.

Investment indicators, along with profitability indicators, are mostly used by investment analysts to make a decision on investing in shares. The indicators are calculated on the basis of the balance sheet and the profit report (Janus, 2010).

METHODOLOGY

The limitation of time series is the reason for applying linear regression to estimate the trend. The research will show the financial indicators for three years, 2018, 2019 and 2020, in a well-known company from BiH (joint-stock company), and then it will show what decisions companies and banks can make based on those indicators. It will also be shown, through the calculations that will be presented below, why certain decisions, those based on financial indicators, are of better quality compared to those made based on the subjective assessment of a certain person.

RESULTS OF THE DISCUSSIONS

In this part of the work, the calculations of the indicators used in the financial analysis, will be presented. The same will be shown in the following table.

Table 1. Calculation of Indicators

Indicators	2018.	2019.	2020.
Liquidity Indicators			
Current liquidity coefficient	1,12	2,30	1,18
Coefficient of accelerated liquidity	1,15	2,50	2,58
Current liquidity coefficient	1,71	3,20	3,90
Coefficient of financial stability	0,80	0,80	0,90
Debt Indicators			
Debt coefficient	0,90	0,54	0,21
Coefficient of own financing	0,44	0,74	0,83
Financing ratio - Financial leverage	0,90	0,50	0,30
Interest coverage coefficient	10,7	22,8	14
Profitability Indicators			
Gross profit margin	52,2%	51,2%	50,9%
Operating margin (EBIT)	10,3%	11,6%	15,9%
EBITDA margin	29,2%	18%	17%

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Net profit margin	15,3%	10%	10%
Return on Total Assets (ROA)	14,5%	10,3%	9,4%
Return on Equity (ROE)	22,3%	16,3%	10,2%
Activity Indicators			
Asset turnover ratio	0,99	0,98	0,94
Receivables turnover ratio	20,15	10,12	5,3
Claims collection days	13	18	21
Supplier turnover ratio	6,13	3,15	5,54
Accounts payable payment days	51	69	63
Inventory turnover ratio	2,13	3,00	3,02
Inventory turnover days	111	92	93
Investment Indicators			
Earnings per share	1,15	1,10	1,12
Dividend per share	0	0	0
Total return on equity (P/E)	1,13	1,8	1,15

Source: Authors

Observing the period from 2018 to 2020, it is concluded that the liquidity indicators are at a sufficiently good level. As can be seen, the ratio of current liquidity is above 1, so the company has enough money to settle its own short-term obligations. The coefficients of accelerated liquidity throughout the observed period are extremely high. In 2019, the accelerated liquidity ratio had a value of 2.50, which is above the recommended values. As a rule, the current liquidity ratio should be, but not necessarily, greater than 2. The ratio stated here in 2018 and 2019 is greater than 3, which is above the recommended value. Therefore, it can be concluded that the observed company is "too liquid" and that the calculated coefficients significantly exceed the upper limit, especially considering 2018 and 2019. The coefficient of financial stability for the observed company, which is the subject of analysis in 2018, is 0.80. According to the rule, this indicator must be less than or equal to 1, that is, long-term assets should be less than the sum of capital and long-term liabilities. The general conclusion that can be made is that the company is financially stable, that the assets and liabilities are matched by maturity, and that a significant part of the current assets is financed from long-term sources, which is confirmed by the liquidity coefficients. However, overemphasized current liquidity indicates a potential threat to profitability.

The debt coefficient indicates how much debt a particular company has. This indicator should be 0.5 or less. In 2019, the debt ratio of the company under analysis was a low 0.54, and in 2020 it was only 0.21. The coefficient of own financing indicates the ratio of own financing of the company's operations. In 2019, the indicated indicator is 0.74 and in 2020 it is 0.83, which indicates that the greater part of the property is financed from own sources. The ratio of total liabilities and capital should be 1:1, but in the modern business economy financial leverage is used to the maximum, so the acceptable ratio is 70:30 in favor of liabilities. The aforementioned indicator cannot be considered separately during the analysis, it is observed in parallel with the company's

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strength in generating income, profitability margins and the ability to generate cash flows for meeting obligations. It is desirable that this indicator be as high as possible. In 2019, the interest coverage ratio is 22.8, which means that the available operating profit increased by depreciation (EBITDA) is 15 times higher than the amount of interest.

