Dissertation

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UNIVERSITY OF TECHNOLOGY OWERRI

An appraisal of the effectiveness of commercial banks loans and advances management strategies : a case study of some selected banks in Nigeria, (1980-1989)

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AN APPRAISAL OF THE EFFECTIVENESS OF COMMERCIAL BANKS' LOANS AND ADVANCES MANAGEMENT STRATEGIES: A CASE STUDY OF SOME SELECTED BANKS IN NIGERIA, (1980 - 1989).

BY

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A THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF SCIENCE (M.Sc.) IN BANKING AND FINANCE OF THE FEDERAL UNIVERSITY OF TECHNOLOGY OWERRI

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ABSTRACT

The problem of commercial banking in Nigeria is the issue of the increasing unauthorised loans, Loan defaults, fraudlent practices, arising from poor accounting procedures, the high risk exposures and the rising provision for bad and doubtful debts which leaves much to be desired. Also, the poor and inefficient management strategies of Loans and Advances especially among the medium and small-sized banks is worrisome and deserves attention if the industry must continue to exist and flourish.

Through questionnaire administration, primary data was gathered for the study. The secondary data was collected from published Annual Reports and Financial Statements of the case study banks. Using the econometric tools of simple and multiple regression of selected variables, the correlation analysis between the net earnings and the Loans and Advances variable, the contingency table and the chi-squared (X^2) test, we were able to analyse the data collected on this study.

The research came up with the findings that, the Loans and Advances variable is an important and significant item in the portfolio management of commercial banks, that there is a high positive correlation between the Loans and Advances granted by commercial banks especially the big-sized banks and their net earnings, suggesting that they can more effectively manage their Loans and

Advances than the medium and small-sized ones and thus are able to continuously remain liquid. Also, the perception of the staffers of the Loans and Advances (credit) departments of the case study banks on the effectiveness of their management strategies tally with the reported books of their individual banks.

The study recommended among others, that banks should reduce their provisions for Bad and Doubtful debts, Reserves and Assets variables in order to be able to have more lonable funds for potential loan applicants, that every polite and efficient management device should be adopted to attract more customers and retain existing ones and that the worker should be fairly treated by bank management so as to ultimately realize the desired goal of profit maximization and to the development of the national economy.

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Owerri
December, 1992

Bernard Okwudiri Enwereuzor

CERTIFICATION

We certify that this work was carried out by Mr. Bernard Okwudiri Enwereuzor in the Department of Project Management Technology, Federal University of Technology, Owerri, under our supervision.

Date ....

Dr. M.U. Anuodam
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Date: 4th August, 1993

Date ....

Sign ....

F.A. Obiocha
(Co-Supervisor)

Date: 3. Aug. 1993.

DEDICATION

This Thesis is dedicated to the Council for the Development of Social and Economic Research in African (CODESRIA) for their Research Grant in 1992 which helped me immensely in seeing this work through.

Long Live CODESRIA!

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CHAPTER ONE

1.0 INTRODUCTION

1.1 Preamble

Banks, and in particular commercial banks have over time been a very important source for the granting of credits to would be investors in an economy. Thus, the Nigerian banking environment is simply an integral part of what obtains in the global economy.

Loans and Advances are the main avenues through which commercial banks extend credits to potential borrowers and investors. It is a major item in the Assets side of the balance sheet of commercial banks.

The effectiveness of the Loans and Advances management strategies of commercial banks could be assessed through among others, the profit earnings of the banks over a period of time. Because of the very nature of commercial banks liabilities, that is, the deposits from customers which is withdrawable at short notice, commercial banks find it difficult to lend to customers on very long terms. Again, even where loans are granted on short term basis, management still needs to adopt strategies that would effectively guarantee the repayment in due time and the maximization of the net profit of the bank.

It is the purpose of this work therefore to find out whether in fact loans and advances form an important item in the management portfolio of commercial banks and how effectively these banks have utilized this item to their net benefit.

1.2. Statement of Research Problem

The high incidence of loan defaults by beneficiaries of Loans and Advances granted by banks in Nigeria calls for urgent attention to stem the rising tide and avert an eventual collapse of the banking industry.

This view is substantiated by the high provision for bad and doubtful debt figures made by commercial and merchant banks over the years. For instance, the Co-operative and Commerce Bank (Nig) Plc made a provision for bad and doubtful debts of ₦2.675 million in 1985, ₦2.887 million in 1988 and ₦19.2 million in 1989. (CCB Annual Reports). These provisions are meant to cushion the bank from the effects of anticipated loan defaults from bank borrowers.

To further buttress this view, the Nigeria Deposit Insurance Corporation (NDIC) has in its "Predential Guidelines for Licensed Banks" (1990) asked the banks to include in their provisions for doubtful classification such items as; but not limited to the following:

(i) Cheques purchased of between 3 to 6 months old but which had been withdrawn or cancelled and substituted with new ones. Similar treatment should be accorded to uncleared effects for which values had been given.

(ii) Outstanding fraud cases of 6 to 12 months old and with chances of full recoveries.

(iii) Interbranch items outstanding for between 3 to 6 months.

(iv) All other intangible suspense accounts outstanding for between 6 months and 12 months. A minimum of 50 percent provision should be made for "other Assets" items classified as doubtful.

Also, the guidelines further required banks to regard items for lost classification to include but not limited to:

(i) Cheques purchased and uncleared effects over 6 months old and for which values had been given.

(ii) Outstanding fraud cases over 12 months and involving protracted litigations.

(iii) Inter-branch items over 6 months old whether or not the origins are known.

(iv) All other intangible suspense accounts over 12 months old.

Full provision (that is, one hundred per cent) should also be accorded to items classified lost.

Licensed banks should review their credit portfolio continuously (at least once in a quarter) with a view to recognizing any deterioration in credit quality. Such reviews should systematically and realistically classify banks" credit exposures based on perceived risk of default. In order to facilitate comparability, the banks' classification of their credit portfolios, the assessment of risk of default should be based on criteria which should include, but are not limited to repayment performance, borrower's repayment capacity on the basis of current financial condition and net realisable value of collateral.

Agbodo (1992) has shown that banks are now back-pedalling on granting credit facilities, unbacked letters of credits and other similar obligations to small and medium scale companies. According to him this is as a result of the uncertain business climate which makes it difficult to ascertain the credit worthiness of Companies, the need to be prudent and the recent strict accounting requirements demanded by the prudential guidelines for licensed banks.

Igere (1991) has on his part noted that the woe betiding Nigerian banks is bad debts, unauthorized loans and fraudulent practices. Osunbor (1991) has also pointed out that following the liquidity crisis which hit some banks in the wake of the mopping up of excessive liquidity and other stringent measures introduced by the Central Bank of Nigeria last year, the protection offered by the Nigerian Deposit Insurance Corporation has helped some ailing banks to recover. Indeed, it has been reported that within the first six months of the corporation's existence it rendered assistance to 10 banks facing liquidity problems with an accommodation facility of up to an aggregate of about ₦2.3 billion.

From the foregoing it is evident that Nigerian commercial banks are faced with a lot of lending risks from defaulting borrowers and the apex bank (the Central Bank of Nigeria) is trying through its prudential Guidelines to arrest the ugly situation in the industry.

1.3 Objectives of the Study

The objectives of this study are to:

(i) Take an insight into the criteria and strategies adopted by commercial banks in granting Loans and Advances to Loan applicants;

(ii) Appraise the effectiveness of commercial bank's loan management strategies with reference to a few selected banks (The United Bank for Africa Plc, First Bank of Nigeria Plc, Co-operative and Commerce Bank Plc and the African Continental Bank Plc);

(iii) Investigate the problems/risks associated with bank lending;

(iv) Recommend policy measures to be adopted by commercial banks in managing their loans and advances and administering them to potential beneficiaries.

1.4 Hypotheses of the Study

This study is to be guided by the following hypotheses:

(i) That Loans and Advances are not important in the management portfolio of commercial banks;

(ii) There is an inverse relationship between the loans and advances granted by commercial banks and their profit earnings;

(iii) That the Loans and Advances management strategies of commercial banks over the years have not been effective.

1.5 Definition of Terms

1. Bank Loans

A bank loan is part of the Assets of a bank usually given out to customers of the bank as credit facility. It is a financing instrument tailored to meet the specific financing needs of the borrower.

2. Advances

An Advance ordinarily means to pay before due time, to lend especially on security.

3. Management Strategies

Management Strategies is defined here to mean those measures undertaken by bank management while advancing and recovering credits (Loans and advances) to their customers.

4. Effectiveness

We define effectiveness to mean the ability of commercial banks to manage their Loans and Advances effectively (efficiently) thereby maximizing profit.

1.6 Scope and Limitations of the Study

The study is intended to cover a period of ten years (1980 - 1989), a period so chosen for some basic reasons, among which include;

(1) The availability of relevant data.

(2) The fact that the period covers three different economic scenaria of the Nigerian economy, namely; a period of oil boom (1980 - 1981) and the subsequent monetization of the oil revenues, a period of austerity (1982-1985) and a period of Structural Adjustment and reforms beginning from 1986. The effects of these periods on bank earnings, Loans and Advances, their provision for Bad and Doubtful debts (a proxy for the rate of loan default) are important.

(3) The Loans and Advances management strategies adopted by these banks and their effectiveness is appraised within the study period.

(4) The study is intended to cover some selected four (4) commercial banks, namely; the United Bank for Africa (UBA) Plc, First Bank of Nigeria (FBN) Plc, African Continental Bank (ACB) Plc, and the Co-operative and Commerce Bank of Nigeria (CCB) Plc. That is two (2) banks out of the three biggest banks in Nigeria (the big three) and two (2) out of the medium-sized banks.

The limitations of this study include such factors as;

(1) Time: The researcher was faced with the problem of apportioning his limited time between writing this dissertation and other personal but vital responsibilities.

(2) Data: The problem of data collection in a developing economy as ours is well known. The absence of a data bank and the secrecy associated with the release of official documents are impediments to research efforts. This study had its own feel of these obstacles. Thus, it was difficult for me to gather all the required official publications on the Annual Reports and Financial Statements for the four selected case study banks for the ten year period of this study. For this, numerous trips had to be undertaken to the Head Offices and branches of these banks, although not without the required bureaucratic red-tapism associated with obtaining information from public establishments. At a stage, some shareholders of these banks became helpful in supplying the required documents.

The receipt of a minimum of Eighty five percent (85%) of the administered questionnaires is however satisfactory.

(3) Funding: The funding of this research was not an easy one as the researcher is constrained by limited resources. The cost of computerization of the models and the various travels associated with such a work were enormous. However, the researcher remains grateful to the Council for the Development of Social Science Research in Africa (CODESRIA"s) Small Grants program for thesis writing for coming up handy with their award almost when all hope was lost in the continuation and eventual completion of this research.

CHAPTER TWO

2.0 LITERATURE REVIEW

The chambers twentieth century dictionary (1981), defines a loan as anything lent, especially money at interest. This agrees with the definition by Hanson (1977) of a loan as the borrowing of a sum of money at an agreed rate of interest, usually for a specified period of time by a government, an institution a business firm or an individual.

Loans can be of the short term when the period of repayment does not exceed one calendar year, or when governments issue treasury bills to the money market. Governments can also borrow on long term by the issue of stocks to the capital market. Long term borrowing usually exceeds a period of one calendar year for repayments to take effect.

Loans and advances are the most important income earners for banks, the most dominant assets as well as the most regulated activity. Government bills and securities are prime elements in the asset portfolio of banks for two reasons. Firstly, they are readily available in Nigeria. Secondly, they have both income and safety appeal for banks. Of all income earning assets, government securities are the most liquid. And of all the prescribed liquid assets, they earn the highest rate of income. Okafor (1987).

Commercial banks offer various services to their customers among which include, the mobilization of savings and other deposits, extension of credit facilities for the transfer of funds, management of customers investment and advising on insurance matters, providing foreign exchange for travellers, business advisory services among others. This is in agreement with Afolabi's (1988) view that commercial banks services which could be grouped into five categories include deposit collection, money transmission services, financial services, foreign services and credit.

Adekanye (1986) has opined that as a general rule, the customer to whom facilities are to be extended must pass the test of reliability, personal integrity and honesty. He does not qualify for bank assistance if he lacks any of these qualities - however strong his security. Thus, it is necessary for a good banker to know his customer very well and be able to judge not only the qualities mentioned above, but also the customer's ability, intelligence, dedication to work, knowledge of the operations of his company and business experience generally.

As profit-making concerns, loans and advances are important items for commercial banks. Over the past decade, loans and advances have consistently accounted for about one-third of banks' total assets

Ajayi (1980). For instance, the United Bank for Africa Plc in 1980 granted the sum of 0.865 billion naira as loans and advances which is about half of its total assets for that year. In 1989, the same bank granted some 3.04 billion naira as loans and advances which was about one-third of its total assets for the year. The other case study banks show the same picture of loans and advances - total assets ratio for the period covered by this study.

The Central Bank of Nigeria acting in its capacity as the apex bank advises commercial banks through its yearly monetary policy circulars to extend a greater proportion of their loans and advances to what it describes as the preferred sectors of the economy which include, agriculture, manufacturing, mining and quarrying, construction and services etc. See Table I below.

Table 1

COMMERCIAL BANKS' LOANS AND ADVANCES CLASSIFIED BY PURPOSE

(PERCENT) 1980 - 1989

	Prescribed Percentage									
ory of wers	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
eferred ctors.										
ricultural oduction	39.0	39.0	59.0	61.0	10.0	12.0	15.0	15.0	15.0	15.0
nufactu- ng Enter- ises	36.0	36.0	16.0	15.0	65.0	63.0	63.0	35.0	35.0	35.0
tal (A)	75.0	75.0	75.0	76.0	75.0	78.0	50.0	50.0	50.0	50.0
ner ctors	25.0	25.0	25.0	24.0	25.0	25.0	22.0	50.0	50.0	50.0
(A) and (B)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

rce: Central Bank of Nigeria, Annual Reports and Statement of Accounts. Various Issues.

Thus, from the table above it is evident that commercial banks extended within the study period on the average some seventy - five percent (75%) of their total loans and advances to the preferred sectors of the economy. Loans and advances therefore constitute a handsome proportion of commercial banks banking activities and a major source of interest generation.

