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The Impact of Credit Policy on the Performance of Nigerian Commercial Banks

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Abstract

The major financial intermediary in any economy is the bank. As financial intermediaries, banks provide means by which funds can be transferred from the surplus unit of the economy to the deficit unit. This role is performed primarily through the acceptance of deposits of different categories and characteristics for onward lending to the numerous customers by way of loans and credits. The study tries to access the impact of credit policy on the performance of Nigerian Commercial Banks using Zenith Bank Plc as case study. Primary data were collected through questionnaires served on sixty (60) respondents (staff: 32 and customer: 28) of the bank. The questionnaires were analysed with the use of chi-square (X^2). The findings from the study show that having a good credit policy in place goes a long way in minimizing the incidence of bad debts. It was also discovered that prudent credit assessment and disbursement, dynamic credit monitoring and decisive actions when there are warning signals, have all helped the bank to maintain a high quality of assets and a high level of profitability.

Keywords: Advance, Overdraft, Credit policy, Collateral

1. Introduction

The economic development of any country depends largely on the amount of investible funds available to her and the efficiency of her financial intermediaries to mobilize such funds from savers who have no immediate use of it and distribute to investors who need funds for productive purposes. One of the major intermediaries saddled with this task is the bank (Ojo et. al, 1982).

Banking as a service industry is organized to make profit for the owners, (the shareholders), through the provision of banking services and supply of financial needs of individual and corporate bodies. As financial intermediaries, banks provide means by which funds can be transferred from the surplus unit of the economy to the deficit unit. This role is performed primarily through the acceptance of deposits of different categories and characteristics for onward lending to the numerous customers by way of loan and advances. They seek to make themselves as attractive as debtors and as efficient as creditors that they earn a substantial gross income from the difference between the interest they charge as creditors and the interest they pay as debtors.

In practical term, the essence of lending demands that, the lender temporarily parts with the possession and the use of what is lent whilst retaining the legal ownership of it, and due time, expects the resumption of the possessor and utility on the property lent out. Hence commercial banks manage depositors' funds with the hope of achieving the major objectives of liquidity, safety and profitability. Achieving this objective, whilst creating credits involves a lot of risks, since the borrowers may not pay back as expected. This could lead to eventual liquidity crunch on the lending bank and therefore, loss of confidence in it by depositors (Adekanye 2010).

Happenings in the Nigerian banking industry point to the fact that the era of distress may not be over yet. The introduction of Universal Banking has brought along with it a new dimension to credit risk exposure due to enlarged scope of portfolio, which could spell doom not only for the financial conglomerate in particular but for the whole financial industry and the national economy as a whole. Coupled with this are the incessant contraventions of CBN guidelines by commercial bank, high cost of interbank rate and the recent global financial crises among others.

To guide against negative consequences that may arise as a result of the above, banks need to map out clear policies and guidelines for efficient and effective credit operations. Hence, the study tries to assess credit policies and management put in place by Nigerian banks to see how adequate they are in coping with the emerging threats in the Nigerian banking industry and proffer solutions in order to forestall another round of distress in the banking industry.

2. Theoretical Framework

2.1 The Concept of Bank Lending and Credit

Lending can be defined as the creation and management of risk assets. According to Agene (1995), lending is defined as a process of analyzing credit or loan. It is considered as an

important task of bank management because it entails taking financial risk which could lead to difficulty on the part of the customer (borrower) in the repayment of both the capital and interest.

According to Osayameh (1986), the principal lending objective of a bank is to provide growth, profitability and liquidity. The term lending covers loans and advances. Lending function represents a significant source of income since the major consideration of the lender is the recovery of both the capital and interest. It is one of the most traditional elements in the relationship between a bank and its numerous customers (Adekanye, 2010).

2.2 Forms of Credit

Credit can be classified into the following forms:

i. **Overdraft** – An overdraft is an open ended credit facility which is repeatedly used until the balance on the account reaches a certain pre-arranged borrowing limit. Theoretically, it is payable on demand but in practice, it may run from year to year without being called in. it is used mainly to finance working capital requirement of raw materials, payment of pressing current liabilities like salaries, creditors and taxes.

