# UNIVERSITI TEKNOLOGI MARA

# DETERMINANTS OF CREDIT RISK OF DISTRESSED COMPANIES IN MALAYSIA

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# ABSTRACT

The effect on economy of businesses and banks failure is excessive, especially to the parties who will bear the consequences such as shareholders, managers, and employees. Businesses and banks failure indicate that they are financially distress when they are unable to meet its financial obligations as at when due. Financial distress companies usually have higher credit risk than those companies who are not in distressed since credit risk is associated with the risk of inability of a counterparty to perform its obligations. In Malaysia, companies that are listed in Bursa Malaysia but in distressed state are listed in PN17 and GN3 lists. The aim of this study is to examine the determinants of credit risk of financially distressed companies in Malaysia by using financial ratios as suggested by Altman (1968) which are liquidity, leverage, profitability, and efficiency. The credit risk ratio is used to assess the factors that affecting company's financial stability. Financial data was collected from financial statements from 2010 to 2019 as part of a descriptive research design. Finding from this study states that credit risk of distressed companies in Malaysia is based on financial leverage, where the higher the debt, the higher the dependency of the firm to debt financing, thus lead to financial distress and liquidity level where even firms that have high ability to convert its assets into cash, they do not necessarily can cover their obligations as at due, leads to higher credit risk.The result of this study will be useful to managers and owners of the companies, existing and potential shareholders, and the Government on the matter of controlling, reducing, and avoiding the credit risk.

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# CHAPTER ONE
# INTRODUCTION

## 1.1 Introduction

According to Bank Negara Malaysia (BNM), credit risk is defined as the risk of inability of a counterparty to perform its obligations. In banking sector, credit risk has become the dominant risk as banks involve with the core business of loan lending and deposit activities (Basel Committee, 2001). Credit risk is one of the most significant challenges faced by commercial banks, and the ability to handle it has a significant impact on the profitability of the institution (Mileris 2012). Credit risk in banking industry is much riskier to the economy as it leads to a contagious panic and causing domino effect as the losses of default will be bear by many parties including banks' shareholders, Government, and depositors (Manab, Theng et al. 2015). Managers, shareholders, lenders, and workers are all worried about the financial health of their business.

Managers and workers' job security can be jeopardised if their companies face financial difficulties. The equity status of shareholders and the claims of lenders are also not assured. As a regulator in a competitive market, the government is concerned about the implications of financial distress for businesses and banks, and the regulatory capital requirement is how the government regulates capital adequacy (Mingo 2000). The possibility that a company will be unable to fulfil its financial obligations when they become due is also referred to as financial distress. According to Baimwera and Muriuki (2014), a company in financial trouble is normally in a cash crunch, making it impossible to pay overdue sums by the due date. The escalating credit risk during recent years among distressed firms are caused by the operating and net cash flow margin (Andrade and Kaplan, 1998). In addition, firms with high leverage are also most likely to fall into distressed firms.

Healthy economic systems are typically centred on a complex network of large, medium-sized, and small businesses, according to economic history. Since banks perform critical roles in a country's financial system and across the organisation, many countries have implemented prudential regulation mechanisms to reduce the risk of financial instability,