**APPRAISAL ON THE IMPACT OF EFFECTIVE CREDIT MANAGEMENT ON THE PROFITABILITY OF COMMERCIAL BANKS**

**Abstract**

This study is focused on the impact of effective credit management on the profitability of commercial banks. The study is divided into five chapters. Chapter one deals with introduction, general over view of the study, statement of problems, objectives of the study, limitation and definitions of the terms. Chapter two consists of general introduction of research topic and of literature review. Chapter three deals with research methodology, research design, and source of data, population and sample size and method of data. Chapter four deals with the data presentation, analysis and test of hypothesis. Chapter five consists of summary, conclusion and recommendation. From the research work, research recommendation which reveals that credit mangers deals with various credit appraisals effective management should be adopted for the profitability of the banks

 **CHAPTER ONE**

**INTRODUCTION**

* 1. **Background of the study**

Granting of loans and advances of credit is one of the banks services of investment policies. Among the crucial growth process is the adequate supply of credit to the different economic units to carry on their activities efficiently and smoothly. There is therefore the need for transferring of funds from the surplus units to the deficit units of the economy. In this wise, commercial bank plays vital role in the allocation of financial resources of capital formation. There are many opportunities for profit improvement or maximization through effective credit management since lending of money has been widely known and accepted as an important function of the banking industry (i.e. commercial banks) a function which the industry is better placed to perform in view of its position as a finance intermediary. The basic principles of lending are the same for all types of credit be it personal institutional credit. The criteria used to determine the data of credit application to grant or not, have however been the genesis of heavy bad debts in the banking industry especially commercial banks. A bank considers a loan or credit to be a bad debt when the possibility of its repayment is the serious doubt and this doubt many be as a result of the following under listed points.
1) Wrong choice and use of lending principle.
2) Failure by the customer to meet credit repayment as agreed and when due.
3) Customer’s occasional request for credit.
4) Frequent attempt by customer to exceed existing limit without prior arrangement.
5) Overdraft balances always at the peak bad debts do have serious negative effect on the banks liquidity and profitability and if they are allowed to persist, undoubted will lead to bank failure.
It is generally accepted that lending is the most risky function performed by the commercial banks and it is therefore important that lending must be done efficiently. In granting loans to customers, banks are expected to critically consider various factors which should enable them to assess the risk associated with the loan and the willingness and ability of the borrower to pay.

**1.2 STATEMENT OF THE PROBLEM**

The following are problems associated with this study
a. **BANK AS FINANCIAL INTERMEDIARIES:** banks find it difficult to operate efficiently in the face of many borrowers.
b.**BANKS AS DEBTORS:** banks owe the customer at any point in time, a duty to make funds available to depositors on demand.
c. **BANKS AS CREDITORS:** banks find it difficult to properly assess and identity credit worthy customers which ensure repayment to guarantee equilibrium of funds flow.
d. **COMMERCIAL BANKS AS COMMERCIAL OUTLETS:**bank owes it as a duty to the shareholder to maximize profit.

**1.3 OBJECTIVE OF THE STUDY**

Commercial banks are general all purpose retail banks. they mobilize deposits of all sizes, both from the depositors and shareholders.
They lend these mobilized funds to willing customers for investment purpose as stated earlier, loans are the most important, most profitable and most risky asset of the banks, not kept liquid due to problems of the loans, banks may be unable to meet their obligations to depositors and public confidence will be lost. These problem loans affect the liquidity of banks, reduce their ability to create deposit, restrict further lending to prospective borrowers, which affect the profitability of the banks.
Therefore, the objectives of the study are:
1. To find out the best ways to manage loans which adversely affects the depositor’s banks and the economy will be a thing of the past.
2. To find out the usefulness of the central bank credit guideline giving to commercial banks

3. To recommend possible ways of making credit policy guideline more effective and beneficial to both commercial bank and their customers.

**1.4 RESEARCH HYPOTHESES**

For the successful completion of the study, the following research hypotheses were formulated by the researcher;

**H0:** Banks does not have adequately financed projects in our economy.

**H1:** Banks does not have adequately financed projects in our economy

**H02:** Low interests have not favoured the borrowing customers.

**H2:** Low interests have favoured the borrowing customers

**1.5 SIGNIFICANCE OF THE STUDY**

1. Loans are important as well as the most lucrative assets of commercial banks credit.
2. It is therefore important that credit proposals be properly articulated and evaluated right form the on set.
3. It is crucial to avoid and minimize bad debts.
4. The collection of vital information for lending and the analysis of the proposal cannot therefore be over looked to be less important.
5. It should be noted that the risk element in credit proposal are usually not easy to quantify.
6. Many banks today are out of business because of poor and bad credit management.

**1.6 SCOPE AND LIMITATION OF THE STUDY**

The study of the effective credit management on the profitability of commercial banks will review to an extent the level at which the bank is fairing. This study will also review how positive and unable the bank is in finding project through lending and how lending and borrowing has affected the profitability and liquidity of commercial banks.
The choice of united bank being necessary is that it has passed through all the era of banking policies and regulations in the country. The study has the following limitations. It is limited to two commercial banks first bank and intercontinental bank plc. The study is limited to time.
Information used are not all product of primary research but are largely obtained from banks and books. Lastly one of the major limitations is the respondents to the questions asked to the bankers who were not ready to reveal or disclose certain information concerning their banks to outsiders.

