

LOAN MANAGEMENT AND THE PERFORMANCE OF NIGERIAN BANKS:AN EMPERICAL STUDY

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Abstract

This study focuses on the effect of loan management on performance of Nigerian banks. Relevant data were collected from financial report. The data was obtained from a survey of some selected banks in Nigeria. The data collected were analyzed by the use of regression. Some performance indicators such as profit after tax, earnings per share and dividend were used to measure the performance of the selected banks. The analyses reveal that loan is a predominate source of revenue, and effective management of loan portfolio and credit function is fundamental to banks safety and soundness. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with the banking sector, has made it clear that portfolio managers should do more. There is also the failure of bank management to establish sound lending policies and adequate credit administration procedure. Banks, as custodians of depositors' fund therefore, are obliged to exercise due care and prudence on their lending operations. While the test reveals that there is no significant relationship between effective loan management and the performance of banks. The work concludes that loan management has not affected the performance of Nigerian banks. Finally the research recommend that effective management of loan portfolio and credit risk be strictly adhere to, and critical evaluation must be made and they should be continuously checked for proper management

1. Introduction

Lending is the principal business activity for most commercial banks. The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Effective management of the loan portfolio's credit risk requires that the board and management understand and control the bank's risk profile and its credit culture. To accomplish this, they must have a thorough knowledge of the portfolio's composition and its inherent risks. They must understand the portfolio's product mix, industry and geographic concentrations, average risk ratings, and other aggregate characteristics. They must be sure that the policies, processes, and practices implemented to control the risks of individual loans and portfolio segments are sound and that lending personnel adhere to them. For decades, good loan portfolio managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with oil and gas lending, agricultural lending, and commercial real estate lending in the 1980s, has made it clear that portfolio managers should do more.

The following research questions were put forward for hypothesis testing:

- a. Will the application of sound credit management policy reduce the profitability of the company?
- b. Can risk associated with lending activities be said to affect the earnings per share?
- c. Is there a relationship between loan management and dividend allocated?

2. Research Hypothesis

The following hypotheses were tested:

Hypothesis I

Ho: That effective loan management does not have an effect on a bank's profit after tax.

H1: That effective loan management does have an effect on a bank's profit after tax.

Hypothesis II

Ho: The effective loan management does not have an effect on a bank's Earnings per share.

H1: Effective loan management does have an effect on a bank's Earnings per share.

Hypothesis III

Ho: The effective loan management does not have an effect on a bank's paid dividends

H1: The effective loan management does have an effect on a bank's paid dividends

In the study on the effect of loan management on Nigerian bank. Some selected bank was used for my analysis. All references therefore relating to the selected banks will be used. The five-year period financial summary covering 2006-2010 will be studied. As a result of time constraint and cost, all the banks could not be covered as there were 22 banks nationwide. The study, therefore, was confined to selected Bank.

3. Literature Review and Theoretical Framework

Since there are many studies in respect of bank's lending behavior, it is therefore imperative to highlight and consider some factor that economist and professionals alike have proposed as virtually significant in explaining the determinants of commercial banks lending behavior.

In the view of Nwankwo (2000), "credit constitutes the largest single income-earning asset in the portfolio of most banks. This explains why banks spend enormous resources to estimate, monitor and manage credit quality". This is understandably, a practice that impact greatly on the lending behavior of banks as large resources are involved. Chodechai (2004) while investigating factors that affect interest rates, degree of lending volume and collateral setting in the loan decision of banks, says: Banks have to be careful with their pricing decisions as regards to lending as banks cannot charge loan rates that are too low because the revenue from the interest income will not be enough to cover the cost of deposits, general expenses and the loss of revenue from some borrowers that do not pay. Nnanna, (2005), further stressed that "Bank lending decisions generally are fraught with a great deal of risks, which calls for a great deal of caution and tact in this aspect of banking operations. The success of every lending activity to a great extent therefore, hinges on the part of the credit analysts to carry out good credit analysis, presentation, structuring and reporting.

