University of Business and Finance

Banking and Insurance Management

Case Study: BIM 399

Harvard Business Review: Fleet Assets Managed Division

Professor: Markus Kässer

Dikutip dari :

Case Study Concept Paper

Student: Luis Carlos Rodriguez Riquelme

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Case study for Credit Risk Management Training
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Summary

Paul Kennedy is the executive director of the Managed Asset Division for Fleet Bank. He must decide how to react to the deteriorating financial conditions of Polaroid in 2001. Fleet is part of a Syndicate that has $350 million of loans outstanding to Polaroid. Fleets exposure is of $40 million.

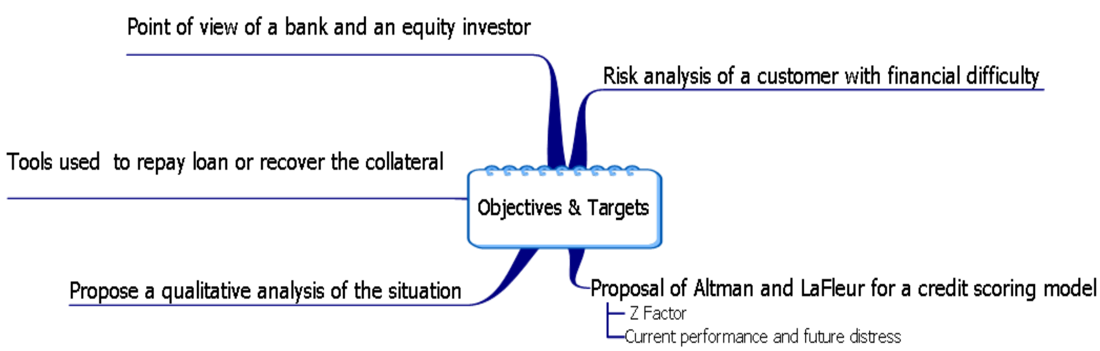
The objective of the case is to perform an adequate risk analysis with a customer with difficulties. It is proposed a quantitative and qualitative analysis of the situation and how this analysis is transformed into managerial actions.

Objectives & Targets

1. Risk analysis of a customer with financial difficulty
2. Utilize and analyse the proposal of Altman and LaFleur for a credit scoring model

    - How is defined the Z Factor?
    - How can current performance lead to future distress?

3. Difference between the point of view of a bank and an equity investor
4. Different tools used to repay loan ot to recover the collateral
5. A qualitative analysis of the risks must be considered as well.

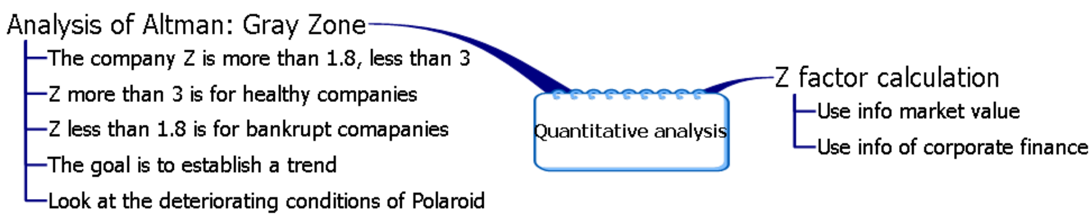


Utilization of Z score

There are some considerations that must be done for the analysis. The use of Z score as a predictor for bankruptcy provides a quantitative and reference that can be transformed into managerial actions. I explain in the following map the action plan for the calculation and interpretation of this indicator.

Calculation and analysis of the information

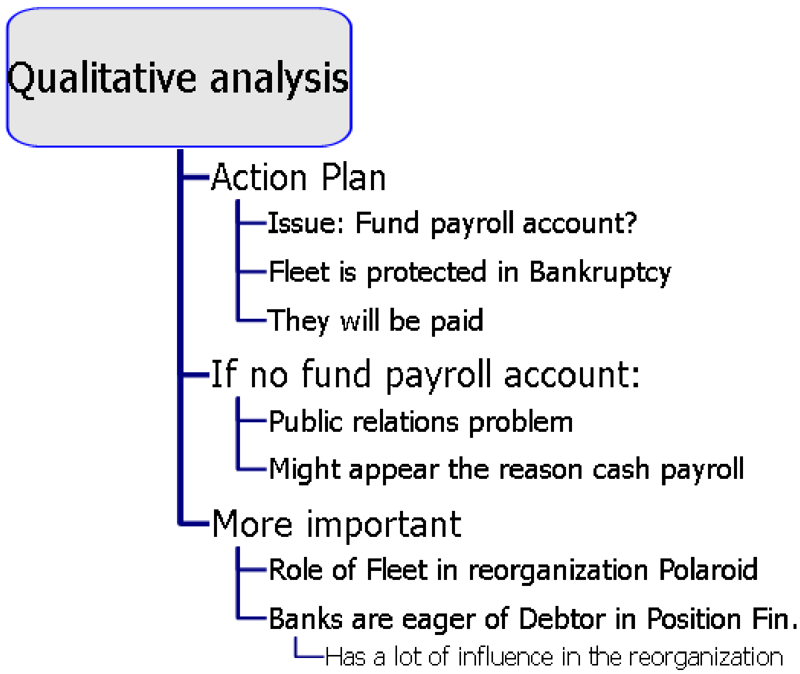
The quantitative analysis is performed according to the information provided in the case and the additional information and is used the parameter of Altman to know that the company is in the "Gray Zone", with a Z score between 1.8 and 3.0. Is important to consider that according to Altman, scores of more that 3 are for healthy companies, while lower than 1.8 are for companies with a very high probability of bankruptcy.



