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Loan Management and Performance of Deposit Money Banks in Nigeria: A Comparative Analysis

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Abstract:
This study investigated how loan management impact on performance of Deposit Money Banks in Nigeria covering the period 2000 - 2021 with special emphasis on First Bank, Access Bank, and United Bank for Africa. The model in the study used secondary data obtained from annual report and accounts of the selected banks for the period under study to determine the effect of loan management (through Loans and Advances and Non-performing loans of banks) on performance of the selected banks (through Return on Asset). The Data were analyzed using ratio analysis and Ordinary least square method. The specific finding of the work is that return on asset has inverse relationship with non-performing loans while they are positively related to loans and advances. The conclusion is that there is a significant relationship between bank performance and loan management. The study then suggests that deposit money banks should set up an efficient structure for loan management.

Keyword: Deposit Money Bank, Return on Asset, Loan and Advances and Non-performing Loans

INTRODUCTION

The banking industry has continued to play a crucial role in the economic development of economies such as Nigeria. This is because banks are able to simultaneously satisfy the needs and preferences of both surplus and deficit units (Owojori, 2011). They therefore contribute to the real productivity of the economy and to the overall standard of living. It is universally acknowledged that the banking industry plays a catalytic role in the process of economic growth and development (Uwuigbe, Uwuigbe and Daramola, 2014). This acknowledgement is reinforced by contemporary conceptualization to the effect that banks are veritable vehicles for mobilizing resources (funds) from surplus units and channeling them to deficit units.

Functions of Deposit Money Banks are to serve in creation of money, payment mechanism, pooling of savings, extension of credits, financing of foreign trade, trust service, safekeeping of valuables and brokerage services. The main function of banks is to receive deposits from individuals who have savings; these deposits are kept in various types of accounts opened in the bank. They lend from those deposits to those in need and charge interest. The Nigerian banking industry has been strained by the deteriorating quality of its credit assets as a result of the significant dip in equity market indices, global oil prices and sudden depreciation of the naira against global currencies (BGL Banking Report, 2010). These have worsened recently as Nigerian banks are contending with the effects of earnings from weak oil prices, shortages of US dollars, devaluation of the naira and slowing economic growth.

The drop in oil prices and the concomitant decline in the value of the naira against the dollar are severely testing the resilience of the recently reformed banking sector, according to a report entitled, "Cheap oil will test Nigerian banks resilience," by British researcher Oxford Analytica published on Nov. 25, 2015. After oil companies and the public sector, banks are the next most

vulnerable to falling oil prices. This is raising fresh concerns about the prospects of a repeat of the 2008-09 banking crisis. The low price of oil has led to a sharp increase in non-performing loans in Nigerian banks because many banks are heavily exposed to the oil sector.

Growth-wise, FBN Quest Limited, a research and investment banking arm of FBN Holdings Plc revealed that Nigerian banks are experiencing their slowest year since the last crisis (2009).

The industry ratio of non-performing loans net of provision to capital increased significantly to 30.9 per cent at end-June 2016 from 5.9 per cent at end-December 2015, depicting weak capacity of the sector to withstand the adverse impact of non-performing loans. "Non-performing loans in the period under review grew by 158 per cent from N649.63 billion at end-December 2015, to N1.679 trillion at end-June 2016", (CBN, 2016). It is however noted that only a few large banks showed resilience to the rising credit risk, even at the point of a very high per cent increase in the NPLs, while the others showed vulnerabilities. Amidst the economic situation facing financial institutions in Nigeria, it is important to know the current shape of loan management (credit risk management) in banks vis-à-vis the performance of Deposit Money bank. It is therefore imperative to lift the veils behind sustainable performance of banks even in a stressed financial system such as being experienced now in Nigeria. It is these problems that this research work aims at examining with a view to finding reasonable solutions.

CONCEPTUAL REVIEW

Loan Management and Credit Risk

Risk is defined as something happening that may have an impact on the achievement of objectives, and it includes risk as an opportunity as well as a threat (Audit Office, 2000). Credit risk is the risk that a loan which has been granted by a bank, will not be either partially repaid on time or fully (Campbell, 2007), and where there is a risk of customer or counterparty default (Gray, et al., 1997). There are many potential sources of risk, including liquidity risk, credit risk, interest rate risk, market risk, foreign exchange risk and political risks (Campbell, 2007). However, credit risk is the biggest risk faced by banks and financial intermediaries (Gray, Cassidy, and RBA., 1997). The indicators of credit risk include the level of bad loans (non-performing loans), problem loans or provision for loan losses (Jiménez and Saurina, 2006).

