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CREDIT RISK ANALYSIS AND ITS MANAGEMENT

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ABSTARCT:

Credit analysis is the evaluation of the potential of an organization to honor its financial obligations. The credit analysis seeks to identify the appropriate level of default risk associated with investing in that particular entity. Credit analysis works to judge a company's capacity to disburse its debt, banks, bond investors, and analysts conduct credit analysis on the company. The main aim of the credit analysis is to look at borrower and the loan facility being planned and to assign a risk evaluation. Using financial ratios, cash flow analysis, trend analysis, and financial projections, an analyst can evaluate a firm's skill to give its obligations. A review of credit scores and any collateral is also used to calculate the creditworthiness of a business. This paper reviews about how to assess the credit value and other parameter and helps the company strategic position and associated risk.

Key words: Credit analysis, Risk, investment, portfolio management, Decisionmaking.

1.1. INTRODUCTION

Nowadays the changing trend in the globalised world and volatility of financial market and credit management is the major focal point. There is an increasing importance of credit risk management due to corporate policy decisions and subsequent bankruptcy has attracted attention.

Bharath and Shumway, et all (2008), study shows that because of increase in global competition resulting in financial crisis and posing major threat to commercial banks and skill to manage with lot of constraints and it is going to be continued challenge for the company to make wise decisions for sustainability.

Doumpos and Zopounidis (2007), study result reveals that credit management explores different combination model for better understanding.Credit analysis is about to study the performance of the company, capacity to manage its funds in relation with company assets, liabilities and cash flow movement including equity. The ratio, trend analysis and financial statements show the firms efficiency level and it is indicator for future profitability of the company.

According to corporate finance institute, Credit analysis is to determine the capability of a organization or person to perform their economic obligation. It contains both qualitative and quantitative factors such as amounts payable, quality, and ability to make payments. Credit analysis is used to determine if the organization or person qualify for a loan or finance. It is also concluding the quality of a bond (source: https://corporatefinanceinstitute.com).

1.2. PROBLEM DEFINITION AND SIGNIFICANCE OF THE STUDY

The importance of risk analysis in credit evaluation: The nature of the business and the competitive environment in which the company operates determine to a large extent the asset investment, financial decisions and profit dynamics of the company. Risk analysis is performed to understand the company's competitive position, its strategy, and its effect on financing needs. The bank expects the principle and the interest to be paid. The risk that the bank takes is that the company will not be able to pay back whole or parts of the total sum so all the credit applications should thoroughly be analyzed.

The purpose of this research is to study the impact of credit analysis in a manufacturing company in Chennai. It was proposed to conduct a view to study the short term as well as long term prospects. The company has incurred a problem with regard to the debt incurred in the organization. So the efforts are made to find and to measure through credit analysis to know its credit worthiness of company a suggest the ways to improve its finance function.

1.3. NEED FOR THE STUDY

The companies are facing lot of problems for the last decade and witnessing a dramatic loss by the banks, company announcement about the credit score, influence of interest rate and coupled with derivates exposure are assumed great significance.

- To study the credit analysis and its present position of selected manufacturing company.
- To know how the company gets funds and how it is managed by and from various resources.

1.4. OBJECTIVE OF THE STUDY

- To study the credit analysis in selected manufacturing company at Chennai
- To analysis credit analysis techniques adopted by company
- To study the performances of credit analysis and assess the effectiveness.
- To give suitable suggestions for improvement in credit analysis of the company.

1.5. SCOPE OF THE STUDY:

This study has been undertaken on behalf of the company in order to identify the possible benefits and disadvantages of implementation of various tools with reference to the finance function. The main scope of this study is to observe the performances of credit analysis to management and evaluate its effectiveness. This study will help the management to know the impact of ratio analysis. This project work as the secondary data may help the future scholar to overcome their limitations presented in the study.

1.6. LIMITATIONS OF THE STUDY:

- Due to the confidential financial records, the data is not exposed so the study may not be detailed and full-fledged.
- Within the short duration, data could be analyzed only in certain perspectives.
- The time within which, the study is being attempted is too short to take out a detailed analysis.
- This analysis is based on secondary data. The Extent of the study is limited.

