PERFORMANCE-RELIABILITY – THE MAIN SUBJECT OF THE BANKING ANALYSIS OF THE CREDITED SOCIETIES

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Abstract
Since the crediting activity occupies the primary role in any banking institution, the necessity of study and its analysis is required by following some steps both at a microeconomic level and at a macroeconomic one. Going over the theme, which aims at the importance of a thorough study of the clients' reliability for highlighting the existing risks in the banking activity in general, and particularly in the crediting activity, becomes as more interesting as their approach at the level of the member states of the European Union tends towards a common theme. Starting from these premises, we have considered as being extremely important the selection of a research theme which aims at the risks in the crediting activity, emphasizing the analysis of the clients' reliability both in the decision of crediting in order to assume the risk of credit and in determining the financial and banking performances. Being given the complexity of the existing risks in the banking activity in general and particularly of the credit risk, the clients' reliability represents an extremely important field, of research and application, bearing in mind both the actual stage of developing the Romanian banking system and the attempts of its alignment to the requirements imposed by the European Union.

Key words: crediting, reliability, performance

JEL classification: E51, L25, M40

1. Introduction

For outlining a more complete picture about the economic and financial situation of the credited economic agents and for diagnosing their reliability state, it is necessary to define and use a set of indicators. The level and the tendency shown in time of these indicators have to express the need of resources for the activity they perform, and also the ability of the economic agent to honour the obligations related to the requested credit. At the same time, the chosen indicators have to support the decisions taken in the crediting activity, to allow the individual to monitor each granted loan.

The indicators system used for assessing the financial reliability of companies should be given a particular importance, both in the financial analysis and in the actual substantiation process of the crediting decision. It is the decision of each bank, by its internal regulations, to define and use such a set of indicators which ultimately are useful to the policies promoted in the crediting field.

The necessity of analyzing the clients' economic and financial situation arises from the bank's need to know all the necessary elements for the substantiating the crediting decision. Within this analysis a special place belongs to the settlement of the credit solicitor's reliability. Banks, in general, have to get ensured about the client's creditworthiness, by which it is actually defined its capacity to support the debt service, to repay the loan at maturity, respectively and to pay the related interest, as well as to prove the existence of the insurance guarantees.

2. The research methodology

In order to achieve all the objectives related to the scientific research, this research is based on certain methods of the scientific research, methods which will be outlined below. Thus, throughout this scientific approach, we have used the method of study and of theoretical analysis in order to extrapolate the level of researches regarding creditworthiness and also performance as the subject of the banking analysis of the credited
societies. We have also used the comparative method in tackling the theoretical aspects, aspects which are outlined better with the help of this method by selecting them and then comparing them. The observation method is also used in this scientific approach, firstly appealing to its non-participating character by exposing researchers’ different opinions and secondly to its participating character, by drawing some conclusions regarding the presented approaches.

Regarding the research techniques and procedures used throughout this scientific approach, we note the following: the study of the specific bibliography, the use of different bibliographical sources, such as articles and special books, collecting and then processing the data, presenting the theoretical aspects using the tables. The research this approach is based on is a fundamental one, which aims at the study of the banking analysis concept. Actually, this research aims at the methods of determining the reliability indicators of the credited societies, classifying them in a reliability category according to the gained score and classifying the client in a reliability category according to the aquired score.

3. Analysis of the reliability/of the performance of the credit applicant

Performance represents: 'achieving the organizational objectives regardless their nature and variety'. The organizational performance shows the individual's ability to make progress due to the efforts made. Performance is not on its own, it is always the product of a comparison. The actual content of performance is dependent on strategic objectives; there is no absolute performance, independent of its objectives; the performances assessment is dependent on setting the objectives; what is performing in a given situation, characterized by certain objectives, may not be characterized by other objectives in another situation (Lavalette and Niculescu, 2001). [1]

Nicoleta Barbuta-Misu (2008) states the fact that performance in a modern enterprise can be defined as a competitiveness state achieved through a high level of efficacy and productivity, having as the main goal the assuring of a durable position on the market. [2]

In the context of economic and financial analysis of clients, banks often face a question to which specialists have tried to answer, namely whether the client's reliability or performance established historically can be a convincing argument for a future crediting?