Cox (1979), has shown that a banker who is faced with the request for loan or overdrafts facilities must always ask four basic questions, namely, the customer's own resources and whether the banks is being asked to lend too much in comparison with these resources. Most managers agree that if the customer has a reasonable amount of his money invested in the project he will have plenty of incentive to see it through to a profitable conclusion. Although no hard and fast rules can be laid down it is often thought that the bank should not have more invested in the business or project than the customer.

Naturally a lender of money is entitled to know the purpose for which the advance is required. A manager must bear in mind while advancing a loan, the monetary policy guidelines of the Central Bank of Nigeria, and the purpose of the advance should fall within the terms of the bank's own policy. Also, because the deposits that Commercial Banks hold are usually withdrawable on short notice, the loans and advances they also make are of short term basis. Thus, Commercial Banks do not engage in long term lending activities.

Again, the mode of repayment is of interest to the lending officer. If the loan proposal is for a business, the advance can only be repaid from future profits of the business. Thus, the officer needs to ensure the advance will increase the profits of the business, after allowing for the interest and charges to be made on the advance. Every available information on a customer should be sourced if the loan is a personal and not a business loan. Such information should include but not limited to his earnings and social life as well as his other previous financial commitments.

Government expects banks to be good corporate citizens and to shoulder various forms of social responsibilities. These expectations, though genuine often have cost implications and are therefore at variance with the income expectations of owners. Persuasive customers could easily generate sentiments which conflict with the policies of a bank or even with the general economic policy of government.

Bank management is therefore placed in a perpetual state of conflict resolution. The conflicting demands of the bank "publics" must be reconciled and harmonised. This demands optimal allocation and efficient management of bank resources and raises the basic issue of bank portfolio formulation and management.

It has been variously argued that banks face risks while granting loans and advances to potential beneficiaries. Two different kinds of risk are important to a bank, investment or default risk and Liquidity risk, any other risks may be described in terms of either or both of them, Aja-Nwachukwu (1990). The default risk is concerned with the assets held by the bank as a creditor. The bank faces the danger that its debtors may not make payments due on interest and principal. As a result, it demands risk premiums from its debtors and other things being equal, the greater the possibility that a debtor will default the greater the default risk and risk premium demanded. Also, default risk could be due to market's evaluation of bank assets which may result in the fluctuation of their yields. The other form of risk is the withdrawal or Liquidity risk in connection with its liabilities. As a debtor to its depositors, the bank faces the risk that its creditors may be unwilling to renew or even extend new credits to it. Even when they decide to continue the credit extension, they may only do so at different terms, for example, at increased interest rate on fixed deposits or reduced services charges, and quality services on current accounts. Thus, the liquidity risk, in addition to interest rate variability, increases with the type and nature of deposits. Banks are therefore placed in a constant search for risk reduction methods.

Orji (1989) has demonstrated also that the problems of bank lending in Nigerian can be associated with, the shareholders, banks and other sources. Many shareholders, who are the main owners have created problems for some of the banks. Facilities granted to them especially the state governments and their parastatals have performed unsatisfactorily as they failed to live up to expectation in the performance of their accounts. In the appraisal of some of the loans and advances granted to state governments, Central Bank Examiners usually do recommend that provision for bad and doubtful debts be made for these facilities.

Again, Orji (1989) has further shown that the administration of the loans and advances portfolio of many banks leaves much to be desired. For instance, the departments charged with the responsibility of granting and monitoring the loans and advances portfolio do not usually co-ordinate their efforts. The administration of bank lending in most banks is characterized by the following irregularities

- Facilities are not subjected to proper credit appraisal before being granted to the customer. In some cases, neither the ability to repay nor adequate securities were available.
- The viability of the projects to be financed and the integrity of the customers are not usually given the pride of place in the processing of application for credits.
- Several instances where customers are allowed to draw part or the total value of the loan facilities without observing conditions precedent to granting the credits such as the submission of irrevocable undertaking to pay future proceeds of sale of goods/services into their accounts or perfecting securities are common.
- Monthly or periodical returns to the Head Office/ Area Offices in respect of Loans and Advances are still being handled with Levity. They are often non-challantly prepared by branches as mere routine exercise with inadequate information for meaningful control.
- The attitude of most of the managers towards [illegible] facilities granted by their predecessors, Area Office or Head Office are usually lukewarm. This attitude had led many facilities to deteriorate since

adequate efforts are not made to monitor them promptly with a view to recovery.

- The credit files of most of the borrowing customers contain little or no information of value. It is disappointing to note that credit files of debtors owing large sums of money contain little or no information at all. Some of the securities pledged for the facilities are either of dubious value or have had their worth grossly exaggerated.
- Owing to the general laxity in staff discipline in most of the banks, branch managers' carefree attitude to recovery are noticed by the authorities. In defiance of bank internal procedures, staff accounts are usually over-drawn, this has generated an atmosphere of general indiscipline in most of the banks.
- Failure of management to have a defined lending policy and follow it religiously.

Other irregularities are that Loans and Advances are granted to a new and untried business which is inadequately capitalized; Loans and Advances granted for speculative purposes, Loans and Advances made because of other benefits such as control of large deposit balances and not based on sound lending principles, failure to establish or enforce repayment programme among others.

Ughamadu (1991) is of the view that bank fraud is being celebrated in Nigeria instead of finding a lasting solution to it. According to him the Central Bank of Nigeria admitted that a total of 32 fraud cases in the sum of ₦134,830 million were attempted in the last one year. Again in April 1984, five Central Bank of Nigeria staff were found "guilty" of conspiracy to steal money totalling ₦152,229 and in July 1986, a four million naira (₦4 million) fraud was discovered in the Exchange Control Department of the bank. The consequencies of bank fraud are obvious. For one thing, it erodes public confidence in the banking sector as a place for depositing their money and by extension it discourages the banking habit. For another, it could scare foreign investors away from the country because the logic for establishing a viable and enabling environment for any country will be meaningless if its banking sector is very porous to fraud.

Apart from the issue of bank fraud, there is also the related problem of loan default that has characterized the lending activities of banks. Banks therefore have had to make adequate provision for bad and doubtful debts. For instance, the United Bank for Africa Plc made a provision of ₦2,335 million in 1980 and up to ₦57,793 million by 1987. Also the Co-operative and Commerce Bank Plc which made a provision for bad and doubtful debt of ₦3,064 million in 1980, provided for ₦19,200 million in 1989. This goes to show the rising trend in default rate and other risk exposures faced by the banks.

Thus, the Central Bank of Nigeria and the Federal Ministry of Finance jointly established the Nigeria Deposit Insurance Corporation. The Corporation established by Decree 22 of June 15 1988 is a federal government agency to insure the deposit liabilities of licensed banks and other deposit taking financial institutions operating in Nigeria. More specifically, the Corporation was established to among other things protect depositors interest in the case of any insured bank facing Liquidation. In the event of Liquidation of an insured bank, the Corporation pays a maximum of ₦50,000 to each depositor.

The Corporation, according to the Business Concord Editorial column of 15th October 1991, revealed that some nine commercial banks were technically insolvent for having accumulated an estimated ₦4.7 billion bad and irrecoverable debts which represented about 73 percent of their total Loans and advances as at December 31, 1990.

Because of the nature of their business, bankers usually ask for security while trying to advance a loan to a potential beneficiary. Among the types of security acceptable for lending in Nigeria include, stocks and shares, life policies, land, Gurantees, letter of Comfort and others. Although theoretically, securities should not be seen as the most important criterion for granting a loan facility, practically and more especially in the Nigeria context they occupy the primary position as the business of lending in Nigeria is full of suspicion and distrust. Thus, the Nigerian banker needs to hedge himself against possible default by his customer.

However, several writers have proposed other alternatives to landed property as a security for bank lending. As reported by Agada (1991) other security alternatives include, lease in process, (i.e. abridged facility granted a prospective lease customer before lease arrangement proper is put in place); Venture capital (where banks take up equity position in Companies seeking funds); hypothecation of inventory (where short term loans are granted against existing and future stock inventory of a Company) and advanced payments guarantee. It is however a known fact that landed property occupies and may continue to occupy at least in the nearest future a prime place in the lending requirements of Commercial Banks in Nigeria.

According to the Chamber's Dictionary (1981) effectiveness means having powerto effect, causing something, successful in producing a result or effect.

The effectiveness of banks in managing their loans and advances has been variously discussed by several commentators. Okafor (1987) has demonstrated that the issue of bank portfolio management is the question of optimal resource allocation among bank assets. A bank must therefore select an asset-mix which enables it to maintain a delicate balance between the need for liquidity and the demands of profitability. This represents a major dilemma for bank management. It is the liquidity versus profitability dilemma associated with commercial banking, the world over. The dilemma can only be contained through optimal portfolio choice.

The need for efficient portfolio-mix arises because a bank's overall performance tends to be related to its portfolio mix. It is known, for instance, that:

(i) the rate of profit - before tax earned by a bank is closely related to the relative proportion of its income earning assets to total assets.

(ii) periodic changes in the relative proportion of income earning assets to total assets generates similar changes in the rate of profit, that is, a rise in the proportion causes a rise in the rate of profit and vice versa.

(iii) profitability is very closely related to the structure of a bank's income earning assets, and

(iv) changes in the structure of such assets tend to give rise to similar variations in profitability.

Again, Okafor (1988) notes that the issue of effectiveness in banks loans and advances management strategies is the most contentious. He goes further to say that available statistics as at the end of 1986 suggests some measure of success in the application of the Central Bank's guidelines on the advancement of their Loans and Advances to the preferred sectors and to agriculture.

The effectiveness or otherwise of Nigerian banks in managing and recovering their bad and doubtful debts has been questioned by many, among whom is Ogundele (1991) who notes that,

> "Nigeria's effort to plug the widening leakage in bank vaults, which has cost the nations economy about ₦11.9 billion bad debts seem to have been characterized by buck passing between borrowers, bankers and supervisory agents".

Banks are thus of necessity required to effectively manage their Loans and Advances by adhering to the canons of good lending and by reducing the amount of bad and doubtful debts resulting from their transactions. The objective is the maximization of profit and the eventual growth of the national economy.

2.1 THE EVOLUTION OF COMMERCIAL BANKING IN NIGERIA

The evolution and early development of commercial banking in Nigeria have been extensively discussed by several eminent writers such as Brown (1966), Nwankwo (1980) and Uzoaga (1981). Other authors have also contributed to the body of literature.

From all recorded accounts, modern commercial banking in Nigeria dates back to the early colonial period. The activities of Transnational Corporations, the financial transactions of the colonial government, the decline of the barter system of trade and the increasing acceptance of British silver currency - all these required an institution in the form of a commercial bank for safety and transmission of funds, the importation and distribution of British silver coins and provision of credit to the government and the trading companies. It was for these purposes that the African Banking Corporation (ABC) based in South Africa was invited in 1892 to open a branch office in Lagos by the Elder Demster and Company - a shipping firm which operated steamship services between liverpool and West Africa. The African Banking Corporation was thus the first modern commercial bank to open a branch office in Lagos. The bank was taken over by Elder Dempster and Company which ran it as a private bank until December 1892 when the Bank of British West Africa (BBWA) now First Bank was organised and registered in London with an authorised capital of £100,000. The Bank of British West Africa opened its first branch in Lagos in 1894. Five years later the paiges Trading firms in Eastern Nigeria under the leadership of the Royal Niger Company established the Bank of Nigeria. Uzoaga (1981).

The real watershed in the evolutionary process of banking in Nigeria was attained in 1952 with the enactment of the first banking legislation - the Nigerian Banking Ordinance of 1952 which was later repealed and replaced by the Banking Act of 1958. The history of Banking in Nigeria fails into five major periods, namely;

(i)	The Era of uncontrolled banking - 1892 - 1952	
(ii)	The Era of Bank failures - 1952 - 1959	
(iii)	The Era of Consolidation or banking legislation	1959 - 1970
(iv)	Era of indigenization	1970 - 1981
(v)	Era of Expansion and competitive banking	1981 to date.

Nwankwo (1980) has reported that the period (1892-1952) is characterised by two main features. One is the absence of any banking legislation. There was ease of entry into the banking industry for all types of aspirants. Anybody could set up a banking company, provided he registered under the companies ordinance, which required that membership of partnership did not exceed ten. Once registered, the individual or company could engage in any type of banking business without any restrictions except that, under the stamp duties ordinance (No. 5 of 1939) the banking company could not issue Bank of England notes.

The second feature of this period is that it was during this era that the three biggest foreign banks and the two biggest indigenous banks were established. The foreign banks were the Bank of British West Africa (BBWA), the Barclays Bank Dominion, colonial and overseas, and the British and French Bank. The two indigenous banks were the National Bank of Nigeria and the African Continental Bank Limited.

Three other indigenous banks were also established within this period, namely; the Nigerian Farmers and Commercial Bank Limited established in 1947, the Agbonmagbe Bank Ltd in 1945 and the Merchants Bank in 1952. There were thus, seven banks altogether during this period of free banking, of these, three were expatriate and four were indigenous banks.

Indeed, it has been variously reported that between 1947 and 1952, a total of 185 banking companies were registered in Nigeria of which 145 were registered in 1947 and 40 in 1952.

The phase (1952 - 1959) of banking development in Nigeria is characterised by four main features, namely; the implementation of the Paton Commission Report in the 1952 ordinance, the collapse of the indigenous banking establishments and the absence of Central Banking in Nigeria. Nwankwo (1980).

Mr. G.D. Paton reported in 1948, and the government enacted the first ever Banking Ordinance in 1952. The ordinance required that no banking business shall be transacted in Nigeria except by a Company which must take up a banking licence from the Financial Secretary after paying in cash ₦25,000 out of an authorised capital of ₦50,000 for indigenous banks and ₦200,000 for expatriate banks. The ordinance further required banks to maintain a reserve fund into which 20 percent of profits would be paid annually until the reserve fund equalled the paid-up capital and to maintain an adequate degree of liquidity. Banks were also prohibited from paying dividends until capitalized expenditure was written off. They were also prohibited from making loans on the security of their shares and from making unsecured loans of more than ₦600 to their directors or to any private company in which the directors had an interest.

To ensure compliance the ordinance provided for bank examination and supervision. The Financial Secretary was given the power to refuse or withdraw a licence if, in his opinion, the affairs of the bank were likely to be conducted or were in fact being conducted in a manner prejudical to depositors" interests.

