**MEASURES NECESSARY TO MINIMIZE THE HIGH INCIDENCE OF BAD DEBTS IN NIGERIA COMMERCIAL BANKS**

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***ABSTRACT***

*This study was carried out to examine the measures necessary to minimize the high incidence of bad debts in Nigeria commercial banks with a special reference to Guarantee Trust Bank, Abuja. Specifically, the study examine the causes of bad and doubtful debts in Nigeria Commercial Bank and find out the effects of bad and doubtful debts in banks profitability,and the economy. The study employed the survey descriptive research design. A total of 141 responses were validated from the survey. From the responses obtained and analyzed, the findings revealed that the causes of bad and doubtful debts in Nigeria Commercial Banks is financial difficulty, poor money management, declining health and medical expenses and high costs of living. The study also revealed that the effects of bad and doubtful debts in banks profitability,and the economy is that it reduce banks' profitability, limit their ability to issue new credit, cause banks problems with their capital adequacy and slow down your cash flow. The study thereby recommend that banks Management should establish sound lending policies, adequate credit administration procedure and an effective and efficient machinery to monitor lending function with established guidelines. Also, reduction of interest rates on lending. Furthermore, the character and financial statement of the borrower must be properly studied. Lastly, the Central Bank of Nigeria should re-introduce interest rate regulation on banks.*

****CHAPTER ONE****

****INTRODUCTION.****

****1.1 BACKGROUND OF STUDY.****

A Bank economic purpose is to act as a financial intermediate it facilities the process of channeling savings into investments and one of the avenue of realizing this objective is by lending effectively.

It was recommended amongst others that state owned commercial banks should be effectiveness Banks should use the services of external consultants to manager collect the debts on account classified as doubt fill and prevent the diversion of funds by some borrower, the banks should try as much as possible to deal directly with contractors or supplies of the borrowers as the case may be.

All business regrettably experience bad debts, but bankers whose stock in trade is money view debt incidence with dread. Never the less, the occurrence of bad and doubt fill debts can be regarded as a difficult occupational associated with business. But for bank, it has for long been contended that, this dreaded and unavoidable disaster which should be kept with in reasonably margin of the total lending portfolio of the bank.

****1.2 STATEMENT OF THE PROBLEM.****

African continental bank was closed down by central bank of Nigeria because of the incidence of bad debts resultant from inefficiency of the bank workers and dishonesty.

Due to this high incidence of bad debt which the banks are experiencing from their customers the central bank of Nigeria set up the recapitalization of #25m to meet up with their customers incase any of the bank liquidate in order to settle or compensate those customers involved. And this is why Banks are merging themselves in order to meet the demand of the central bank of Nigeria

 This unfortunate fund in the Nigeria banking industries had debt creditors of the bank loose their more and their dividends as bad debts.

Conflate between boards and management banks or among members of the boards and management. This caused dissipation of bank resources and the entrenchment of harmful operating practices.

Africans continental bank was also closed down due to doubt fill debts which gave rise to fraud and other unethical practices represent the most dominate factor responsible for its distress. It can often traced to the very high incidence of bad debts and loan losses. This could be called fraud and unprofessional conduct.

Weak internal control most operational problems are by and large symptomatic of poor quality management. The qualify of management often make the difference between success and failure in banking as in most often frauds of economic endeavour. Decade ago to the fact that all the net profit generated has been sunk into yawning gap of bad and doubt fill debt.

****1.3 OBJECTIVES OF THE STUDY****.

 Bad debt problem has become a vital problem which the banking industry are facing because they are generally known for creating of credit loans and advantages to customers and this is one of the duties or the motive of banking.

The minimization of high incidence of bad debt being the main aim and objectives of this work the objective for this study can then not be over emphasized if the effects of the debts on the bakery on the customer and on the society in general is appreciated.

     However the study will among other things find the causes of bad debts by finding out whether the under listed factors about the incidence of bad debt and this factors include the following:

\* Non – adherence of canons of good lending.

·        Inadequate analysis

·        Lack of supervision of loans.

·        Dishonesty of some bank officials.

·        Lending on political ground

·        Low managerial skill

·        Diversion of loan

·        Inflation

·        Recession

**1.4 RESEARCH QUESTION**

**The following questions have been prepared for the study**

i. What are the causes of bad and doubtful debts in Nigeria Commercial Banks?

ii. What are the effects of bad and doubtful debts in banks profitability and the economy?

**1.5 SIGNIFICANCE OF THE STUDY.**

The relevance of this study is under score in its desire to asset bank confirm the multifarious causes of bad debts in their operation and help alert and knows his customers project proposal and account operation thoroughly the unbendable nature of his proposed or the flagging position of his account could be easily spotted.

**1.6 SCOPE OF THE STUDY**

The study will investigate the causes of bad and doubtful debts in Nigeria Commercial Banks. The study will also examine the effects of bad and doubtful debts in banks profitability, investors, the public and the economy.

**1.7 LIMITATIONS OF THE STUDY**

Financial constraint- Insufficient fund tends to impede the efficiency of the researcher in sourcing for the relevant materials, literature or information and in the process of data collection (internet, questionnaire and interview).

 Time constraint- The researcher will simultaneously engage in this study with other academic work. This consequently will cut down on the time devoted for the research work.

**CHAPTER TWO**

**REVIEW OF LITERATURE**

**INTRODUCTION**

Our focus in this chapter is to critically examine relevant literature that would assist in explaining the research problem and furthermore recognize the efforts of scholars who had previously contributed immensely to similar research. The chapter intends to deepen the understanding of the study and close the perceived gaps.