Credit risk arises whenever a lender is exposed to loss from a borrower, counterparty, or an obligor who fails to honour their debt obligation as they have contracted (Luy, 2010). According to Colquitt (2007), this loss may derive from deterioration in the counterparty's credit quality, which consequently leads to a loss to the value of the debt, or according to Crouhy, et al., (2006), the borrower defaults when he is unwilling to fulfill the obligations. Increasing shareholders' return with bank performance is one major objective of banks' management.

This is done by charging interest on loans to customers which are normally established taking into consideration the prevailing market rate and the established bank rate by the apex bank in the economy. The interest rate being charged on loans by the Deposit Money Banks is normally higher than the bank rate being approved by the apex bank, and building into it other charges as may be determined by the banks.

Bank performance is usually measured by profitability. Also, profitability is normally proxied by two alternative measures: the return on assets (ROA), which is the ratio of profits to assets and return on equity (ROE), which is profit to equity ratio. Generally, ROA shows the ability of banks

management to generate profits from the banks' assets, which may be biased due to off-balance-sheet transactions. On the other hand, ROE, which is often referred to as bank's equity multiplier, indicates the return to shareholders on their equity and it equals return on assets times the total assets-to-equity ratio. Banks with high equity and low leverage in the capital structure usually report high ROA, but low ROE. However, the analysis of return on equity (ROE) ignores the high risk associated with high leverage, and bank financial leverage is usually determined by monetary authorities. Hence, ROA emerges as the key ratio for analyzing bank profitability (IMF, 2002).

The return on assets (ROA) is a ratio that measures company earnings before interest & taxes (EBIT) against its total net assets. The ratio is considered an indicator of how efficient a company is using its assets to generate before contractual obligation must be paid. It is calculated as: ROA= EBIT/ Total Assets. Return on assets gives a sign of the capital strength of the banking industry, which will depend on the industry; banks that require large initial investment will generally have lower return on assets (Appa, 1996).

THEORETICAL REVIEW

Determining Performance and Financial Position of Banks

CAMELS Theory:

The 'CAMELS' approach was developed by bank regulators in the US as a means of measurement of the financial condition of a financial institution. Accordingly, the 'Uniform Financial Institutions Rating System' was established by the Federal Financial Institutions Examination Council in the US. Here, the acronym 'CAMELS' stands for, Capital Adequacy (C), Asset Quality (A), Management (M), Earnings (E), Liquidity (L) and Sensitivity to Market Risk (losses arising from changes in market prices) (S).

(i) **Capital Adequacy:** Capital adequacy is measured by the ratio of capital to risk-weighted assets (RWA). A sound capital base strengthens confidence of depositors

(ii) **Asset Quality:** One of the indicators for asset quality is the ratio of non-performing loans to total loans (GNPA). The gross non-performing loans to gross advances ratio is more indicative of the quality of credit decisions made by bankers. Higher GNPA is indicative of poor credit decision-making.

(iii) **Management:** The ratio of non-interest expenditures to total assets (MGNT) can be one of the measures to assess the working of the management. . This variable, which includes a variety of expenses, such as payroll, workers compensation and training investment, reflects the management policy stance.

(iv) **Earnings:** It can be measured as the return on asset ratio.

(v) **Liquidity:** Cash maintained by the banks and balances with central bank, to total asset ratio (LQD) is an indicator of bank's liquidity. In general, banks with a larger volume of liquid assets are perceived safe, since these assets would allow banks to meet unexpected withdrawals.

(vi) **Sensitivity to Market Risk** (losses arising from changes in market prices) (S).

Credit Risk Theory:

Credit risk, as defined by the Basel Committee on Banking Supervision (2001), is also the possibility of losing the outstanding loan partially or totally, due to credit events (default risk). It can also be defined as the potential that a contractual party will fail to meet its obligations in accordance with the agreed terms. Credit risk is also variously referred to as default risk, performance risk or counterparty risk (Brown and Moles, 2012). Credit risk is by far the most significant risk faced by banks and the success of their business depends on accurate

measurement and efficient management of this risk to a greater extent than any other risks (Gieseche, 2004). Credit risk is critical since the default of a small number of important customers can cause large losses, which can lead to insolvency (Bessis, 2002).