The second feature of this era is the collapse of the indigenous banking boom. The 1952 ordinance became operational for all banks in the country in 1955 and by this time all the mushroom banks established since 1945 had collapsed with the exception of three namely;

the African Continental Bank, the Agbonmagbe Bank and the Merchants Bank. The National Bank of Nigeria incorporated in 1933 and the three already mentioned were the four indigenous banks plus the three expatriate banks that survived the banking boom of the late 1940"s and the early 1950"s.

The third feature was the beginning of state support for and assistance to indigenous banking. The four indigenous banks that survived the boom era could not have been able to do so if not for the support and assistance of the state. For instance, the African continental Bank received massive injection of public funds before it was able to qualify for licence at the expiration of the three years" grace period allowed under the 1952 ordinance in 1955. Also, in pursuance of this policy of encouraging indigenous banking development the Western Region government injected public funds into the National Bank of Nigeria Limited, the Merchant Bank of Nigeria Limited and the Agbonmagbe Bank.

The fourth feature of this phase was the absence of a central or Apex Bank in the country. As had been noted elsewhere in this work, the first ever banking legislation in Nigeria was enacted in 1952. Prior to this time, it was an era of uncontrolled entry into banking business in the country. The liquidity requirements also worked hardship on indigenous banks because there was no Central Bank of Nigeria before 1958 and no organised securities market before April 1960 nor did the ordinance empower the Financial Secretary to perform some Central Banking functions such as provision of liquidity to banks in event of difficulty. Hence there was no institution which could help a bank in distress either by issuance of additional cash in exchange for the bank's assets or by extension of loans on the basis of whatever assets the bank could provide. This suitation no doubt contributed to the high failure rate among indigenous banks. Uzoaga (1981).

The third phase of commercial banking evolution in Nigeria was one that required the consolidation of the banking industry through legislations to put a permanent stop if possible to the frequent bank failures that characterised the second phase.

As noted by Nwankwo (1980), this era was characterised by the establishment of the Central Bank of Nigeria in 1959, the laying of the foundations of the Nigerian money and capital markets, for example, the Treasury Bills Ordinance promulgated in 1959, the Barback Committee's report that resulted in the establishment of the Lagos Stock Exchange in 1961, the emergence of mixed banks. Also, five banking legislations within the period need to be mentioned. They include, the 1958 banking ordinance which became effective in 1959, the 1961, 1962 and 1964 Amendments and the 1969 Banking Decree.

The 1958 ordinance dropped references to authorized capital, the paid-up capital for indigenous banks remained at ₦25,000, that for expatriate banks was raised from ₦200,000 to ₦400,000 and the portion of profits to be transferred to the reserve fund was increased from 20 percent to 25 percent. Under the ordinance banks were also prohibited from owning real estate except where strictly necessary.

The 1961 Amendment was mainly on the liquidation of banks and provided for the appointment of a receiver and liquidator.

The 1962 Amendment raised the minimum paid-up capital for indigenous banks from ₦25,000 to ₦500,000 with a period of seven years for existing banks to comply. The Amendment further required expatriate banks to keep within Nigeria assets of at least ₦500,000, it required banks to write off losses before making the 25 per cent transfer of profits to the reserve fund, changed the definition of liquid assets and empowered the Central Bank of Nigeria to be flexible in applying the definition for the purpose of computing the liquidity ratio, allowed banks to own real estates for the purposes of future expansion.

Under the 1969 Decree, all banks were required to be locally incorporated, increased the minimum paid-up capital for indigenous banks to ₦600,000 and for expatriate banks to ₦1.5 million. The Decree also required banks for the first time to maintain a capital deposit ratio of between 10 and 30 percent, raised the capital loan ratio from 25 to 33½ percent. It also empowered the Central Bank of Nigeria to monitor and vet bank advertisements and to authorize closure or opening of bank branches and bank amalgamations.

The above enactments, provisions and amendments were aimed at closing the loopholes in previous legislation and to get the system working.

Okafor (1988) observed that the seed of the indigenization process was sowed during the civil war period. The experiences of the war demonstrated the virtues of national self reliance to most Nigerians. The spirit of self reliance was germane to the promulgation of the Enterprise Promotion Decree in 1972, popularly called the Indigenization Decree, by which government sought to increase local participation in the ownership, management and control of all sectors of the Nigerian economy. The goal of indigenization in the banking sector was basically to make the operations of banks more relevant to the needs of the policy making machinery of the system.

More specifically, in 1973 the Federal Government, in pursuance of its policy of ensuring that Nigerians own and control the commanding heights of their economy, took enough percentage interest in the three biggest expatriate commercial banks in the country to bring total indigenous ownership to 40 percent. The Government later in 1976 acquired additional 20 percent in the three biggest foreign banks and 60 percent in the other foreign banks to bring indigenous ownership in these banks to 60 percent.

Another feature of this era is the renewed boom in indigenous banking. This time the banks were established by State Governments and not private individuals as was the case in the era of uncontrolled banking in Nigeria.

From 1981, the start of this phase of banking development in Nigeria, there appears to be another period of scramble in the industry. A scramble similar as it were to the second phase of the development era.

By 1981 the total number of commercial banks operating in the country stood at 20 with the number of branch offices at 869. The number of Merchant Banks was 6 while the number of their branch offices stood at 15 (CBN, Annual Reports, 1981). As at 1986, the total number of commercial banks in the country had risen to 29 with branches numbering 1,367 of which 481 branches were opened under the rural banking programme. In addition, the number of their branches and representative offices abroad stood at 10 at the end of 1986. The number of Merchant banks stood at 12 with 27 branches offices.

A total of 18 applications for banking licences were received by the Central Bank during the year (1986), compared with 12 in 1985. Nine of the applications were for commercial banking services while the other 9 were for merchant banking. Total number of applications outstanding at the end of 1986 were 21 ; 13 commercial and 8 merchant banks. These had been duly processed and waiting for approval.

However, by 1989, the time which this study covers, the number of commercial banks in operation stood at 47 while that of merchant banks rose to 34. The number of branch offices of commercial and merchant banks also increased from 1,665 and 46 in 1988 to 1,856 and 56 by 1989 respectively. (CBN Annual Reports, 1989). Table 2 shows the Ten-year Growth or Expansion of the Commercial and Merchant Banks in Nigeria.

Table 2

TEN-YEAR GROWTH IN NUMBER OF COMMERCIAL AND MERCHANT BANKS IN NIGERIA (1980-1989)

Year	No. of Comm. Banks (A)	No. of Branch Offices (B)	No. of Merchant Banks (C)	No. of Branch Offices (D)	Total A+C	Total B+D
1980	20	740	6	12	26	752
1981	20	869	6	15	26	884
1982	22	991	8	19	30	1010
1983	25	1108	10	24	35	1132
1984	27	1213	11	25	38	1238
1985	28	1297	12	26	40	1323
1986	29	1367	12	27	41	1394
1987	33	1483	16	33	49	1516
1988	41	1665	24	46	65	1711
1989	47	1856	34	56	81	1912

Source: Central Bank of Nigeria, Annual Reports and Statement Accounts, various issues.

The table reveals that between 1980 and 1989, the number of commercial banks in the country had increased from 20 to 47 with the number of branch offices going from 740 to 1,856. Also, the Merchant banks witnessed an increase in their number, coming from 6 in 1980 to 34 by 1989. The number of their branches also skyrocketed from 12 in 1980 to 56 in 1989. The total number of commercial and merchant banks operating in the country by the end of 1989 was 81 with 1912 branch offices nation-wide.

In terms of Annual Growth of Commercial and Merchant Banks in the country within the period 1980-1989, the following picture is revealed by table 3.

Table 3

ANNUAL GROWTH OF COMMERCIAL AND MERCHANT BANKS IN NIGERIA (1980-1989)

Year	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
No of App. received (both Comm. & Merchant)	8	11	13	10	3	12	18	36	45	NA
No of Banks that commenced operation in the year										
Commercial (A)	0	0	2	3	2	1	1	4	9	6
Merchant (B)	0	0	2	2	1	1	0	1	8	10
Total A+B	0	0	4	5	3	2	1	5	17	16

Source: Central Bank of Nigeria, Annual Reports and Statement of Accounts. Various issues.

Table 3 shows that 8 applications were received in 1980 and 45 in 1988. The number of commercial and Merchant banks that commenced operations in 1987 and 1988 were 5 and 17 for the respective years. 16 Commercial and Merchant banks opened in 1989. Thus, there has been a rapid growth in the number of banks operational in the economy on an annual basis over the study period. The growth in the number of banks and the volume of investments have various implications in terms of the level of competition and risk of financial crisis as well as making monitoring more difficult.

The increase in the number of banks has resulted in keen and stiffer competition in the banking industry with concomitant proliferation of products and incentive to attract deposits. This is compounded by the growth in strength, in number and popularity of the non-banking financial institutions which have more or less taken steam out of banks" strength by offering similar and alternative products. For example, in the wake of the central bank"s pegging of interest rates, after the earlier deregulation, banks went foot-dragging in terms of granting loans, while depositors on their own part developed cold feet going to the banks but rather went to the non-bank financial houses where extra statutory interest rate or benefits were available. (Ovbioghor and Ademola) (1991).

Among the new products since the introduction of the Structural Adjustment Programme (SAP) in Nigeria in 1986 include, the Unit trust schemes, Insurance cover for some depositors, Deposit Certificate issues, express cards, such as the UBA-cards and Electronic mail transfers among others. Other innovations include such services like staturday banking and mobile banking. Also, other strategies being adopted by banks to keep afloat include the rendering of prompt and efficient services and automation. Banks have also started curtailing their operations/overhead expenses to ensure that they have reasonable returns on their investments. Rather than be greedy, banks are now ready to take a little margin of profits for their transactions since the margin has shrank with intense competition.

A new dimension to the competition is the turning of marketing departments of most banks into places for beautiful and attractive ladies and energetic young men called "marketing Officers" whose job is to canvass for deposits on personal basis from high net-worth individuals and corporate bodies. Apart from the so called marketing officers, all other members of staff are expected to solicit for deposits. The amount of deposit attracted by staff sometimes determines the total package of their remuneration or even their status in the bank and sometimes inability to attract deposit may cost one his job.

Another dimension of the competitive syndrome is that many banks have suffered poaching of their qualified and experienced staff. To survive this situation, most banks, particularly the new ones now offer very fantastic salaries to staff as incentive for high productivity and a way of retaining them.

2.2 TYPES OF LOANS (CREDITS) OFFERED BY COMMERCIAL BANKS

Commercial banks are in business to render services. The services are many and divergent but the types and the quality available will depend upon the degree of development of a country's financial system.

The need for loans (credits) arises from the need or desire of either households or firms wanting to obtain economic goods and services ahead of their ability to pay.

In Nigeria there are five methods used generally by banks to extend credit facilities to their customers. These include, Loans and Advances, Overdrafts, Discounting drafts, Bank Guarantees and letters of credit.

Loans and Advances are by far the largest asset on the Balance Sheet of many banks. All Loans and Advances are technically repayable on demand, except for term loans. The rates charged on these assets are quite high and are usually fixed by the Central Bank.

A loan itself is a financing instrument tailored to meet the specific financing needs of the borrower and could take various forms depending on funds applications, source of repayment and repayment cycle, the type of security, if any and the origin. Bank Loans could also be classified according to categories of borrowers to whom various lending considerations apply.

Banks usually grant small loans to sole traders and individuals (such as salary earners) to help them over a difficult period or supplement the payment of school fees, medical bills and other unforeseen expenses. The amount granted is usually unsecured and is repayable in the shortest possible time. Only people with high integrity are eligible for such short-term, unsecured facilities. Adekanye (1983).

Term loans for business are also treated under this category. Short-term loans cover periods of less than a year; medium-term loans are those over one year but less than five years; while those over five years are long-term. Term loans may be required for the extension of business premises or buying of new equipments.

Term Loans of between three to five years are usually covered by some collaterals and their repayment is normally installmental. The amortisation amount is normally a ballon payment which incorporates both the accrued interest and the periodic amortisation of the loan. A typical term loan will have a grace period during which the repayment of the loan is waived and the borrower is expected to build up capacity.

An advance ordinarily means to pay before due time, to lend especially on security. Thus, an advance is similar to a loan. A self-liquidating advance is a loan used to finance a specific transaction, which can as well recoup and repay itself, while "clean" advance is a loan not supported by the control of goods or funds that is, there need not be a specific underlying transaction.

The table below shows the loans and advances granted by the case study bank over the ten-year period of this study.

Table 4

LOANS AND ADVANCES GRANTED BY CASE STUDY BANKS (1980-1989) (₦'000)

	BANKS			
Years	UBA	ACB	CCB	FBN
1980	864,836	438,298	62,424	1,039,239
1981	1,161,294	534,466	81,194	1,339,420
1982	1,519,426	542,189	112,416	1,490,132
1983	1,619,691	654,174	146,053	1,376,705
1984	1,553,263	615,476	190,675	1,402,456
1985	1,409,137	689,834	221,570	1,474,541
1986	1,471,419	773,150	262,179	1,860,452
1987	1,798,628	865,758	296,099	2,047,113
1988	2,008,138	968,086	382,646	2,253,388
1989	3,044,131	1,152,463	445,339	1,851,481

Source: Annual Report and Statement of Accounts of the Banks.

As can be seen, the two banks - the First Bank and the United Bank for Africa Plc granted more loans and advances over the ten year period of this study than the other two banks - the African Continental Bank and the

Co-operative and Commerce Bank Plc. The United Bank for Africa Plc, for instance granted in 1980 the sum of ₦864.836 million which rose to ₦3.044 billion by 1989, whereas the Co-operative and Commerce Bank granted ₦62.424 million in 1980 rising to just ₦445.339 million as at 1989.

Overdrafts facilities are generally granted to business customers - large corporate bodies and medium/small scale enterprises. Only current account holders with a bank can benefit from this type of facility. Unlike a loan account where only periodic payments are made, an overdraft account is a running account. Drawings and deposits are made on the account as frequently as funds are needed or received in connection with the business to which the account relates. The facility allows the customer to overdraw his current account up to the limit of the facility. It is usually renewable on an annual basis, but sometimes in less than one year.

In an overdraft account, the whole or part of the amount granted may be released at a time, according to the customer's needs. A part or the whole sum may be repaid and reborrowed many times over and again, without consultation during the currency of the overdraft arrangement. Ituwe (1983).