Precisely, the chapter will be considered in three sub-headings:

* Conceptual Framework
* Theoretical Framework
* Empirical framework

**2.1 CONCEPTUAL FRAMEWORK**

**Bad Debt**

Recounting some other benefits of financial intermediaries (FIs), Vicary (2007) posited that FIs offer much substantial liquidity on their secondary securities to lenders. FIs can provide enormous liquidity to their creditor and yet lend on a much longer term to their debtors. Especially, with demand deposits of banks which are perfectly liquid banks as financial intermediaries allow drawings on them without notification. Banks authorised even time deposits to be drawn upon a subject to certain conditions involving only some loss of interest. Asantey and Tengey (2014) remark that the public takes advantage in the bank's specialization in selling deposits with particular features and some other functions such as transferring funds, collecting cheques for their clients, and offering safe-deposit vaults. Most important of all is the dominant lender function which attracts the public to banks and induces it to hold deposits with them. Empirical studies have shown the contribution of commercial banks to the growth and development of organisations; small, medium and large both locally and internationally (Ahiabor, 2013), as well as private individuals through their lending activities. Consequently, the contribution of commercial banks to the growth of these parties is not limited to one country or jurisdiction. As postulated by Aballey (2009), bad loans resulting from the inability of debtors to reimburse loans and interests within the specified time cause adverse effects on the financial condition of the creditor (Agu & Okoli, 2013). Per the name and its effects, bad loans logically follow that they are functionally in resistance to the financial circumstances of the bank. By the time these loans will be referred as "bad loans", there is the fright that the debtor cannot fully pay the amounts involved and the interest. In this regard, a financial loss is encountered instead of profit, leading to adverse effects on the banks, the defaulting organisation and in fact other corporations and individuals who would like to borrow from the banks in future. Available literature gives different descriptions or definitions of bad loans including the submission of Fofack (2005) who consider bad loans as loans which for a relatively long period of time do not generate income. In such situations, the principal and or interest on these loans have been left unpaid for at least ninety days. Bad loan may also refer to one that is not earning income, and complete payment of principal and interest is no longer expected, principal or interest is ninety days or more delinquent, or the maturity date has passed, and payment in full has not been made. Some researchers noted that certain countries use quantitative criteria for example number of days overdue scheduled payments while other countries rely on qualitative norms like information about the customer’s financial status and management judgment about future payments (Bloem & Gorter, 2001). Alton and Hazen (2001) described bad loans as loans that are ninety days or more past due or no longer accruing interest. A critical assessment of the previous definitions of bad loans steers to the evidence that for loans which principals and interest have not been paid for at least ninety days are deemed bad. A classification of advances of the banking industry in December 2008 showed that out of the total loan portfolio of GH¢5,966,804,133.00, 7.68% was nonperforming. This covered loans recognised within second-rate, indefinite and loss levels. Loans in these categories have exceeded ninety days concerning repayment (Bank of Ghana, 2008).

**Banks Financial Intermediation (FI)**

The easier means for money (funds) to exchange hands is through a direct exchange between the holders of the money and the one in need of it. However in practice such a direct exchange comes with so many challenges that make it very difficult for the exchange to occur. In the face of these challenges another route known as indirect financing attempts to minimize or solve all the challenges associated with direct financing. Indirect financing involves a financial intermediary standing between the lender-savers and the borrower-spenders and helping transfer funds from one hand to the other (Gambrah, 2012). Financial intermediation can therefore be explained as financial institution serving as mediators between the person or a company who has gotten excess funds and wants to give it out as loan and an individual or firm ready to receive credit from the unit who has excess funds to lend. As described by Gambrah (2012), this indirect way of lending to the borrowers has some functions including reduction in transaction cost, risk sharing, information asymmetry and huge savings accumulation. This means that banks as the financial intermediaries serve as an agent between the borrower and the lender. Other things being equal, lenders are interested in minimizing all kinds of risk of capital and interest loss on leans or financial investments they make. These risks (Vicary, 2007) may arise in the form of risk of default or risk of capital loss on stock-market assets, such risks on secondary securities are far less than on primary securities for individual lenders. Bad loans need to be avoided in view of the fact that their effects are multidimensional; thus they do not only hinder profitability among commercial banks, but they also limit lending to the defaulting SMEs, individuals and other corporations. This assertion is based on evidences in Ghana (Appiah, 2011) and in foreign countries (Karim et al. 2010). The 2013 Ghana Banking Survey indicates that many commercial banks in Ghana are encountering massive bad loans. The situation is considered serious because the country’s major banks such as Ghana Commercial Bank, Ecobank (Ghana) Limited, Stanbic Bank (Ghana) Limited and Standard Chartered Bank (Ghana) Limited are facing the same problem. The report does not reveal the exact repercussions of the situation; but based on other evidences, it is certain that bad loans appalls the financial condition of banks. At large, the main effect of bad loans on banks is the fact that increasing bad loans limit the financial growth of banks (Karim, Chan & Hassan, 2010; Kuo et al., 2010). This consequence is as a result of the fact that bad loans deprive banks of the needed liquidity and limit their capability to fund other potentially viable businesses and make credit facilities available to individuals. Karim et al. (2010) argues that there are a lot of other viable businesses that the bank cannot explore as a result of the fact that its funds are caught up in bad loans. In the face of these consequences, the bank experiences a shortfall in generated revenues (Ghana Banking Survey, 2013), and this translates into reduced financial performance (Karim et al., 2010; Ghana Banking Survey, 2013).

**Loan management**

This refers to efficient combination of the major loan policies guidelines identifying some variables to ensure that loans granted to beneficiaries are collected promptly and at the same time sustaining customers’ confidence and loyalty to the bank. Van Horne (1995) identified four major variables including quality assessment of customers’ accounts, setting up of credit period, enticement to repay loan on time and cost of securing the loan. In the views of Van Home (1995), assessment of the quality of the customer account examines the ability of the customer to repay the loan on time. Banks are expected to set appropriate credit period giving enough time to allow the customer derive the full benefits of the credit. Asiedu-Mante (2011) concurred with an assertion that banks need to entice loan beneficiaries to repay on such enticement must be motivating enough before the aim can be achieved. Other area of consideration is the expenditure level that could be incurred in the collection exercise. This implies that the bank must not grant credit where the amount to be expended on collecting the debt will likely be greater than the debt itself. To blend these variables into an efficient workable system requires careful planning, controlling and co-ordination of all available human and material resources. Further, Asiedu-Mante (2011) describes loan management as involving the establishment of formal legitimate policies and procedures that will ensure that the proper authorities grant credit, the loan goes to the right people without any superior influence, the loan is granted for the productive activities or for businesses which are economically and technically viable, the appropriate size of loan is granted, the loan is recoverable and there is adequate flow of management information within the organization to monitor the loan activity. Undeniably, loan goes with risk seen as the distribution of financial losses due to unexpected changes in the credit quality of counterparty in a financial agreement. He also sees it as the probability of default or any type of failure to honour a financial agreement. Kay (2002) indicated that the probability of default is estimated by specifying a model of investor uncertainty; a model of the available information and its evolution over time; and a model definition of the default event. Jensen and Payne (2006) admit that banks operate within a sound and well-defined criteria for new credits as well as the expansion of existing credits. Banks make sure that credits extend within the target markets and lending strategy of the institution. Before allowing a credit facility, the bank must carry out an identification exercise through an assessment of risk profile of the customer/transaction. Such identification exercise include, among other things: credit assessment of the borrower’s industry, and macro-economic factors, the purpose of credit and source of repayment, track record/repayment history of borrower and assess/evaluate the repayment capacity of the borrower. In his contribution, Rosenberg (2006) advocated that credit customers can also be identified the proposed terms and conditions and covenants, adequacy and enforceability of collaterals and as well ensuring that loan application is accepted by the required authority.

