

Credit Risk Analysis Based on Case Study of Al-Arafah Islami Bank Limited

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Letter of Transmittal

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To

Assistant Professor Mrs. Nusrat Farzana
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Subject: Submission of internship report on Credit Risk Analysis on the basis of case study of Al-Arafah Islami Bank Limited(AIBL).

Dear Ma'am,

It is indeed a best feeling for me to get the opportunity to deliver the internship report of Credit Risk Analysis on the basis of case study of Al- Arafah Islami Bank Limited(AIBL) to complete the necessities for the Bachelor of Business Administration Degree. The report is the result of the knowledge which has been acquired from the respective internship course.

I tried my level best for preparing this internship report.

I hope that you will find this plan worthy reading. Please feel free for any query or classification that you would like me to explain.Hope you will appreciate my hard work and excuse my minor errors. Thanking you for your cooperation.

Sincierly yours,

Sadia Zannat

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Acknowledgment

The journey of internship has been a very tactful way for me to understand about the applied knowledge that exist outside of our bookish knowledge. By performing this internship program I have come across about the office situation but also boosted up my internal skills and self confidence.

Firstly, I wouldn't like to miss the opportunity to convey my best regards to my academic supervisor Mrs Nusrat Farzana, Assistant Professor, School of Business & Economics, United International University, for giving me her precious time to communicate and guiding me throughout the internship journey.

Moreover, I also like to convey my cordial gratitude to Md. Shyfur Rahman, SPO & BAMLCO AS. of AIBL for the direction to giving me essential information as well as the other employees of Al- Arafah Islami Bank Limited of Shyamoli Branch.

Finally, I am super grateful to United International University for organizing the internship program which has given us an oppurtuntiy to acquire some external knowledge and work experience.

Executive Summary

I have done the report on the basis of the case study of credit risk of Al- Arafah Islami Bank Limited . I have used both primary and secondary data to prepare the report.

Also I have used the history, mission and vision of Al- Arafah Islami Bank Limited. Then in the theoretical framework I have provided where we get credit related information then what things I have to give focus when I am doing credit risk evaluation and how I have to do credit scoring.

In the analysis part I have done qualitative and quantitative analysis. To do that I have used 3 years data of the Sapphire Design Limited and then done calculation in excel after that used in the report then done graph of qualitative and quantitative analysis and total graph. Also giving the assessment criteria based on that I have done how Al-Arafah Islami bank Limited used to do credit risk rating of their borrower.

At last in the findings we provide what things that Al- Arafah Islami Bank Limited followed and in the recommendation give some suggestions . At last, in conclusion we see Al- Arafah Islami Bank Limited always try to get their better version about credit risk administration therefore they can increase revenues and decreases damages.

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Chapter1- Introduction

1.1 Introduction

Upgrading financial circumstances of a nation's different types of financial institution are defining as the most essential fact in this matter. Among them banking sector is playing most important role. There are two types of bank like public & private bank in the upgrading country named Bangladesh, which are playing major role in the sector like management of capital, opportunities of employment and so more.

1.2 Background of the Report

The report named "Credit Risk Analysis based on case study of Al-Arafah Islami Bank Limited(AIBL)" to complete the requirements of the Bachelor of Business Administration Degree of United International University.

1.3 Objective of the report

The major objective is to analysis Credit Risk based on case study of Al-Arafah Islami Bank Limited(AIBL) to complete the requirements of the Bachelor of Business Administration Degree.

1.4 Scope of the Report

The report has been concerned about the credit risk management of AIBL. In this report overall credit risk management of AIBL has been discussed .

1.5 Methodology of the Report

I have used both Primary & Secondary data to prepare the report.

1.5.1 Primary Data

* Through direct communication with bank's employees.

1.5.2 Secondary Data

* Yearend Report of AIBL

* Separate types of journal and books connected to banking. Also used some data from the internet.

1.6 Limitations of the Study

- For the purpose of confidential security and obligation some data are not provided by the AIBL.
- Due to their busy corporate schedule employees of AIBL didn't give me much time that I have expected in certain circumstances.

Chapter2- Overview of the Company

2.1 History of Al- Arafah Islami Bank Limited

Well Al- Arafah Islami Bank which was founded on 18 June 1995 like a nationwide institution so that it can get prosperity in world and after here. This AIBL is always following the direction of Holy Quran and the path of Rasul (SM).

2.2 Mission of Al- Arafah Islami Bank Limited

- To gain satisfaction of Almighty Allah is the major fact here and here after.
- Following Shariah in banking activities.
- Attempting advanced technology to provide upgrading financial services.