It is often argued that excessive dependency manifested by banks for crediting, towards the reliability indicators resulted from previous activities, not always makes the decision regarding the granting or rejecting future credits to be the correct one.

From this point of view, it seems that in assessing the clients' reliability in terms of past (historical) creditworthiness, minor importance to the analysis of the post-factum business should be given and should be insisted on the one of future, forecast activities which, otherwise, is the aim of the requested credit, with the goal of achieving a maximum of certainty in drawing the conclusions.

Determining the applicants' possibilities to repay the loan is mainly a problem of economic analysis. The financial analysis concerns both the past actions of the company and its future prospects or of the business which is the subject of the requested credit. In specialized literature it is outlined and largely confirmed by practice the opinion that the analysis should aim at five fundamental characteristics, otherwise known as 'the 5 M', namely:

- Men – meaning to investigate everything related to human potential, to professional structure and the managerial one;
- Money – consisting of all financial problems, especially of own capitals, solvency, liquidity and profitability;
- Merchandise – referring to the quantity, quality and the assessing type of the assets;
- Materials – which refers to the technological level, reliability, performances and quantitative and qualitative assessments of the fixed;
- Market – regards the position on the market, distribution of the products and services, commercial diagnosis, in general.

The post-factum financial analysis of the past actions of the company consists in the interpretation of the creditworthiness indicators on which are actually emphasized the strenghts and weaknesses registered in the evolution of the company which requests the loan.

The future prospective financial analysis must prove the fund needs of the company in their evolution, to allow checking the reality of the credit application and to outline the real possibilities of repaying the loan and of paying the due interest and commissions.

Although practice has shown that separate interpretation, based on scoring, of reliability indicators, without taking into consideration the interdependencies and mutual influences between the elements which determine the registered level, may lead to mistaken conclusions, since, in this case, a major importance is given to the formulation of value judgements of reliability indicators, this value becoming decisive in fundamenting and adopting the crediting decision.
In everyday practice, though, it is often noted that although the activities performed by the economic agents are relatively profitable and the debt service to the bank is impeccable, the calculated value of reliability indicators 'in the past' allows classifying the credits only in the performing categories D and E, 'doubtful' and 'loss', respectively. This leads to the situation in which the decisions taken by banks are not always favourable to clients and so the economic agents cannot be granted credits either because insufficient reliability or because of the extremely high cost of credit (the interest level), resulting from calculations.

Financial connections which appear between banks and their clients arise an extremely complex phenomenon, of great magnitude, which also supposes and imposes, logically speaking, a careful analysis of these.

To perform the analysis of a client's economic and financial situation, applicant for a bank loan, the following types of analysis are considered to be relevant for the bank:

- analysis of the accounting positions, in evolution;
- cost, income, profit analysis;
- analysis of the indicators;
- analysis of the breakeven point;
- analysis of the forecasts in terms of fund flows and liquidities.

It is precisely mentioned the fact that when analysing the assets of a trading society and especially its fixed assets, two aspects should be emphasized, considered to be of the utmost importance, namely:

- what is the value which can be achieved by its selling;
- the maximum (estimated) time of immediate conversion of the assets into liquidities.

The banking practice proves that, actually, most of commercial banks, in order to simplify the analysis work and to get maximum of efficiency in the relationship with the client, appeal to a limited set of indicators, quite easy to be achieved and used, whose determination is made based on the data from periodic reports which the economic agents are obliged to draw up and submit to the jurisdiction of the Financial Administration, namely: the balance sheet, the profit and loss account, the statement of assets, the trial of balance (Trenca, 2004).