**Loan Administration**

Loan portfolio administration is an essential part of the credit process which support and control extension and maintenance of credit. Typically, the bank’s back office in its credit administration function takes the responsibility of credit administration to ensure completeness of documentation (loan agreements, guarantees, transfer of title of collaterals etc) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt. Siaw (2013) adds that disbursement of loan should be effected only after completion of covenants, and receipt of collateral holdings having ensured that the loan application has proper approval before entering facility limits into computer systems. In case of exceptions necessary approval should be obtained from competent authorities. Loan monitoring has also been empirically supported Siaw (2013) as another important administration exercise after the loan is approved and disbursed. The loan should be continuously watched over keeping track of borrowers’ compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments. As part of loan administration function, obligors should be communicated ahead of time as and when the principal/mark-up instalment becomes due. Any exceptions such as non-payment or late payment should be tagged and communicated to the management. Proper records and updates should also be made after receipt. To complement with, Appiah (2011) advises institutions to devise procedural guidelines and standards for maintenance of credit files. The credit files include all correspondence with the borrower and also contain sufficient information necessary to assess financial health of the borrower and its repayment performance. Such files must be organize information in such a way as to facilitate review by the external / internal auditors. Appiah (2011) further reiterates that institutions should ensure that all security and collateral documents are kept in a fireproof safe under dual control. Registers for documents should be maintained to keep track of their movement. Where insurance coverage supports the documents, procedures should also be established to track and review relevant insurance coverage for certain facilities/collateral. Physical checks on security documents should be conducted on a regular basis.

**Loan Processing**

There is an element of risk in any loan granted because the expected repayment may not occur. Lending involves a lender providing a loan in return for a promise of interest and principal repayment in future (Kay, 2005). Because of this risk of default in loan repayment, lenders need to project into the future and make sound judgment that will ensure that repayment is effected at the agreed date. Available literature places so much importance on the lender’s role in ensuring good decisions relating to the granting of loans in order to minimize credit risk. The lender must always aim at assessing the extent of the risk associated with the lending and try to reduce factors that can undermine repayment. The lender should therefore assemble all the relevant information that will assist him/her in arriving at a sound credit decision. In view of the possibility of non payment which leads to loan default, banks have adopted a standard loan request procedures and requirements usually contained in credit policy manual to guide loan officers and customers. As Rose (1999) advocates, even if the customer cannot repay loan facility in full when due the margin of error must be minimal. In essence Dunkman (1996) suggests that critical assessment of the customer’s creditworthiness, otherwise called pre-lending safeguards, must be carried out on character, capacity, cash, collateral, conditions and control. In complement, Thanh (2014) developed mnemonics used as common checklist to review loan application, which include CAMPARI (Character, Ability, Margin, Purpose, Amount, Repayment, Insurance / Security). During loan appraisal banks must ensure due diligence so as to avoid or reduce high rate of loan default thereby minimizing credit risk which in turn seek to maximize shareholders’ worth. The assessment of the creditworthiness therefore involves the gathering, processing and analyzing information on the loan applicant. An important aspect of information is by way of credit references and credit rating. However, the responses provided on applicants by other banks are nothing to write home about and in certain instances no reaction is given. Inadequate provision and evaluation of security against loans might equally cause credit/loan default. Securities for loans and overdrafts are to ensure recovery of the funds lent to the borrower in the event that the borrower becomes unwilling or incapable of meeting his commitments. Dunkman (1996) outlines reasons for security as safeguarding against some doubts about borrowers’ repayment ability, basis for increasing amount of loans over and above existing facilities, and as a last resort to recover loan in the face of default. Even though security is necessary to safeguard loans, banks are cautioned not to over rely on them for a reason that realizing loan securities are not always easy due to some complicated processes banks must go through, making such securities counterproductive.

**Loan Classification and Provisioning**

All licensed financial institutions are required to monitor and review their portfolio of credit and risk assets at least once every quarter on a regular basis. The banking Act of 2004 Section 53(1) specifies prudential norms for banks to reviewed loan defaults once every month and classify them into four grades of risk: (i) standard (ii) substandard; (iii) doubtful; and (iv) loss. Assets in risk grades (ii) to (iv) are considered non-performing and therefore no income may be accrued on them. In view of the above, banks take into account the assets used in securing the facility to determine the level of provision to be made. Bank of Ghana regulations indicate that certain amount of provisions are made on the aggregate outstanding balance of all current advances, and aggregate net unsecured balance of all other categories.