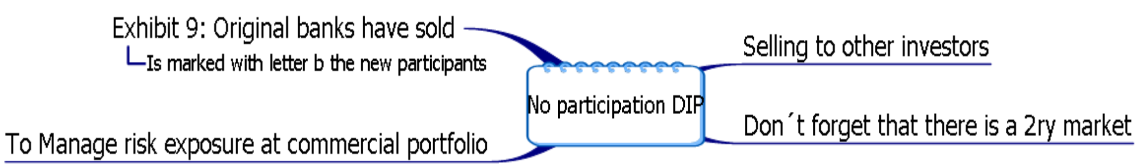
What are the choices for the workout officer?

Considering that the customer will reorganize under the Bankruptcy leads to understand the distribution of the organizational structure of the bank and understand the differences between the loan officer, the credit officer and the workout officer.

Is important consider as well the qualitative risk that has this situation for Kennedy.



Having considered that is very important the participation in the Debtor in Possession Financing, is important as well consider not participate in this process, and its consequences:



The problem of the management in this case is how to deal with the bank when it has provided a Working Capital loan. At the same time has to be considered all the negotiations that are in place between the management and the Bank Officers and the alternative and constraints that they have.

The case can be divided in three main blocks for its analysis.

1. What tell us the Z score about the risk of the bank?
2. How is the bank organized to manage the risk? Role of Workout officer
3. Economic environment of Fleet in 2001

The following is the calculation of the Z factor for Polaroid

Calculation of Z factor for Polaroid					
	Polaroid Corporation Financials				
		Dec-97	Dec-98	Dec-99	Dec-00
	Working capital	556	360	367	326
	Retained earnings	1265	1193	1160	1151
	EBIT	180.9	1	122.6	103.3
	Sales	2146.4	1845.9	1978.6	1855.6
	Total Assets	2133	2198	2040	2043
	Number of shares	45.1	44.2	44.3	45.1
	Closing Price	45	19	20	8
	Market Value of Equity	2029.5	839.8	886	360.8
	Total Liabilities	1649	1808	1669	1668
X1	**WC / Total Assets**	0.260666	0.163785	0.179902	0.159569
X2	**Ret Earn / Total Assets**	0.593061	0.542766	0.568627	0.563387
X3	**EBIT / Total Assets**	0.08481	0.000455	0.060098	0.050563
X4	**Market Value / Total Lia**	1.230746	0.464491	0.530857	0.216307
X5	**Sales / Total Assets**	1.006282	0.839809	0.969902	0.908272
Z factor = 1.2*X1 + 1.4*X2 + 3.3*X3 + 0.6*X4 + 1.0*X5					
	1.2 X1	0.312799	0.196542	0.215882	0.191483
	1.4 X2	0.830286	0.759873	0.796078	0.788742
	3.3 X3	0.279873	0.001501	0.198324	0.166858
	.6 X4	0.738448	0.278695	0.318514	0.129784
	1.0 X5	1.006282	0.839809	0.969902	0.908272
	Z FACTOR	3.167688	2.07642	2.4987	2.185139

Is necessary to analyze each X component of the equation and ask ourselves if is good to have a high Z factor. The answer is yes, when you have a higher Z factor you have more working capital, more retained earnings and better earnings. Other parameters that are less important in the calculation are the market value and the sales.