**1.7 DEFINITION OF TERMS**

**BAD DEBT:** These means irrevocable debts of an organization

 **CANNON:**Generally accepted standard on which an idea or subject is based.
**CREDIT FACILITIES:** This include loans, overdrafts, advances, commercial papers, lease, and guarantee etc. that is those form of credit connected with a bank’s credit risks.
**LOANS:** A credit facility extended by one party (lender) to another (borrower) subject to specific terms and conditions agreed upon by both parties.
**OVERDRAFT:** An account drawn over. It is a short term revolving time agreed with the bank.
**POLICY:**Guideline.
**PROBLEM LOANS:** All types of credit facilities granted by banks to their customer for whom the customers are unable to repay within the agreed time and conditions.
**TERM LOAN:** Credit facilities granted for a period normally more than one year.
**LIQUIDITY:** Money or goods that can be sold to repay debts.
Security: goods or property pledged against money borrowed.
**GUARANTEE:**A promise usually in writing by one person to pay the present or future debts of another, such a promise must be made to the person to whom the debts is or will be due or paid.
**CONVEYANCE:** The dead by which interest on lend for e.g. mortgage lease, charge or vesting instrument is conveyed to a purchaser.
**PORTFOLIO:** Collection of shares or investment.

**1.8 ORGANIZATION OF THE STUDY**

This research work is organized in five chapters, for easy understanding, as follows

Chapter one is concern with the introduction, which consist of the (overview, of the study), historical background, statement of problem, objectives of the study, research hypotheses, significance of the study, scope and limitation of the study, definition of terms and historical background of the study. Chapter two highlights the theoretical framework on which the study is based, thus the review of related literature. Chapter three deals on the research design and methodology adopted in the study. Chapter four concentrate on the data collection and analysis and presentation of finding. Chapter five gives summary, conclusion, and recommendations made of the study

**CHAPTER TWO**

**REVIEW OF RELATED LITERATURE**

**2.1 INTRODUCTION**

In order to discuss the important of credits/loans in bank’s asset structure and the effect of credit management on profitability, we need to understand what is meant by credits/loans. Loans and credits are inter-changeable on this study and can be described as an agreed sum of money granted by a bank to a customer for an agreed purpose repayable with interest in regular installments at agreed intervals. Hence credits mean receiving goods or services and pays at a future date. Ojo (1982:57 – 64), described credit as that amount of money granted to a customer by a bank on request with interest on demand except in the case of term loans which are repayable over a designated period of time. This chapter therefore, reviews and examines some related literatures on the loan management concepts, credit policy formulation, criteria for loan decision and its effects on portability, loan reviews and monitoring policy, Loans classifications and recovery procedures.

**2.2 TYPES OF CREDIT FACILITIES**

The foremost obligation of any bank is to supply the credit needs of business enterprises/organizations, Communities and individuals. To accomplish this, a number of facilities are provided by the banks in form of Loans and advances. In Crosse’s view (1962:216), “they range from short term self liquidating loans to finance the manufacture, storage or shipment of commodities, through loans to supply working capital over varying periods of time, to loans to finance the acquisition of capital assets”. Therefore, simply classify loans into short-term lending and long term working capital loans. While facilities under the short-term loans is for seasonal or short term working capital purposes, the long term working capital needs of businesses spans over period longer than one year/season. Olashore (1988), classified loans granted by Nigerian banks in terms of uses, he grouped loans into Investment which allows a business to obtain credit for capital goods (e.g. expansion of factory or procurement of machinery ), Commercial which includes bank credit (e.g. overdraft, loans and advances, trade credit, commercial papers, hire purchases, etc) and consumption loans, which permits individuals or households to purchase goods (e.g. refrigerators, television, cars etc ) they could not afford if they have to pay immediately. In terms of maturity profile, he classified loans into long-term, intermediate, short-term and demand loans are classified into public sector borrowers. Based on the above, banks credit facilities can be broadly categorized thus;

**Cash Disbursement**

Credits in this category may be direct or indirect. Direct credits will includes overdraft, terms loans (i.e. shortterm, medium-term, and long-term personnel papers, certificate of deposit and leasing. Indirect credits relates to where a bank gives an undertaken to make payment in the event of certain occurrence, included here are acceptances, guarantees, bonds, indemnities and letters of credits.

 **Loans According to Purpose Includes**

 Credits to priority sectors such as Agriculture, Production and Manufacturing, credit to other sectors such as general commerce, mining and constructions, credit to rural borrowers; and credit to small scale enterprises. It is important to note, that the sectoral distributions of Bank’s loans and advances guided by Central Bank of Nigeria monitory and credit guidelines issued from time to time. Agu, (1988); Classified loans and advances granted by Nigerian banks in terms of their security thus:

1. **Secured:**

 Facilities (loans or advances) secured by bills or land or other title documents, negotiable securities, guarantees, Life assurance policies, etc.

1. **Unsecured Loans:**

 Ojo, (1976); described this as “usually temporary out-of pocket loans granted to customers of undoubted financial strength and to salary earners in the middle and top income groups, whose monthly salaries are paid regularly into the banks (from which any temporary accommodation given would be liquidated). They are usually meant for consumption and of small amount.