Commercial Banks are usually interested in engaging in short-term lending. Funds advanced on overdraft basis are in theory repayable on demand while interest is payable on the outstanding balance on a daily basis.

Discounted Drafts/Bills Discounted is a common form of credit in developed economies that is now gaining ground in Nigeria. In discounting a bill, a bank makes available to the receiver an amount close to the face value of the bill and holds the bill until maturity. Usually a small amount is deducted as service charge. To protect itself the bank has an option of discounting a bill "with recourse". Here the bank has the right to fall back on the customer in case the bill is not honoured upon maturity. This acts like the "security" in lending and enables the discounting bank to spread the risk between herself and the customer. For big and trusted, credit worthy customers, the bills could be discounted "without recourse", the opposite in effect and protection of "with recourse" explained earlier. Discounted bills by Nigerian banks include, treasury bills, treasury certificates and other bills.

Atimes, Direct Credit can be given for the value of a bill to the account of a customer before it is sent "for collection". This is an incentive to some prime customers on the strength of cheques lodged. More often than not, a limit to the amount to be given is stated and the categories of bills/cheques that qualify for this, to minimize the incidence of unpaid items.

Below is a table illustrating the amount of bills discounted for two of the case study banks, namely - the United Bank for Africa (UBA) Plc and the First Bank of Nigeria (FBN) Plc over the study period. The other two banks ACB and CCB Plc did not involve themselves in discounting bills. Over the study period from available records.

Table 5

BILLS DISCOUNTED BY TWO OF THE CASE STUDY BANKS (1980-1989) (₦'000)

	BANKS	
Years	UBA	FBN
1980	418,963	663,926
1981	824,891	509,799
1982	686,791	1,052,426
1983	1,102,057	1,658,364
1984	1,216,744	2,461,955
1985	2,393,310	2,557,323
1986	1,978,332	1,183,389
1987	925,572	2,158,312
1988	1,507,514	2,284,345
1989	753,034	962,893

Source: Same as for table 4

Also, the sale of goods by a Nigerian exporter may give rise to a foreign bill. A Bill of Exchange will be drawn and sent to the foreign buyer for acceptance. A usance draft can call for payment after a certain number of days upon the acceptance of the bill. The most common terms are 30, 60, 90, 120 and 180 days. If it is a sight draft, then the buyer pays it right away. If it is usance the buyer accepts it and pays when it is due. A time or usance draft drawn by a seller on a buyer and accepted by the buyers - is called a trade acceptance. This item appears on the seller's balance sheet as a Note Receivable. Banks are usually prepared to purchase at a discount, trade acceptances from the payee, thereby financing a company's receivables. The discounting of bills is practically the same as making an advance upon the security of the bills. Adekanye (1983).

A guarantee is an engagement of undertaking to be collatercally liable or answerable for the debt, default or miscarriage of another person. When a bank is confronted by a prospective borrower who has no assets, or unencumbered on which a charge could be taken to secure the lending, and the bank does not desire to grant him the requested credit facility clean (unsecured), the usual arrangement is that a relative or friend of the customer may be requested to guarantee the account. In which case, the friend or relative, who must be a person of substance (that is credit worthy), acts as surety for the debtor in case of default of payment. Adeniji (1984).

A bank guarantee or bond is an instrument under the common seal of the bank, whereby the bank undertakes to pay a certain sum of money to a third party or a promise by the bank as the obligor to pay to another (the obligee) a sum of money, if the performance guaranteed does not occur. The obligation is however conditional upon establishing default by the contractor. The primary liability is still that of the customer, the bank only assumes a secondary liability and its position under the guarantee is only that of the surety.

Bank guarantees represent short-term financing facility and enables the customer to avoid or postpone an actual outlay of cash.

Letters of credit is similar to a guarantee in that the bank undertakes, on behalf of the customer, to pay a specified amount, if certain conditions stipulated in its terms are met. It is commonly used in international trade for import/export transactions. Adekanye (1983).

An exporter who is the beneficiary of a letter of credit can use the reputation of the bank that issued the instrument to obtain payments whilst the goods are still in transit. He may also obtain immediately payment for usance letters of credit by getting a bank in his country to negotiate the shipping documents.

The essence of letters of credit, which become very prominent in Nigerian during the import licence era was to assure exporter of receiving (money) payment for his goods and also to assure the importer of receiving his goods. Here two banks, the issuing bank and the accepting bank agree to settle transactions on behalf of their customers, the exporter and the importer respectively.

2.3 REQUIREMENTS FOR BANK LENDING

Certain companies may have the powers of their Directors to borrow highly restricted, credit facilities may therefore be in contravention of rules and regulations of such companies. Such facilities may turn unenforceable and irrecoverable. Bankers are therefore interested not only in the borrower's ability to repay but also in his legal capacity to borrow.

In lending to a Corporation or limited liability company, it is essential to examine the charter or memorandum and articles of association to ascertain who has authority to borrow on its behalf. In many cases, banks, also follow the practice of requiring a corporate resolution signed by the members of the board of directors setting forth the borrowing authority and designating the person or persons who have the authority to negotiate for loans and to execute borrowing instruments.

The bank will also endeavour to assess the ability, experience, qualifications and other relevant qualities of the directors and principal management of the client or prospective company, since it is these officers that will carry into effect the Company's projections. The concern of the banker here is to ensure that the Company he is asked to lend money will be led or managed by responsible men with good track records, that is, people with determination and ability to weather bad times as well as to capitalize on good times. That then is the reason why the banker will normally ask the potential borrowing client Company to supply a list of its directors and principal management showing their functions, qualifications, ages and experience.

The concept of character, as it relates to credit transactions, means not only the willingness to repay debts but also a strong desire to settle all obligations within the terms of the contract. A person of character usually possesses attributes such as honesty, integrity, industry and morality. The past record of a borrower in meeting his obligations is usually weighed heavily in evaluating his character for credit purposes.

The questions the banker will normally ask are, who is the customer?, what is his previous relationship with the bank and what does his previous credit record look like? The banker has to know his customer based on existing banker-customer relationships, and if there are any doubts in his mind, he is in a priviledged position to make reference, obtain confidential information such as status or credit reports through available sources.

Most bad debts arises as a result of lack of adequate knowledge of the loan seeker. A few discreet enquires about him would have revealed more information to enable better judgement to be made.

No bank wants a loan to crystallise into hardcore borrowing. Consequently, the main test of the customer's loan request is the ability to repay from sources which must be reasonable, certain and adequate. In other words, the ability to create income is the controlling criterion of bank lending.

Having learnt from bitter experience that many types of security prove of little value in avoiding a loss once the borrower is in a position of default the bank will normally not agree to lend money unless it is satisfied with the probability of repayment, the timing of such repayment and the source from which the repayment is to be made. In this regard, it is important to bear in mind the fact that a sound bank lending should be collectable from planned self liquidation of the borrower's assets or from his anticipated income or profits rather than from forced liquidation of any collateral that may be pledged.

That is why a would-be-borrower will normally be required to submit with his loan application a summary of his past (at least three years) and projected Balance Sheets, Income Statements, and Cash Flows, preferably assuming implementation of the projected financing arrangements and their repayments. If it is a trading or manufacturing concern, the analysis of financial statements must show that adequate cash flow can be generated to repay the loan. Previous profit records will show the likely trend and the bank must be reasonably certain that, ultimately, its facilities can be repaid.

Thus, the ability to produce tangible security is not the most important criteria for granting credit facilities, as the offer of collateral does not weaken the need for a thorough examination of the proposal.

Credit will not be extended to business concerns unless capital has been supplied by the owners to support the debt. The net worth of a firm (the capital supplied by the owners) is one measure of its financial strength. It is often one of the principal determinants of the amount of credit a bank is willing to make available to a business borrower. The amount and quality of the assets held by a firm reflect the prudence and resource-fulness of its management. Some or all of these assets may serve as security for a loan and thus as insurance that the loan will be repaid should the borrower's ability to create income not be sufficient to retire the loan. It in fact shows that the proprietor of the business has a stake in it and will be committed to its survival.

Collateral protection for a loan may be arranged in many different ways, depending on the nature of the business and the particular circumstances in each case. Apart from the above form of direct pledge of assets, it may take the form of full guarantee of financial institutions, for example, Insurance Companies and other banks and the personal guarantees of the project sponsors (usually backed by specific assets), where the sponsors are people of immense wealth and reputation.

The lending bank should satisfy itself about the suitability of an advance. Even where the requirements of a borrower satisfies all safety and risk considerations, it is absolutely necessary for the banker to ensure that the purpose of the loan is not in conflict with the economic and monetary policies of the government. Apart from the guidelines, there are certain ventures that are not financed by banks such as gambling, betting and smuggling and drug trafficking which are against the laws of the land.

Economic conditions also affect the ability of the borrower to repay financial obligations but are beyond the control of the borrower and the lender. Economic conditions are the environment within which business units and individuals operate. Borrowers may have good character, an apparent ability to create income and sufficient assets, but economic conditions may render the extension of credit unwise. It is here that the banker must become an economic forecaster. The longer the maturity of the loan, the more important economic forecasting becomes, since there is a greater possibility of an economic downturn before the loan has been fully repaid. The economy is subject to short and long-run fluctuations which vary in intensity and duration. These movements are never the same, conform to no definite pattern, and may affect different industries and areas of the country differently.

Many borrowers fare well in periods of prosperity, but in periods of recession capital may be dissipated, income may decline and even character may be undermined. These factors give rise to the non-payment of debts. The banker must therefore keep informed as to the economic pulse of the nation, the community and the industry or industries in which he makes loans.

Also, in extending credit to business borrowers, a bank is interested in the economic function performed by the business and its importance in the industry. A knowledge of what is happening in the industry is very important - changes in competitive conditions, technology, the demand for products and distribution methods. If a loan applicant is not performing a function basic to the operation of the economy, the lender will be less likely to act favourably on the credit application than if the opposite were the case.

Furthermore, a loan which will bring a once-for-all benefit to the bank will naturally be less attractive than one which has the potential for ancillary business obtainable from the client. The banker will, for instance, be more attracted to a loan which has the prospects of ultimately involving other services such as handling international trade transactions (e.g. letters of credit, bills for collection and direct remittances, private or public placement of very long term debt or equity issues, trustee services, financial and investment advisory services). These, of course, accrue additional revenue to the bank. So in negotiating a loan, the banker considers the prospective global relationship of the bank with the client, and this in many cases affects his disposition and pricing of the loan.

Adekanye (1986) has noted that the above principles as discussed can further be broken down into such questions as;

(i) How much does the customer want to borrow?

(ii) Why does the customer want bank finance?

(iii) How long does he want it for?

(iv) How does he intend to repay?

(v) Is the customer's business financially strong enough to keep going if his plans suffer a setback?

(vi) What security can he offer?

(vii) What is your (lender's) assessment of the customer?

It is very vital to determine the exact amount required by the loan applicant. Whereas it is dangerous to lend less hence tieing up capital unproductively in an investment, it is also more dangerous to lend more, enabling the customer to divert the surplus and face problems of repayment. Thus, over lending is as bad as under-lending.

To determine how much an applicant actually wants, so many issues are considered. In the case of an overdraft, it is a kind of eat-as-you-have system and since overdrafts are used monstly to finance inventories and increase the working capital, it is easy to determine what the applicant requires. A look at the turnover for say a month or two gives an idea of the most economic "amount" needed by the applicant.

However, the customer's contribution to the project for which the loan is required is important. It is one of the ways the banker can determine the borrower's commitment. The higher his investment the greater will be his determination to succeed and make profits.

The purpose of the loan facility should be understood clearly and the credit officer should ensure that this falls within the customer's business competence. It is also advisable for the credit officer to advise applicants on the prospects of their intended business.

Only when it is known why a customer needs finance is it possible to consider the proposition in detail. The main consideration is whether, it is in the interest of the customer and the bank. If it seems likely that a business proposition will fail, there is little point in going ahead. To do so would not be in the customer's interest and even if security were taken, the bank could be confronted with the problem of realising the security and the possible losses arising therefrom.

Commercial bank deposits are generally short-term in nature and payment is on demand by the customer/ depositors. As a result banks are guided by the maxim that "Those who borrow short should not lend long". Thus, commercial banks should not lend long. This can only be justified by the attractiveness of the proposition. If what is required is medium-term loans, then the customer is better advised to approach Merchant banks whose speciality it is to lend on medium-term. If a long-term loan is required then the capital market is the best place to seek for such permanent financing.

Thus, the duration for which a loan application is required is important in determining whether the loan is to be considered or not.

It is very important for the bank to know the source of repayment of a loan. The borrower should be able to demonstrate clearly that he has carefully examined and worked out how the additional finance will help profitable growth and how the business can comfortably cope with arrangements for reducing the borrowing steadily. As repayment of every loan or advance is expected from future earnings, a borrowing customer must be able to submit a simple cash budget. (Adekanye 1986).

In the case of a personal loan, the lending officer will normally ask for details of the borrower's earnings now and in the immediate future and his normal monthly expenditure. This statement will also show the existing payments on his mortgage, insurance premiums, hire purchase repayments, personal and house keeping expenses.

For businesses too, the advance can only be repaid from future profits (unless the business is to cease trading and sell off its assets to pay its creditors). Therefore, the manager needs to ensure that lending the bank's money will increase profits of the business, after allowing for the interest and charges to be made on the advance. Cox (1981).

Nowadays a bank manager is trained to consider the future profitability of business customers and it is usual for him to ask the customer for a cash budget and projected Profit and Loss Account and Balance Sheet for the forthcoming year.

The type of advance signifies to the bank the expected source of repayment. A very important factor considered in repayment prospects is the ability of the loan beneficiary to manage his business efficiently. Where security is taken it should never be looked upon as the source of repayment, but only as something to fall back on if the expected source of repayment should fail.

The Bank Manager would more often than not require the Balance Sheet and Profit and Loss Accounts of the customer for at least three years, including the current and projected cash budget.

The Manager does an analysis of these documents and arranges a meeting with the customer to strengthen out issues that remain doubtful to him. After the meeting the Manager will be in a better position to determine the potential strengths and weaknesses of the business and thus whether it is wise or not to extend the loan facility.

