Available online at www.sciencedirect.com

ScienceDirect

Procedia Economics and Finance 26 (2015) 278 – 285

Procedia Economics and Finance

www.elsevier.com/locate/procedia

4th World Conference on Business, Economics and Management, WCBEM

Rating as a Useful Tool for Credit Risk Measurement

Ivana Weissova[a,]*, Boris Kollar[b], Anna Siekelova[c]

[a]*University of Zilina, Faculty of Operation and Economics of Transport and Communications, Department of Economics, Univerzitna 8215/1, 010 26 Zilina, Slovakia*

[b]*University of Zilina, Faculty of Operation and Economics of Transport and Communications, Department of Economics, Univerzitna 8215/1, 010 26 Zilina, Slovakia*

[c]*University of Zilina, Faculty of Operation and Economics of Transport and Communications, Department of Economics, Univerzitna 8215/1, 010 26 Zilina, Slovakia*

Abstract

The present contribution deals with the issue of credit risk and rating, which is one of the useful tools for measuring to credit risk. Rating and credit risk are closely linked. In general, we can define credit risk as the probability of loss from a debtor's default. While rating is like a meter, by which it should be possible to compare two borrowers and determine, which of them has more likely, that in the end he pays for his obligation. In the rating process are systematic processed information about enterprise´s developments from its past and the future outlook. The rating of the enterprise is carried out by taking into account quality criteria ("soft facts") and quantitative criteria ("hard facts"). Hard facts are calculated from the financial statements of the company through the implementation of financial-economic analysis. So, hard facts provide a reliable statement about of the financial stability of the company and its financial health. The values of indicators which are achieved are combined according to their significance and then they are transferred to the internal rating scale. Then this value is used to express quantitative rating of enterprise. Present contribution is going to deal with calculation of hard facts and quantitative criteria for rating measurement. Rating assignment is going to be carried out on a model example. Hard facts are going to be determined based on the financial statements of the selected company and the rating is going to be assigned according to the rating scale which is going to be established for model example.

Peer-review under responsibility of Academic World Research and Education Center

Keywords: rating, credit risk, hard facts, financial analysis

* Ivana Weissova. Tel.: +421-41-513-3227.
E-mail address: ivana.weissova@fpedas.uniza.sk

Peer-review under responsibility of Academic World Research and Education Center
doi:10.1016/S2212-5671(15)00853-9

1. Introduction

Frajtova-Michalikova, Spuchlakova, Cug (2014) state that the relationship between rating and credit risk is closed. Like the title said rating had been a useful tool for credit risk measurement. Based on these facts we offer several chosen definitions of credit risk. So then we could go on problems with rating itself. With this idea also agree many other authors.

According to Medvedev et. al. (2012) credit risk is the risk of default which is caused by debtor failure (because he did not pay for his commitments which were agreed between himself and his creditors in certain circumstances) and thus he creates the loss claim for his creditors.

According to Hyranek and Bikar (2010) credit risk is the uncertainty moment which is connected with bank business. It means it is the risk of default which resulted from fact that debtor or other contracting part will not fulfill his commitment which was agreed in the contract. And contract was agreed according certain circumstances for example in certain time, in certain amount and then this financial transaction will not realize according agreed conditions.

Sivak et al. (2006) and Kliestik, Lyakin, Valaskova (2014) agree with the view that credit risk is the risk of default which is the result of debtor failure because he did not pay his commitments. Commitments which are caused for him from closed contract. And this way he causes the loss from claim for his creditor.

2. Rating

According to Cisko, Kliestik (2013) What exactly is rating? In everyday language, but also in the news is this term often confused with the similar assessment. However according the rating definitions, they are not rating. Rating is most often confused with scoring.

Regulation 1060/2009 of The European Parliament and of The Council on credit rating agencies, defines credit rating follows: Credit rating means an opinion regarding the creditworthiness of an entity, a debt or financial obligation, deb security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories. This opinion is also stated from other authors Adamko, Kliestik, Birtus (2014)

Zak (2002) states that Big Encyclopaedia of Economics offers even more extensive and even more exhausted definition of rating. But we reduce it for better understanding. Rating is evaluation of creditworthiness of entities. This assessment is carried out by rating agencies. Rating agencies given credit rating marks (from the worst to the best) according rating scale for rated entities. Assigned rating expresses the probability of rated entities to pay their financial commitments.

Gavlakova, Kliestik (2014) and also Misankova, Kocisova, Frajtova-Michalikova, Adamko (2014) state that it is very important to be aware of that this is not an investment recommendation whether the price of share or issue shares convenient or not. Rating also not to deal with other types of risks for example exchange risk, interest risk and so on. From this definition implies that the role of credit rating is not to assess the rated entity profitability but his creditworthiness. It means ability to pay his commitments either in the position of applicant for the credit or the issuer. The way how to create rating is different for cities, states, banks, insurance companies or enterprises. Therefore it is not possible to define single rating methodology for every one of entities. Rating is deep, methodological and time-consuming view of rated entities. These are not only numbers it is complete evaluate of entity.

2.1 The brief history of rating and rating agencies

According to Vins (2002) establishment of rating or rating industry dating back in 1909 in the United States of America. In this year John Moody started to rate bonds of railway companies and railway industry was very important industry at that time. In 1910 he extended his evaluate with other companies - public utilities and industrial companies.

Rating agencies are an integral part of the rating. In the world there are many rating agencies and these deal with rating. In the biggest and the most famous rating agencies we can include Standard & Poor´s, Moody´s Investors Service, Fitch Ratings and others such as Duff & Phelps or R&J (before that The Japan Bond Research Institute – JRBI). In Slovak republic we can find two rating agencies. These agencies are European Rating Agency (ERA) and Czech Rating Agency (CRA).