1. **Secured Against Real Estate**

 Are loans secured on real estate’s particularly landed properties.

**2.3 CREDIT MATURITY PROFILE**

 Bank loans have varying maturity patterns within which loans are to be liquidated. According to Adekanye, (1986), all loans and advances are technically repayable on demand except for the term loans”. Agu, (1988); categorized the maturity pattern of loans and advances granted by Nigerian banks into:-

1. Those maturing within three months (i.e. 1-3 m)
2. Those maturing within six months (i.e. 1-6 m)
3. Those maturing within twelve months(I.e.1-12 m)
4. Those maturing later than twelve months (i.e. above 1yr).

**2.4 LOANS/CREDIT MANAGEMENT CONCEPT IN NIGERIA BANKS**

 Management has been defined as the process of coordinating, controlling, directing and planning of limited resources to achieve the corporate goal. In managing its loans portfolio, banks are guided by government economic and monetary policies, objectives and the cannons of lending. Foremost the bank’s lending is informed by government economic policy goals as spelt out in the annual budget and defined by CBN Monetary and Credit Guidelines and the Regulatory and Institutional Environment within which its operates. Banks lending ability is dependent on its deposits profile (demand, time and savings deposits) which Marshall and Swanson, (1980); pointed out constitute the largest portion of money supply to the economy. Generally, deposits of customer are repayable on demand except for time deposits which have specific maturity time for repayment. It implies, therefore that sufficient liquidity is required to absorb possible customers’ deposit withdrawals and some required to meet customers’ demand for loan. Loans and advances are the largest earning assets of banks but the objective of liquidity is to meet deposit withdrawals conflict with meeting customers’ demand for loan. Again, Marshall and Swanson, (1980); agrees with this when they opined that the liquidity objective conflict with the objective of profitability in the conduct of Commercial Bank Management “In explaining this conflict further, Nwankwo, (1980); contended that orthodox banker consider he owes two obligations in his daily banking operation; Maximum liquidity to depositor to repay the deposits on demand or as agreed; and maximum profitability to shareholders who has contributed to set up the business. Effective lending /credit in orthodox banking philosophy according to him (Nwankwo), is the successful reconciliation of these two obligations. This philosophy he dismissed is unacceptable in a developing economy and, therefore, advocated a philosophy of creative banking. Effective lending based on this philosophy implies that question of lending which maximizes the bank’s objectives of liquidity, and profitability with the economy’s objectives of maximum development. Over the years, the question of resolving these twin issues of liquidity and meeting customer’s demand for loan have been a great source of concern and this led to the development of various methods of meeting the objectives. The methods have evolved over the years with concepts like commercial loan theory (Real Bill doctrine), shift ability doctrine anticipated Income theory and liability management.

**Commercial loan theory (Real Bill Doctrine)**

 Prior to the World Economic Depression of 1930’s the widely held view about the liquidity question was the real bill doctrine. In this theory, the liquidity question of banks can be resolved by acquiring short- term liquidating loan asset. This implies that meeting customers demand for loans should only be based on granting of loans to customer for short - term financing of their working capital and loan secured by real goods in production, marketing and shipment. The sale of such goods invariably provides the means for liquidating the loans. According to Adewumi, (1980); the real bill doctrine dominates lending practices because there were no enough secondary reserve assets which could have served as alternative liquidity to the Banks. He opined that government bonds in existence as at that time were not really marketable as secondary market were undeveloped or even non- existents. Thus the bank’s source of liquidity a part from cash was their portfolio.

**Shiftabilty Doctrine**

This was developed during the 1920’s and 1930’s with increased holding by banks of marketable securities. To meet customers deposit withdrawals, the shiftability theory of asset management, advocates banks holding of marketable securities so that liquidity could be met by shifting or selling the securities held to other buyers. The theory presupposes a well-developed secondary securities market, Kreps (1972:18), pointed out that the doctrine was viewed by bankers as an improvement of the real bill doctrine. He argued, however, that liquidity can only be generated based on this doctrine in normal times’ as marketable securities may fail to yield the desired liquidity in times of liquidity squeeze. For the doctrine to be fully operationalised, he contended that there must be a lender of last resort, willing and able to lend to banks during the time of liquidity squeeze.

**Liability Management:**

 With the emergence of commercial deposits in 1961, a new approach to the liquidity question in loan management developed. Commercial deposit is an alternative means of raising deposits to meet customer deposits withdrawals. It was thus possible for banks to lend most of their deposit liabilities without being constrained by the size and maturity patterns of such loans. According to Woodworth, (1971); a proper liquidity management entails the generation of enough liquid resources as and when desired, thus eliminating the constraints of earlier concepts. In his speech recently, Ede, (2003), said “according to the contingency plan of the CBN that came into effect 31st July, 2002, a bank that records a liquidity ratio greater than 20% but less than or equal to 25% or a bank whose account with CBN was overdrawn and not covered on the next working day consecutively for five working days within a month, shall have its management invited for discussion on its plan to improve liquidity or request the bank to realize assets that do not qualify for inclusion in the liquidity ratio compilation. Also a bank that records liquidity ratio equal to or less then 10% and is unable to meet its maturity obligation, suffers clearing operation losses for 15 continuous days or up to 20 days during a calendar month shall have its management in or board charged. Also such bank stands suspended from clearing until it makes good its clearing position”. The above measures by CBN is to ensure adequate liquidity to meet up with customers deposit withdrawals as well as demands for loans. The interest earned from loans granted help for the growth of the banks. The various concepts explained above seek to reconcile the bankers’ Trion objectives of liquidity and profitability. According to Marshall and Swanson, (1980); the real bill doctrine emphasizes the need to balance the maturity structure of assets against deposit liabilities. The other concept provided an alternative ways of resolving the liquidity question without being unduly constrained by the maturity patterns of loans.