1.7. RESEARCH DESIGN:

A). ANALYTICAL RESEARCH: The nature of research design is analytical study. Analytical research is to determining the validity of hypothesis based on analysis of details collected. The researcher uses details and information are already available and carried out analysis to make significant valuation of the material.

B). DATA SOURCE: According to M.M. Blair, Secondary data “Those are already in existence and which have been composed for some other purposes”. This study is based on secondary data. The details regarding the company like the company profile and financial data was sourced from company’s website and financial records**.** The researcher collected data through available secondary sources. The required data and information were collected in the form of through, company’s annual report, website and from balance sheet provided by the company during the period of the year 2015 –2019.

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C). FINANCIAL TOOLS USED: The following tools are used to find answer for the stated objective. The tools are namely a). Ratio Analysis b). Trend Analysis.

A). Coverage Ratio: To measure the income, cash or assets provide for debt or interest expenses. The highest coverage ratio, the greater ability of a company to meet its financial obligations. The analysis includes a) Interest coverage ratio b). Debt coverage ratio c). Cash coverage ratio d) Asset coverage ratio.

B). Efficiency ratio: Efficiency ratios measure a company's capability to use its possessions and control its liabilities effectively in the current period .These ratios calculate how efficiently a company uses its possessions to make revenues and its ability to manage those possessions. This includes a). Asset turnover ratio b). Inventory turnover ratio c). Receivables turnover ratio and d). Payables turnover ratio.

C). Profitability ratio: Profitability ratio measure the skill of the company to generate profit comparative to revenue, assets balance sheet, and shareholders' equity. It helps the lenders to determine the growth rate of corporation and their capacity to pay loans. a). Gross profit b). Working profit c). Return on assets d). Return on equity and e). Return on capital employed.

1.8. MAJOR FINDINGS OF THE STUDY:

- The interest coverage ratio has highly increased during 2018-19 and decreased in 2014-15.
- The debt coverage ratio is high in 2018-19 i.e 5.135 times and less in 2015-16 i.e 0.36 times.
- The cash coverage ratio highly increased in the year 2018-19 and decreased in 2014-15.
- During the year 2015-19 the total assets coverage ratio of the company was 1.486, 1.195, 5.68, 7.113 and 8.516 times this indicates that every rupee of total asset of the company is utilized to pay for more than one rupee.
- There is a widespread fluctuation in payable turnover ratio over the study period in the year 2015-2019.
- The working capital position of the company to declining over the years.
- The debt ratio has been continuously fluctuating over the years.
- The debt to equity ratio to declining over the study period.
- The proprietary ratio are increased over the years 2015-19.
- Debt to asset ratio and debt to capital has been decreased in 2015-19.
- The debt to capital ratio has been decreasing over the years 2015-19.
- The trend value estimates the increase in profits of the company from the year 2014-2019.
- The trend value estimates the upliftment in profit of the company projected for next two years i.e 2019-2020 and 2020-2021.

1.9. SUGGESTIONS FOR BETTERMENT:

The following are the suggestions are given to stabilize the financial position and condition of the company**. a).** The company can reduces the investment in tangible assets. b). The duration of creditors turnover can be increased to avoid payment frequently. c). To reduce the working capital expenses strict measures can be taken to decrease day to day expenses. d). The Company can depend more on debt capital, So that the equity share holders will get high returns for their investment.

ISSN: 2278-4632
Vol-10 Issue-6 No. 14 June 2020

1.10. CONCLUDING REMARKS:

For any organization, to study the economic capability to pay their debt with its future course of action is very significant indispensable. The study on credit analysis at has given in depth knowledge on the subject and also paved way for knowing how its preparation are made and further, making suitable suggestions for its improvement through the analysis done. To sum up, an efficient and effective analysis will obviously be an essential tool for the company's credit worthiness or financial obligations.

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