Although people have been facing credit risk ever since early ages, credit risk has not been widely studied until recent 30 years. Early literature (before 1974) on credit uses traditional actuarial methods of credit risk, whose major difficulty lies in their complete dependence on historical data. Up till now, there are three quantitative approaches of analyzing credit risk structural approach, reduced form appraisal and incomplete information approach (crosbie et al, 2003).

EMPIRICAL AND METHODOLOGICAL REVIEW

Kargi (2011) evaluated the impact of credit risk on the profitability of Nigerian banks. Financial ratios as measures of bank performance and credit risk were sourced from the annual reports and accounts of sampled banks from 2004-2008 and analyzed using descriptive, correlation and regression techniques. The findings revealed that credit risk management has a significant impact on the profitability of Nigerian banks. It concluded that banks' profitability is inversely influenced by the levels of loans and advances, non-performing loans and deposits thereby exposing them to great risk of illiquidity and distress.

Owojori et al (2011) highlighted those available statistics from the liquidated banks clearly showed that inability to collect loans and advances extended to customers and directors of companies, relatives to directors/managers was a major contributor to the distress of the liquidated banks. At the height of the distress in 1995, when 60 out of the 115 operating banks were distressed, the ratio of the distressed banks' non-performing loans and leases to their total loans and leases was 67%. This deteriorated to 79% in 1996, to 82% in 1997 and by December 2002, the licenses of 35 of the distressed banks had been revoked.

On studies that found a direct relationship between credit risk and bank performance, Kosmidou, Tanna and Pasiouras (2005) examined the determinants of profitability of Domestic UK Deposit Money banks from the period of 1995 to 2012. The findings of their study provide the evidence that credit risk affect positively the bank profitability. The study carried out by Ben-Naceur and Omran (2008) to examine the impact of bank concentration, regulations, financial and institutional development on bank profitability in middle East and North Africa countries from 1989 to 2005, found that credit risk has positive and significant effect on bank profitability and cost efficiency.

Mekasha (2001) investigated credit risk management and its impact performance on Ethiopian Commercial Banks. The researcher used 10 years panel data from the selected commercial banks for the study, to examine the relationship between ROA and loan provision, non-performing loans and total assets. The study revealed that there is a significant relationship between bank performance and credit risk management.

Charles, Okaro Kenneth (2013) examined the impact of credit risk management on capital adequacy and banks financial performance in Nigeria. For this purpose, six banks were selected by using positive sampling technique. Data were obtained from the published financial statements from 2004 to 2009. Panel data model was used to estimate the relationship that exists among Loan Loss Provisions (LLP), Loans and Advances (LA), Non-performing Loans (NPL), Capital Adequacy (CA), and Return on Assets (ROA). Results showed that sound credit risk

management and capital adequacy related positively on banks' financial performance with the exception of loans and advances which was found to have a negative impact on banks' profitability in the period under studiedBased on the findings, they recommended that Nigerian banks establish appropriate credit risk management strategies by conducting rigorous credit appraisal before loan disbursement and drawdown. It is also recommended that adequate attention be paid for Tier-one capital of Nigerian banks.

Kolapo, Ayeni and Ojo (2012) using panel data regression for the period 2000 to 2010 found that the effect of credit risk on bank's performance measured by the Return on Asset (ROA) of banks is cross-sectionally invariant. They concluded that the nature and managerial pattern of individual firms do not determine the impact. Also, Hosna, Manzura and Juanjuan (2009) reemphasized the effect of credit risk management on profitability level of banks. They concluded that higher capital requirement contributes positively to bank's profitability.

Muhammed, Shahid, Munir and Ahad (2012) used descriptive, correlation and regression techniques to study whether credit risk affect banks performance in Nigeria from 2004 to 2008. They also found that credit risk management has a significant impact on profitability of Nigerian banks.

Li yuqi (2007) examined the determinants of bank's profitability and its implications on risk management practices in the United Kingdom. The study employed regression analysis on a time series data between 1999 and 2006. Six measures of determinants of bank's profitability were employed. They proxied Liquidity, credit and capital as internal determinants of bank's performance. GDP growth rate, interest rate and inflation rate were used as external determinants of banks profitability. The six variables were combined into one overall composite index of bank's profitability. Return on Asset (ROA) was used as an indicator of bank's performance. It was found that liquidity and credit risk have negative impact on bank's profitability.

