THE CONSIDERATIONS ABOUT THE BORROWER`S CREDITABILITY

TRISTAN JINTCHARADZE

PHD, Professor Free University

Abstract - The article "The considerations about the borrower`s creditability" critically analyzes the acting rule of assessing the creditability of borrower legal entities, there are shown their negative sides: the multitude of units, controversial results, the non-existence of complete information and many others. Accordingly, exactly this reason is named as one of the cause of accrual of 3.5 Billion non-repayable loan towards the Georgian banks. The author names the second reason – the low level of qualification and intuition of credit experts / officers employed for creditability assessment purposes, the absence of precise look of the future in them, etc.An author issues the conceptual proposals towards both sides.

Keywords - Creditability, Borrower legal entity, Coefficients, Assessment

ANNOTATION

Maybe, there is no company throughout the world, which will have enough own resources to run (execute its operations). Thus, they apply bank for credit purposes. Among the financial products offered through the market, credit takes the main place. Until the decision about the credit issuance is being carried out, the banks check the borrower`s creditability, or the ability to pay the demanded credit under that time, which should be defined as credit`s payment timeframe. The banks assess the borrower`s creditability differently as there doesn`t exist united, universal methods for this purpose.

That fact, that commercial banks of each country have the huge problem loans or non-repayable credits, gives us the basis to critically take look at the methods of borrower`s creditability definition and seek its perfection ways. Exactly this goal is set into the current article.

THE CREDITABILITY DEFINITION MODELS OF THE BORROWER LEGAL ENTITIES OPERATING IN GEORGIA

Generally, the definition of borrowers creditability is being done by quantitative and qualitative methods. This fact, that commercial banks of Georgia have accumulated 3.5 Billion Lari from the borrowers, means that in our country none of the borrower`s creditability definition approach is mastered.

In which approach fail the commercial banks – in quantitative or in qualitative? We consider, that they fail in quantitative approach. It has a reason –the competition is quite high on credit market and they are afraid of "Freezing" the money. One more, that credit money whether is lent or free, it is valuable and in order to avoid the extra cost, it should be involved in "work". Besides, they mainly hire staff with low qualification. Under poor qualification we don`t imply the lack of higher education under specialty field, but the impossibility to use the acquired knowledge and worked out skills, competences in particular situation, the lack of look and many more. Among the Georgian banks` staff, which assesses the borrower`s creditability maybe only one percent should be properly qualified. Notwithstanding the fact, that banks often conduct competitions and they have a lot of pretenders, sometimes the competition criteria is imperfect. Besides, in Georgia we haven`t sufficient amount of staff in above mentioned field of work. The last sentence is proven by the accumulated amount of problem loans. If it isn`t so, they why do they have such a huge amount of problem loans? Many of readers of this article will answer: it happened because our country fell in poverty, the lending companies and the population both became poor. It`s true, but none of events in the nature doesn`t emerge rapidly, preliminarily it reveals some symptoms. It was happening in case of borrowers` impoverishment. These symptoms were occurring in recent years as well, but they needed to be seen, perceived, analyze the future situations with good intuition and assess. Thus comes out the conclusion: Georgian commercial banks haven`t the credit officers having such properties, in other case they shouldn`t accrue 3.5 billion non-repayable loan.

This is one issue. Another issue is, that the methods of definition of borrower`s creditability is imperfect. We are talking about the quantitative approach models of its definition. In this purpose, Georgian commercial banks use financial coefficient or Altman Z score or some other else. Each of these have their own disadvantages.

The disadvantage of financial coefficients are in their multiplicity. These coefficients are divided into 5 groups (working activity, liquidity, financial stability, profitability, market activity) and they require to perform more than 20 economic indicators` calculations of borrower legal entity. Performance of such large quantity of indicators also requires a plenty of time and hardly to estimate the borrower`s future creditability position. The condition complicates the fact, that the number of indicators give conflicting results at the same situation. In such condition, should

the appraiser give the priority to good or bad indicator – nowhere is taught.

Under our consideration, the whole complex of indicators defining the borrower`s creditability should split into two layers, thus the borrower should be analyzed according to two-layered system. The first layer should include the indicators, according to which it`s easy to get whether the borrower is "alive" or "dead" or "more likely alive" or "more likely dead". The second layer should be formed with indicators, which negative meaning didn`t show the risk of borrower`s bankruptcy. We shouldn`t perceive them as the borrower`s bankruptcy symptom, as they can be eradicated by performing some particular events.