**Profitability**

 Profit maximization is the primary objective of all business organizations banks as one of the profit oriented organizations tries to maximize profit by minimizing costs, risks and bank loan losses which eventually turns bad. Profits enhance the growth and expansion of any bank and it does constitute retained earnings and dividends. Dividend is the proportion of profit given to share- holders usually at the end of accounting period as returns on their investment. What makes up this profit in lending or credit facilities offered is the rate of interest charged by the banks. So if the banks are able to recover the principal plus the interest charged, then profit is declared as a result of the loan recovered.

**Bad and Doubtful Debt in Banks**

 Bad debts are those credits/loans granted to customers by banks in which the customers are unable to repay. In other words, they are debts owed the banks by customers which are not only uncollectible but also unpayable. Bad debts have over the years brought colossal losses to banks and it has been identified as one factor that is responsible for the recent spate of distress in the banking sector. In spite of all the efforts by the monitoring authorities at observing lending principles and putting in appropriate lending or credit policies, bad debt remain a serious problem of the banking sector.

**2.5 CREDIT/LENDING POLICY FORMULATION**

 The management of any loan should start with the credit policy. The term “Credit policy” refers to those decision variables that influence the amount of credit given out to customers. The formulation of which is the responsibility of the bank directors and management. It entails establishing guidelines which incorporates the extent of any discretion or authority delegated to the various executives and officers charged with credit administration. It thus set out rules which form the basis for subsequent monitoring. Crosse, (1962:191), pointed out that a “well – conceived lending policies are essential if a bank is to perform its credit. Creating function effectively and minimize the risk inherent in any extension of credit”. The credit (Loans and Advances) are affected by economic conditions, industry norms, change in technological, competition etc. the banks have no control on factors such as economic condition, industry norm, competitions etc but can certainly influence the level of credit facilities to be given out through its credit policy within these constraints imposed externally. The credit policy of any organization may be lenient or stringent one depending on its approach

**Lenient Credit policy**

Banks or firms operating a lenient credit policy tends to give credit facilities to customers very liberally that is credits are granted even to those customers whose credit worthiness are not known or is doubtful. Banks with this policy tends to have higher or a number of customers patronizing them, which in turn incur/record higher or more bad debt losses which affects the growth and profitability of the bank and also face the problem of liquidity.

**Stringent Credit Policy**

These are banks or firms who are very selective in extending credit or loans. They offer credit facilities to their customers who have proven credit worthiness. The banks or organizations with stringent credit policy follow tight credit standard and terms and as a result, minimize cost, risks, and chances of bad debts and problem of liquidity. In Nigeria, credit policies of banks must fall within the provisions of the regulatory/legal environment of bank lending. Policy decisions should address lending issues like the kind and number of loans a bank will give, to whom and under what circumstances. Onwughara (1992), enumerated factors, other than the legal/regulatory ones that need to be taken into consideration in formulating lending policies as follows:-

**Structure of Deposit and Loan Maturity Profile**

There should be proper matching of deposit to loan maturity to avoid the embarrassment of liquidity problem or cash squeeze of not being able to meet depositors’ withdrawal. According to him, it is a bad policy to lend long when the bank’s deposit base is short-term in nature. Current account deposit for instance, is very volatile and it would be imprudent to use it to match long-term lending. In formulating a lending policy therefore, the bank should have a good knowledge of its deposit structure.

**Repayment**

While taking cognizance of the Monetary and Credit Guidelines, the banks’ lending policy should spread their risk over short, medium and long-term credit.

 **Interest Rate**

 In credit policy formulating, the bank should determine its average cost of funds which would form the basis for determining both deposit and lending rate. The 1992 guideline provides for maximum spread of 5% between the banks average cost of funds and their lending rate which implies that the maximum lending rate of a bank would be the average cost of funds plus 5%. This forms the basis for determining the bank’s prime lending rate. As per the government’s fiscal policy of 2004, the interest on bank lending was based on an average of 12% discount rate.

1. **Security**

 Lending policy should state maximum amount that can be lent unsecured and the type of securities that are acceptable for other credits in excess of the unsecured limit.

1. **Disbursement Condition and Covenants**

The policy should be clear in the conditions and covenants that must be met before disbursement of a loan take place.