Poudel (2012) appraised the impact of the credit risk management in bank's financial performance in Nepal using time series data from 2001 to 2011. The result of the study indicates that credit risk management is an important predictor of bank's financial performance. Fredrick (2010) demonstrated that credit risk management has a strong impact on bank's financial performance in Kenya.

Meanwhile, Jackson (2011) towed the line of Fredrick (2010) by using CAMEL indicators as independent variables and return on Equity as a proxy for banks performance. His findings were also in line with that of Fredrick who also concluded that CAMEL model can be used as proxy for credit risk management. Musyoki and Kadubo (2011) also found that credit risk management is an important predictor of bank's financial performance; they concluded that banks success depends on credit risk management.

MODEL SPECIFICATION

The functional model of the study becomes

$$ROA = f(NPL/L, LA/TA) \text{ ---------- (1)}$$

$$ROE = f(NPL/LA, LA/TA) \text{ ----------(2)}$$

Where;

- **ROA:** Return on Assets (which is obtained as a ratio of Profit after Tax to Total Assets (PAT/TA) *100)
- **NPL:** Ratio of Non-Performing Loan to Loans and Advances: (NPL/LA) *100
- **LA:** Ratio of Loans and Advances to Total Assets.

$$ROA = \beta_o + \beta_1(NPL) + \beta_2(LA) + \mu_t \text{ ----------(3)}$$

Where; β_1 and β_2 are the partial slope coefficients or parameters of the independent variables, NPL and LA respectively, β_0 is the intercept term or constant variable in each of the models, and μt is the disturbance term (error term).

A Priori Expectation

The 'a priori expectation' in the model is that the independent variables, NPL and LLP are expected to have an inverse relationship with bank performance while LA is expected to have positive relationship. The mathematical expression is represented as; $\beta_1, \beta_2, < 0$; $\beta_2 > 0$.

Note that in the models: NPL = (NPL/LA) *100; LA = (LA/TA)*100.

DATA SOURCES

For this study, secondary data was collected. The data was obtained from Banks annual financial reports (2000-2021). The population of study comprises of (3) three quoted banks namely: First Bank of Nigeria Plc, United Bank for Africa Plc, and Access Bank Plc. The choice of the quoted Banks is due to their perceived stability, network of branches, size of workforce, public perception and profitability. The data used are aggregates for each variable obtained for the period 2000 – 2021. The period was chosen to cover to a reasonable extent the period of various reforms in the banking sector and because of the availability of data.

UNIT ROOT TEST

This paper carried out stationarity test of the variables using Augmented Dickey-Fuller (ADF).

The Augmented Dickey-Fuller (ADF) test for unit roots was conducted for all the time series employed for the study. A variable is stationary when ADF values exceed the critical values.

The result of unit root test, in relation to FBN, Access Bank and UBA is summarized in table 4.1, 4.2 and 4.3 below. It shows that ROA, NPL and LA are stationary at first difference and as indicated.

Table 4.1: FBN

Variable	ADF VALUE	Critical Value at 10% level	Order of Integration
ROA	-4.914921	-2.681330	I(1)
LA	-3.635787	-2.690439	I(1)
NPL	-3.141406	-2.728985	I(1)

Source: Extracts from Result of Stationarity Test

Table 4.2: ACCESS BANK

Variable	ADF VALUE	Critical Value at 10% level	Order of Integration
ROA	-4.603969	-3.420030	I(1)
LA	-3.599136	-3.342253	I(1)
NPL	-2.240343	-1.081330	I(1)

Source: Extracts from Result of Stationarity Test

Table 4.3: UBA

Variable	ADF VALUE	Critical Value at 10% level	Order of Integration
ROA	-2.865332	-2.681330	I(1)
LA	-2.957938	-2.681330	I(1)
NPL	-2.927268	-2.681330	I(1)

Source: Extracts from Result of Stationarity Test

PRESENTATION OF REGRESSION RESULTS

FBN

Dependent Variable: ROA				
Method: Least Squares				
Sample: 2000 2015				
Included observations: 16				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.370609	1.378706	-1.719445	0.0092
NPL	-0.006575	0.009452	-0.695570	0.0498
LA	0.016563	0.032666	0.507056	0.6206
R-squared	0.317939	Mean dependent var		2.013753
Adjusted R-squared	0.297622	S.D. dependent var		1.060344
S.E. of regression	1.007259	Akaike info criterion		3.019702
Sum squared resid	13.18941	Schwarz criterion		3.164563
Log likelihood	11.15762	Hannan-Quinn criter.		3.027120
F-statistic	10.81137	Durbin-Watson stat		1.944308
Prob(F-statistic)	0.002332			

The result shows that the variables NPL has inverse relationship with ROA, showing that NPL has a negative effect on bank performance.

