



# PROJECT FINANCE AS A FORM OF FINANCIAL MANAGEMENT IN RUSSIAN AGRICULTURE

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## **Abstract**

*Now there is a need of use of new instruments of financing of agro-industrial production as the existing mechanisms of crediting and subsidizing of interest rates are represented insufficiently effective. The agriculture is characterized by the low profitability which isn't allowing producers to use effectively borrowed funds as their cost during the last time grows the advancing rates. As a result of the use of the bank credits the financial condition of the agricultural enterprises worsens, the need of development of new financial instruments for simplification of access for producers of agricultural production to financing is a consequence of that. In this regard, we offer use of mechanisms of a project financing. Also, we recommend improving a technique of an assessment of projects with the purpose of implementation of the most effective financial support of agro-industrial production. Implementation of the specified offers will allow improving mechanisms of support of producers of agrarian production.*

**Keywords:** import substitution, state support, credits, agro-industrial production.

## **1 INTRODUCTION**

During being of sanctions, Russia needs to increase the volume of agricultural production. It is necessary to use for achieving this increase the following resource groups: financial, land and labor. In our view, the issue of financing of creation and to a lesser extent the expansion of agricultural production is the most difficult. This is due to the specifics of agricultural production and the difficulty of using the data for the purposes of own resources of manufacturers, including because of the relatively high debt load of the agricultural sector.

In terms of sanctions is necessary to revise and update the priorities of macroeconomic policy tools, primarily monetary. In recent years the Bank of Russia practically all monetary policy drove to a lower level of inflation. To this end, the bulk of oil and gas revenues to "freeze" in the accounts of the Central Bank; significantly reduced the refinancing of banks; increasing the standard of emergency (Ayvazov, 2013).

Because of this policy, there was underfunding investment in infrastructure, high technology, real sectors of the economy. The continuation of this policy calls into question the possibility of transition to innovation and investment development path of the Russian economy in general and the agricultural economy in particular.

Russian Government has to use the tools of monetary politics' order to achieve

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macroeconomic balance. To coordinate fiscal and monetary policy of the Central Bank and the Government of the Russian Federation should not be put before mutually exclusive goals. Therefore, in our view, the primary objective of monetary policy in Russia is now looking for ways to increase the budget and bank financing for investment in socio-economic and technological development without a sharp increase in inflation. For this purpose, it is advisable to: consider a significant reduction of the refinancing rate, so that the banks were able to lend to the real sector of the economy; increase investment spending budget; exempt from compulsory redundancy term deposits of citizens to be insured to avoid double burdens; reduce the cost of banks to reduce bank margins, for it to consider the payment of interest on commercial banks' mandatory reserve in the fund, and on correspondent accounts with the Central Bank of Russia.

All these measures will enhance the ability of bank lending and investment budget, which will lead to a further increase in the volume of gross domestic product, increased demand for cash resources, revitalize the real economy and thus will contribute to the return of the majority of government spending in the budget in taxes (Maslova, 2009).

## 2 ANALYSIS

The main problem of the Russian agrarian economy is a drawback of finances which were provided by the State program and the empowerment of medium- and long-term lending. Along with the tools enabling discretionary monetary policy is necessary to provide the use of discretionary fiscal policy measures stimulating (increasing subsidies and grants).

The effectiveness of any kind of economic policy is determined by the ratio of the results (effects) to the cost of its implementation. The greatest effect can be reached only by combining the tools of fiscal and monetary policy. If we compare the effectiveness of fiscal and monetary policy, then, from our point of view, in terms of decline in production efficiency of the instruments of fiscal policy will be higher than from the use of monetary, especially if you can reduce the sensitivity of investment to interest rate changes. We should actively use the financial leverage due to their high mobility.

In this regard, we consider it appropriate to consider the possibility of applying such a mechanism of investment resources as project financing. The method is not traditional for the Russian banking system, but we suppose that it will be quite perspective. Financing is defined as "to provide the necessary financial resources of the entire economy of the country, regions, businesses, entrepreneurs, and citizens, as well as the various economic programs and economic activities" (Raizberg, Lozovskiy, & Starodubtseva, 2006).

Accordingly, project financing in the broadest sense can be defined as "a method of attracting long-term debt financing for large projects through the "financial engineering" (Raizberg, Lozovskiy, & Starodubtseva, 2006), based on the loan under the cash flow generated only by the project; it depends on the creation of a detailed assessment of the project, operational risks and the risks of income and their distribution among investors, creditors, and other stakeholders on the basis of contracts and other contractual arrangements " (Yescombe, 2013). In this aspect of project finance is a global process involving many participants and all aspects of project development and implementation, the contractual relationship into a single system. Such financing is usually aimed at the implementation of major projects, often with a large public importance: related to the extraction of natural resources, the financing of independent power projects, public infrastructure (roads, transport, public buildings), etc.

The narrow understanding of project financing with the direct participation of credit institutions is the placement of attracted funds for the implementation of certain projects. Unlike conventional loan in which the source of repayment of borrowed funds is the whole economic activity of the client, with project financing source of repayment of credit debt is the cash inflows resulting from the implementation of a specific project.