**Factors Accounting for Bad Loans**

Some research findings and publications indicate that bad loans are caused by poor management. Berger and De Young (1997) argue that managers in most banks and other financial institutions with the problem of bad loans do not practice adequate loan underwriting, monitoring and control. Credit culture is another factor which has been recognized by some research findings as a cause of bad loans. Sometimes borrowers decide to apply for credit without cogitating about tomorrow and what else they need to buy with income. When this happens, a loan culture can develop where borrowers take out huge credit not because it is financially tactful to do so but because they see others do it. This can result in defaulted loans. According to Fofack (2005), a World Bank policy research working paper on bad loans in Sub-Saharan Africa revealed that bad loans are caused by adverse economic shocks coupled with high cost of capital and lowinterest margins. Francis (2009) stated that the accumulation of bad loans is attributable to some factors, including economic downturn, macroeconomic volatility, terms of trade deterioration, high-interest rate, excessive reliance on overly high-priced inter-bank borrowings, insider borrowing and moral hazard. Another literature (Robert, Amidu & Roberta, 2006) identified sudden market changes as yet another factor which accounts for bad loans. Any unexpected market shift can modify the loan market by affecting how much money people can take as loans and make payments. If the market suddenly changes and prices of items increase due to shortage or increased demand, borrowers will have limited money to pay off their loans which can lead to loan default. Appiah (2011) indicated in his work that problem loan can emanate from diversion of funds on the part of loan clients and overdrawn account where there is no overdraft limit or overdraft taken on account which has not been actively operated for some time and overdraft taken in excess of the reasonable operational limit. He also identified lack of good skills and judgement on the part of lenders as a possible cause of bad loans. Bloem and Gorter (2001) asserted that bad loans may be caused by less predictable incidents such as the cost of petroleum products, prices of key exports, foreign exchange rates, or interest rate change abruptly. They also indicated that poor management, poor supervision, overoptimistic assessments of creditworthiness during economic booms and moral hazards resulting from generous government guarantees and delayed loan disbursement could also lead to loan default.

According to Onwudiegwu (2001), the concept of default is less obvious than it first seems, for it could result from non - or delayed payment of interest and or principal for a given period. One or a combination of the following factors could contribute immensely to default especially in a depressed economy. The more one borrows; the more one would want to borrow consequently. The volume of the loan would increase which decreases the ability to repay as opposed to the willingness to repay. The ability to repay increases with increased net income although that does not say anything about the willingness to repay. One would expect borrowers with high net income to have low debt/equity ratio, the lower the debt/equity ratio, the higher the ability to repay. The effect of high net income and low debt/equity ratio is a precaution for borrowers to build up valuable assets. Onwudiegwu (2001) equally posited that, as the value of the collateral increases, the default rate is expected to decline. Where there is income variance as a result of economic or natural circumstance, credit service ability per individual borrower decreases and hence default could increase. Such income variances are common in agricultural and manufacturing sectors. The higher the interest rate, the more the outstanding balance the borrowers have to pay considering the principal. Rate of inflation has link with the real interest to be paid by the borrowers. If inflation is higher than the interest rate, it will mean that the lending bank would be paying borrowers to take its loans. The close monitoring of borrowers to ensure a loan is not diverted to unproductive use, though costly, has a lot of bearing on ability of the borrower to repay. The effort is put in ensuring utilization of a facility, the less chance of default.

**Interest Rate and Private Investment in Nigeria**

User‟s cost of capital is an indispensable factor in any investment decision of the private sector. Any increment in user‟s cost (interest rate) of capital will bring about a decline in investment. Interest rate can have a substantial effect on the rate and pattern of repayment of debt and of economic growth by influencing the volume of productivity, disposition of saving as well as volume and productivity of investment. The Keynesian investment theory and the Mckinnon-shaw (1973) savings and investment hypothesis constitute the theoretical basis for the use of interest rate policy in stimulation of the economy via investment. The Keynesian theory implies that low interest rate, as a component of cost of funds, encourages borrowing for investment. Some empirical findings are inconsistent with the fact. (Green and Villanueva 1991, negative relationship between interest rate and investment, studies by others (Serven and Solimano 1993, Van wijubergen 1985) have shown that in repressed financial markets. Credit policy affects investment in a distorted manner. Skully (1997) also in his study on Fiji and other countries in the region stressed that the availability of finance has constraint for private investment in Fiji.

**Securities For Bank Lending**

Securities for bank lending are property pledged as collaterals for loans by borrowers. Securities are the general name for stocks, mortgages, bonds, and certificates showing ownership of property. From the foregoing, the preview of securities for bank lending shall be limited to such properties held as securities by banks in Nigeria. Shegolar and Thomas (1999), Mandel (2000) From the diagnosis of the Nigerian Banking system, some of the securities held by banks before any lending is made to any individual, corporation or government and those securities often demanded by banks for loans and advances in the country have been shown to be quite unsatisfactory. One of such is the requirement of bank that prospective borrower should pledge any real estate holding for loans given to them. Such estate includes heavy plants and machinery, landed properties and other physical assets. Real estate properties must be immovable properties. The advantage it has to the bank is that due to the fact that it is stationary, the banks lay confidence on it to recover its debts in case of default. This category of security constitutes a major singular security in Nigeria banking industry) Mandel (2000) According to Olayinka (1999) other securities pledged by customers wishing to borrow from the bank is their money in either saving, current or time deposits, especially if the account has a regular cash flow usually from any salaries or wages or even other private sources.

**Obstacles Toward Effective Performance**

As should be expected in most business enterprises in developing economies the banking industry has certain factors that are militating against the effective performance of their lending function. Most of the people operating various businesses in Nigeria are illiterates. They do not easily understand nor do they appreciate reasons a lot of difficulties are encountered if loans are mismanaged. Explaining to such business men and women ways and means of improving their account with the bank before asking for loan is usually a mere waste of time. They would prefer to offer kickbacks than to understand the simple operation of the system. (Okoh 1997). The credit departments of some banks do not have the required level of man power and the will needed to perform difficult and technical transactions involved in lending.

**Bank Recapitalization And Consolidation**

The banking sector has a long way to go, in playing its expected role in the development and growth of the economy. To activate the potentials of banks in the economy, there is the need to employ certain pro-active measures Egwuatu(2004). Prior to the year 2004, the bank‟s capital base was about two billion naira. A family can therefore contribute that sum and register / own a bank and begin to gather deposits from the public. Managing the fund becomes a problem because there may not be liquid enough to cater for the financial needs of the public. This leads to frequent bank failure. The banks were not giving long term loans because they would want to get back their money on time to avoid the problem of bad and doubtful payment. Their aim therefore, is to shore up the financial base of the banks in the country beyond fragile level. The fragmented nature of the banking industry could a real obstacle to development and growth of the economy. The fragmented nature of the banking industry has been partly attributed to the high interest rate regime in the country. The hope of lower interest rate will have to come from a rising stock of long term funds in the system. Edozie(2005) pointed out that, due to the frequency of bank failure in Nigeria the CBN decided to increase the capital base of the banks to twenty five billion naira to make the banks stronger financially and to be more liquid. The banks that could not make it, merged with two or more banks to recapitalize. Some banks acquired one or more banks to recapitalize so as to be stronger financially.