Security should be taken as a safe-guard, a hedge, an insurance against unforeseen developments. Thus, it should not been seen as the most important criterion for granting credit facilities, as the offer of security does not weaken the need for a thorough appraisal of the proposal for lending. This does not however mean that security as a requirement for bank lending is unimportant. It should only act as a second way out.

It is generally agreed that Loans and Advances are not to be made just because they are secured. The real security is the character of the borrower as the bulk of bank lending is based on trust and faith in the customer and his business.

The issue of security and its types is left out here for a more detailed discussion in the subsequent section.

The customer to whom facilities are to be extended must of necessity pass the test of reliability personal integrity and honesty. It is therefore important that the banker has a good knowledge of his customer as to be able to judge his ability, intelligence, dedication to work, knowledge of basic operations of the company and his business experience generally.

The Manager should refer to all this information prior to an interview with a customer. He should take into account the borrower's health and age and the value of connected family and business accounts held at the branch. With personal customers he looks particularly to see if any past advances were repaid in accordance with the arrangements made. With a business customer, besides being concerned with the past history of the account, he wants to satisfy himself that the customer has experience at his job, has the necessary degree of management ability to run the business and is ploughing back profits into the business.

2.4 SECURITIES ACCEPTANCE FOR BANK LENDING IN NIGERIA

Although every lending proposition should 'stand up by itself" - that is, it should be good enough not to need any security - a manager often asks for suitable security from the customer in case the advance should go wrong. There is a wide range of securities to cover a bank loan, and the main types are

(i) a mortgage of stocks and shares
(ii) an assignment of a life policy
(iii) a mortgage over land
(iv) a guarantee, and
(v) other securities.

There are three main requirements of any security accetable to a bank:

(i) it should be easy to value
(ii) it should be easy for the bank to obtain a good legal title
(iii) it should be readily marketable or realizable.

A fourth requirement, though a less essential one, is that it is useful if the value of the security increases as time goes by . Cox (1981).

Stocks and shares that are quoted on the Nigerian Stock Exchange are generally acceptable to banks as security for an advance. They are very easy to value as their prices are usually published weekly in the **Business** Times, Business Concord, Financial Punch and other such weekly financial papers. Their prices can also be obtained from the Stock Exchange Daily List.

It is usually easy to obtain a good legal title over Stock exchange securities. The transfer of stocks and shares from one person to another is effected by means of a stock transfer form. The bank has the choice of taking either a legal or equitable mortgage.

In the case of a legal mortage, the customer deposits his share certificate with the bank and signs and has witnessed the bank's form of mortgage, together with a stock transfer form covering the shares in question. The bank then sends the share certificate in the name of the bank. Thus, the bank becomes the owners of the shares and receives any dividends paid by the Company, these are normally credited to the customer's account. When the advance is repaid and the customer wishes to receive back his security, the bank transfers the shares back into his name by completing another stock transfer form and sending it, together with the certificate in the bank's name to the Company registrar who then prepares another new share certificate. However, Nigerian banks do not transfer shares into their names, they also seldom use nominee companies.

For an equitable mortgage, the share or stock certificates are deposited, with or without delivery of a blank transfer form to the lender. Most banks in

Nigeria take an equitable mortgage by asking the borrower to surrender the share certificate and signing a transfer form.

However, a bank cannot accept its own shares as security for lending.

In accepting the insurance certificates as security for bank loans, the banker ascertains that:

(i) The insurance company is registered under the Insurance Act, 1976.

(ii) The insurance company is reputable and honours its obligations.

(iii) The policy has acquired surrender value. A policy does not acquire a surrender value until premiums have been paid for three years. The surrender value can be ascertained on a yearly basis from the insurance company of the assured.

(iv) The age of the assured has been admitted. Before a life policy is issued, evidence of age is required. Usually a birth certificate or a sworn declaration of age is acceptable. Where this has not been submitted, the insurance company may still go ahead to issue the policy and state that age is not admitted. Since the premium is based on age and cheaper premiums are payable by younger people, insurance companies usually reserve the right to adjust the sum assured before paying upon the policy on which age has been incorrectly stated.

Thus, before a bank accepts a life policy as security, it ensures that age has been admitted.

(v) The instalment premium payments have not fallen into arrears, as to be able to claim on a policy, payments of premium must be regular.

(vi) The policy holder has an insurable interest in the assured. An insurable interest is presumed in the following cases:

- individual on his own life
- man on the life of his wife; or,
- woman on the life of her husband.

(vii) Upon accepting a life policy as security, the beneficiary clause of the policy should be amended to cover assignment of the policy to the bank. Adekanye (1983).

Land appears the most acceptable security to banks. The term land as used by bankers refers to a piece or parcel of land together with its attachments - be such fixtures or valuables underneath. It is often referred to as real property or real estate. The preference which banks have for Land as security over and above other securities, stems from the fact that Land is the most indestructible property offered as security. Not only that over the past many years, the value of land per se has consistently appreciated, but also that any development done on land adds to the value of the Land. Ituwe (1983).

In Nigeria, prior to 1978, the title to Land was evidenced by:

(i) Freehold Conveyances and Leases

(ii) Certificate of occupancy; or

(iii) Assignments of freehold Conveyances, leases and certificates of occupancy.

Freehold conveyances, leases and assignments effected before 29th March, 1978 are still valid. However, with effect from that date when the Land Use Act came into force, all undeveloped Land in each state became vested in the Governor of the State. According to the Decree; all land comprised in the territory of each state in the Federation are hereby vested in the Military Governor of that state and such Land should be held in trust and administered for the use and common benefit of all in accordance with the provision of this Decree (Land Use Decree No.6 of 1978).

Thus, only the State Governor could have a freehold interest in Land. Under this Act, it is now illegal for individuals to prepare freehold conveyances in respect of undeveloped land. Those freehold conveyances effected before March 1978 are still valid and are converted to rights of occupancy. They are still acceptable as security for bank lending.

As to developed property, leases and assignments effected after the Land Use Act, 1978 are valid provided the consent of the Governor is obtained to the transactions as provided by the Act. Since the Land Use Act became Law, the certificate of occupancy has become the most important title document to Land. This certificate can only be issued by a state Governor and relates only to land in urban areas. The title to Land in rural areas is called right of occupancy, processed by the Local Government, but must be signed and approved by the State Governor. Other Valid title documents include a Land Certificate in parts of Lagos, Conveyances registered before March, 1978 and assignments of developed property. However, the certificate of occupancy is superior to any other title document. Adekanye (1983).

A guarantee is a collateral security involving three parties, in which the third party, the guarantor, agrees to be liable for the debts of a second party, the bank customer, if he doesn't pay the first party, the bank. Guarantees are often taken from the directors of a Limited Company as part security for the Company's bank account, thus preventing the directors from hiding behind the "shield" of Limited liability for at least a part of the Company's debts. They may also be taken from members of a club or society to guarantee and advance to the club, and from friends and relatives to guarantee a personal account. One company from a group of Companies may guarantee the bank accounts of the other Companies in the group: where all group Companies guarantee each others" accounts this is known as an inter-locking guarantee.

When a Limited Company is guaranteeing, an individual or other Company, the bank ensures that:

(i) The memorandum and Articles of Association of the Company permit the Company to issue guarantees.

(ii) The Board's resolution authorising the issue of guarantee is sumbitted.

(iii) There is a resolution authorising the guaranteed Company to borrow from the bank.

The major problem of guarantees is that, however, hard the bank tries to explain the potential liability, the guarantor never expects to be called upon to pay. He may have to pay if and when a court action is taken against him by the bank.

Where a guarantee is for a fixed sum, as is generally the case, it does not, of course go up in value over a period of time, even during periods of inflation.

There are other securities apart from the ones discussed earlier which the banks may accept in granting Loans and Advances to potential beneficiaries. These include according to Adekanye (1983)

(i) Vehicles/Chattels

A bank can create a lien or bill on vehicles or Chattels. The invoices and other title documents are deposited with the bank. Thereafter, charge forms are prepared.

(ii) Fixed and Floating Charge

A security commonly taken from Companies is a fixed and floating charge which takes all the assets of the Company including stocks, debtors, machinery and plant. The floating part allows the Company to buy and sell assets without restriction - the charge only "crystallizes" when certain events take place, such as default on an advance.

2.5 RISKS ASSOCIATED WITH BANK LENDING

Risk is defined as the probability of incuring a lose. Under conditions of risk, an investor knows exactly the range of possible outcomes to expect from an investment opportunity as well as the likelihood or probability of each outcome. Were the range of possible outcomes is wide, exposure to risk would be high and conversely, Okafor (1983). Partee (1980) has also opined that, a third major challenge to the banking industry, in addition to coping with the high cost of deposit competition and guarding against interest rate risk in an uncertain environment, is that of adjusting to probable changes in credit risk exposure. He goes furhter to note that he has no doubt that credit risk poentials is on an upward trend, and that it is likely to be reflected in all major aspects of bank lending activities.

In any lending arrangement two types of risk usually arise. The first is the well-known "default risk", which means simply that the borrower may not be able to repay the loan in whole or in part at the time repayment is scheduled. The ultimate lender then suffers a monetary loss equal in whole or part to the defaulted loan. To the extent that the borrower pledged specific assets to secure the loan, the degree of the loss suffered by the lender is reduced.

The provision for Bad and Doubtful debts of the case study banks is used here as a proxy for the rate of loan default and by extension the default risks faced by these banks in their transactions.

Table 6

PROVISION FOR BAD AND DOUBTFUL DEBTS OF CASE STUDY BANKS (1980-1989). A PROXY FOR DEFAULT RISK (₦'000)

	BANKS			
Years	UBA	FBN	ACB	CCB
1980	2,335	34,293	1,141	3,064
1981	6,073	42,100	6,516	3,978
1982	14,812	16,864	5,873	2,586
1983	17,997	21,319	5,149	1,887
1984	21,700	30,316	4,701	1,380
1985	29,082	137,096	3,510	2,676
1986	38,633	177,043	1,068	6,838
1987	57,793	237,896	21,336	2,913
1988	52,042	276,811	42,107	2,887
1989	34,655	72,594	10,633	19,200

Source: Same as for table 4

The table above reveals a fluctuating trend in the provisions made for bad and doubtful debts over time. The provisions are meant to cushion the banks from the possible effects of loan defaults and thus their exposure to credit risks from bank borrowers. The figures provided for, some way have a relationship with the level of deposits which individual banks hold.

A closer look at the table shows that the United Bank for Africa Plc for instance, made a provision for Bad and Doubtful debt of ₦2,335 million in 1980 which rose to ₦57.793 million in 1987 and that the First Bank's figure rose from ₦34.293 million in 1980 to ₦2.76 billion by 1988.

Again, the African Continental Bank made a provision for Bad and Doubtful debt of ₦1.141 million in 1980 which rose to ₦42.107 million by 1988.

The above figures go to show the level of risks associated with bank lending activities and by extension their sensitivity to these risk exposures.

The second type of risk faced by lenders is concerned with the liquidity of the asset acquired in relation to that given up by the ultimate lender. The property of liquidity pertains to the ability of the ultimate lender to dispose of the asset quickly and at a price reasonably close to that given for it. Liquidity is related to several characteristics of the assets. First, is the asset issued by a well-known firm, individual, or government unit whose financial position is above suspicion? If so, the asset is potentially highly marketable. Second, what is the length of time before the asset matures, that is, before the ultimate borrower can redeem the asset? Generally, the longer the term to maturity, the less liquid an asset is. Third, does the asset bear interest? If the asset bears interest and is in the nature of a bond, the longer the term to maturity, the greater will its market price fluctuate for a givenchange in market interest rates. For this reason also, longer-term assets are generally less liquid than those with maturity dates close at hand.

Finally, how well developed is the market for this type of asset? For example, are prices quoted daily, are the assets sold on a nationwide exchange, do financial institutions deal in them? The more highly developed the market for a type of asset, the more liquid it is. Osuagwu (1992).

2.6 LOANS AND ADVANCES MANAGEMENT/RECOVERY STRATEGIES

Every creditor from time to time finds himself in a position that requires him to initiate action to either recover a loan or manage the inherent risk associated with lending activities.

As had been previously pointed out, two major risks are faced by lending institutions, namely: the default risk and the liquidity risk.

The Nigerian banking environment was in the 1950s characterized by a series of bank failures arising from several factors. It is in recognition of the fact that a possible cause of bank failure could come from large doses of loan default that the Nigerian Deposit Insurance Corporation was established by Decree 22 on June 15, 1988. The Corporation was established with the following objectives:-

(a) To help promote safe and efficient banking system by providing technical and financial assistance to insured banks in serious difficulty as to protect them against destructive runs.

(b) To protect depositors interest in the case of any insured bank facing liquidation.

(c) To inculcate banking habit among Nigerians.

(d) To examine the books of all insured deposit taking institutions in order to ensure fair play among competing banks.

(e) To invest the money collected from all insured deposit taking institutions as premium into profitable ventures in the country.

(f) To assist monetary authorities in the formulation and implementation of monetary policies; Ogunambala (1991).

The coporation is financed by premium paid by insured banks. All licensed banks insured by the corporation are required to pay 15/16 of one percent of the total assessable deposit liabilities standing in their books at the end of every financial year. In the event of liquidation of an insured bank, the corporation pays a maximum of ₦50,000 to each depositor. Thus, as a way of managing their default risk or insuring against possible loan defaults, banks have become insured by the corporation as a risk reduction method.

Another method for reducing the risk associated with loan default is by the diversification of loan portfolio. It is well known that loan defaults can move together over time. That is, defaults rise during economic downturns and fall during economic upturns. However, since different types of loans have different default risks, that is, their risk of default is not positively or perfectly correlated, diversification of loans, that is, making them to different individuals whose activities are not related to the business cycle in the same way serves to reduce the overall risk of default. That is the more reason why commercial banks diversify their loan portfolio by lending to various sectors of the economy at varying percentages with the so called preferred sector taking up to seventy five percent (75%) of their loan portfolio in any given year.

Since the deposit claims on commercial banks is a problem to them, banks as much as possible try to remain liquid because the cost of illiquidity is dangerous on the continued existence of banks.

Several means of reducing the liquidity risk are available to banks. First, the various diversified financial institutions are a basic part of the infrastructure known as the financial market. By their existence they help to create "The market", and the existence of a financial market where securities are actively traded tends to enhance the liquidity of all securities.