Net profit margin shows the relationship between net profit and total revenue. In the example that is the subject of the analysis, the net profit is 15.3% in 2018 and is at a satisfactory level. Gross profit margin represents the difference in price, i.e. the difference between the cost price of the product and the selling price. Through the presented period of 3 years, it can be stated that the gross profit margin recorded a decrease. There can be many reasons why this happens and it is up to the manager to recognize the real reasons. Also, it is up to the manager not to make a mistake in estimating the reduced gross profit margin. EBIT in 2019 recorded an increase compared to the previous period. The decrease in operating expenses and the decrease in depreciation expenses influenced the increase in the operating margin. EBITDA margin i.e. operating profit before amortization decreased initially, then increased by only one percent. The profitability of the assets measures the return that the company has achieved on the total assets, i.e. on total engaged funds. The realized return on total assets is 14.5% in the first year of analysis, and then decreases. It can be said that this is satisfactory and that the analyzed company adequately manages the hired funds. The indicator of return on capital in the last year of analysis is 10.2%, which is a satisfactory value. However, it is evident that it has also decreased.

The turnover ratio of total assets shows the relationship between total income and total assets, i.e. how many times in one year assets are converted into income, and it is desirable that it be at least 1. In the specific case, it can be concluded that the indicated indicator is below the required. The receivables turnover ratio is used to calculate the duration of receivables collection, i.e. it partly defines the quality of part of current assets, i.e. claims. The higher the turnover ratio, the shorter the days of tying up funds, i.e. the shorter the period of collection of receivables, i.e. receivables are collected faster. Observing the period of the last three years, it is evident that the receivables collection period has been extended, which indicates that the company credits certain customers for more than 30 days or that there are certain disputed receivables. The stock turnover period in the last three years has been without significant changes, 100 days.

The days of paying payables to suppliers in 2019 are short. A long period of payment of obligations towards suppliers (over 90 days) indicates irregular servicing of certain obligations, i.e. points to the fact that it breaks payment currencies, which can ultimately result in account blocking. Profit per share in 2019 increased compared to the previous reporting period, due to the increase in net profit.

CONCLUSION

Users of banking services have two key products at their disposal, namely a loan and a deposit. A loan is a sum of money that a certain user of banking services wants to take, with the payment of a certain interest for the same, while a deposit is a sum of money that the user, or client, entrusts to the bank for use for a certain fee. Banking business carries with it a certain risk. There are several forms of risk, namely: credit risk, liquidity risk, market risk, operational risk, and strategic risk. All these risks have

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an important place in the bank's operations, and the bank wants to minimize and overcome them over time, and to successfully continue its operations. In order to see if a certain legal entity can get a certain loan, it is necessary to check the financial health of a certain institution. In order to achieve this, it is necessary to check the financial indicators, and when we talk about them, we are talking about liquidity ratios (current, current, accelerated liquidity and financial stability), indebtedness (indebtedness ratio, own financing, financial leverage, coverage interest, repayment capacity), profitability (net and gross profit margin, operating profit margin, EBITDA and net margin, and profitability of assets and return on capital), activities (turnover ratios of total assets, turnover ratio of receivables as well as days of tying up funds, days of payment liability to the supplier), and investments (earnings per share, dividend per share and profitability of the share). In the research part, the previously mentioned coefficients were investigated, on the example of a Bosnian company, a joint-stock company, which is listed on the Sarajevo Stock Exchange. As the main conclusion of the research part, it can be stated that in order to make correct financial decisions, it is necessary to follow the position of science, therefore it is necessary to use financial indicators and, especially, their interpretation. Through the work, primacy is given to financial indicators in the process of making uncertain business decisions in banking business, in relation to subjective assessments. Therefore, subjective analysis cannot be relevant or the basis for making decisions about crediting business organizations, but rather it must be financial methods, i.e. calculation and analysis of financial indicators.

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