**Loans and Bank Profitability**

Empirically (Robert et al., 2006), it is noted that the genesis of the problem of loan default is the quality of credit management practices of the banks, which requires scrutiny to find ways of ensuring improvements. Bank performance determinants have drawn the interest of academic research as well as management of banks. Studies deals with internal determinants employ variables such as size, capital, credit risk management and expenses management. The need for credit management in the banking sector is inherent in the nature of the banking business. The efficient management of credit portfolio of banks is crucially significant in enhancing profitability, maximizing shareholders’ wealth as well as deepening financial intermediation to stimulate economic growth and development. Asiedu-Mante (2002) asserts that very low deposits and high default rates have plunged some banks into serious liquidity problems, culminating in the erosion of public confidence in these banks. He further stressed that a combination of poor lending practices and ineffective monitoring of credit facilities to customers have contributed to high credit risk and significant low profit in some banks. This situation has most often plunged some banks into distress as withdrawals, could not be honoured. Athanasoglou et al. (2005) proposed that bank risk taking (lending/loans) has pervasive effects on bank profits and safety. Jensen and Payne (2006) declare that the profitability of a bank depends on its ability to foresee, avoid and monitor risk relating to loans. Additionally, possible to cover losses brought about by risk arisen and it also has the net effect of raising the ratio of substandard credits in the bank's credit portfolio and decreasing the bank’s profitability. Further, Athanasoglou et al. (2005) observe that the role of bank remains central in financing economic movement and its effectiveness could exert positive influence on an all-embracing economy as a sound, and successful banking sector is better able to resist adverse shocks and contribute to the stability of the financial system. Penurious asset quality and low levels of liquidity are two main causes of bank failures and symbolised as the principal risk sources regarding credit and liquidity risk and attracted great attention from researchers to study their impact on bank profitability. Risk associated with loans is by far the most vital risk encountered by banks, and the success of their business relies on accurate measurement and efficient management of this risk to a greater extent than any other risk (Thanh, 2014). Improvements in credit risk will boost the marginal cost of debt and equity, which in return rises the cost of funds for the bank (Basel Committee on Banking Supervision, 1999). Researchers employed a number of ratios to measure credit risk. The ratio of loan loss provisioning as a share of net interest income (LOSRENI) is one standard of credit quality, which depicts high credit quality by showing low figures. Robert et al., (2006) describe profitability as the central aim of all business enterprises. Without profitability, the business will not survive in the long-run. So measuring current and past profitability is very relevant. Profitability is measured by income and expenses. Income is generated from the activities of the business. A business that is highly profitable has the ability to reward its owners with a large return on the investment (Asantey & Tengey (2014). A profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. Important changes in the operating environment particularly credit/loan is likely to affect bank profitability. Empirical analysis finds that both bank-specific as well as macroeconomic factors are important determinants of the profitability of banks (Asantey and Tengey, 2014). Brealey and Myers (2003) argued that there are various important measures in determining profitability of an organization. These include net profit margin, return on assets (ROA), and return on equity (ROE). The ratio of net income to equity (ROE) as the accounting return on equity often serves as a target profitability measure at the overall bank level. Market Return on Equity is a price return or the ratio of the price variation between two dates of the banks' shares. Under some specific conditions, for example, when the price-earnings ratio remains constant, it can serve as a profitability benchmark.Both ROE and the market return on equity should be in line with shareholders expectations for a given level of risk of the banks’ shares. Return on assets (ROA) is another measure of profitability for banking transactions. The most common calculation of ROA is the ratio of the current periodical income, interest income and current fees, divided by asset balance. ROA can be decomposed into four constituent's parts by an accounting identity: Profitability = ROA = NI/TA + NII/TA – OV/TA – LLP/TA where NI is net interest income, NII is non-interest income, OV is non-interest overhead expenses, and LLP is loan loss provisioning (Asantey & Tengey, 2014). The net interest margin (NI/TA) creates a wedge between returns to savers and investors and reflects the cost of bank intermediation services and the efficiency of the banking sector. In general, the higher the net interest margin, the higher are banks’ profit margins and more stable is the banking sector. However, a higher net interest margin could reflect riskier lending practices associated with substantial loan loss provisions and could be an indication of inefficiency in the banking sector (Asantey & Tengey, 2014). The drawback of accounting ROE and ROA measures, and of the P&L (profit and loss) of the trading portfolio, is that they do not include any risk adjustment. Hence, they are not comparable from one borrower to another, because their credit risk differs, from one trading transaction to another, and because the market risk varies across products. This drawback is the origin of the concept of risk-adjusted performance measures. This is an incentive for moving, at least in internal reports of risks and performances to economic values, mark to market or mark to model values, because these are both risk and revenue adjusted. ROE measures how much the firm is earning after tax for each dollar invested in the firm. In other words, ROE is net earnings per dollar equity capital (Samad & Hassan, 2000). It is also an indicator of measuring managerial efficiency. By and large, higher ROE means better managerial performance; however, a higher return on equity may be due to debt (financial leverage) or higher return on assets. Financial leverage creates an important difference between ROA and ROE in that financial leverage always magnifies ROE. This will always be the case as long as the ROA (gross) is greater the interest rate on debt (Asantey& Tengey, 2014). ROE is calculated as ROE = Net profit after tax / Shareholders’ Equity. Equally appropriate is the use of Net Interest Margin (NIM) to evaluate the financial performance of banks. Net interest income is the difference between interest income and interest expense. It is the gross margin on a bank’s lending and investment activities. The higher the ratio, the cheaper the funding or, the higher the margin the bank is obtaining. A bank’s net interest margin is a key performance measure that drives ROA (Peters, Raad & Sinkey, 2004). Net Interest margin (NIM) is another profitability measure usually employed banks. NIM is calculated as NIM= (Interest Income – Interest Expense)/Total Asset. To most financial analysts, Return on Deposit (ROD) is one of the best measures of bank profitability performance. This ratio reflects the bank management’s ability to utilize the customers’ deposits in order to generate profits. Research (Tarawneh, 2006) has proven this ratio suitable for profitability measurement. ROD is calculated as ROD = Net Profit after Tax / Total Deposit.