1. **Control**

A well articulated policy should aim at effective administration and control of credits. To achieve this, lending limits should be delegated to committees and responsible officers while sanctions are also clearly spelt out for violation of delegated lending limit. Crosse, (1962); is of the view that in formulation of sound lending policies, the following factors should be given due consideration; According to him, the starting point of loan policy should be knowledge of the legitimate needs of the community or credit markets which the bank serves or intends to serve. The important is that bank credit should further the stability and growth of the community or the economic wellbeing of its inhabitants. The issue of Monetary and Credit Guidelines by the Central Bank of Nigeria annually is aimed at enforcing this important consideration so as to channel bank credits towards the overall economic growth and development of the country. The next task of bank management according to him (Crosse) is to appraise the bank’s willingness and ability to meet customer needs. The bank’s ability to grant loans, given adequate liquidity and capital protection, is limited only by the volume of its relatively stable deposits, that is, time and saving deposits. Determining the character of loans is another consideration in credit policy formation. A bank’s lending or credit policies are in effect “screening” devices by which the Directors and Management seek to establish the kind and character of loans they feel their bank should make. It means therefore, that the character of a loan should take precedence over its form. The bank should, as a matter of policy establish ceiling on the various forms of lending which in Nigeria is guided by the Provision of the Monetary and Credit Guidelines. In determining the character of loans, Crosse proposed 3Ps of policy;

1. Payment

2. Purpose

3. Protection

Payment, he advocates, should be a basic premise of a bank’s lending or credit policy taking the means and timing of repayment into considerations. Loans and advances should be made when a borrower agrees in advance to a repayment programmed related to a realistic appraisal of his ability. Purpose for which loan proceeds is to be put, is considered to be important in credit policy because without knowledge of it, the banker cannot know whether the money he lends will produce income or profit to repay the loans and cannot relate the repayment programmed to the nature of the transaction. Beside, the form of monetary policy is sometimes to restrict credits or to channel credits to a particular sector of the economy, and knowledge of the purpose of loan application will assist the banker in the landing decision so as to comply, therefore requires that the purpose be disclosed. Protection constitutes the third element in determining the character of loan. The importance of protection is derived from the responsibilities which a bank owes to its depositors and shareholders. Bank management need to take every possible precaution to obtain adequate protection from the borrower so as to have something to hedge on and minimize losses in the event of default which resulted in low profitability which subsequently affect the growth of the bank.

**2.6 CRITERIA FOR LOAN/CREDIT DECISION AND ITS EFFECT ON PROFITABILITY**

 Lending always involves some elements of risks stemming from circumstances which result from the nonpayment of the loan obligation when they fall due. As nonpayment of loans and advances by customers when they fall due has serious implications on the bank and even the society, there is the need for proper Credit Analysis to assist in lending/credit decision.

**Credit Analysis**

 The purpose of credit analysis is to identify and weigh all the events that may prevent the repayment of a credit in the future and by implication the capacity of the borrower to repay the facility. The analysis must therefore focus on the capacity of the borrower to repay. The evaluation of all credit proposals submitted to the bank must be based on a well written analysis which must be brief and concise. The length and depth of a credit analysis is dependent on the complexity of the transaction, client’s financial condition, the degree of risk involved as well as whether it is a new proposal or a renewal of an existing credit or an interim or annual review. The extent of the analysis is also dependent on the risk rating. Generally, credit analysis should not be a mere re-arranging of fact or figures as obtained from the customer, rather, it must be a reflection of the relationship managers view of the risk inherent in the package based on the thorough understanding of the request, as well as its financial performance. According to Weston and Copeland, (1988); there are five (5) C’s of credit that managers should consider in the evaluation of Credit Risk. These are Character, Capacity, Capital, Collateral and Condition which they explained thus;

**Character**

 Has to do with the ability of a customer to try and honor his obligations. The importance of this is the fact that every credit transaction must have a promise to pay.

**Capital**

It’s measured by the general financial position of the firm as indicated by financial ratio analysis, with special emphasis on the tangible net worth of the enterprise or individual.

 **Collateral**

It’s represented by assets offered by the customer as a pledge for security of the credit extended.

 **Condition**

This has to do with impact of general economic trends on the firm or special developments in certain areas of the economy that may affect the customer’s ability to meet the obligation.

 **Capability**

 This has to do with the capability of the borrower to repay back the loan. Mather, (1972); identified three basic principles behind lending/credit which are:

1. Safety

2. Suitability

3. Profitability

**Safety:** The loan must be safe, which means that it should be granted to a reliable borrower who can repay from reasonable source within a relatively short period. The liquidity of the advance in the ordinary course of business should be supported by the deposit of security as an insurance against unforeseen developments. Suitability: This is concerned with ensuring that lending is concentrated on purposes which are desirable from the standpoint of the economic health of the nation. Profitability: To test credit facility proposal along these lines, the following factors needs to be considered:

1. The borrower
2. The business of the borrower
3. The capital resources of the borrower
4. The amount required
5. The purpose of the advance
6. The sources of repayment
7. The security
8. The profitability

 Ahmed, (1991); summed up the criteria thus; “the most crucial consideration in lending /credit is the twin elements of Trust and Confidence; trust is the viability and profitability of the proposition or project and confidence in the manager or promotes sponsoring it. As a matter of fact, all text books discussions on the cannons of lending are no more than mere analysis of factors employed to ascertain the existent or absence of these two important elements.” As pointed out earlier, the objective of credit analysis is to minimize the possibility of loan losses which in turn affects the profitability; hence the analysis must be rigorous and thorough. When a loan proposal is not objectively scrutinized, the possibility of defaults is high. This view is supported by Mabogunje (1993:1), when he said; “A good Manager should not give out Kobo that will stretch the funds at the disposal of the bank. In a situation where the deposits of members of a community were recklessly given out as loans to friends and relations or cornered by the directors of the bank does not augur well for healthy banking”. A quantitative approach to credit evaluation was developed by Cohen, Gilmore and Singer, (1966); they developed a computer model that was intended to simulate the decision process of a loans/credits officer in processing loan application. One part of this process was analyzing the credit rating of the applicant. To do this, they utilize historical and perform financial information to compute several ratios which were compared with industry parameters. These ratios were:

1. Network to Total debt
2. Funds for debt services to funds provided by operation using three year average.
3. Liquidity measures such as cash to current liabilities, cash plus receivables to current liabilities, current inventory to three year average inventory.
4. Profitability measures such as three year average of net profits and trend in net profits. Though the study did not directly estimate a loan risk function, the financial ratios identified were used in estimating loan risk in their simulation of the lending process.

In their own contribution, the National Association of Bank Loan and Credit Officers in United States of America issued a publication in 1964 listing seven financial ratios as predictors of failures and, therefore, to be utilized in credit analysis to avoid loan losses as a result of poor analysis. The ratios identified were:

1. Quick Assets to Networth
2. Current Assets to Networth
3. Fixed Assets to Networth
4. Total Debt to Networth
5. Sales to Receivables
6. Cost of Sales to Inventories
7. Sales to Networth.

**RATIOS**

A financial statement ratio is computed by dividing the naira amount of one item reported in the financial states by the naira amount of another item reported. The purpose is to express a relationship between two relevant items that is easy to interpret and compare with other information. The relationship between two items can be more easily compared to other standards, such as, for example, the current ratio of other companies, or industry-wide ratios and could be converted to a percentage by multiplying the ratio by 100. Ratios are classified according to their evaluation of firms; i. Profitability.

 ii. Liquidity.

 iii. Solvency.

**Profitability Ratios**

Profitability analysis consists of test to evaluate a firm’s earning performance during the year. The results are combined with other data to forecast the firm’s potential earning power. Potential earning power is very important to long-term creditors and shareholders because, in the long run, the firm must operate a satisfactory profit to service. A firm’s financial soundness depends on its future earning power. Adequacy of earning is measured in terms of the relationship between earnings and either total asset or common stockholders’ equity, the relationship between earnings and sales, and the availability of earnings to common stockholders

**2.7 SECURITIES FOR BANK LOANS AND ADVANCES**

In granting loans and advances, banks generally require some form of security on which to hedge on in case the customer defaults in liquidating his loan obligation. Nwaeze, (1988); explains that security for bank loans and advances are in form of tangible assets, guarantee, stocks, shares and such other items of commercial values that can be sold for cash in case of defaults. He opined however, that the best security is the financial viability of the business to generate profit, meet commitments as and when due, yield reasonable returns on capital and adequate liquidity for operation. Adeniyi, (1992); Contend that, the type of security to be obtained by banker depends on the amount of the credit, the duration of the repayment and the nature of the transaction. He identified securities acceptable to consist but not exclusive of the following:

1. Title to land (as evidenced by deeds of conveyance, leases, assignments or certificate of occupancy)
2. Stock and Shares
3. Life Insurance Policy.
4. Vehicles and Chattels
5. Promissory Notes.
6. Company Assets (Comprising of Stock In – Trade, debts, Raw Materials, goods in the process of manufacture, factory site, plants and machineries).
7. Personal and corporate guarantees.
8. Domiciliation of payments from the bank’s list of acceptable counterparties.
9. Charge on fixed deposits.
10. Trust Receipts.

**2.8 LOAN REVIEW, MONITORING AND EVALUATION**

This constitutes an important element of loan management. An effective monitoring and supervising of loans granted minimize the incidence of bad debt and hence increases the profitability and growth of the bank. It involves keeping a close watch in the health of the borrower. Monitoring is an important aspect of credit administration. It is the easiest means of detecting any error of judgment committed during the appraisal and granting of loans and advances. It gives the signal that a rightly analyzed loan and advances is moving towards derailment. Etloite (1989), argued that however competent a manager is in his lending practices, bad debt will arise or the repayment of a loan and advance will become doubtful from time to time will eventually affect profitability. He pointed out that bad debts pass through doubtful stage prior to a real loss of money occurring and that there are lots of reasons for lending becoming unsatisfactory. These reasons according to him include;

1. Customers not being able to manage their business efficiently,
2. A principal member of the company dying
3. A falling demand for goods or services
4. Excessive drawing by the proprietors of the business or
5. Failure to live within their means and even adverse whether condition working against a particular business.

 He suggested that to prevent the must possible situations occurring while allowing the customers every reasonable chance to get out of their difficulties, the manager must learn to recognize early signs of potential bad debts. The following procedures shall be adopted in the monitory process;

1. **Plant Visitation**

This gives the monitoring officer a first hand and greater insight into the customers operations which might not be captured in financial and other reviews conducted in the office.

1. **Credit Reviews**

The objectives of the reviews would be to come up with the true and correct picture of the accounts and credits at the time of the review and also the likely picture thereafter. The review must therefore address credit quality, compliance with approved terms and conditions, the security position and the profitability of the account. Regular monitory and supervision of loans granted to customer Ahmed (191:26), pointed out “ enables one to take immediate steps to either rectify anomalies resulting in such incident or take whatever action is deemed legally expedient or necessary to minimize imminent losses”. Sadiku, (1992); further enumerated the following tools for monitory loans and advances granted to customers.