Another algorithm, approached by some banks, after which the calculation for verifying the client's reliability can be made, based on data from the checking balance of the previous month loan application, requires finding of values for the following indicators (Zaharciuc E., 2000): [4]

- liquidity of assets (current assets/current liabilities);
- solvency assets (own capital*100)/total liabilities);
- gross profit ratio (gross profit *100)/turnover);
- financial profitability rate (net profit*100)/own capital);

4. Classifying the client in a reliability category according to their scoring

In the context of financial analysis, each indicator is associated with a weight factor which will correspond to a certain percentage of the bank main interest, for the credit to be granted. For example, in the case of a commercial bank which is to promote a main interest of 40% a year expected to be practised on the market, let's say, in the period between January and March of the next administration year, the allocation of coefficients could be achieved as follows:

- for liquidity indicators - 5 percent
- for management indicators in which:
  - rotation of current assets - 2.0 percent
  - rotation of stocks - 3.0 percent
  - rotation of stocks - 1.5 percent
  - rotation of stocks - 1.5 percent
- for profitability indicators in which:
  - gross profit margin - 12 percent
  - net profit margin - 6.0 percent
  - financial profitability - 6.0 percent
- for solvency indicators in which:
  - indebtedness - 10 percent
  - covering the debt (operating profit/paid interest) - 5.5 percent
  - 4.5 percent
- for flow indicators (cash flow)
  - cash-flow = Total revenue period/Total payments to be made - 5 percent

General total 40 percent

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indebtedness (current liabilities/total assets).

Based on this calculation, on the second stage, a scoring is made, according to the table below, the framing in intervals being made according to the registered level of the above performance indicators, thus (Trenca I., 2002): [5]

Table no. 1 Performance indicators

<table>
<thead>
<tr>
<th>The name of indicators/level</th>
<th>Scoring</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20</td>
</tr>
<tr>
<td>General liquidity</td>
<td>&gt;2</td>
</tr>
<tr>
<td>Solvency heritage</td>
<td>&gt;2</td>
</tr>
<tr>
<td>Gross profit rate</td>
<td>&gt;10%</td>
</tr>
<tr>
<td>Financial rentability rate</td>
<td>&gt;5%</td>
</tr>
<tr>
<td>Indebtedness</td>
<td>0 – 0.3</td>
</tr>
</tbody>
</table>

Source: Trenca I., 2002

As a result of summation of named points, according to the total scoring and the value intervals predetermined by rules, the bank client, and implicitly the loan, is then allocated to one of the performance category:

Table no. 2 Performance categories

<table>
<thead>
<tr>
<th>Group</th>
<th>Given scoring</th>
<th>Characterization</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>85 - 100</td>
<td>Standard</td>
</tr>
<tr>
<td>B</td>
<td>70 - 87</td>
<td>Under observation</td>
</tr>
<tr>
<td>C</td>
<td>50 - 69</td>
<td>Substandard</td>
</tr>
<tr>
<td>D</td>
<td>25 - 49</td>
<td>Doubtful</td>
</tr>
<tr>
<td>E</td>
<td>&lt;25</td>
<td>Loss</td>
</tr>
</tbody>
</table>

Source: Trenca I., 2002

The clients who, by the calculated scoring after the mathematical relations mentioned above, succeed in the first two categories, namely 'standard' and 'under observation', have the advantage of an easier access to getting the loan, especially if the other conditions required by the loan regulations of the commercial bank are fulfilled.