**Implication of Bad Loans for Banks**

The interest income generated from loans contribute significantly to the profitability performance of financial institutions. However, when loans become delinquent, it has a serious negative effect on the health and operations of the banks. One of the reasons is that, in line with the Bank of Ghana regulations, the lending institution has to make provision and charges for credit losses (bad debt/impairment) which ultimately reduce the profit level. Again, large non-performing loan portfolio tends to undermine the bank’s ability to grant more credit. This is because the loanable funds tend to deplete when repayment of loans delays or fail to come. According to Bloem and Gorter (2001), though issues relating to non-performing loans may affect all sectors, the most serious impact is on financial institutions such as commercial banks and mortgage financing institutions which tend to have large loan portfolios. Another cogent implication of bad loans which is sometimes described as ‘‘toxic asset'' is the lack of credence on the part of depositors and investors leading to liquidity challenges. Again, another implication of bad loans for banks is the that huge amounts written off as bad debt adversely affect the growth of the shareholder's wealth since the profit which is re-invested (ploughed back) into the business to grow the capital base is reduced as a result of provision for credit losses. Bloem and Gorter (2001) observe that the provisions for bad loans reduce total loan portfolio of banks and as such affects interest earnings on such assets. This constitutes huge cost to banks. In 2006, ADB made a total provision for bad and doubtful loans to the tune of GH¢35,080,800.00 which reduced the bank’s loan portfolio from GH¢186,004,100.00 to GH¢150,923,300.00. The bank’s charge for bad debts also reduced its net interest income by about 25% (ADB, 2006). In a similar token, dividend payment is equally negatively affected because the provision for credit losses are deducted before dividends are declared. Some foreign records indicate that failing banks have tremendous amount of bad loans prior to failure and that asset quality is a significant predictor of insolvency (Berger & De Young, 1997). Indeed in Ghana, most Micro-finance institutions, rural and commercial banks have collapsed mainly on account of bad loans. The issues discussed above show the gravity of the implication of bad loans on the operations of banks and this study identifies the factors accounting for the incidence of bad loans, the impact of bad loans on the bank’s profitability

**2.2 THEORETICAL FRAMEWORK**

**Agency Theory**

Commercial banks and their sustainable maturity are undoubtedly germane to industrial advancement. This is, as a result, the banking sector is among the very few sectors that add to economic development in various aspects. First of all, commercial banks uninterruptedly contribute to economic progress by paying taxes and creating employment. Moreover, commercial banks entail the anchor of the growth of other sectors by granting them access to credit facilities in the form of loans. Moreover, much empirical evidence exists on the contribution of commercial banks to financing particular firms and sectors. The study is underpinned by the Agency Theory (AT) which supports the opportunistic behaviour of individuals. In relation, Jensen and Payne (2006) explain that customers and investors alike would expect their bankers to respond favourably to their objectives for joining them in business. Banks as agents of their customers and investors try to put in place mechanisms that seek to align the interest of the agent and the principal. All parties in their own self-interest are at the same time motivated to maximize organizational values (Francis, 2009). Mechanisms used to address agency problems as far as banks profitability is concerned to include effective loan portfolio management to minimize the incidence of bad loans and thereby to maximize profitability which in essence safeguards the worth of stakeholders (Jensen & Payne, 2006).

**2.3 EMPIRICAL REVIEW**

Olokonla(2015)examines the causes of bad and doubtful debt in Nigeria commercial banks. It presents a framework to x-ray the risk and to validate the checks and balances to prevent or rather reduce the risk. The study uses both primary and secondary tools for data collection to determine causes of bad debts. Analysis of Variance (ANOVA) and autoregressive model were applied to validate the result spanning the period 1993 to 2011. Lending is one of the major functions of banks though the most risky. Yet any bank that wants to remain in business must lend. Due to the fact that bank’s primary function is to act as intermediary between savers and borrowers, the barometer for measuring their earnings is interest from lending. Lending is a risk. Granting of credit is risk that can be viewed as the most important risk which Nigerian banks face bearing in mind the staggering size of their non-performing assets. Credit risk therefore is the risk which could occasion a loss for a bank due to a default by a customer in meeting its obligation. It is observed that incessant increase in interest rate is a strong and statistically important factor that causes bad debt in Nigeria commercial banks. Banks Management should establish sound lending policies, adequate credit administration procedure and an effective and efficient machinery to monitor lending function with established guidelines, reduce interest rates on lending. They should study the character and financial statement of the borrower before granting them loans. Keywords: Bad debts, Customer’s default, Credit risk, borrowers, nonperforming assets.

Francias(2018) assess the Loan granting and its recovery problems on Commercial Banks. The research was intended to achieve the following objectives: To find out the several problems facing loan recovery, the effects of loan default on commercial banks and the measures that will be used in reducing the incidence of loan default. Relevant data were collected from both primary and secondary sources. Questionnaires were the main primary data collection instrument employed while data from various relevant publication constituted the sources of secondary data. Upon the analysis of data, the following conclusions were drawn: That problem of loan default stemmed from the fact that there is unavailability of security to be disposed by banks to realize funds. And also customer’s attitude towards loan payment. On the basis of the above findings, it was recommended that commercial banks should use some risk control measures to guide against loan default. Also, before granting loan, they should examine critically the project statement submitted by the customer or borrower which will help them to find out the realistic repayment pattern and also help them in knowing if the projects are realistic based on the customer’s past performance. Also, the Central Bank of Nigeria should create a conducive environment for the successfully operation of commercial banks in Nigeria.

Larrisa(2019) examines the causes of bad and doubtful debt in Nigeria commercial banks. It presents a framework to x-ray the risk and to validate the checks and balances to prevent or rather reduce the risk. The study uses both primary and secondary tools for data collection to determine causes of bad debts. Analysis of Variance (ANOVA) and Vector Autoregressive (VAR) model were applied to validate the result spanning the period 1993(Quarter 1) to 2011(Quarter 4). The Impulse response shows that incessant increase in interest rate is a strong and statistically important factor that causes bad debt in Nigeria commercial banks. Bank`s Management should establish sound lending policies, adequate credit administration procedure, effective and efficient machinery to monitor lending function with established guidelines, reduce interest rates on lending etc.