This relationship is statistically significant at 95% confidence level and meets the a priori expectation. The result also shows that a unit increase in NPL will lead to 0.007unitdecreasein bank performance respectively *ceteris paribus*.

On the other hand, the relationship between LA and ROA is opposite that of other variables. The result shows that a positive insignificant relationship exists between them.

ACCESS BANK

Dependent Variable: ROA				
Method: Least Squares				
Sample: 2000 2015				
Included observations: 16				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.434757	0.835977	-2.912467	0.0121
NPL	-0.004045	0.042749	-0.010417	0.0118
LA	0.016440	0.012016	1.368099	0.1945
R-squared	0.454144	Mean dependent var		1.843125
Adjusted R-squared	0.440012	S.D. dependent var		0.964315
S.E. of regression	0.952667	Akaike info criterion		2.908258
Sum squared resid	11.79846	Schwarz criterion		3.053118
Log likelihood	-20.26606	Hannan-Quinn criter.		2.915676
F-statistic	9.184521	Durbin-Watson stat		2.366908
Prob(F-statistic)	0.036843			

The result shows that the variables NPL has inverse relationship with ROA, showing that NPL has a negative effect on bank performance. This relationship is statistically significant at 95% confidence level and meets the a priori expectation. The result also shows that a unit increase in NPL will lead to 0.004 unit decrease bank performance respectively *ceteris paribus*. On the other hand, the relationship between LA and ROA is opposite that of other variables. The result shows that a positive non-significant relationship exists between them.

UBA

Dependent Variable: ROA				
Method: Least Squares				
Sample: 2000 2015				
Included observations: 16				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.342914	0.814650	4.103495	-0.0012
NPL	-0.020731	0.012206	1.698479	-0.0132
LA	0.075197	0.027908	0.094466	0.0184
R-squared	0.386601	Mean dependent var		1.435625
Adjusted R-squared	0.292232	S.D. dependent var		0.978298
S.E. of regression	0.823031	Akaike info criterion		2.615716
Sum squared resid	8.805947	Schwarz criterion		2.760576
Log likelihood	-17.92573	Hannan-Quinn criter.		2.623134
F-statistic	14.096697	Durbin-Watson stat		1.868131
Prob(F-statistic)	0.041718			

Just as the cases of FBN and Access Bank, this result also shows that NPL has inverse relationship with ROA, showing that NPL has a negative effect on bank performance. A unit increase in NPL will lead to 0.02 unit decrease in bank performance respectively *ceteris paribus*. On the other hand, the relationship between LA and ROA is opposite that of other variables. The result shows that a positive non-significant relationship exists between them.

The relationship between the variables of the different banks can be stated as follows

- **FBN:** ROA = -2.370609-0.006575*NPL + 0.016563*LA
- **ACCESS BANK:** ROA = -2.434757-0.004045*NPL + 0.016440*LA
- **UBA:** ROA = -3.342914-0.020731*NPL + 0.075197*LA

RECOMMENDATIONS

From the findings, the followings policy recommendations are imperative to loan management and performance of Deposit Money Banks in Nigeria.

1. Deposit Money Banks in Nigeria should not only be concerned about profit maximizing in a complex and competitive market as we have now. While taking out loans and advances, due diligence should be done in their loan management.
2. Credit risk management should have a wider coverage (integrating other forms of risk as defined in Enterprise Risk Management) to bring about more efficient loan management in Deposit Money Banks.
3. The researcher recommends the need to strengthen supervision of banks by the Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC) to prevent buildup and accumulations of NPLs in the future. The Central Bank of Nigeria (CBN) should regularly assess the lending attitudes of financial institutions. There is therefore need to strengthened bank lending rate policy through effective and efficient regulation and supervisory framework.
4. Training and retraining to enable employees of Deposit Money Banks acquire the latest skills on loan management.

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