Since the interest rate applied by banks also includes in it a measure of the crediting risk, it is advisable that it is differentiated according to the financial situation of the debit client and, respectively, of the risk category in which the discussed credit is appointed. In this context, it is useful to operate with an adequate tool, which allows correlation between the actual interest and the risk the bank takes when granting the loan (Basno and Dardac, 1999), [6]

It is begun from an interest, considered to be basic, to which the risk margin is added, expressed by percentages, which rises as the credit becomes more risky. In a way, it is assumed that the differentiated, calculated and then negociated interest, especially in the case of risky loans, must play an inhibitory role, to diminish the need for crediting of the less careful entrepreneur, by higher paid price for the borrowed resource (Bâtrîncea, 2003). [7]

Such a tool can be designed like this:

Table no. 3 Differentiated interest

<table>
<thead>
<tr>
<th>Loan category</th>
<th>Provision</th>
<th>Charged interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.-Standard</td>
<td>0%</td>
<td>Usual interest</td>
</tr>
<tr>
<td>B.-Under observation</td>
<td>5%</td>
<td>Usual interest + 3 percent</td>
</tr>
<tr>
<td>C.-Substandard</td>
<td>20%</td>
<td>Usual interest + 5 percent</td>
</tr>
<tr>
<td>D.-Doubtful</td>
<td>50%</td>
<td>Usual interest + 10 percent</td>
</tr>
<tr>
<td>E.-Loss</td>
<td>100%</td>
<td>It is not credited</td>
</tr>
</tbody>
</table>

There are also other experiences specific to the bank practice in our country and, according to one of these, the level of a set of indicators is calculated, taking into account the nature of the developed activity, in our case, for productive activities, as seen in the table below:

Table no. 4 The calculation of reliability indicators for clients with productive activities

<table>
<thead>
<tr>
<th>Profitability</th>
<th>Solvency</th>
<th>Liquidity</th>
<th>Activity</th>
</tr>
</thead>
</table>

Source: [5, 6, 7]
The used indicators are the following (Trenca, 2007):

\[ \text{operating margin} = \frac{\text{Operating Profit}}{\text{Operating income}} \times 100 \]  

(1)\[ \text{financial profitability} = \frac{\text{Net Profit}}{\text{Own capital}} \times 100 \]  

(2)\[ \text{indebtedness} = \frac{\text{Total Debts}}{\text{Total liability}} \times 100 \]  

(3)\[ \text{current liquidity} = \frac{\text{Current assets}}{\text{Current liability}} \times 100 \]  

(4)\[ \text{rotation of current assets (in days)} = \frac{\text{Current assets (average balance)}}{\text{Turnover}} \times T \]  

(5)\[ \text{circulation from the turnover (run by bank)} = \frac{\text{Bank circulation}}{\text{Turnover}} \times 100 \]  

(6) For each of these indicators, the individual scoring is established which, then, by summation, allows to determine a total score according to which the classification of each trader is made, in one of the economic and financial performance groups, as follows:

- group A 41 - 50 points
- group B 26 - 40 points
- group C 16 - 25 points
- group D 5 - 15 points

If the client's given score approaches a minimum or maximum performance of a group, this may be adjusted, either by diminishing it or by increasing it, according to some subjective factors which can be taken into account, namely:

- changes into the economic and financial situation, until de analysing date, with reference to the share capital, by issuing shares, associations, mergers;
- investment completion with exploiting possibilities of production capacities and of selling products on the existing markets or on new markets, especially for export;
- reorganization/restructuring of the activity, by changing the sources of supply or the selling markets, by technological innovations;
- the management quality (composition, outstanding accomplishments, morality, social position etc);
- other factors whose influence can be quantified and justified explicitly.

A particular aspect of the analysis made by the credit moderator for the existing clients of the bank will be the debt service. Although it is considered' in the past', it emphasizes the client's behaviour in his relationship with the bank, the morality and the responsibility which he invests in this partnership.