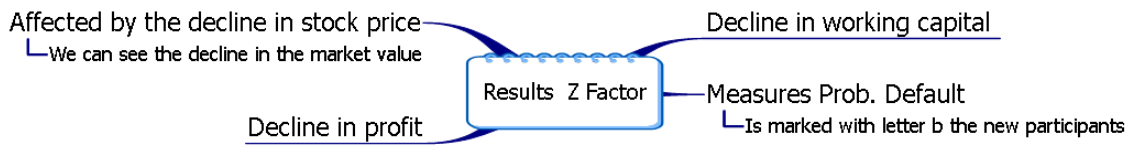
How can we get a higher Z factor?

First we see at the components with higher coefficient: working capital, more retained earnings and retained earnings. However other solution is to see that the total assets element is present in four of the five components. One has to decide if the managerial actions to decrease the total assets can be taken.

The most important result of this calculation is being able to see that an abstract calculation can lead us to managerial action.

Trend of Z factor

If we see the trend of the Z factor, we see a decline in it essentially for the decrease in the stock price, shown in the decrease in the market value as well as a decrease in the working capital and the profit of the company.



Potential Loss for Fleet

If we see the equation in page 4 of the case, we see the following equation:

Expected Loss = Probability of Default + Loss Given Default

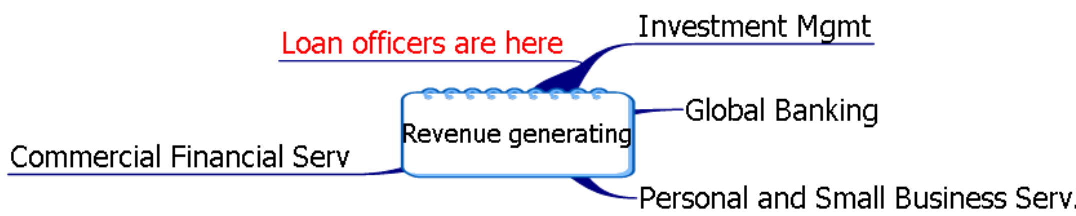
And the Loss Given Default is calculated as follows:

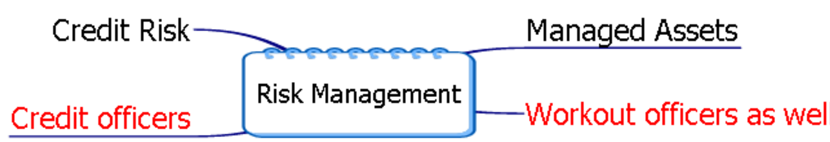
Loss Given Default = Value of Loan Outstanding – Collateral Held by Bank

How is the bank organized for risk?

If we analyze Exhibit 4 and 5 in the case study, we identify the first three divisions of Fleet as revenue generators; there we can find the loan officers. We can add as well in this category the Global Banking.

But if we ask what is really doing the risk management division doing? Essentially, their most important tasks is the analysis of credit risk and the managed assets. Here we find the credit officers and the workout officers.





Is important to underline that the banks have thin margins and high leverage. A loss loan can signify a problem. The trust is very important for a bank, the knowledge that someone is not paying them affects significantly.

To decrease the risk exposure, the credit officer analyze which borrowers are able to pay and monitor the health of current loans. They charge different costs of capital for different risk profiles.

The credit officer must work closely with the client. If the credit worthiness is lower, the management is transferred to the workout officer. They are in charge of improve the credit worthiness of the clients and preserve the value of the collateral, as well as obtain more collateral from clients.

Analyzing Exhibit 6 of the case we see the following quadrants to compare the viability of the costumer with the amount of collateral

Collateral +

Viability -			Viability +
	Prepacks Immediate 363 sale Liquidation	**Gentle Restructuring** Event driven Time and more money	
	Bleeder Middle mkt dying industry Keep alive, try improve collateral	**Classic** No enough collateral Get collateral, more collateral	

Collateral -

It should not be surprising in this example that with low viability the bank is more "patient" than when the client has low collateral. When is evaluated more collateral, is better to liquidate and not expect for more deterioration.

What should Kennedy do?

Checking the income statement in Exhibit 3 for Fleets we can conclude the following:

Net Income:
From 3.9 M to 0.931 M

Provision for credit Loses
From 1.3 M to 2.3 M

Net Loans
From 132 M to 123 M

* This last figure can mean that de lending opportunities have declined or the bank is more selective.

ROE
From 20.2 % to 5.3%

Thinking about the risk of Polaroid is important to analyze what collateral is available and discussions have to take place between Kennedy and other members of the syndicate. He has to think about how much is possible to sell of the $40 M of Fleet in the Syndicate.

Here is important to consider that any shortfall between the sale price and the $40 M is a loss. But is better a loss now of wait for further deterioration of the collateral.

However, the negative side of the sell can be that Fleet loss influence in the DIP Financing, losing good opportunities to make profit. Is important to consider as well the effects in the public image that can have the sell the loan.