   According to Onanuga (1998) overdraft can be issued to overcome difficult periods like payment of school fees, medical bills, expenses during festivals etc. It is created by allowing the account holder to withdraw a certain amount in excess of the amount standing to the credit of his account. It is short term in nature, non-specific and normally made available to meet general trading requirements.

ii. **Advances** – Nwanko (1987) defined advances as any facility apart from overdrafts and loans, granted to a customer for a short period of time by means of which the customer obtains cash or credit in advance of collection by the bank of relative counterpart funds from another bank's third party. It is a short term credit extension which is granted for a definite period usually 30 and 180 days. Advances are usually granted for a specific purpose, for example, payment of various collections, refinancing of maturing loans, project bridging finance, refinancing of letters of credit for project equipment imported etc. The exact maturity date of an advance is normally determined at the onset and this makes it possible for the project to have a lower interest charge on the advance due to the reduced risk.

iii. **Loan** – According to Agene (1995), a loan is regarded as a financial assistance rendered by a bank to its customers in monetary term and repayable over a specific period of time with interest element. Unlike overdraft facility which is a short term credit, loan may be medium or long term for the finance of fixed assets acquisition.

   Loans and advances are important sources of bank revenue as it yields the bulk of the bank's revenue. They constitute the highest percentage of the total assets of a bank as can be seen below from an extract of Zenith Bank's financial statement.

Table 1. Loans and advances in bank's asset structure

Assets	Group 2010 N'Million	Bank 2010 N'Million
Cash and balances with CBN	141,724	130,604
Treasury bills	298,869	287,981
Due from other banks	399,503	374,604
Loans and advances	731,285	667,860
On-lending facilities	22,536	22,536
Advances under finance lease	13,188	12,731
Insurance receivables	711	
Investment securities	210,345	171,985
Investment in subsidiaries		37,134
Deferred tax assets	1,162	
Other assets	18,936	13,470
Investment property	7,623	7,036
Property and equipment	67,145	63,517
TOTAL ASSETS	**1,895,022**	**1,789,458**

Source: Zenith Bank Group Annual Report of Financial Statements, 2010.

From the table, it can be seen that loans and advances constitute the largest proportion of the total assets of Zenith Bank group and its subsidiary representing 38.59% and 37.32% respectively.

2.3 Loan Management Techniques

Lending or credit creation seek to maximize profitable objective of bank, this however, has an imperative for liquidity and solvency objective. The resolution of these issues has been a great source of concern over the year and has led to the development of various method of meeting the objective.

Some of the methods are: the real bill doctrine, the shiftability theory, the anticipated income theory and the liability management theory

(1) **The real bill doctrine** – This is also known as the commercial bill theory. it was enunciated by ADAM SMITH and it postulates that if a bank an restrict its assets to real bill of exchange, it will limit the quantity of bank liability caused by valuing the quantity of bank fund according to the needs of business. This mean that the bank assets will be of such nature that can be turned into cash on short notices and thus place the bank in a position to meet unexpected call for cash.

(2) **The shiftability doctrine-**this is an extension of the bill doctrine it was developed during the 19205 and 1930s. due to the variety of banks securities suitable as secondary reserve asset, the bank felt that that with the availability of shiftable open

market financial assets, the real bill theory will no longer restrict them to short term lending only (Adewumi, 1984) to meet customer deposit withdrawals the shiftability theory of asset management advocate security bank holding of marketability securities so that rigidity could be met by shifting or selling the securities help tom other buyer. The theory presupposes well developed secondary securities market.

(3) **Anticipated income theory –** this parotid that the liquidation of term loan is not by sale of asset of the borrower the liquidation of term loan is not by sale of assets of the borrower. The liquidation of term loam is not by sale of asset of the borrowers as in the bill doctrine, neither is it by shifting of the term loan to some other lender as in the shifting ability of theory of liquidation rather, it is through the anticipated income of the borrower. The emphasis of this theory is the ability of the loan so granted to generate enough cash flow for the liquidation of the facility.

(4) **Liability management theory** – with the emergence of commercial deposits in 1961, a new approach to the liquidation problem of loan management developed. Commercial deposit is an alternative means of raising deposit to meet customer deposit withdrawals this, it is possible for bank to lend most of their deposit liability without being constrained by the sizes and maturity patterns of such loan. Soludo (2009) pointed out that a proper liquidation management entails the generation of enough liquid resources as at when desired, thus elimination the constraints of earlier concepts.