Secondly, some financial institutions avail themselves of "Lenders of last resort". The Central Bank is such a lender and can by timely purchase of government securities or other means add liquid funds to the financial system when necessary. Examples of instruments that reduce the risk of illiquidity of commercial banks in Nigeria on maturity include, Treasury Bills, Treasury Certificates, Certificates of Deposits, Bankers Unit Fund, the Call Money Fund etc.

Commercial banks invest their excess funds in these money market instruments that have varying maturity dates to earn interest and to remain liquid or avoid the risk of illiquidity whenever these instruments maturity dates fall due.

Once the bank has decided to recover its loan, demand for payment in the manner required by the terms of the loan agreement should be made upon the debtor. If verbal demand is made, it should be followed by a letter outling the terms of the bank"s demand. The demand for payment should make it clear that the bank is willing to accept nothing less than the payment in full and should give the debtor a reasonable deadline to accomplish this. Depending upon circumstances, a reasonable deadline might be as little as a few days or as long as several months. It should be made clear to the debtor that the bank accepts payment as soon as possible and that procrastination or stalling on the part of the debtor will not be tolerated. In making demand for payment, the bank should be careful not to waive any of its rights and may wish to consult its solicitors prior to demanding payment.

The function of the collection/recovery lawyer is two fold. He assists the creditor in determining what legal remedies are available, assesses the possible effectiveness of these remedies; and represents the creditor in any court action instituted to implement these remedies. Most banks retain a lawyer who performs legal work for them from time to time and may wish to employ its regular lawyer in handling its recovery cases. However, it should be noted that the legal actions involved in loan recovery are a highly specialized field and therefore, the bank may wish to retain a lawyer who is a specialist. A high degree of knowledge of this particular area of law, aggressiveness and resourcefulness are all prerequisities for the successful debt collector. It is also extremely helpful for a debt collector to have a close working relationship with the bank's commercial loan officers, and that he has an in-dept understanding of the bank's attitudes and policy as well as the manner in which it services and documents its loan.

The bank should furnish its lawyer with all information pertinent to the recovery case, including copies of ledger cards, financial statements, notes

Collateral receipts and memoranda. In addition, the case should be thoroughly discussed with the debt collector by the officer servicing the loan.

Banks right of set-off is a legal right which a debtor has to set-off against the debt due to him sums due by the creditor. The right of set-off can only be exercised if both debts are in the same right and of known amounts. Thus a banker has a right of set-off in respect of different accounts of his customer, one in debit and the other in credit, provided there is no express agreement to the contrary. This is usually done after giving due notice to the customer. This notice is essential because if the customer has issued cheques on the account with the credit balance and such cheques are dishonoured, the banker runs the risk of paying damages to the customer for the wrongful dishonour of cheques.

The banker"s right of set-off crystallises in the following instances:

(i) On the death, bankruptcy and mental incapacity of a customer;

(ii) On the bankruptcy of a firm or when a company is put into liquidation;

(iii) On receipt of notice of assignment of the credit balance on an account. Adekanye (1986)

Every lender, having exhausted all other means of recovering a loan sooner or later finds he or she must resort to court action to force recovery. Loan Officers who are inexperienced in such matters will probably find their first day in court a frustrating experience. Without doubt, patience, perserverance are prerequisites for any creditor involved in a court action.

Both the bank officer and the attorney should make a detailed study of all documents in the credit file prior to their court appearance. The strengths and weaknesses of the creditors case should be thoroughly analyzed, and every effort should be made to anticipate the defences which may be presented by the debtor. A plan of attack that takes advantage of those areas in which the bank"s case is the strongest should be prepared. Except in very minor cases, an officer of the bank who has a thorough knowledge of the case should accompany the solicitor to court. The success of any action in court depends on three factors - the soundness of the bank's case, the ability of the bank's solicitor and the adequacy and accuracy of the information furnished to the attorney by the bank.

Thus, the best recovery officer is not only knowledgeable and aggressive but is also resourceful and flexible. The issue of flexibility requires that he takes the best decision in a situation where the debtor requests for an out of court settlement.

Most banks have embodied with their "Letter of Acceptance" a provision that if the holder of this letter shall deem itself insecure, then the entire indebtedness aforesaid shall at the option of the holder and without notice be and become immediately due and payable or words of similar nature. This is commonly known as an acceleration clause and gives the bank the opportunity to declare the loan immediately due and payable should it find that the debtor's situation is deteriorating. Without a clause of this nature, the bank might find itself unable to take any action until the next maturity of the debtor's loan even though it is aware of the deterioration of the debtor's position.

CHAPTER THREE

3.0 METHODOLOGY

This study will rely on both primary and secondary data.

3.1 Data Collection

The primary data was collected through the administration of some six hundred and thirty (630) questionnaires, administered in the ratio of 180:180:150:120 on each of the case study banks, namely; the First Bank of Nigeria (FBN) PLC, the United Bank for Africa (UBA) PLC, African Continental Bank (ACB) PLC, and the Co-operative and Commerce Bank of Nigeria (CCB) PLC respectively, bearing in mind their relative shares of the market. Okafor (1988) notes that as at December 1986, the First Bank of Nigeria had a (Spread, Assets, Loans and Advances, and Deposits) SALD market share index in percentage of 17.36, the UBA - 15.60, the ACB - 6.23 and the CCB - 2.00.

The questionnaire is designed to be responded to by three categories of staff of the Loans and Advances (credit) departments of the banks, namely; the credit officers, credit supervisors and credit clerks. The sampling technique adopted in the administration of the questionnaire is the judgemental sampling method based on their relative sizes, Okafor (1988).

The secondary data required for this work will include, data on the provision for Bad and Doubtful debts (a proxy for the rate of loan default), Loans and Advances, the net earnings (profit after deductions), customers deposits and other liabilities, Assets, and Reserves of the selected banks. The sources of these data are the published Annual Reports and Financial statements of the case study banks. These information will be derived from the Balance Sheets and the Profit and Loss Accounts of these Banks.

3.2 Data Analyses

The method of analyses of this study will involve;

(1) The Chi-squared (X^2) test and the Contingency table will be used to test for the perceived degree of effectiveness of the Loans and Advances management strategies adopted by the banks.

(2) Correlation analysis between the net earnings (profit) and the Loans and Advances granted by the banks.

(3) Simple and multiple regression analyses of the data using the ordinary least squares (OLS) method. (Econometric Analysis).

The Econometric analysis would involve the following:

Specifying the models to be tested. We make the Net Earnings (N) the dependent variable (the regressand) and include the explanatory variables or regressors in the model to test for the significance of the explanatory variables in contributing to the Net Earnings. To grasp the individual impact of the independent variables, we specify simple regression models with each of the variables. Multiple regression models are also specified to test the joint impact of the whole variables taken together. We may also alter at random the variables included in the multiple regression model.

Since the sample size is less than thirty, we use the student t-test to test for the significance of each explanatory variable in contributing to the Net Earnings of the banks.

The F-test is also used to test for the overall significance of the explanatory variables taken together.

The coefficient of determination - R^2 which measures the Goodness of fit is calculated. But by including additional explanatory variables in the function we raise the coefficient of multiple determination. To correct this defect we adjust R^2 by taking into account the degrees of freedom which clearly decrease as new regressors are introduced into the function, Koutsoyiannis (1977). We therefore use the adjusted R^2 ($\bar{R}^2$) instead of R^2.

3.3 Definition of Variables (Data)

(1) The Net Earnings (N)

The net earnings (N) is the profit after all deductions have been made within the accounting year. It is the dependent variable in this study.

(2) Provision for Bad and Doubtful Debts (B)

The provision for bad and doubtful debts (B) is the provision made for transactions within the accounting year which are considered bad and doubtful of recovery. It is used here as a proxy for the rate of loan default.

(3) Loans and Advances (L)

The Loans and Advances (L) is part of the Assets of a Bank usually given out to customers of the bank as credit facility.

(4) Customers Deposits and Other Liabilities (C)

These comprise deposits made by bank customers in the form of saving, demand and Time deposits and other such liabilities that the bank might incur or be exposed to.

(5) Assets (A)

The Assets here consists of fixed Assets and "other Assets" of the bank. Fixed Assets include Buildings, Office and House Equipments, vehicles etc. Other assets are things like Investments, Stocks etc.

(6) Reserves (R)

The Reserves constitute the amount put aside for contingencies. They are profits earned over the years that have not been distributed to shareholders but set aside to meet future requirements.

3.4 Specification of the Models

In order to determine the relative importance of each explanatory variable in contributing to the Net Earnings, we fit each bank's data into simple regression models. The specification takes the following functional form:

$$N = f(B) + U \quad (1)$$

$$N = f(L) + U \quad (2)$$

$$N = f(C) + U \quad (3)$$

$$N = f(A) + U \quad (4)$$

$$N = f(R) + U \quad (5)$$

where;

N = The Net Earnings or Net Profit of the bank.

f = The functional notation

B = Provision for Bad and Doubtful Debts

C = Customers deposits and other liabilities

A = Assets

R = Reserves

U = Error term or Disturbance term

L = Loans and Advances

The linear specification of the model takes the forms:

$$N = a_o + a_1 B + U \qquad (6)$$

$$N = a_o + a_1 L + U \qquad (7)$$

$$N = a_o + a_1 C + U \qquad (8)$$

$$N = a_o + a_1 A + U \qquad (9)$$

$$N = a_o + a_1 R + U \qquad (10)$$

where the variables are as defined earlier, and a_o and a_1 are coefficients.

Also, in order to test the joint impact of the explanatory variables in contributing to the net profit, we develope a multiple regression model. The specification takes the following functional form:

$$N = f(B, L, C, A, R) \qquad (11)$$

where the variables remain as previously defined.

In undertaking this test we require to alter at random the variables to establish which of them taken jointly better explains or contributes more to the net earnings of the individual banks over the study period. The linear relationship of the model can take the following form:

$$N = a_o + a_1 B + a_2 L + a_3 C + a_4 A + a_5 R + U \qquad (12)$$

$$N = a_o + a_1 B + a_2 L \qquad (13)$$

$$N = a_o + a_1 B + a_2 L + a_3 C \qquad (14)$$

$$N = a_0 + a_1 L + a_2 A + a_3 R \qquad (15)$$

and so on. Where a_0, a_1, a_2, and a_3 are coefficients. The actual analysis is left out here until Chapter 4 when the analysis is carried out.

CHAPTER FOUR

4.0 ANALYSIS OF DATA AND INTERPRETATION OF RESULTS

4.0 TEST OF HYPOTHESES

4.1 HYPOTHESIS I

This hypothesis states that;

H_0: Loans and Advances are not important in the portfolio management of commercial banks.

H_A: Loans and Advances are important in the portfolio management of commercial banks.

The hypothesis is tested using simple and multiple regression results of selected variables of case study banks.

*Note that the t-values are in parentheses under the estimated coefficients.

CASE STUDY BANK I - THE UNITED BANK FOR AFRICA (UBA) PLC

Table 7

Regression Data for UBA PLC (1980-1989) (₦'000)

Years	Reserves (R)	Assets. (A)	Bad Debts (B)	Loans & Advances (L)	Customers Deposits (C)	Net Earnings (N)
1980	47,597	48,173	2,335	864,836	1,576,225	20,036
1981	64,312	124,990	6,073	1,164,294	2,407,218	22,715
1982	78,239	148,476	14,812	1,519,426	2,548,230	26,602
1983	92,818	256,119	17,997	1,619,691	2,939,911	29,279
1984	109,600	275,769	21,700	1,553,263	3,114,546	31,482

985	134,093	333,455	29,082	1,409,137	4,319,600	34,193
986	163,839	348,054	38,633	1,471,419	3,932,789	42,081
987	191,179	710,543	57,793	1,798,628	4,766,726	73,653
988	253,468	903,138	52,042	2,008,138	5,872,884	54,766
989	341,755	1,430,228	34,655	3,044,131	8,159,295	64,764

Source: Annual Reports and Statement of Accounts (Various Years).

The regression results for the above bank are as follows:

$$N = 8486.72 + 0.8999B \qquad (1)$$
$$(5.8797)$$
$$R^2 = 0.8121, \; F = 34.571, \; DW = 1.8823$$

$$N = 868.9082 + 0.0238L \qquad (2)$$
$$(3.2211)$$
$$R^2 = 0.5646, \; F = 10.376, \; DW = 1.1110$$

$$N = 8551.2989 + 0.0079C \qquad (3)$$
$$(4.2636)$$
$$R^2 = 0.6944, \; F = 18.179, \; DW = 1.7548$$

$$N = 23243.774 + 0.0365A \qquad (4)$$
$$(4.6678)$$
$$R^2 = 0.7314, \; F = 21.788, \; DW = 1.4098$$

$$N = 14733.022 + 0.1708R \qquad (5)$$
$$(4.7316)$$

$$R^2 = 0.7367, \quad F = 22.388, \quad DW = 2.0244$$

$$N = 1750.252 + 0.6985B + 0.0115L \qquad (6)$$
$$(4.9971) \quad (2.6077)$$

$$R^2 = 0.9047, \quad F = 33.218, \quad DW = 2.2697$$

$$N = 1795.4335 + 0.0114L + 0.0006C + 0.6974B \qquad (7)$$
$$(0.9502) \quad (0.0096) \quad (3.5956)$$

$$R^2 = 0.9047, \quad F = 18.982, \quad DW = 2.2738$$

The simple regression results in equations (1) to (5) show the following; The provision for Bad and Doubtful Debts - B, Customers Deposits and other liabilities - C, Assets - A, and the Reserves - R, are significant at the 1% level in explaining the net earnings of the Bank over the study period. The Loans and Advances is significant at the 5% level.

The Loans and Advances, Assets, Customers Deposits and other liabilities all bore the correct apriori economic signs. The provisions for Bad and Doubtful Debts and the Reserves bore the wrong (positive) signs). This is quite surprising as these variables are supposed to dampen or reduce the net earnings of the bank.

When a multiple regression analysis is taken for the variables under consideration the following results in equations (6) and (7) emerge. The results show that in equation (6) the Loans and Advances in correctly signed and significant even at the 1% level while the provision for Bad and Doubtful Debt is significant at the 1% level but is wrongly signed. In equation (7) the Loans and Advances and Customers Deposits are correctly signed but the Bad Debts is wrongly signed. The Customers Deposits is not significant even at 50% level whereas the Loans and Advances is, only at the 50% level.