2.3 Vision of Al- Arafah Islami Bank Limited

- Intellectuality and brilliance of the directors and the satisfaction of Almighty Allah has made Al- Arafah Islami Bank Limited as one of the best leading bank in our nation.

Chapter3- Theoretical Framework

3.1 Explanation of Credit Analysis

Credit analysis defines ratios which points the feasibility of fault.

3.2 Credit Data

If a bank like to take data retated to clients there are available couple of ways. Apparently source of data are usually provided to evaluate creditworthiness include the following:

- A bank can use a client's financial statements like income statements, balance sheets and so more.
- Different types of credit reports related to the client's pasttime of account with other corporate institution.
- The most often used paths to get data related to the likelihood of clients not paying is to evaluate whether they have settled previous responsibility.

3.3 Credit Assessment

Well, there are no specific rules of evaluating the feasibility that a client will not pay. But the five things that are moral ways to assess. These are-

- preparedness to payloan duties.
- Authority of the clients to provide loan duties beyond activiting cash flows.
- Economical storage of the clients.
- If loan is not pay due to disablity certain asset need to be promised.
- Common financial stability for the clients in terms of trade.

3.4 Credit Scoring

The method of counting score on the basis of data gathered after that on the basis of score loan will be accepted or rejected. A bank may give loan only those clients who have a score above 59 percent.

Chapter4- Analysis of Credit Risk Rating System of Al- Arafah Islami Bank Limited

At first AIBL has taken three years of data of the firm about the balance Sheet, Profit and Loss Statement & Cash Flow Statement. After that AIBL has done Validation of the three Statement. Then AIBL is used Quantitative Analysis and Qualitative Analysis to analysis the credit risk of the firm.

4.1 Quantitative Analysis

Under Quantitative Analysis AIBL is using six Criteria. These are-

A. Leverage

1. Financial Debt to Tangible Net Worth(DTN)
2. Financial Debt to Total Assets (DTA)

B. Liquidity

1. Current Ratio (CR)
2. Cash Ratio(Cash)

C. Profitability

1. Net Profit Margin(NPM)
2. Return on Assets(ROA)
3. Operating profit to Operating Assets(OPOA)

D. Coverage

1. Interest Coverage(IC)
2. Debt Service Coverage Ratio(DSCR)
3. Operating Cash flow to Debt Ratio (CDR)
4. Cash Flow Coverage Ratio(CCR)

E. Operational Efficiency

1. Stock Turnover Days(STD)
2. Trade Debtor Collection Days(TDCD)
3. Asset Turnover(AT)

F. Earning Quality

1. Operating Cash Flow to Sales (CFS)
2. Cash flow based Accrual Ratio(CAR)

Quantitative Indicators(60)

Criteria	Scale	Actual Parameter	Score Obtained
A. Leverage	10		10
1. Financial Debt to Tangible Net Worth(DTN)	7	0.048014629	7
2. Financial Debt to Total Assets (DTA)	3	0.029952945	3
B. Liquidity	10		10
1. Current Ratio	7	19.40371173	7
2. Cash Ratio	3	1.114082732	3
C. Profitability	10		10
1. Net Profit Margin(NPM)	5	0.08397869	5
2. Return on Assets(ROA)	3	0.080204817	3
3. Operating Profit to Operating Assets(OPOA)	2	0.087852147	2
D. Coverage	15		15
1. Interest Coverage(IC)	3	20.04	3
2. Debt Service Coverage Ratio(DSCR)	5	21.04	5
3. Operating Cashflow to Debt Ratio(CDR)	4	57.41	4
4. Cashflow Coverage Ratio(CCR)	3	55.03333333	3
E. Operational Efficiency	10		7
1. Stock Turnover Days(STD)	4	132.6666667	2
2. Trade Debtor Collection Days(TDCD)	3	4.333333333	3
3. Asset Turnover(AT)	3	0.942633333	2
F. Earning Quality	5		5
1. Operating Cash Flow to Sales(CFS)	3	0.229646877	3
2. Cashflow based accural ratio (CAR)	2	-0.086666667	2
Sum	60		57
Percentage		95%	

Through this quantitative indicator Al- Arafah Islami Bank limited has done quantitative analysis of the borrower.

4.2 Qualitative Analysis

Under qualitative analysis the following factors will be focused-

- A. Representation of Characteristic
- B. Business and Industry Risk
- C. Administration Risk
- D. indemnity Risk
- E. Connection Risk
- F. Permissible Risk

Based on these things Al- Arafah Islami Bank is doing qualitative analysis. Broadly discussed in the next page.