1. Daily accounts balances: this entails checking the customer’s ledger or accounts at frequent internals
2. Audited and management accounts of the borrower: is also a useful aid in monitory the financial health of the borrower with such accounts, the lender can check and compute relevant figures such as

a. Sales turnover

 b. Net profit to sales

 c. Retained earning

d. Net cash generation

e. Gearing

These figures could be compared with the industry figures or parameter so as to make judgment of how the customer is fairing. He opined that an efficient monitory system will dictate the types of supervision that should be given to various segments of the loan portfolio and this will help in early identification of problem loans.

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

* 1. **Research design**

The researcher used descriptive research survey design in building up this project work the choice of this research design was considered appropriate because of its advantages of identifying attributes of a large population from a group of individuals. The design was suitable for the study as the study sought to appraisal on the impact of effective credit management on the profitability of commercial banks

* 1. **Sources of data collection**

Data were collected from two main sources namely:

(i)Primary source and

(ii)Secondary source

**Primary source:**

These are materials of statistical investigation which were collected by the research for a particular purpose. They can be obtained through a survey, observation questionnaire or as experiment; the researcher has adopted the questionnaire method for this study.

**Secondary source:**

These are data from textbook Journal handset etc. they arise as byproducts of the same other purposes. Example administration, various other unpublished works and write ups were also used.

* 1. **Population of the study**

Population of a study is a group of persons or aggregate items, things the researcher is interested in getting information appraisal on the impact of effective credit management on the profitability of commercial banks. 200 staff of selected banks in Akwa Ibom State was selected randomly by the researcher as the population of the study.

* 1. **Sample and sampling procedure**

Sample is the set people or items which constitute part of a given population sampling. Due to large size of the target population, the researcher used the Taro Yamani formula to arrive at the sample population of the study.

n= N

 1+N (e) 2

n= 200

1+200(0.05)2

= 200

1+200(0.0025)

= 200 200

1+0.5 = 1.5 = 133.

**3.5 Instrument for data collection**

The major research instrument used is the questionnaires. This was appropriately moderated. The secretaries were administered with the questionnaires to complete, with or without disclosing their identities. The questionnaire was designed to obtain sufficient and relevant information from the respondents. The primary data contained information extracted from the questionnaires in which the respondents were required to give specific answer to a question by ticking in front of an appropriate answer and administered the same on staff of the two organizations: The questionnaires contained structured questions which were divided into sections A and B.

* 1. **Validation of the research instrument**

The questionnaire used as the research instrument was subjected to face its validation. This research instrument (questionnaire) adopted was adequately checked and validated by the supervisor his contributions and corrections were included into the final draft of the research instrument used.

* 1. **Method of data analysis**

The data collected was not an end in itself but it served as a means to an end. The end being the use of the required data to understand the various situations it is with a view to making valuable recommendations and contributions. To this end, the data collected has to be analysis for any meaningful interpretation to come out with some results. It is for this reason that the following methods were adopted in the research project for the analysis of the data collected. For a comprehensive analysis of data collected, emphasis was laid on the use of absolute numbers frequencies of responses and percentages. Answers to the research questions were provided through the comparison of the percentage of workers response to each statement in the questionnaire related to any specified question being considered.

Frequency in this study refers to the arrangement of responses in order of magnitude or occurrence while percentage refers to the arrangements of the responses in order of their proportion. The simple percentage method is believed to be straight forward easy to interpret and understand method.

The researcher therefore chooses the simple percentage as the method to use.

The formula for percentage is shown as.

% = f/N x 100/1

Where f = frequency of respondents response

N = Total Number of response of the sample

100 = Consistency in the percentage of respondents for each item

Contained in questions

**CHAPTER FOUR**

**PRESENTATION ANALYSIS INTERPRETATION OF DATA**

**4.1 Introduction**

Efforts will be made at this stage to present, analyze and interpret the data collected during the field survey. This presentation will be based on the responses from the completed questionnaires. The result of this exercise will be summarized in tabular forms for easy references and analysis. It will also show answers to questions relating to the research questions for this research study. The researcher employed simple percentage in the analysis.

**DATA ANALYSIS**

The data collected from the respondents were analyzed in tabular form with simple percentage for easy understanding.

A total of 133(one hundred and thirty three) questionnaires were distributed and 133 questionnaires were returned.

Question 1

Gender distribution of the respondents.

TABLE I

|  |
| --- |
| **Gender distribution of the respondents** |
| Response | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Male | 77 | 57.9 | 57.9 | 57.9 |
| Female | 56 | 42.1 | 42.1 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the above table it shows that 57.9% of the respondents were male while 42.1% of the respondents were female.