2.4 Credit Policy Formulation

The management of any loan started with the credit policy, the formulation of with is the responsibility of which is the bank board of directors and management. It is the base for determine what type of credit to grant to customers.

Nwankwo (1980) define credit policy as a blue print containing management guidelines for use by line officer of a bank in the handling of credit applications. Its objective is to provide corporate direction through a standardized procedure, derived from operational interest of the bank, in satisfying the customer credit need but with full cognizance of the prevented monetary and fiscal policy guidelines of the government.

Adekanye (2010) however identify three basic types of credit policy. They are the restrictive credit policy, moderate credit policy and liberal credit policy. A restrictive credit policy is adopted by a bank that has no plan to grow at a rate that is more than minimal. Such a bank is not willing to take my risk more than minor one and prefer to do business with customer whose paying habit almost never vary within terms.

Moderate credit policy is a mixture of restrictive and liberal policy approaches to credit. It tends to match receivable to provide adequate cash flow, while a liberal policy is a high risk policy with the probability of heavy loss of receivable the danger of such bank survival can be real because they are usually prone to undercapitalization and occasionally liquidity problem.

Therefore, to minimize risks, enhance lending and maintain standard, the loan policy should specify the quantity of loan to be made the type of securities to be accepted and limits for the different types of loan

2.5 Credit Appraisal Procedure

The purpose of credit appraised is to solicit enough information about the applicant in order to determine willingness and capability to serve the loan if granted, in accordance with the term of the loan agreement it enable bank to determine the degree of risk they are willing to assume and the amount of credit that can prudently be expected, given the risk involving and the term and condition for granting the loan. it is therefore expected that a good credit appraisal should follow the established cannot of good lending which include: character, capital, capacity, collateral, condition and duration (Ibitoye, et al 1999, Ekezie, 1997)

i. **Character** – This refer to the person or the entity borrowing the money. It relates to the borrower integrity, responsibility and credit worthiness based on past insure. Ones inherent character cannot be change overnight, hence this factor is very important in starting off a debt relationship.

ii. Capital – This is essential in credit appraised as it represent the sales of the borrower in the business being financial with the borrower fund. The underling principal here is that, the higher the stake of the loan seeker in the venture for which assistance is though the greater in commitment to the success of the venture. The loan portfolio of the leading bank should also be consideration.

iii. **Capacity –** The past performances of customer will give an insight into whether he has technical and management capacity to execute the project for which credit is being requested. Establishing the capability of the loan seeker involves the credit officer's perception of the liability of the proposed project in mobilizing enough fund for repayment in establishing the possibility of the project being self liquidation (Aremu, 2001;Obisesan,2005)

iv. **Collateral –** this is otherwise known as security. It is the right conference on a creditor to make him redeem in is loan obligation. A security base arrangement usually creates additional moral state on the side of the customer which result in a prudent and effective utilization of available resources. According to Osayameh (1986), "security are particularly relevant in our sit nation in this country, where banking education and habits are still relatively low. Loan should not be disabused until a customer has satisfied all security formalization and no disbursement should be granted again anticipatory approval".

v. **Condition –** this consider the external micro-environment and the attendant force over which the borrower has no control. This can render a good credit today bad in future if condition becomes in favorable to business. For example, government policy reversal, technological change, terrorist attack etc. can jeopardize the objective of taking loan.

vi. **Duration** – this is the length of time for which the customer require the loan. Bank is expected to be liquid on demand. This is the reason why some banks cannot afford to lend on long term. It is therefore very germane for any banking institution in performing its lending function to consider liquidation, cost, profitability, convenience and confidence since all these serve as coeds with which customer are tied to their bankers.

3. Methodology

3.1 Data Presentation and Analysis

The study made use of primary data which were collected through the questionnaires. Seventy five (75) questionnaires were serve while sixty (60) were returned filled. The sixty respondent consist of 32 staff members and 28 customer within the Lagos metropolis where the headquarter of the bank is demonical. The simple percentages were used to analyses the respondents' responses as shown in the tables below:

Table 2. Whether the bank has a credit policy put in place

Response	Number of Respondents	Percentage (%)
Yes	53	88
No	07	12
TOTAL	**60**	**100**

Source: Field Survey, 2013.

From the table above, majority (88%) of the respondent comprising both staff and customer were aware that Zenith bank has a credit policy in place. Those that were unaware were the customers who probably have not had any cause to borrow from the bank.