	Criteria	Parameter	Score	Actual Parameter	Score Obtained
G	<i>Representation Characteristics</i>		10		10
G.1	Attitude towards financing bank				
G.1.1	Within 3 years how long the adopter was antithetically pointed			0 term	5
	[antithetically pointed defines the adopter's debt pointed as per BB debt explanation rules such as SS,DF,BL]	0 terms	5		
		1term	4		
		2terms	3		
		3 terms	1		
		>3terms	0		
G1.2	Within last 3 years how long the adopter's debt was rearranged			0 terms	4
		0 term	4		
		1terms	3		
		2 terms	2		
		3terms	1		
		>3 terms	0		
G.2	Attitude towards distributors			Agree	1
	Within 1 year did the adopter pay its distributors frequently	Agree	1		
		Disagree	0		

	Criteria	Parameter	Score	Actual Parameter	Score Obtained
H	Business & Industry Risk		7		4.75
H.1	Selling Extention			Below 5%	0
	*selling extention definens yearend sale growing	>10%	2		
	The way of counting selling extention is[(recent year sales -past year sales)/past year sales]*100	5% to 10%	1		
		Less than 5%	0		
H.2	Age of Business			Above 10 years	2
	How long the adopter doing in this way of trade	>10years	2		
		7 - 10 years	1.5		
		5 - 7 years	1		
		4 - 5 years	.5		
		<4 years	0		
H.3	Industry expectation			Stable	0.75
	Crucial evaluation of five years expectation of enterprise and adopterr's sales vacillation	increasing & Low vacillation	1		
	* vacillation defines dealing suspincion	Stable	0.75		
		increasing but High vacillation	0.5		
		decreasin g	0		
H.4	Extented Term External Credit Rating of the adopter			1	2
		1	2		
	Rating Grade should be marked in line with BB Rating Mapping as per BRPD circular 18/2014	2&3	1.5		
		>3	0.5		
		Unrated	0		

	Criteria	Parameter	Score	Actual Parameter	Score Obtained
I	Administration Risk		7		4
I.1	Expertness of administration			Above 10 years in the connected line of commerce	2
	Efficiency of the administration on the basis of sum number of ages of expertise of the best administrators in the enterprise	Above 10 years in the connected line of commerce	2		
	*BestAdministrators defines MD&next two stages	5-10 years in the connected line of commerce	1		
		Below 5 years	0		
I.2	Presence of legacy schedule			Yes, with better retention of legacy	2
		Yes, with better retention of legacy	2		
		Yes, but doubttable retention of legacy	1		
		No legacy	0		
I.3	Observing Firms			Un authorised	0
	BSEC listedobserver are defined as identified	Identified observer	2		
		Other observer	1		
		Un authorised	0		
I.4	switch in outer observer within last 4 years			Disagree	0
		Agree	1		
		Disagree	0		

	Criteria	Parameter	Score	Actual Parameter	Score Obtained
J	Indemnity Risk		11		9.5
J.1	Basic Indemnity			Affixed Hypothecation	1.5
		Entierly Promised advantages	2		
		Affixed Hypothecation	1.5		
		2 nd Charger	1		
		No indemnity	0		
J.2	Mortgage			Affixed collateral onMunicipal Corporation	2
		Affixed collateral onMunicipal Corporation	2		
		Affixed collateral on Pourashava	1.5		
		reasonable mortgage	1		
		No mortgage	0		
J.3	Applicable mortgage blinker			Above 100%	5
	The law of applicable mortgage blinker is[applicable mortgage/ sum debt]	Above100%	5		
		80% -100%	4		
	*applicable mortgage should be defined as per BRPD circular no 14 issued on September23,2012	70%- 80%	3		
		50% - 70%	2		
		Below 50%	0		
J.4	Kind of security			Private security orCorporate security without potential economical power	1
		Govtsecurity/Banksecurity	2		
		potentialCorporatesecurity	1.5		
		private security or Corporate security without potential economical power	1		

	Criteria	Parameter	Score	Actual Parameter	Score Obtained
K	Connection Risk		3		3
K.1	Account dealing	Above 3 years Accounts with flawless file	3	Above 3 years Account with flawless file	3
		below 3 years Accounts with flawless file	2		
		Doing favorable account conduct with few dues	1		
		Often late payment & fitful conduct in account	0		
L	Permissible Risk		2		2
L.1	Permission with nature regulations			Agree	1
		Agree	1		
		Disagree	0		
L.2	Associated Regime			Better Associated Regime	1
	** Independent of Management	Better Associated Regime	1		
		Doubtable Associated Regime	0		
Sum			40		33.25
Percentage			83.1%		

Through this qualitative indicator Al- Arafah Islami Bank Limited is done qualitative analysis of the borrower.

