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VALUE-BASED APPROACH TO THE ASSESSMENT OF BORROWER'S CREDITWORTHINESS

This study set out to develop a new approach to the solution of the problem of loan underwriting including the assessment of the borrower's creditworthiness and loan terms' scheduling [1]. In response to this problem, we treated the loan as the bank's investment project and applied the value-based analytical approach typical of investment analysis and project evaluation to the assessment of credit's economic appropriateness.

The findings of this study suggest that the usage of the internal rate of return as a criterion for loan granting decision at the initial stage of loan underwriting allows: (1) to eliminate the limitation which is common to the main types of loans where the occurrence of the indiscrete series of the positive cash flows to serve debt is a must; (2) to simplify the process of credit pre-screening at the bank through the use of a minimum number of essential parameters.

The usage of IRR calculated based on the project's expected cash flows earmarked for loan servicing as a hurdle rate offers lender an opportunity:

- to define the credit terms taking into consideration the distribution of positive cash flows throughout the duration of the project's economic life;
- to calculate the possible real effective interest rate concerning the borrower's nonstandard schedule of cash flows;
- to make a rough analysis on the economic efficiency of lending and state the necessary criterion to initiate the procedure of loan underwriting for the projects with a nonstandard schedule of cash flows where the calculated hurdle rate represented by IRR outnumbers the lender's cost of capital;

- to state the sufficient criterion to perform the procedure of loan underwriting where calculated hurdle rate represented by the IRR value outnumbers the market prevailing (or corporate recommended) credit interest rate.

An additional point is that the proposed IRR-approach to the cash flows' analysis can also be initially used by borrower as a tool for the credit solvency's self-testing [2] via screening of periods with corresponding cash flows that can be used for loan servicing. Hence the proposed approach can also be treated as an attempt to use some elements of financial engineering to create the distinct credit products that tailor terms of a loan to needs of the borrower.

References:

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Капіталізація компаній: позитивні наслідки пандемії Covid-19

Для світової економіки XXI сторіччя вже ознаменувалось безліччю потрясінь. Варто відзначити, що широке коло вчених висували теорії про настання фінансової кризи у 2020 році. Деякі з них спирались на волатильність, інші – на те, що вже тривалий час ситуація є стабільною і тому криза повинна