Osayameh (1996) states that, the major objective of commercial banks' lending is to maximize profit. The staggering increase in volume of banks credit in Nigeria in 2005 alone lends credence to this assertion. In 2005, aggregate banks credit to the domestic economy grew by 30.8% to a staggering increase of N2,007.4 billion compared with the rate of 22.5 per cent, while credit to the core private sector increased by 29.4 per cent to N1,950 billion(CBN). Management of such resources should therefore transcend the use of traditional techniques based mainly on the use of rule-of thumb, hunches and experience. The present volume and complexity of transaction in bank lending and credit administration in Nigeria call for the use of scientific techniques like those of management science and operations research to aid their lending and credit administration. Ojo (1999), in a study on roles and failure of financial intermediation by banks in Nigeria revealed that, "commercial banks can lend on medium and short term basis without necessarily jeopardizing their liquidity. If they must contribute meaningfully to the economic development, the maturity pattern of

their loans should be on a long term nature rather than of short term period”. However, Oloyede (1999) claimed that “it is generally acknowledged that commercial banking by its nature is highly prone to volatility and fragility – whether arising from exogenous shocks or endogenous policy measures – and therefore, amenable to regulations and supervision”. The forms of regulation vary, but in general, they embrace statutory regulations or rules of behaviour that may be administratively imposed or that can be guided through a market-oriented approach. One of such guidelines is Section 20 of Bank and Other Financial Institution Act 1991 (BOFIA) as amended which restricted the terms and amount of loans that can be given to banks insider. For instance, a bank is not allowed to grant unsecured credit facilities in excess of one year to any of his officers and employees.(Soludo, 2005).This results from the high turnover of their debt liabilities. A large part of the gross out payments by a bank is met from current gross receipt of funds in the normal course of business”. Chodechai (2004) further stressed that “banks’ lending decisions are also influenced by the past relationship with the borrowers”. Past relationship according to him can help banks to obtain more private information, leading to a more accurate understanding of the borrower’s business and financial situation. Carletti et al (2006) however, discussing on multiple-lending is of the opinion that banks choose to share lending whenever the benefit of greater diversification, in terms of higher cost per project monitoring dominates the cost of free-riding and duplication of efforts.

If banks set interest rates too high, they may induce adverse selection problems because high-risk borrowers are willing to accept these high rates. Once these borrowers receive the loans, they may develop moral hazard behavior or so called borrower moral hazard since they are likely to take on highly risky projects or investments (Chodecai, 2004). From the reasoning of Stieglitz and Weiss, it is usual that in some cases we may not find that the interest rate set by banks is commensurate with the risk of the borrowers .These theories predict that the number of borrowing relationships will be decreasing for small, high-quality, informational opaque and constraint firms, all other things been equal. (Godlewski & Ziane, 2008) It is found in literature that banks should be less inclined to share lending (loan syndication) in the presence of well-developed equity markets and after a process consolidation. Both outside equity and mergers and acquisitions increase banks’ lending capacities, thus reducing their need of greater diversification and monitoring through share lending. (Carletti et al, 2006; Ongene & Smith, 2000; Karceski et al, 2004; Degryse et al, 2004). This theory has a great implication for banks in Nigeria in the light of the recent 2005 consolidation exercise in the industry. As for the soft-budget-constraint problem, multiple-bank lending enables banks not to extend further inefficient credit, thus reducing firms’ strategic defaults. Both of these theories consider multiple-bank lending as a way for banks to commit towards entrepreneurs and improve their incentives.

None of them, however, addresses how multiple-bank lending affects banks' incentives to monitor, and thus can explain the apparent discrepancy between the widespread use of multiple-bank lending and the importance of bank monitoring. But according to Carletti et al (2006),

4. Methodology

The study adopts the use of survey research design because it requires the population of study selected carefully in order to ensure adequate representation. The study therefore makes use of annual report which is suitable to the study being investigated to selected banks. As at 2010, there were 22 banks and they constitute the population of study. The population of this study embraces all the five banks out of the 22 banks but because of the numerous constraints inherent in carrying out such a research work, 20% of the total were taken, which was rounded up, and 5 banks was selected namely: first bank of Nigeria, Guaranty trust bank, United bank of Africa, Unity bank and Wema bank. The major instrument for data collection was secondary data, which the data analyzed in this study were derived from the audited financial statements of the selected banks in Nigerian within 2006 and 2010.

