A STUDY ON CREDITRISK EXPOSURE FOR VARIOUS CREDIT PROPOSALS OF CITY UNION BANK

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ABSTRACT:

Credit risk management in banks is to maintain credit risk exposure within proper and acceptable parameters. It is the practice of mitigating losses by understanding the adequacy of a bank's capital and loan loss reserves at any given time. The bank has to monitor not only the entire portfolio but also individual credits. Credit risk is fundamentally significant for sustaining the ability of any investment bank. The studies show that credit risk was one of the risk for determining the economic crisis that the world has suffered from. This research is to study the credit risk exposure of City Union Bank and to try to assess the severity of the bank. In this study Altman's Z score Model is used for assessing the credit risk in City Union. It indicates credit risk score value according to their proposals. These proposals indicates upper bond value and lower bond value.

KEYWORDS: Credit Risk, Altman's Z score Model, Proposals.

INTRODUCTION:

The Banking sector has an essential role in the growth of an economy. It is the key driver of economic growth of the country and has a vibrant role to play in converting the idle capital resources for their optimum utilisation so as to attain maximum productivity. The foundation of a complete economy depends on how sound the banking sector is and vice versa. The current scenario that is prevailing in the global banking industry is the danger of default risk. Risk is an unavoidable element in all the areas of a business firm and the risk particularly credit risk, becomes more severe for the banks and financial institutions. Simply the credit risk is the inability of repayment of the credit by the customer, technically the credit risk can be defined" as the potential that a borrower or counter-party will fail to meet its duties in accordance with agreed terms". Since a bank lends in many ways thereby exposes itself to the credit risk. Moreover there emerges other sources of credit risk for a bank or a financial institution, as it floats more financial product like futures, swaps, bonds, equities, options etc. or indulge itself into various other financial activities other than lending like accepting interbank transactions or trade financial or forex transactions etc. Credit risk has three elements exposure towards a party that may possibly default, the probability of default and lastly the recovery rate.

OBJECTIVES OF THE STUDY:

A Study on credit risk exposure for various credit proposals of city union bank.

ADVANTAGES OF THE STUDY:

- The Altman's Z Score Model provides a quantitative measurement into a company's financial health.
- The Z Score highlights factors contributing to a company's financial health and uncovers evolving trends that indicate improvements or worsening in financial condition.
- The Z Score is a critical tool business managers use to evaluate financial health. It helps managers align business approaches with capital distribution decisions and provide transparency of financial condition to lenders and equity capital providers.
- Business managers use the Z score to increase capital and secure credit.
- The Z Score is an effective tool to demonstrate credit worthiness to bankers and accuracy of business model to investors.
- The Z Score model is based on actual financial information derived from the operating performance of the business enterprise.

RESEARCHMETHODOLOGY:

The secondary data was collected from the annual reports of the bank, website and various statements prepared by the bank i.e., balance sheet and profit and loss account of the bank.

TOOLSUSEDFORANALYSIS:

Altman's Z-Score Model.

REVIEWOFLITERATURE:

BhuniaandMukhuti(2011)developed a model that predicts financial distressed companies in India under the Z- Score model with accuracy classification of 81%. However, Steven et al. (2011) in their study in Malaysia that was carried out using the Z- Score in order to determine company's performance after the financial stress that is derived through environmental stress.

AltmanandHotchkiss(2006) described four basic terms of bankruptcy, default, insolvency and failure which are used differently by various researchers. Technical insolvency is a situation in which company is unable to fulfil its current obligations due to liquidity. Whereas bankruptcy itself is a formal declaration of bankruptcy by court as a result of a petition for bankruptcy reorganization or liquidation of assets.

Yap, Yong, and Poon (2010) developed a model to predict failure for Malaysian based companies and constructed a strong discriminant function with seven different ratios that has predictive accuracy.

Venkataramana,RamakirishnaiahandAzash(2012)made analysis in the companies in the Indian market and the researches used bankruptcy prediction models and also conducted ratio analysis for the companies.