Question 2

The positions held by respondents

TABLE II

|  |
| --- |
| **The positions held by respondents** |
| Response | Frequency | Percent | Valid Percent | Cumulative Percent |
| **Valid** | HRMs | 37 | 27.8 | 27.8 | 27.8 |
| Accountants  | 50 | 37.6 | 37.6 | 65.4 |
| Customers care officers  | 23 | 17.3 | 17.3 | 82.7 |
| Marketers  | 23 | 17.3 | 17.3 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

 The above tables shown that 37 respondents which represents27.8% of the respondents are human resource managers 50 respondents which represents 37.6 % are accountants 23 respondents which represents 17.3% of the respondents are customers care officers, while 23 respondents which represent 17.3% of the respondents are marketers

**TEST OF HYPOTHESES**

Banks does not have adequately financed projects in our economy

 **Table III**

|  |
| --- |
| **Banks does not have adequately financed projects in our economy**  |
| Response  | Observed N | Expected N | Residual |
| Agreed | 40 | 33.3 | 6.8 |
| strongly agreed | 50 | 33.3 | 16.8 |
| Disagreed | 26 | 33.3 | -7.3 |
| strongly disagreed | 17 | 33.3 | -16.3 |
| Total | 133 |  |  |

|  |
| --- |
| **Test Statistics** |
|  | Banks does not have adequately financed projects in our economy  |
| Chi-Square | 19.331a |
| Df | 3 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 33.3. |

Decision rule:

There researcher therefore reject the null hypothesis Banks does not have adequately financed projects in our economy as the calculated value of 19.331 is greater than the critical value of 7.82

Therefore the alternate hypothesis is accepted that Banks have adequately financed projects in our economy

**TEST OF HYPOTHESIS TWO**

Low interests have not favoured the borrowing customers

Table V

|  |
| --- |
| **Low interests have not favoured the borrowing customers**  |
| Response  | Observed N | Expected N | Residual |
| Yes | 73 | 44.3 | 28.7 |
| No | 33 | 44.3 | -11.3 |
| Undecided | 27 | 44.3 | -17.3 |
| Total | 133 |  |  |

|  |
| --- |
| **Test Statistics** |
|  | Low interests have not favoured the borrowing customers  |
| Chi-Square | 28.211a |
| Df | 2 |
| Asymp. Sig. |  .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 44.3. |

Decision rule:

There researcher therefore reject the null hypothesis Low interests have not favoured the borrowing customers as the calculated value of 28.211 is

 greater than the critical value of 5.99

Therefore the alternate hypothesis is accepted that state Low interests favoured the borrowing customers

**CHAPTER FIVE**

**SUMMARY, CONCLUSION AND RECOMMENDATION**

**5.1 Introduction**

It is important to ascertain that the objective of this study was to ascertain appraisal on the impact of effective credit management on the profitability of commercial banks

In the preceding chapter, the relevant data collected for this study were presented, critically analyzed and appropriate interpretation given. In this chapter, certain recommendations made which in the opinion of the researcher will be of benefits in addressing the challenges of effective credit management on the profitability of commercial banks

* 1. **Summary**

This study was on appraisal on the impact of effective credit management on the profitability of commercial banks. Three objectives were raised which included: To find out the best ways to manage loans which adversely affects the depositor’s banks and the economy will be a thing of the past, to find out the usefulness of the central bank credit guideline giving to commercial banks, to recommend possible ways of making credit policy guideline more effective and beneficial to both commercial bank and their customers. In line with these objectives, two research hypotheses were formulated and two null hypotheses were posited. The total population for the study is 200 staff of selected banks in Akwa Ibom State. The researcher used questionnaires as the instrument for the data collection. Descriptive Survey research design was adopted for this study. A total of 133 respondents made up human resource managers, accountants, customers care officers and marketers were used for the study. The data collected were presented in tables and analyzed using simple percentages and frequencies

**5.3 Conclusion**

Based on the findings of the study the following conclusions were made: First, the variations in the bank’s profitability are as a result of the problems of the management of the loans and advances of the banks. This can be observed as most of the banks have more than 50 percent of their profitability being determined by the fluctuations in the way the loans and advances were handled. Furthermore the study established that the effects of credit management on the profitability of the banks studied cut across all the banks, the Kruscal Wallis statistical tests suggests that the z value calculated is less than the tabulated z value in most cases. This means that the effect of the credit management on the profitability of the banks is almost on all the banks. This leads to the conclusion that the way credit is being managed in the bank affects its profitability. Finally, the study established that the management of the loans and advances (credit) by the banks is ineffective. This is as a result of the increase in the amount lost to the loans and advances by the banks over the years considered in the study.

**5.4 Recommendation**

The following recommendations have been made based on the findings of the study: There is the need for a strong policy on the management of banks’ credit facility. This involves the need for control at the various stages of collecting loans and advances in the banks. Furthermore, banks must ensure strict tradeoff between the liquidity and the profitability of the banks. This will ensure strict compliance with the money being kept by the bank and the amount granted for loans and advances. There is the need for an immediate change in the banks’ management style and internal control system of the banks. This will help to enhance the debt recovery method in operation. There should also be close watch of the laonable funds portfolio by the regulatory authorities (CBN, NDIC etc). Furthermore, the formulation and implementation of appropriate economic policies by the government as well as maintaining a stable economic environment will enhance the development of a secured loan and advances portfolio to both the customers and the banks. There is also the need for a proper and well articulated analyses over all collaterals presented for loans and advances. This will help the banks in ensuring that the assets serving as collaterals have the economic value that will cover the loans and advances collected. It will further help the recovery effort in case of any default.

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