5. Analysis And Interpretation Of Hypotheses

H_0 – Effective loan management does not have an effect on a bank's profit after tax.

H_1 - Effective loan management does have an effect on a bank's profit after tax.

5.1. Loan and PAT

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.147 ^a	.022	-.305	16195.39248

a. Predictors: (Constant), UBA_LOAN

Table:1

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.739E7	1	1.739E7	.066	.813 ^a
	Residual	7.869E8	3	2.623E8		
	Total	8.043E8	4			

a. Predictors: (Constant), UBA_LOAN

b. Dependent Variable: UBA_PAT

Table:2

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	21596.442	18293.213		1.181	.323
	UBA_LOA	-.011	.043	-.147	-.257	.813
	N					

a. Dependent Variable: UBA_PAT

Table:3

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.304 ^a	.093	-.210	14643.59184

a. Predictors: (Constant), FBN_LOAN

Table:4

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.570E7	1	6.570E7	.306	.618 ^a
	Residual	6.433E8	3	2.144E8		
	Total	7.090E8	4			

a. Predictors: (Constant), FBN_LOAN

b. Dependent Variable: FBN_PAT

Table:5

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	30157.416	15432.286		1.954	.146
	FBN_LOA	-.011	.021	-.304	-.554	.618
	N					

a. Dependent Variable: FBN_PAT

Table:6

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.863 ^a	.744	.659	5.04518E6

a. Predictors: (Constant), GTB_LOAN

Table:7

ANOVA^b

Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.221E1	1	2.221E1	8.725 .060 ^a
	Residual	7.636E1	3	2.545E1	
	Total	2.984E1	4		

a. Predictors: (Constant), GTB_LOAN

b. Dependent Variable: GTB_PAT

Table:8

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	9202744.426	5676094.410		1.621	.203
	GTB_LOA N	.040	.014	.863	2.954	.060

a. Dependent Variable: GTB_PAT

Table:9

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.132 ^a	.017	-.310	1.55715E7

a. Predictors: (Constant), UNITY_LOAN

Table:10

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.285E13	1	1.285E13	.053	.833 ^a
	Residual	7.274E14	3	2.425E14		
	Total	7.403E14	4			

a. Predictors: (Constant), UNITY_LOAN

b. Dependent Variable: UNITY_PAT

Table:11

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-6825268.865	1.645E7		-.415	.706
	UNITY_LOAN	.052	.228	.132	.230	.833

a. Dependent Variable: UNITY_PAT

Table:13

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.096 ^a	.009	-.321	3.24513E7

a. Predictors: (Constant), WEMA_LOAN

Table:14

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.961E13	1	2.961E13	.028	.878 ^a
	Residual	3.159E15	3	1.053E15		
	Total	3.189E15	4			

a. Predictors: (Constant), WEMA_LOAN

b. Dependent Variable: WEMA_PAT

Table:15

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2006247.603	5.293E7		-.038	.972
	WEMA_LOAN	-.182	1.087	-.096	-.168	.878

a. Dependent Variable: WEMA_PAT

Table:16

The simple linear regression is applied to each of the hypothesis and the decision to be taken depends on the P values obtained. For each of the hypothesis, the decision rule is to reject the null hypothesis and accept the alternate hypothesis where the P value is less than 0.05 or to accept the null hypothesis (H_0) and reject the alternate hypothesis (H_1) where P value is greater than 0.05.