ANALYSIS OF THE RESULTS:

ALTMAN'S Z-SCORE MODEL

Altman's Z-score model is constructed based on financial ratios, Husein and Pambekti concluded that financial ratios founded in the company's financial statement are an efficient way toanalyze the soundness of the company and can be used to anticipate future financial difficulties. Altman's Z-score is a linear combination of four or five financial ratios, weighted by coefficients. The coefficients were estimated by identifying a set of firms which had declared bankruptcy and then collecting a matched sample of firms which had survived, with matching by industry and approximate size (assets). While there are many Altman Z-score models for different types of companies, for example the 5 factor model is used for manufacturing companies and there is a model that is designed for banks, this paper uses Altman 4 factor model to measure the financial stress of the companies. This formula is used for the non-manufacturing and emerging companies (Altman, 4). The formula used is as follow;

Where; X1 = working capital (current assets (CA) – current liabilities (CL)) / total assets (TA)

X2 = retained earnings (RE) / total assets (TA)

X3 = earnings before interest and tax (EBIT) / total assets (TA)

X4 = total book equity (TE) / total liabilities (TL)

The results obtained from the model is then compared to a benchmark that is set to determine the financial soundness of the company.

The criteria used to interpret the Z-score model is; -

Safe Zone if Z-score > 2.99 (risk free)

Gary Zone if 1.81 < Z-score < 2.99 (at risk)

Distress Zone if Z-score < 1.81 (bankruptcy)

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Particulars	Mar '15	Mar '16	Mar '17	Mar '18	Mar '19
Working capital	-138.65	123.68	258.73	160.27	170.76
Current asset	793.18	1052.97	1312.57	1345.78	1660.03
Current liabilities	931.83	929.29	1053.84	1185.51	1489.27
Total asset	27871.13	31251.97	35270.78	39937.26	45258.88
X1	0.69	0.49	1.90	0.64	0.64
X2					
	Mar '15	Mar '16	Mar '17	Mar '18	Mar '19
Net income	384.13	444.69	502.77	592.00	682.85
Equity Share Dividend	65.62	71.78	0.00	19.84	21.96
Tax On Dividend	13.36	20.71	0.00	4.04	4.51
Retained earning	305.15	352.20	502.77	568.12	656.38
Total asset	27871.13	31251.97	35270.78	39937.26	45258.88
X2	0.01	0.01	0.01	0.01	0.01
X3					
X3	Mar '15	Mar '16	Mar '17	Mar '18	Mar '19
EBIT	384.13	444.69	502.77	592	682.85
Total asset	27871.13	31251.97	35270.78	39937.26	45258.88
X3	0.01	0.01	0.01	0.01	0.02
X4					
X4	Mar '15	Mar '16	Mar '17	Mar '18	Mar '19
Total book equity	28,255.27	31,696.67	35,773.56	40,529.27	45,941.75
Total liabilities	27,871.14	31,251.97	35,270.78	39,937.24	45,258.89
X4	1.01	1.01	1.01	1.01	1.02
Z Score	5.72	4.41	13.66	5.43	5.44

Z SCORE MODEL

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Interpretation

The above table shows that the banks Z score was at 5.72 in the year 2015, 4.41 in the year 2016, 13.66 in the year 2017, 5.43 in the year 2018 and 5.44 in the year 2019 were the Z score value is greater than 2.99. It reveals that the is in risk free zone for the past five years.

FINDINGS OF THE STUDY:

The banks Z score was at 5.72 in the year 2015, 4.41 in the year 2016, 13.66 in the year 2017, 5.43 in the year 2018 and 5.44 in the year 2019 were the Z score value is greater than 2.99. It reveals that the bank is in risk free zone for the past five years.

CONCLUSION

A financial analyst can adopt the following tools for analysis of the financial statement. These are also termed as methods of financial analysis. The banking sector is one of the core sectors in the economic development of India. So the purpose of the study is to concentrate oncredit risk exposure for various credit proposals of City union bank. This study attempted to find out whether CUB have performed well or not. The main objective of the study is to evaluate the credit risk exposure of the bank in the last five years and to predict the future performance of the bank. For this purpose a balance sheet of five years was analysed usingAltman's Z score Model. The conclusion is that City Union Bankis in risk free zone for the past five years.

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