The ability to pay the bank, at maturity, the credit rates and the according interests, in accordance with the recent regulations in this field, is estimated to be:

- good – if the rates and the interest are paid at maturity or with a delay of up to 7 days;
- weak – if the rates and the interest are paid with a delay of 8 to 30 days;
- doubtful – if the rates and the interest are paid with a delay of over 30 days.
After corroborating the economic and financial performances with the debt service, the category of the client's reliability will be established, according to the table below:

<table>
<thead>
<tr>
<th>The debt service</th>
<th>Good</th>
<th>Weak</th>
<th>Doubtful</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>performances</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>Standard</td>
<td>Under</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>observation</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Under</td>
<td>Substandard</td>
<td>Doubtful</td>
</tr>
<tr>
<td></td>
<td>observation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>Substandard</td>
<td>Doubtful</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>Doubtful</td>
<td>Loss</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E</td>
<td>Loss</td>
<td>Loss</td>
<td>Loss</td>
</tr>
</tbody>
</table>

Source: authors' proposal

For a better account, we mention that for clients the framing into reliability categories will be made after debt service, as follows:

- 'standard' category: if the client does not have rates which are non-refunded or unpaid interests;
- 'under observation' category in the case when due rates and interests are paid with a delay of up to 7 days;
- 'substandard' category: the case when due rates and unpaid interests have a delay of up to 30 days;
- 'doubtful' category: the case when the rates and interests have a delay of between 30 and 60 days and they are determined with the risk of non-payment;
- 'loss' category: the client has unpaid debt older than 60 days and is unable to honour his duties.

Once the client is placed, after his performances and the debt service, into one of the above mentioned categories, according to this, a total scoring is established which, in the end, allows to determine the interest level for the required credit.

In fundamenting the crediting decision and also in assessing the bankruptcy risk, besides financial analysis, based on financial, selective indicators, of the above type, the nonfinancial analysis is extremely useful, as we have already mentioned, and it is used more and more in the bank practice in our country (Trenca, 2007). It concerns those aspects which cannot be captured with the help of value indicators, but which can contribute to the checking of a client's reliability. It covers information which regard the client's activity, the owners (shareholders), the management, the market on which it is acted, the clients and suppliers, participants with capital to other companies, the investment projects, the applied strategies, the juridical aspects of the establishment and functioning of the company, the internal and external auditing etc. For this purpose, different methods are used in practice, one of them being the S.W.O.T. method.

5. Conclusions and proposals

Following this study and the conclusions drawn by the present work, it is also attempted by the credit institutions to propose the elaboration of a system of commensurable quality indicators which include assessing elements, such as the seniority of the economic agent in the concerned activity, the experience and seniority of shareholding and of management, the relationship history of the crediting and of debts towards the state, the technological level expressed by the age of the endowed equipment etc. By such a system, even if subjective character cannot be wholly eliminated, at least this character which is specific to these qualitative indicators would be diminished, thus being given a much more realistic credibility to the whole analysis way of the credit applicants' reliability.

This work, according to the motivation of research, of aimed objectives and of the achieved results, is focused around one extremely important element in the banking system, namely the analysis of the clients' reliability in the crediting process, in the dynamic and diverse context of the current mechanisms of the market economy, dealing with the credit risk as a conscious assumption of reality and attempting to successfully discover the best practices in its management.

Financial analysis involves a concrete analysis of the economic agent's reliability based on indicators (of liquidity, solvency, profitability etc) and it is based on the financial information provided by the client (balance, profit and loss account, trial balance, cash-flow etc), on which the crediting institutions seek to identify and quantify the risk of the client's performance, the risk of liquidity and the risk related to the capital structure and financing. Apparently, the risk of the client's performance is of the utmost importance for the creditor because it refers to the possibility that the debtor might not have a satisfactory performance, namely not to generate acceptable profits which can assure his own capacity of financing and, implicitly, of repayment of incurred loans.

As a fundamental principle, a fact must be kept in mind, namely that any economic agent can survive on significant periods with small profits or even with losses, but will never survive without cash. The capacity to pay the creditors and to pay the debts at maturity has a special importance, without it societies inevitably head
towards incapacity of payment, foreclosure and/or liquidation/bankruptcy. The one which reflects the extent to which a society had or will have financing capacity to honour the debts and to cover the necessity of investment expenses is the cash-flow situation. It provides vital information related to the change in time of the financial position of the company, namely to the manner in which the company is financed and the funds which it mobilizes are allocated.

6. Bibliography