5.2.Decision

Since for **hypothesis one**, in **UBA** the significance is 0.813 which is far greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and profit after tax.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 14.7% low direct relationship between loan management and profit after tax and the R – squared value of 0.22% show that loan management cannot determine profit after tax to a high degree

In **FBN** (First Bank of Nigeria) the significance is 0.618 which is far greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and profit after tax.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 30.4% low direct relationship between loan management and profit after tax and the R – squared value of 0.93% show that loan management cannot determine profit after tax to a high degree

In **GTB** (Guaranteed Trust Bank) the significance is 0.60 which is just a little greater than 0.05, the null hypothesis (H_0) can still be rejected since the is also a high relationship and compared with other banks the t value is very low so we can fail to reject the alternate hypothesis (H_1). Therefore, there is a significant relationship between loan management and profit after tax.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 86.3% strong direct relationship between loan management and profit after tax and the R – squared value of 74.4% show that loan management determine profit after tax to a high degree

In **Unity bank** the significance is 0.833 which is far greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and profit after tax.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 13.2% low direct relationship between loan management and profit after tax and the R – squared value of 0.17% show that loan management cannot determine profit after tax to a high degree

In **Wema** the significance is 0.878 which is far greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and profit after tax.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 9.6% low direct relationship between loan management and profit after tax and the R – squared value of 0.9% show that loan management cannot determine profit after tax to a high degree

5.3.LOAN and EPS

H_0 – Effective loan management does not have an effect on a bank's Earnings per share.

H_1 - Effective loan management does have an effect on a bank's Earnings per share

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.574 ^a	.329	.106	117.12255

a. Predictors: (Constant), UBA_LOAN

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	20212.927	1	20212.927	1.473	.312 ^a
	Residual	41153.073	3	13717.691		
	Total	61366.000	4			

a. Predictors: (Constant), UBA_LOAN

b. Dependent Variable: UBA_EPS

Table:17

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	307.465	132.294		2.324	.103
	UBA_LOAN	.000	.000	-.574	-1.214	.312

a. Dependent Variable: UBA_EPS

Table:18

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.805 ^a	.648	.531	54.73135

a. Predictors: (Constant), FBN_LOAN

Table:19

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	245.638	57.679		4.259	.024
	FBN_LOA	.000	.000	-.805	-2.352	.100
	N					

a. Dependent Variable: FBN_EPS

Table:20

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	16570.239	1	16570.239	5.532	.100 ^a
	Residual	8986.561	3	2995.520		
	Total	25556.800	4			

a. Predictors: (Constant), FBN_LOAN

b. Dependent Variable: FBN_EPS

Table:21

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.401 ^a	.161	-.118	23.52207

a. Predictors: (Constant), GTB_LOAN

Table:22

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	318.936	1	318.936	.576	.503 ^a
	Residual	1659.864	3	553.288		
	Total	1978.800	4			

a. Predictors: (Constant), GTB_LOAN

b. Dependent Variable: GTB_EPS

Table:23

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	180.236	26.464		6.811	.006
	GTB_LOAN	-4.799E-8	.000	-.401	-.759	.503

a. Dependent Variable: GTB_EPS

Table:24

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.588 ^a	.345	.127	14.05988

a. Predictors: (Constant), UNITY_LOAN

Table:25

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	312.735	1	312.735	1.582	.297 ^a
	Residual	593.041	3	197.680		
	Total	905.775	4			

a. Predictors: (Constant), UNITY_LOAN

b. Dependent Variable: UNITY_EPS

Table:26

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5.012	14.853		-.337	.758
	UNITY_LOAN	2.586E-7	.000	.588	1.258	.297

a. Dependent Variable: UNITY_EPS

Table:27

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.094 ^a	.009	-.322	320.13111

a. Predictors: (Constant), WEMA_LOAN

Table:28

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2723.026	1	2723.026	.027	.881 ^a
	Residual	307451.774	3	102483.925		
	Total	310174.800	4			

a. Predictors: (Constant), WEMA_LOAN

b. Dependent Variable: WEMA_EPS

Table:29

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-24.343	522.185		-.047	.966
	WEMA_LO AN	-1.748E-6	.000	-.094	-.163	.881

a. Dependent Variable: WEMA_EPS

Table:30

The simple linear regression is applied to each of the hypothesis and the decision to be taken depends on the P values obtained. For each of the hypothesis, the decision rule is to reject the null hypothesis and accept the alternate hypothesis where the P value is less than 0.05 or to accept the null hypothesis (H_0) and reject the alternate hypothesis (H_1) where P value is greater than 0.05.