The F-Statistics are quite high indicating that the variables are important in contributing to the net profit of the bank. Also, the R^2 is high showing that the variables taken together explain about 90% of the variation in profit earnings.

The following conclusions can be drawn from the result arrived at above.

(1) The Loans and Advances, Assets and Customers Deposits and other liabilities are important variables in the portfolio management strategies of the United Bank for Africa Plc.

(2) The Reserves and the provision for Bad and Doubtful Debts which bore wrong economic signs exhibited some measure of surprise. It could however be explained to mean that even as the bank made increased provisions for these variables, the net earnings increased because the beneficiaries of the Loans and Advances repaid their debts promptly without involving the bank in the depletion of its Reserves possibly in litigation

to force them to repay. Also, the increased Bad Debt figures could be as a result of the exigencies of the time, that is, the economic depression in the country, when banks are afraid that borrowers may default in the repayment of their debt obligations as they fall due. Thus, the bank needed to make additional provisions for Bad Debts to cushion such effects.

The whole scenaria above did not however reduce the profit levels of the bank as the interest rates on loans and advances plummeted within the period of the Structural Adjustment Programme (SAP) in the country.

CASE STUDY BANK II - FIRST BANK OF NIGERIA (FBN) PLC

Regression Data For FBN Plc (1980 - 1989) (₦'000)

Table 8

Years	Reserves (R)	Assets (A)	Bad Debts (B)	Loans & Advances (L)	Customers Deposits (C)	Net Earnings (N)
1980	34,500	243,205	34,293	1039239	2141980	17967
1981	41700	342006	42100	1339420	2262066	28402
1982	48100	430381	16864	1490132	2793200	25233
1983	55600	872995	21319	1376705	3570313	29850
1984	62900	802462	30316	1402456	4115546	29144
1985	76260	618029	137096	1474541	4134070	53404
1986	97917	1361677	177043	1869452	4412745	86625

1987	114920	1350998	237896	2047113	5010455	68013
1988	124323	1442719	276811	2253388	5646396	74224
1989	137843	1817996	72594	1851481	7958080	57098

Source: Annual Reports and Statement of Accounts (Various Years).

The regression results from the above data for the First Bank of Nigeria (FBN) Plc come up as follows:

$$N = 24368.1890 + 0.2163B \qquad (1)$$
$$(4.9984)$$

$R^2 = 0.7575$, $F = 24.984$, $DW = 1.9559$

$$N = -43320.340 + 0.0559L, \qquad (2)$$
$$(5.0663)$$

$R^2 = 0.7624$, $F = 25.667$, $DW = 1.3876$

$$N = 9860.7372 + 0.0088C \qquad (3)$$
$$(2.3664)$$

$R^2 = 0.4118$, $F = 5.600$, $DW = 1.2139$

$$N = 14177.888 + 0.0354A \qquad (4)$$
$$(3.6765)$$

$R^2 = 0.6282$, $F = 13.516$, $DW = 1.2863$

$$N = 4001.5075 + 0.5415R \qquad (5)$$
$$(4.2952)$$

$R^2 = 0.6975$, $F = 18.449$, $DW = 1.4278$

$$N = -34685.7546 + 0.0458L + 0.0083A \qquad (6)$$
$$(2.1035) \quad (0.5492)$$

$R^2 = 0.7722, \quad F = 11.864, \quad DW = 1.2642$

$$N = -43201.2548 + 0.0556L + 0.0001C \qquad (7)$$
$$(3.2141) \quad (0.0248)$$

$R^2 = 0.7624, \quad F = 11.231, \quad DW = 1.3847$

$$N = -2335.0709 + 0.0132L + 0.0030C + 0.1475B \qquad (8)$$
$$(0.4384) \quad (0.7898) \quad (1.6384)$$

$R^2 = 0.8358, \quad F = 10.184, \quad DW = 2.0286$

The simple regression results obtained from the data on the First Bank of Nigeria (FBN) Plc, equations (1) to (5) is almost similar to that of other Banks.

The Loans and Advances, Customers Deposits and the Assets Variables assumed the correct economic signs and are significant at the 5% level. The provision for Bad and Doubtful Debts and the Reserves although significant at the 1% level had the wrong economic signs.

The multiple regression results equations (6) to (8) show that the equation (7) is much more reliable. However, the bank should endeavour to attract more depositors to enable it have at its disposal enough loanable funds since the loans and advances have been shown to contribute effectively to the net earnings of the bank, if well managed. The Bank should reduce its Bad and Doubtful Debts figures to have more money for potential loan applicants. The wrong economic sign of this variable shows that it has been on the increase probably as a way of containing the possible default from the bank's borrowers.

CASE STUDY BANK III - CO-OPERATIVE AND COMMERCE BANK OF NIGERIA (CCB) PLC

Table 9

Regression Data for CCB PLC (1980 - 1989)

(₦'000)

Years	Reserves (R)	Assets (A)	Bad Debts (B)	Loans & Advances (L)	Customers Deposits (C)	Net Earnings (N)
1980	-	12066	3064	62424	132357	3064
1981	-	18209	3978	81194	155398	3978
1982	679	15704	2586	112416	186729	2716
1983	1143	67314	1887	146053	211761	632
1984	1350	27505	1380	190675	290743	829
1985	1533	27178	2676	221570	331244	433
1986	1533	51927	6838	262179	371575	3798
1987	2341	68882	2913	296099	433533	3232
1988	3146	112046	2887	382646	682616	3222
1989	4640	206141	19200	445339	866846	5974

Source: Annual Reports and Statement of Accounts (Various Years)

The following are the regression results for the Co-operative and Commerce Bank (CCB) Plc.

$$N = 1603.3827 + 0.2498B \quad (1)$$
$$(3.3283)$$

$R^2 = 0.5807$, $F = 11.077$, $DW = 1.1361$

$$N = 1472.9275 + 0.0060L \quad (2)$$
$$(1.3854)$$

$$R^2 = 0.1935, \quad F = 1.919, \quad DW = 1.1250$$

$$N = 85020.8436 - \underset{(-1.7810)}{0.0693C} \qquad (3)$$

$$R^2 = 0.2839, \quad F = 3.172, \quad DW = 2.3574$$

$$N = 1758.5175 + \underset{(2.0480)}{0.0170A} \qquad (4)$$

$$R^2 = 0.3440, \quad F = 4.194, \quad DW = 1.3002$$

$$N = 1901.7185 + \underset{(1.4112)}{0.5414R} \qquad (5)$$

$$R^2 = 0.1993, \quad F = 1.992, \quad DW = 1.1759$$

$$N = -96.5946 + \underset{(0.4574)}{0.0102L} + \underset{(0.9868)}{0.0118C} + \underset{(0.4780)}{0.0146A}$$

$$\underset{(-1.5778)}{-3.4512R} + \underset{(1.5047)}{0.2276B} \qquad (6)$$

$$R^2 = 0.7682, \quad F = 2.651, \quad DW = 1.8588$$

$$N = 350.3659 + \underset{(1.1385)}{0.0179L} + \underset{(2.9064)}{0.3379B} - \underset{(-1.2358)}{1.8904R} \qquad (7)$$

$$R^2 = 0.6676, \quad F = 4.018, \quad DW = 1.0101$$

The simple regression results equations (1) to (5) reveal the following: The Loans and Advances and the Assets Variables are correctly (positively) signed. The provision for Bad and Doubtfull Debts, Customers Deposits and other liabilities, and the Reserves are wrongly signed. The Bad and Doubtful Debts is significant at the 1% level in explaining the net profit earnings of the Bank. The Loans and Advances, and the Reserves are significant at the 20% level while the Customers Deposits and the Assets Variables are significant at the 10% level in contributing to the variation in earnings of the Bank.

The following anology can be drawn from the results above.

(1) The Loans and Advances and the Assets Variables are important but need a little more management in order to realise increased profit.

(2) The provision for Bad and Doubtful Debts, Reserves and the Customers Deposits which assumed wrong apriori economic signs need to be reviewed. If the net earnings of the bank increases via improved Loans and Advances management strategies this will induce more depositors to open up accounts with the Bank. Also, the Reserves and the Bad and Doubtful Debt figures should be reduced and same made available to potential loan applicants. This would undoubtedly improve the earnings of the Bank.

When a multiple regression analysis of the variables is taken equations (6) and (7), the following picture is revealed. All the Variables excepting the Bad and Doubtful Debt assumed the right economic signs and are significant at the 20% level. The R-squared is quite high indicating that over 66% of the Variation in the net earnings of the bank can be accounted for by the Variables taken together. As observed earlier the bank should reduce its Bad and Doubtful debt figures to allow it have enough loanable funds and thus make more profit from its operations.

CASE STUDY BANK IV - AFRICAN CONTINENTAL BANK (ACB) PLC

Table 10

Regression Data For ACB Plc (1980 - 1989)

(N'000)

Years	Reserves (R)	Assets (A)	Bad Debts (B)	Loans & Advances (L)	Customers Deposits (C)	Net Earnings (N)
1980	500	90904	1141	438298	650231	51287
1981	500	81730	6516	534466	758595	53059
1982	500	92689	5873	542189	692771	56618
1983	500	142409	5149	654174	942798	59328
1984	500	187834	4701	615476	1,090,097	-11423
1985	500	192265	3510	689834	1081104	7461
1986	500	211706	1068	773150	1190149	-32974
1987	500	225358	21336	865758	1355583	-16281
1988	500	477198	42107	968086	1753737	-156575
1989	500	427922	10633	1152463	2254358	23702

Source: Annual Reports and Statement of Accounts (Various Years)

The regression results for the African Continental Bank (ACB) Plc is as follows:

$$N = 46327.8925 - 4.2052B \qquad (1)$$
$$(-3.9298)$$

$R^2 = 0.6588, \quad F = 15.444, \quad DW = 1.8280$

$$N = 120289.9864 - 0.1616L \qquad (2)$$
$$(-1.8208)$$

$R^2 = 0.2930, \quad F = 3.315, \quad DW = 2.5170$

$$N = 85020.8436 - 0.0693C \qquad (3)$$

$$R^2 = \qquad (-1.7810)$$

$$R^2 = 0.2839, \quad F = 3.172, \quad DW = 2.3574$$

$$N = 79791.4437 - 0.3585A \qquad (4)$$

$$(-3.1986)$$

$$R^2 = 0.5612, \quad F = 10.231, \quad DW = 2.0268$$

$$N = -9614.5619 + 0.1952L - 0.4949A - 2.2277B \qquad (5)$$

$$(1.2417) \quad (-1.6336) \quad (-1.3954)$$

$$R^2 = 0.7697, \quad F = 6.683, \quad DW = 1.1004$$

$$N = -32521.5725 + 0.2739L - 0.7613A \qquad (6)$$

$$(1.7517) \quad (-3.0368)$$

$$R^2 = 0.6949, \quad F = 7.973, \quad DW = 1.1239$$

$$N = 47785.6053 + 0.0625L - 3.9059B - 0.0422C \qquad (7)$$

$$(0.1760) \quad (-2.6286) \quad (-0.2788)$$

$$R^2 = 0.6715, \quad F = 4.088, \quad DW = 1.8478$$

Equations (1) and (4) show that both the Bad and Doubtful debts and the Assets Variables were correctly signed and significant at the 1% level in contributing to the earnings of the bank. The Loans and Advances and the Customers Deposits assumed wrong signs - when taken separately. The Reserves Variables had a zero variance possibly because of the constant ₦500,000 which the variable maintained over the study period.

When a multiple regression of the variables was taken in equation (5), the Loans and Advances, Assets and Bad and Doubtful debts had the right economic signs and were significant at the 50% and 20% levels.

Thus, the bank should increase its Loans and Advances to Customers while trying as much as possible to reduce its bad debts figures and its assets. This will further allow it have more money at its disposal to Loan out.

Also, equation (7) suggests that the bank should endeavour to make policies and adopt management strategies that would encourage more customers to deposit with it.

Summary

The results obtained from the analysis of the four case study banks tend to disprove our earlier stated hypothesis. Thus, we would accept the alternative that Loans and Advances are important in the portfolio management of commercial banks since it has been shown through this study that it is significant in contributing to the net earnings of these banks.

The work has also shown that banks whether of the large, medium or small-size need to adopt management strategies that would enable them attract more customers and thus make more loans available to potential applicants so as to maximize their net earnings. This is very necessary especially in this period of Structural Adjustment when the competition in the industry can best be described as keen.

4.2 HYPOTHESIS II

This hypothesis states that:

H_o: There is an inverse relationship between the

Loans and Advances granted by commercial banks and their profit earnings.

H_A: There is a direct relationship between the Loans and Advances granted by commercial banks and their profit earnings.

This hypothesis is tested using the Correlation coefficient - r, existing between the Loans and Advances and the net earnings of the individual case study banks.

CASE STUDY BANK I - UNITED BANK FOR AFRICA (UBA) PLC

Table 11

Loans and Advances and Net Profit of (UBA) Plc 1980 - 1989 (₦'000)

Years	Loans and Advances - L	Net Profit - N
1980	864,836	20036
1981	1161,294	22715
1982	1519,426	26602
1983	1619,691	29279
1984	1553,263	31482
1985	1409,137	34193
1986	1471419	42081
1987	1798,628	73653
1988	2008,138	54766
1989	3044,131	64764

Source: Annual Reports and Statement of Accounts (Various Years)

The correlation Coefficient for the above data is +0.7514. This means a high positive correlation between the Loans and Advances granted and the Net profit of the Bank within the study period.

Put differently, this suggests that as the Loans and Advances granted by the bank increases the net profit increases alongside.

The above finding disproves our stated hypothesis and thus the alternative is accepted, that is, that there is a direct relationship between the Loans and Advances granted by the bank and its net profit.

The bank should therefore grant more and more Loans and Advances to its customers as this increases its net profit.

CASE STUDY BANK II - FIRST BANK OF NIGERIA (FBN) PLC

Table 12

Loans and Advances and Net Profit of FBN Plc

1980 - 1989 (₦'000)

Years	Loans and Advances	Net Profit
1980	1039239	17967
1981	1339420	28402
1982	1490132	25233
1983	1376705	29850
1984	1402456	29144
1985	1474541	53404
1986	1869452	86625
1987	2047113	68013

1988	2253388	74224
1989	1851481	57098

Source: Same as for table 7

The correlation Coefficient resulting from the two sets of data above is +0.8731. This is a high positive degree of association between the two Variables - Loans and Advances and the Net Profit earned by the bank over the period under consideration. As before, it follows that as the Loans and Advances increase so also does the net profit accruing to the bank.