4.3 Graph of Quantitative Score,Qualitative Score& Total Score



Assessment Criteria:

Greater than or equal to 80%= Excellent, 70% Up to 80%= Good
60% Up to 70%=Marginal, Less than 60%=Unacceptable

4.4 Summary of Credit Risk Rating System

	Score Obtained	Scale	Percentage	CRR(Credit Risk Rating)
Quantitative Assessments	57	60	95%	Excellent
A. Leverage	10	10	100%	Excellent
B. Liquidity	10	10	100%	Excellent
C. Profitability	10	10	100%	Excellent
D. Coverage	15	15	100%	Excellent
E. Operational Efficiency	7	10	70%	Good
F. Earning Rating	5	5	100%	Excellent
Qualitative Assessments	33.25	40	83.1%	Excellent
G. Representation of Characteristics	10	10	100%	Excellent
H. Business & Industry Risk	4.75	7	67.9%	Marginal
I. Administration Risk	4	7	57.1%	Unacceptable
J. indemnity Risk	9.5	11	86.4%	Excellent
K. Connection Risk	3	3	100%	Excellent
L. Compliance Risk	2	2	100%	Excellent
Aggregate	90.25	100	90.3%	Excellent

So I can say AIBL can give loan to the Sapphire Design Limited.

Chapter-5 Findings, Recommendations & Conclusion

5.1 Findings

During my internship journey I have got some findings about the AIBL which are given below-

1. The bank always tries to follow the regulation of the Bangladesh Bank to investigate the credit risk.
2. Getting economical survey and confidential documentry from the customer is tough.
3. Sometimes greater operating expense than the higher debt services arranged by the bank because of keenly observation of the credit operation.

5.2 Recommendations

On the basis of the findings the following recommendations are given below-

1. Efficient training program should be arranged by the AIBL so that workers can be more expertise in doing their own work.
2. The bank helps their customers to understand about the credit rules.

5.3 Conclusions

Well for any economical company loan is one of the most essential part due to producing revenue and boost up financial functions of the nation. Moreover due to inborn danger, loan has to fulfill the necessities of the debtor accurate usage are very essential. As a sum up of the matter that the Al-Arafah Islami Bank Limited always tries to evaluate the credit risk factors which are connected to the loans. It always tries to follow the regulation of Bangladesh Bank to evaluate the credit risk. At the end of the conclusion they always try to get their better version about credit risk administration therefore they can increase revenues and decrease damages.

Bibliography

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2. Corporate Finance, Twelfth Edition, by Ross, Westerfield ,Jafee ,Jordan

Appendix

Quantitative Assessments					
		2019	2020	2021	Average
Leverage					
DTN	Total liabilities/Tangible net worth	0.012884013	0.069717868	0.061442006	0.048014629
DTA	total debt/total asset	0.008549142	0.043714988	0.037594706	0.029952945
Liquidity					
Current Ratio	current asset/current liabilities	39.35523114	8.53192446	10.32397959	19.40371173
Cash Ratio	Cash& Marketable Securities /current liabilities	2.554744526	0.384442446	0.403061224	1.114082732
Profitability					
Net Profit Margin	(Net profit/Total revenue)*100	8.58%	8.26%	8.36%	0.08397869
Return on total asset (ROA)	Net Income/Total Asset	8.13%	7.88%	8.05%	0.080204817
OPOA	EBIT/Average Total Assets	8.91%	8.63%	8.82%	0.087852147
Coverage					
Interest Coverage(IC)	EBIT/Interset Expense	20.04	20.04	20.04	20.04
Debt Service Coverage Ratio(DSCR)	Net Operating Income/ Debt Service	20.04	21.04	22.04	21.04
Operating Cash flow to debt ratio(CI)	Cashflow from operations/Total debt	57.41	55.41	59.41	57.41
Cash flow Coverage Ratio(CCR)	operating cash flow/total debt	55.89	53	56.21	55.03333333
Operational Efficiency					
Stock Turnover Days(STD)	COGS/Average inventories	133	130	135	132.6666667
Trade Debtor Collection Days (TDCD)	(Avg. account receivable/ annual total sales)*365 days	4	5	4	4.333333333
Asset turnover(AT)	Total Sales/((begining assets+ending assets)/2)	94.79%	93%	95%	0.942633333
Earning Quality					
CFS	operating cash flow/sales	27.59%	19.72%	21.58%	0.229646877
CAR		-0.09	-0.09	-0.08	-0.086666667