Table 3. Whether the bank has contributed to the growth of customer business thereby performing its intermediation role effectively

Response	Number of Respondents	Percentage (%)
Yes	44	73
No	16	27
TOTAL	**60**	**100**

Source: Field Survey, 2013.

From table two, it is evidently clean that 73 percent of the total respondent survey, agree that the bank has been efficient in the performances of intermediation role by help people to boost their business through the lending function.

Table 4. Whether the credit policy of the bank has contribute positively toward the bank profitability

Response	Number of Respondents	Percentage (%)
Yes	32	100
No	-	-
TOTAL	**60**	**100**

All the staff member who filled and returned the questionnaire agree that the credit policy of the bank has contributed to the growth of the bank profitability. Customer of the bank do not know what has contributed to the growth of the bank profit hence could not answer the question.

Table 5. Whether the recent distress in the Nigeria banking Industry was as a result of loan default

Response	Number of Respondents	Percentage (%)
Yes	32	53
No	28	47
TOTAL	**60**	**100**

From the analysis in table 4, the 32 member of staff surveyed allege that the customer do not redeem their loan as at when due while the 28 customer who filled the questionnaires alleges that the distress in the banking industry was due to the high level corruption of the banks management. It can therefore be deduces that both reason given by both parties were responsible for the recent bank distress in Nigeria.

3.2 Test of Hypotheses

The hypotheses were tested with the use of chi-square (X^2) at 5% significant level with n-1 degree of freedom.

$$X^2 = \sum_{t=1}^{n_1} \frac{(O_t - E_t)^2}{E_t}$$

Where O_t = Observed Frequency;

E_t = Expected Frequency;

X^2 =Chi-squire symbol.

3.2.1 Hypotheses I

Ho: The bank does not have any credit policy put in place.

Hi: The bank has credit policy put in place.

Table I repeated: whether the bank has a credit policy put in place

Response	Number of Respondents	Percentage (%)
Yes	53	88
No	07	47
TOTAL	**60**	**100**

Chi – Square Table:

Option	O	E	O - E	$(O-E)^2$	$(O-E)^2$
Yes	53	30	+23	529	17.633
No	07	30	-23	529	17.633
				X^2 =	**35.266**

Since the X^2 calculate (35.266) is greater than the X^2 table value (3.84) at 5% level of significance, the alternative hypotheses (Hi) is accepted while the one (Ho) is rejected, meaning that the bank management has a credit policy put in place.

3.2.2 Hypothesis II

H_O: The bank credit policy has not contributed positively toward its profitability.

Hi: The banks credit policy has contributed positively toward it profitability.

Table 3. replicated:Whether the credit policy of the bank has contributed positively toward its profitability

Response	Number of Respondents	Percentage (%)
Yes	32	100
No	-	-
TOTAL	**32**	**100**

Chi – Square table:

Option	O	E	O - E	$(O-E)^2$	$(O-E)^2$
Yes	32	16	16	256	16
No	0	16	-16	256	16
				X^2 =	**32.0**

From the second table above, the X^2 calculation of 32 is greater than the table value of X^2at 5% level of significances of 3.841, therefore the null hypothesis is rejected while the alternative hypothesis is accepted. This means that the credit policy put in place by the bank has contributed positively toward its profitability.

4. Conclusion

From the study, it was discovered that the bank surveyed (Zenith Bank plc) has in place a very good credit policy which has really enhances its growth in term of performances. It was

also discovered that loan default has not been the only problem leading to bank distress in Nigeria as was discovered that many of the bank owner and the management always connive to divert people funds to their personal business out of corruption tendencies. Analysis from the paper also showed that the bank surveyed has assisted in no small way in contributing to the growth of customers' business thereby improving the economic conditions of its environment. It was therefore recommended among others, that credit department of various Nigerian banks be manned by professionals and erring bank staff found culpable of financial impropriety and abuses of office should be punished by the regulatory authorities. Nigerian bank should desist from just employing workers based on connection as this practice has really brought down the dignity and pride of the banking profession in Nigeria.

Also, banks in Nigeria should avail themselves of other means of generating income besides loan and advances so as to diversify their earning base and to minimize over dependence on loan and advances. All these would go a long way in reducing the risk associated with their operations through loans and credit as a means of getting return.

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