For **hypothesis two**, in **UBA** the significance is 0.312 which is greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and earnings per share.

The regression also helped use to further conclude with the R (coefficient of correlation) that there is a 57.4% direct relationship between loan management and earning per share and the R – squared value of 32.9% show that loan management cannot really determine earnings per share to a high degree

In **FBN** (First Bank of Nigeria) the significance is 0.1 which is greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and Earnings per share.

The regression also helped us to further conclude with the R (coefficient of correlation) that there is an 80.5% direct relationship between loan management and EPS and the R – squared value of 64.8% show that loan management can determine EPS to a somewhat high degree but we still accept the null hypothesis since the test is not significant

In **GTB** (Guaranteed Trust Bank) the significance is 0.503 which is just a little greater than 0.05, the null hypothesis (H_0) can still be rejected since this is high significance when compared with other

banks t value is very low so we can fail to reject the alternate hypothesis (H_1). Therefore, there is a significant relationship between loan management and EPS.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 40.1% low direct relationship between loan management and EPS and the R – squared value of 16.1% show that EPS cannot be determine by Loan management to a high degree

In **Unity bank** the significance is 0.297 which is far greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and EPS.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 58.8% direct relationship between loan management and EPS and the R – squared value of 34.5% show that loan management cannot determine EPS to a high degree

5.4.Loan and dividend

\square_0 – Effective loan management does not have an effect on a bank’s paid dividends.

\square_1 - Effective loan management does have an effect on a bank’s paid dividends

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.052 ^a	.003	-.330	.18171

a. Predictors: (Constant), GTB_LOAN

Table:31

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	1	.000	.008	.934 ^a
	Residual	.099	3	.033		
	Total	.099	4			

a. Predictors: (Constant), GTB_LOAN

b. Dependent Variable: GTB_DIV

Table:32

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.879	.204		4.300	.023
	GTB_LOA	4.405E-11	.000	.052	.090	.934
	N					

a. Dependent Variable: GTB_DIV

Table:33

For **hypothesis three**,

In **GTB** (Guaranteed Trust Bank) the significance is 0.934 which is far greater than 0.05, the null hypothesis (H_0) is accepted and the alternate hypothesis (H_1) is rejected. Therefore, there is no significant relationship between loan management and Dividend payable.

The regression also helped use to conclude with the R (coefficient of correlation) that there is a 5.2% low direct relationship between loan management and Dividend payable and the R – squared value of 0.3% shows that loan management cannot determine Dividend to a high degree

6. Conclusion And Recommendations

The goal of every organization is to remain in business through profit making. It is also worth mentioning that granting of loan contributes to the profit of banks through the charging of interest. Loans given to borrowers, shareholders' and depositors' money and hence should be critically evaluated before they are being granted and they should be continuously checked to for proper management.

Effective management of loan portfolio credit risk requires that the Board understand and control the bank's risk profit.

The following are recommended to banks, particularly, United Bank for Africa Plc, First Bank of Nigeria, Wema Bank and Unity Bank to enable them carry out effective loan management which will in turn assist in the performance of banks:

- a. Credit officers should intensify efforts on their job, routine check on customers and prudent approach to recover loans and advances granted to customers.

- b. Loans granted to customers should be placed under constant supervision.
- c. The purpose of the loan should be known and ensure the feasibility and viability of every loan proposal.
- d. Credit managers should make adequate analysis on prospective borrowers. The financial statement must be used to determine the strength of customer and his ability to pay.

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