Mujeedeen(2017)assess bad loans and its impact on the profitability of banks in Ghana using Agricultural Development Bank Limited as a case study. The study is a descriptive survey which made use of semi-structured questionnaire to collect primary data from respondents. Additionally, a retrospective approach was taken to collect secondary data from the published financial reports of the bank (ADB Ltd) for a period of 5 years (2010-2014). Data collected for the study were analysed quantitatively using Microsoft software ‘‘Statistical Package for Social Sciences (SPSS) version 16.0. From the data analysed the study found an undulating trend of bad loans at an average of 6% bad loan ratio to total loan disbursed over the 5-year period understudy. Additionally, the study found customer’s business failure, high loan interest rate, inadequate loan monitoring and wrong timing of loan disbursement as the main factors accounting for bad loans at the bank. The study further observed that bad loans substantially impact negatively on the bank's interest income draining an average of one-fifth of the bank's interest income over the study period (2010-2015). Nearly the same amount of net profit earned by the bank is lost to bad loans. The study then concluded that the incidence of bad loans at the bank was great and requires effective credit management policies and procedures by the board and management of the bank. The study, therefore, recommended that board and management reduce loan interest rate, adequately resource credit officers for effective loan monitoring and ensure timely processing and disbursement of loans. It is also recommended for a future study to assess the credit management practices of the bank.

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

**3.1 INTRODUCTION**

In this chapter, we described the research procedure for this study. A research methodology is a research process adopted or employed to systematically and scientifically present the results of a study to the research audience viz. a vis, the study beneficiaries.

**3.2 RESEARCH DESIGN**

Research designs are perceived to be an overall strategy adopted by the researcher whereby different components of the study are integrated in a logical manner to effectively address a research problem. In this study, the researcher employed the survey research design. This is due to the nature of the study whereby the opinion and views of people are sampled. According to Singleton & Straits, (2009), Survey research can use quantitative research strategies (e.g., using questionnaires with numerically rated items), qualitative research strategies (e.g., using open-ended questions), or both strategies (i.e., mixed methods). As it is often used to describe and explore human behaviour, surveys are therefore frequently used in social and psychological research.

**3.3 POPULATION OF THE STUDY**

According to Udoyen (2019), a study population is a group of elements or individuals as the case may be, who share similar characteristics. These similar features can include location, gender, age, sex or specific interest. The emphasis on study population is that it constitute of individuals or elements that are homogeneous in description.

This study was carried out assess measures necessary to minimize the high incidence of bad debts in nigeria commercial banks using Guarantee Trust Bank, Gwarinpa, Abuja. Bank staff and customers form the population of the study. And, this information was gotten from staff and customers that were present as at the day and time of this research.

**3.4 SAMPLE SIZE DETERMINATION**

A study sample is simply a systematic selected part of a population that infers its result on the population. In essence, it is that part of a whole that represents the whole and its members share characteristics in like similitude (Udoyen, 2019). In this study, the researcher adopted the convenient sampling method to determine the sample size.

**3.5 SAMPLE SIZE SELECTION TECHNIQUE AND PROCEDURE**

According to Nwana (2005), sampling techniques are procedures adopted to systematically select the chosen sample in a specified away under controls. This research work adopted the convenience sampling technique in selecting the respondents from the total population.

In this study, the researcher adopted the convenient sampling method to determine the sample size. Out of the population of Bank staff and customers, the researcher conveniently selected 147 participants as the sample size for this study. According to Torty (2021), a sample of convenience is the terminology used to describe a sample in which elements have been selected from the target population on the basis of their accessibility or convenience to the researcher.

**3.6 RESEARCH INSTRUMENT AND ADMINISTRATION**

The research instrument used in this study is the questionnaire. A survey containing series of questions were administered to the enrolled participants. The questionnaire was divided into two sections, the first section enquired about the responses demographic or personal data while the second sections were in line with the study objectives, aimed at providing answers to the research questions. Participants were required to respond by placing a tick at the appropriate column. The questionnaire was personally administered by the researcher.

**3.7 METHOD OF DATA COLLECTION**

Two methods of data collection which are primary source and secondary source were used to collect data. The primary sources was the use of questionnaires, while the secondary sources include textbooks, internet, journals, published and unpublished articles and government publications. The reason for using both primary and secondary source of data is, so that the researcher will have concrete and more valid answers to the research questions

**3.8 METHOD OF DATA ANALYSIS**

The responses were analyzed using the frequency percentage tables, which provided answers to the research questions.

**3.9 VALIDITY OF THE STUDY**

Validity referred here is the degree or extent to which an instrument actually measures what is intended to measure. An instrument is valid to the extent that is tailored to achieve the research objectives. The researcher constructed the questionnaire for the study and submitted to the project supervisor who used his intellectual knowledge to critically, analytically and logically examine the instruments relevance of the contents and statements and then made the instrument valid for the study.

**3.10 RELIABILITY OF THE STUDY**

The reliability of the research instrument was determined. The Pearson Correlation Coefficient was used to determine the reliability of the instrument. A co-efficient value of 0.68 indicated that the research instrument was relatively reliable. According to (Taber, 2017) the range of a reasonable reliability is between 0.67 and 0.87.

**3.11 ETHICAL CONSIDERATION**

The study was approved by the Project Committee of the Department. Informed consent was obtained from all study participants before they were enrolled in the study. Permission was sought from the relevant authorities to carry out the study. Date to visit the place of study for questionnaire distribution was put in place in advance.

**CHAPTER FOUR**

**DATA PRESENTATION AND ANALYSIS**

**INTRODUCTION**

This chapter presents the analysis of data derived through the questionnaire and key informant interview administered on the respondents in the study area. The analysis and interpretation were derived from the findings of the study. The data analysis depicts the simple frequency and percentage of the respondents as well as interpretation of the information gathered. A total of one hundred and forty-seven (147) questionnaires were administered to respondents of which only one hundred and forty-one (141) were returned and validated. This was due to irregular, incomplete and inappropriate responses to some questionnaire. For this study a total of 141 was validated for the analysis.