In our opinion, first group, or group of critical indicators should include the borrower`s following financial indicators:

- The permanent low rate of liquidity coefficient;
- Turnover funds` chronic insufficiency;
- The critical excess of overdue payable bills;
- The sustainable growth of lent amount and exceeded limits;
- The high share of overdue account receivable;

The second layer group should imply all the rest financial indicators, even the profitability rate, as the profitability is in direct connection with costs, for which elimination the borrower might be given the business recommendations.

As we have mentioned, in order to assess the borrower`s creditability, some commercial bank uses the E. Altman`s (the western scientist) model [1, page 938]:

$$Z = (3{,}3 \cdot k_1) + (1{,}0 \cdot k_2) + (0{,}6 \cdot k_3) + (1{,}4 \cdot k_4) + (1{,}2 \cdot k_5)$$

The fixed indicators of given formula is calculated as follows:

k1 = profit (before the deduction of loan percent and taxes) / total assets

k2 = realization / total assets

k3 = equity (market price) / borrowed capital (under inventory price)

k4 = accrued reinvested profit / total assets

k5 = net turnover equity / total assets

E. Altman considered 2,675 as the critical meaning of this indicator and in seen future (following 2-3 year) have grouped the borrowers as standing on the edge of bankruptcy (Z < 2,675) and having the solid financial conditions (Z > 2,675).

Assessing the borrower`s creditability by Georgian commercial banks using the Altman`s model, we have the following remarks:

- The model is built on the basis of an American companies, which business organization is different from Georgia;
- Altman Z score is built in 1940-1950 years. After that time, many years passed and the economic situation has changed.
- Altman`s model can be used only by large enterprises, in particular joint-stock companies, which shares are quoted on the stock exchange (the calculation of Altman model`s third indicator – k3 is only available for them). True, that Altman has worked out the Z score modified version for those societies, which aren`t quoted on the stock exchange [2, page 222], but, in Georgia, the number of joint-stock companies is very small (2273), and the number or rest of enterprises (584024) – more.

Exactly under the similar purpose, the Russian scientists decided to work out (draw up) their own model projecting the borrower enterprises` bankruptcy, which should be useful for all types of enterprises. This model was made by the scientists of Irkutsk University in 2006 year. The bankruptcy projection calculating formula in the model is as follows:

$$R = (8{,}38 \cdot k_1) + (1{,}0 \cdot k_2) + (0{,}054 \cdot k_3) + (0{,}63 \cdot k_4)$$

The calculation of indications is being done as follows:

k1 = circulating capital / assets

k2 = net profit / equity

k3 = income from the realization / assets

k4 = net profit / costs

The enterprise bankruptcy risk under this model is being assessed as follows:

R < 0 – the bankruptcy risk is at its maximum.

R = 0 - 0.18 - the bankruptcy risk is high (60-80%).

R = 0.18 – 0.32 - the bankruptcy risk is at its average level (50-60%).

R = 0.32 – 0.40 - the bankruptcy risk is low (15-20%).

R = 0.42 – the bankruptcy risk doesn`t exist.

It`s obvious, that most desirable is, that Georgia could have its own Georgian model calculating the bankruptcy of Georgian enterprises, but there is no such model yet. Under such circumstances, its more advisable, that Georgian commercial banks should define the borrowers` creditability not with E. Altman`s model but with above mentioned Russian model. It is newer and besides, the outer and inner factors of Russian and Georgian business (which stipulate the financial healthiness of the business) are almost the same.

CONCLUSION

According to the analyze and assessment of acting models defining the borrower legal entities` creditability in Georgia, we can make the following conclusions:

- The financial coefficients are numerous and often they give the controversial results;
- Altman Z score can`t be used for each types (legal types) of enterprises.

For those banks, who use the financial coefficient in order to assess the creditability, our suggestion is to split it into first and second layer indicators (we have presented these layers in the article) and conclusion regarding to approval or rejection of the loan should be made only under the first layer indicators.

We suggest using the Altman Z score model only for those banks, which borrowers are the joint-stock companies. Generally, we suppose, that it would be better, if Georgian commercial banks would calculate the borrowers` creditability with Russian model.

As for the staff employed for defining the borrowers creditability, their adjustment shouldn`t be subject only professional knowledge and education. In our opinion, they should be examined on their future look. It is the inborn skill and few one possesses it. Anyway, these staff needs the good competence of future look and banks should seek the psychologists support to select such staff.

THE REFERENCE LITERATURE

[1] Kovalev V. V. – Financial Management. M., "Prospect",pp 10-70, 2007.

[2] Petrov A. IU., Petrova V. A. Complex analysis of bank`s financial activity. M. pp 115-145, 2007.

[3] Altman, Edward; Couette, J.; Narayanan, P; Nimmo, R. Managing Credit Risk, 2nd Edition. John Wiley and Sons.pp 105-170,2008

★★★