The legal basis for this type of funding is still the same loan agreement concluded, usually in the form of a credit line. This form of cooperation is most convenient for the bank, as it allows to keep records of target use of funds by the borrower, the borrower's financial condition, as well as compliance with the stages of the project. This

loan agreements often provide an opportunity for the bank to interest rate unilaterally, or a list of grounds for denial of the current tranche of the loan, either reason to demand early repayment of the loan amount together with interest. For example, a bank may provide in the loan agreement the right to increase the interest rate in case of delay in repayment by the borrower of this loan or absence of a stipulated term documentary evidence of registration with the relevant authorities of the Federal Registration Service of Russia for state registration of mortgage (mortgage) facility under construction, the pledgee for which the bank acts (Alekseyeva, 2008).

In the case of the need to finance large-scale projects really, banks tend to combine their efforts in order to issue a syndicated loan to the borrower. This is due not so much the desire of banks to minimize their credit, foreign exchange, interest and legal risks, as the need to comply with the reserve policy of the Bank of Russia.

In accordance with the provisions of the Bank of Russia № 254-P, the credit institution is obliged to classify loans issued in one of five categories of quality (to the extent that collateral for granted loans), and to create reserves for portfolios of homogeneous loans to the amount of principal (which are not included: due to the law, business practice or the provision of loan payments in the form of interest for the use of the loan, fees, penalties and other payments in favor of the credit institution resulting from the agreement on the loan) (Bank of Russia, 2004).

The requirements of the Bank of Russia said part pretty tough. Thus, to include a loan for the second to the fifth category of quality, the bank is required to obtain certain software. Under the provision of the loan is meant to provide a collateral, bank guarantees, the guarantee deposit (deposit), divided into one of two categories of quality software, installed above Regulations № 254-P. For example, to ensure I category of quality may include: a pledge of listed securities of countries having an investment grade rating not lower than "BBB" by classification rating agency S & P (Standard & Poor's) or the rating not lower than the classifications "Fitch Ratings", Moody's as well as securities of the central banks of these countries or the Bank of Russia bonds, securities issued by the Ministry of Finance, etc.

Typically, banks make out collateral relating to the II category of quality: liquid collateral objects listed in the Regulation № 254-P, guarantees (bank guarantees), guarantees, etc. The higher the loan amount, the more significant shall be supplied to the loan fell within at least a third category of quality at which banks are obliged to create reserves in the amount of 21 to 50% based on the amount of principal. On the lower quality categories (4<sup>th</sup> and 5<sup>th</sup>), the bank must create reserves to 100% of the principal amount.

Project financing provides the customer a number of advantages: the possibility of expanding existing businesses, attract additional funds, separation of financial flows on current and project business, attracting financial resources for long-term, individual approach on the part of the bank, the possibility of a phased investment of own funds in the project and use as collateral assets acquired during the project, as well as comprehensive banking services (including consulting in the preparation of business projects).

This type of funding also features purpose - the creation or implementation of major projects, the funds for which is difficult to accumulate a narrow circle of participants.

Funds in project financing may be directed to:

- The purchase of a non-residential real estate in the secondary market or the real estate objects of unfinished construction;
- Purchase of land for an investment project;
- Construction work on new construction, as well as reconstruction, restoration or capital construction;
- The acquisition of fixed assets for the modernization and reconstruction of production;
- The creation of new production capacity, etc.

This type of lending is relevant for use in metallurgy, electric power, food, wood, and petroleum industries.

The main criteria for making an investment decision about the use of public funding in the implementation of regional investment projects are indicators of economic efficiency of the project (part of the total for all years of the regional investment project produced gross regional product in the region of the Russian Federation, which can be provided as a result of the implementation of this investment project) and

indicators of financial performance of the project (net present value and internal rate of return of the project) (Prikaz N117, 2008)

In this regard, we consider relevant to build a model that allows to carry out an initial evaluation of the feasibility of project financing based on indicators of financial leverage. The model is based on the following assumptions:

1. Tax corrector is assumed to be 0.94 in all cases. For enterprises, the agricultural taxpayers of the single tax rate is 6 percent for companies applying the common system of taxation, income tax rate of 0 percent, so the assumption used in the model will provide some slack performance differential gearing.
2. The level of the average interest rate on the loan is taken as 17%, taking into account possible fluctuations in the financial market in terms of sanctions. The average settlement rate on loans to businesses in 2016 amounted to 15 % (n.d., 2017) (CBRF, 2018).
3. The minimum rate of return on assets was assumed to be 16%, as at a smaller index value of financial leverage effect will be negative, therefore, the project cannot be accepted for implementation.
4. The maximum value of the lever arm may not exceed 5, as in this case, the borrower will not be able to provide effective security for repayment of borrowings.
5. Fees due to the specifics of agricultural production are carried out once a year.
6. Project payback period is rounded to the nearest whole number.

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Table 1 The main indicators for deciding on a project financing

Name	Indicator value				
The lever arm	1	2	3	4	5
The differential lever	1	1	1	1	1
The level of financial leverage effect	0.94	1.88	2.82	3.76	4.7

Without discounting the cash income, the maximum payback period for which the project can be recommended for adoption at a given level of profitability is 7 years. Present value of cash flow of the project will be  $-IC$  (invested capital)  $+CF$  (cash flow) / 2,826.

## 3 CONCLUSIONS

Despite the fact that project finance is now able to be very popular tool lending, its practical application is not very developed due to the incompleteness and conflicts of law. In particular, adjusted the legal framework of project finance in various sectors of the market: the granting of concessions and guarantees, insurance, syndicated right, the stock market, trust, leasing operations, and others. At the same time, this mechanism potentially allowing through the creation of new agricultural producers how to ensure implementation import substitution programs and facilitate the creation of new jobs in the agricultural sector.

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