**4.1 DATA PRESENTATION**

**Table 4.1: Demographic profile of the respondents**

|  |  |  |
| --- | --- | --- |
| **Demographic information** | **Frequency** | **percent** |
| **Gender**  Male |  |  |
| 72 | 51.1% |
| Female | 69 | 48.9% |
| **Age** |  |  |
| 25-30 | 33 | 23.4% |
| 31-35 | 56 | 39.7% |
| 36-40 | 35 | 24.8% |
| 41+ | 17 | 12.1% |
| **Marital Status** |  |  |
| Single | 40 | 28.36% |
| Married | 101 | 71.63% |
| Separated | 0 | 0% |
| Widowed | 0 | 0% |
| **Education Level** |  |  |
| WAEC | 69 | 48.93% |
| BS.c | 40 | 28.36% |
| MS.c | 32 | 22.69% |
| PH.d | 0 | 0% |

**Source: Field Survey, 2023**

**4.2 DESCRIPTIVE ANALYSIS**

**Question 1: What are the causes of bad and doubtful debts in Nigeria Commercial Banks?**

**Table 4.2: Respondents on question 1**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **S/N** | **ITEM STATEMENT** | **SA**  **4** | **A 3** | **D 2** | **SD 1** | **X** | **S.D** | **DECISION** |
| 1 | financial difficulty | 32 | 28 | 21 | 19 | 3.2 | 2.55 | Accepted |
| 2 | Poor money management | 29 | 33 | 21 | 17 | 3.2 | 2.57 | Accepted |
| 3 | Declining health and medical expenses | 32 | 27 | 21 | 20 | 3.1 | 2.55 | Accepted |
| 4 | High costs of living | 28 | 32 | 23 | 017 | 3.1 | 2.41 | Accepted |

**Source: Field Survey, 2023**

In table 4.2 above, on the causes of bad and doubtful debts in Nigeria Commercial Banks, the table shows that all the items (item1-item5) are accepted. This is proven as the respective items (item1-item5) have mean scores above 2.50.

**Question 2:**  W**hat are the effects of bad and doubtful debts in banks profitability,and the economy?**

**Table 4.3:** Respondent on question 2

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **S/N** | **ITEM STATEMENT** | **SA**  **4** | **A 3** | **D 2** | **SD 1** | **X** | **S.D** | **DECISION** |
| 1 | reduce banks' profitability | 28 | 26 | 24 | 22 | 3.3 | 5.78 | Accepted |
| 2 | limit their ability to issue new credit | 32 | 26 | 23 | 19 | 3.5 | 5.91 | Accepted |
| 3 | cause banks problems with their capital adequacy | 29 | 28 | 23 | 20 | 3.4 | 5.8 | Accepted |
| 4 | slow down your cash flow | 25 | 28 | 27 | 20 | 3.2 | 5.7 | Accepted |

**Source: Field Survey, 2023**

In table 4.3 above, on the effects of bad and doubtful debts in banks profitability,and the economy, the table shows that all the items (item1-item4) are accepted. This is proven as the respective items (item1-item4) have mean scores above 2.50.

**CHAPTER FIVE**

**SUMMARY, CONCLUSION AND RECOMMENDATION**

**5.1 SUMMARY**

In this study, our focus was to assess the measures necessary to minimize the high incidence of bad debts in Nigeria commercial banks using Guarantee Trust Bank Gwarimpa, Abuja as a case study**.** The study specifically was aimed to the causes of bad and doubtful debts in Nigeria Commercial Banks and the effects of bad and doubtful debts in banks profitability,and the economy. A total of 141 responses were validated from the enrolled participants where all respondent are drawn from bank staff and customers.

**5.2 CONCLUSION**

Based on the finding of this study, the following conclusions were made:

i. The causes of bad and doubtful debts in Nigeria Commercial Banks is financial difficulty, poor money management, declining health and medical expenses and high costs of living.

ii. The effects of bad and doubtful debts in banks profitability,and the economy is that it reduce banks' profitability, limit their ability to issue new credit, cause banks problems with their capital adequacy and slow down your cash flow.

**5.3 RECOMMENDATION**

Based on the responses obtained, the researcher proffers the following recommendations:

i. Banks Management should establish sound lending policies, adequate credit administration procedure and an effective and efficient machinery to monitor lending function with established guidelines.

ii. Reduction of interest rates on lending.

iii. The character and financial statement of the borrower must be properly studied.

iv. The Central Bank of Nigeria should re-introduce interest rate regulation on banks.

v. Banks should be making public the names of bad and doubtful debtors (by compilation of bad debtors‟ black book in banks).

vi. For agricultural lending, the rate should be pegged; say 5% while banks that extended such credits to farmers should be allowed to recoup their loss margin through fax rebate among other incentives.

vii. Giving business advisory services to customers and further extension of credit to alleviate a promising problem loans.

viii. Finally, the financial institutions should all together, set up credit bureau system which is a form of data bank where every bank will submit the names of its defaulting customers for references by others. This will equally frustrate multiple borrowing from banks for the same purpose by the dubious customers.

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**APPENDIXE**

**QUESTIONNAIRE**

**PLEASE TICK [√] YOUR MOST PREFERRED CHOICE(S) ON A QUESTION.**

**SECTION A**

**PERSONAL INFORMATION**

**Gender**

Male ( )

Female ( )

**Age**

25-30 ( )

31-35 ( )

36-40 ( )

41+ ( )

**Marital Status**

Single ( )

Married ( )

Separated ( )

Widowed ( )

**Education Level**

WAEC ( )

BS.c ( )

MS.c ( )

PH.d ( )

**SECTION B**

**What are the causes of bad and doubtful debts in Nigeria Commercial Banks?**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **S/N** | **ITEM STATEMENT** | **SA** | **A** | **D** | **SD** |
| 1 | financial difficulty |  |  |  |  |
| 2 | Poor money management |  |  |  |  |
| 3 | Declining health and medical expenses |  |  |  |  |
| 4 | High costs of living |  |  |  |  |

W**hat are the effects of bad and doubtful debts in banks profitability,and the economy?**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **S/N** | **ITEM STATEMENT** | **SA** | **A** | **D** | **SD** |
| 1 | reduce banks' profitability |  |  |  |  |
| 2 | limit their ability to issue new credit |  |  |  |  |
| 3 | cause banks problems with their capital adequacy |  |  |  |  |
| 4 | slow down your cash flow |  |  |  |  |