This debunks our hypothesis and the alternative is accepted, namely, that a direct relationship exists between the Loans and Advances granted by the bank and the net profit it earns.

CASE STUDY BANK III - CO-OPERATIVE AND COMMERCE BANK OF NIGERIA (CCB) PLC 1989 - 1990 (₦'000)

Table 13

Loans and Advances and Net Profit of CCB Plc 1980 - 1989 (₦'000)

Years	Loans and Advances	Net Profits
1980	62424	3064
1981	81194	3978
1982	112416	2716
1983	146053	632
1984	190675	829

1985	221570	433
1986	262179	3798
1987	296099	3232
1988	382646	3222
1989	445339	5974

Source: Same as for table 7

The Correlation Coefficient here is +0.4399 which indicates a low positive degree of association between the Loans and Advances and the net profits of the bank. It follows that low values of Loans and Advances are associated with low values of net profit.

The positive sign of the relationship shows however that as one of the variables increases the other also increases but at a slow rate.

This finding also disagrees with our earlier hypothesis, so the alternative hypothesis is accepted. The bank should endeavour to give out more Loans and Advances in order to earn more profit.

CASE STUDY BANK IV - AFRICAN CONTINENTAL BANK (ACB) PLC

Table 14

Loans and Advances and Net Profit of ACB Plc

1980 - 1989 (₦'000)

Years	Loans and Advances	Net Profit
1980	438298	51287
1981	534466	53059
1982	542189	56618

1983	654174	59328
1984	615476	-11423
1985	689834	7461
1986	773150	-32974
1987	865758	-16281
1988	968086	-156575
1989	1152463	23702

Source: Same as for table 7

The Correlation Coefficient resulting from the data above is -0.5413. This means a high negative association between the Loans and Advances granted by the bank and the corresponding net profit over the study period.

This result agrees with our hypothesis. This economically means that the bank has not been doing very well in terms of profit generation. Thus, it should try to reduce is Reserves and Asset values to have more loanable funds at its disposal.

4.3 HYPOTHESIS III

This hypothesis is that;

H_0: The Loans and Advances management strategies of commercial banks over the years have not been effective.

H_A: The Loans and Advances management strategies of commercial banks over the years have been effective.

The hypothesis is tested by recourse to the use of questionnaires. The survey data resulting from the questionnaires is tested by the use of contingency tables and the X^2 (chi-squared) tests. Simple percentages of the data is as well computed.

As stated earlier in the methodology, the questionnaire is administered to three categories of staff in the credit department of each of the case study banks, namely; credit officers, credit supervisors and credit clerks. The United Bank for Africa (UBA) Plc and the First Bank of Nigeria (FBN) Plc each had one hundred and eighty (180) administered questionnaires. The African Continental Bank (ACB) Plc had one hundred and fifty (150) questionnaires administered. While the Co-operative and Commerce Bank (CCB) Plc had one hundred and twenty (120) questionnaires administered. Thus, six hundred and thirty (630) questionnaires are administered nationwide and returned as the data below shows.

CASE STUDY BANK I - UNITED BANK FOR AFRICA (UBA) PLC

In response to question number 8, that is; How do you perceive the effectiveness of your bank's loans and advances management strategies over the period (1980 - 1989)?

The following is the survey data:

Table 15

DEGREE OF PERCEIVED EFFECTIVENESS OF THE LOANS AND ADVANCES MANAGEMENT STRATEGIES OF UBA PLC

Scale	Category of Staff					
	Credit Officers	%	Credit Supervisors	%	Credit Clerks	%
1	-	-	-	-	-	-
2	20	36.36	18	33.96	25	48.08
3	12	21.82	18	33.96	12	23.07
4	19	34.55	7	13.21	13	25.00
5	4	7.27	6	11.32	2	3.85
6	-	-	4	7.55	-	-
7	-	-	-	-	-	-
Total	55	100	53	100	52	100

Source: Survey Data

Scale: Ranging from (1) = Extremely Effective
(2) = Quite Effective
(3) = Slightly Effective
(4) = Neither Effective nor ineffective
(5) = Slightly ineffective
(6) = Quite ineffective
(7) = Extremely ineffective

Table 16

OBSERVED AND EXPECTED FREQUENCIES FROM TABLE 15

Respondents	High(x)	%	Undecided(Y)	%	Low(Z)	%	Total
Credit Officers (A)	32(36.09)	58.18	19(13.41)	34.55	4(5.5)	7.27	55
Credit Supervisors(B)	36(34.78)	67.92	7(12.92)	13.21	10(5.3)	18.87	53
Credit Clerks (C)	37(34.13)	71.15	13(12.68)	25.00	2(1.95)	3.85	52
Total	105		39		16		160

Source: Computed from table 15

Table 17

COMPUTATION OF X^2 FROM TABLE 16

Cell	O	E	O-E	$(O-E)^2$	$(O-E)^2/E$
AX	32	36.09	-4.99	16.73	0.46
AY	19	13.41	5.59	31.25	2.33
AZ	4	5.5	-1.5	2.25	0.41
BX	36	34.78	1.22	1.49	0.04
BY	7	12.92	-5.92	35.05	2.71
BZ	10	5.30	4.7	22.09	4.17
CX	37	34.13	2.87	8.24	0.24
CY	13	12.68	0.32	0.10	0.007
CZ	2	1.95	0.05	0.002	0.001
Total	160				$10.37 = X_c^2$

$df = (h-1)(k-1)$ (see: Loveday, R. (1977)

$= (3-1)(3-1)$

$= 2 \times 2 = 4$

$X_C^2 (0.05) = 9.48$

Decision rule:

If $X_C^2 > X_4^2 (0.05)$

Reject H_0 (i.e. Null Hypothesis) otherwise

Accept H_0: This means that the difference between the observed and expected frequencies are significant.

Thus,

$10.37 > 9.48$

Therefore, we reject our Null Hypothesis and accept the Alternative hypothesis. It follows from our finding that the United Bank for Africa's Loans and Advances management strategies over the study period had been effective as the respondents have shown.

* Note that; O = Observed frequencies

E = Expected frequencies

df = Degrees of freedom

The test is conducted at the 5% level of significance.

CASE STUDY BANK II - FIRST BANK OF NIGERIA (FBN) PLC

Table 18

DEGREE OF PERCEIVED EFFECTIVENESS OF THE LOANS AND ADVANCES MANAGEMENT STRATEGIES OF THE BANK

Scale	Category of Staff					
	Credit Officers	%	Credit Supervisors	%	Credit Clerks	%
1	-	-	-	-	-	-
2	23	44.23	22	42.31	25	49.02
3	10	19.23	8	15.38	7	13.73
4	16	30.77	19	36.54	7	13.73
5	3	5.77	2	3.85	8	15.68
6	-	-	1	1.92	4	7.84
7	-	-	-		-	-
Total	52	100	52	100	51	100

Source: Survey Data

Scale: Ranging from (1) = Extremely Effective
(2) = Quite Effective
(3) = Slightly Effective
(4) = Neither Effective nor ineffective
(5) = Slightly ineffective
(6) = Quite ineffective
(7) = Extremely ineffective

Table 19

OBSERVED AND EXPECTED FREQUENCIES FROM TABLE 18

Respondents	High(x)	%	Undecided(Y)	%	Low(Z)	%	Total
Credit Officers (A)	33(31.87)	63.46	16(14.09)	30.77	3(6.04)	5.77	52
Credit Supervisors(B)	30(31.87)	57.69	19(14.09)	36.54	3(6.04)	5.77	52
Credit Clerks(C)	32(31.26)	62.75	7(13.82)	13.73	12(5.92)	23.52	51
Total	95		42		18		155

Source: Computed from table 18

Table 20

COMPUTATION OF X^2 FROM TABLE 19

Cell	O	E	O-E	$(O-E)^2$	$(O-E)^2/E$
AX	33	31.87	1.13	1.28	0.04
AY	16	14.09	1.91	3.65	0.26
AZ	3	6.04	-3.04	9.24	1.53
BX	30	31.87	-1.87	3.49	0.11
BY	19	14.09	4.91	24.11	1.71
BZ	3	6.04	-3.04	9.24	1.53
CX	32	31.26	0.74	0.55	0.02
CY	7	13.82	-6.82	46.51	3.37
CZ	12	5.92	6.08	36.97	6.24
Total	155				$14.81 = X_c^2$

$$df = (h-1)(k-1)$$

$$= (3-1)(3-1)$$

$$= 2 \times 2 = 4$$

$X_c^2 = 14.81$

$X_4^2\ (0.05) = 9.48$

Decision rule:

If $X_c^2 > X_4^2\ (0.05)$

Reject H_o, otherwise Accept H_o

Thus,

$14.81 > 9.48$

Therefore, we reject our null hypothesis. This means that the Loans and Advances management strategies of the First Bank of Nigeria Plc within the study period had been effective as perceived by the staff in the credit departments nation-wide.

CASE STUDY BANK III - CO-OPERATIVE AND COMMERCE BANK OF NIGERIA (CCB) PLC

Table 21

DEGREE OF PERCEIVED EFFECTIVENESS OF THE LOANS AND ADVANCES MANAGEMENT STRATEGIES OF THE BANK

Scale	Category of Staff					
	Credit Officers	%	Credit Supervisors	%	Credit Clerks	%
1	-	-	-	-	-	-
2	14	40	13	40.62	15	40.54
3	7	20	9	28.13	8	21.62

4	3	8.57	5	15.63	2	5.41
5	6	17.14	2	6.25	7	18.92
6	5	14.29	3	9.37	5	13.51
7	-	-	-	-	-	-
Total	35	100	32	100	37	100

Source: Survey Data

Scale: Ranging from: (1) =Extremely Effective

(2) = Quite Effective

(3) = Slightly Effective

(4) = Neither Effective nor ineffective

(5) = Slightly ineffective

(6) = Quite ineffective

(7) = Extremely ineffective

Table 22

OBSERVED AND EXPECTED FREQUENCIES FROM TABLE 21

Respondents	High (X)	%	Undecided(Y)	%	Low(Z)	%	Total
Credit Officers(A)	21(22.21)	60	3(3.37)	8.57	11(9.42)	31.43	35
Credit Supervisors(B)	22(20.31)	68.75	5(3.08)	15.63	5(8.62)	15.63	32
Credit Clerks(C)	23(23.48)	62.16	2(3.56)	5.41	12(9.96)	32.43	37
Total	66		10		28		104

Source: Computed from table 21

Table 23

COMPUTATION OF X^2 FROM TABLE 22

Cell	O	E	O-E	$(O-E)^2$	$(O-E)^2/E$
AX	21	22.21	-1.21	1.46	0.07
AY	3	3.37	-0.37	0.14	0.04
AZ	11	9.42	1.58	2.49	0.26
BX	22	20.31	1.69	2.86	0.14
BY	5	3.08	1.92	3.69	1.19
BZ	5	8.62	-3.62	13.10	1.52
CX	23	23.48	-0.48	0.23	0.009
CY	2	3.56	-1.56	2.43	0.68
CZ	12	9.96	2.04	4.16	0.42
Total	104				$4.33 = X_c^2$

$$df = (h-1)(k-1)$$
$$= (3-1)(3-1)$$
$$= 2 \times 2 = 4$$
$$X_c^2 = 4.33$$
$$X_4^2\ (0.05) = 9.48$$

Decision rule:

If $X_c^2 > X_4^2\ (0.05)$

Reject H_o (Null Hypothesis) otherwise Accept H_o. However, in our present analysis we have to accept the Null Hypothesis, that is, that the Loans and Advances management strategies of the Co-operative and Commerce Bank Plc has not been effective over the study period.

This is because $X_c^2 < X_4^2$ (0.05) i.e. $4.33 < 9.48$.

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Table 24

DEGREE OF PERCEIVED EFFECTIVENESS OF THE LOANS AND ADVANCES MANAGEMENT STRATEGIES OF THE BANK

Scale	Category of Staff					
	Credit Officers	%	Credit Supervisors	%	Credit Clerks	%
1	-	-	-	-	-	-
2	18	42.86	12	30	22	45.83
3	6	14.29	8	20	8	16.67
4	11	26.19	12	30	9	18.75
5	5	11.90	7	17.5	8	16.67
6	2	4.76	1	2.5	1	2.08
7	-	-	-	-	-	-
Total	42	100	40	100	48	100

Source: Survey Data.

Scale: Ranging From: (1) = Extremely Effective

(2) = Quite Effective

(3) = Slightly Effective

(4) = Neither Effective Nor ineffective

(5) = Slightly ineffective

(6) = Quite ineffective

(7) = Extremely ineffective

Table 25

OBSERVED AND EXPECTED FREQUENCIES FROM TABLE 24

Respondents	High (X)	%	Undecided(Y)	%	Low(Z)	%	Total
Credit Officers(A)	24(23.91)	57.15	11(10.34)	26.19	7(7.75)	16.66	42
Credit Supervisors(B)	20(22.77)	50	12(9.85)	30	8(7.38)	20	40
Credit Clerks(C)	30(27.32)	62.5	9(11.82)	18.75	9(8.86)	18.75	48
Total	74		32		24		130

Source: Computed from table 24

Table 26

COMPUTATION OF X^2 FROM TABLE 25

Cell	O	E	O-E	$(O-E)^2$	$(O-E)^2/E$
AX	24	23.91	0.09	0.008	0.0003
AY	11	10.34	0.66	0.44	0.04
AZ	7	7.75	-0.75	0.56	0.07
BX	20	22.77	-2.77	7.67	0.34
BY	12	9.85	2.15	4.62	0.45
BZ	8	7.38	0.62	0.38	0.05

CX	30	27.32	2.68	7.18	0.26
CY	9	11.82	-2.82	7.95	0.67
CZ	9	8.86	0.14	0.02	0.002
Total	130				$1.88 = X_c^2$

$$df = (h-1)(k-1)$$
$$= (3-1)(3-1)$$
$$= 2 \times 2 = 4$$
$$X_c^2 = 1.88$$
$$X_4^2\ (0.05) = 9.48$$

Decision rule

If $X_c^2 > X_4^2\ (0.05)$

Reject H_o, otherwise accept H_o. Our present finding is that $X_c^2 < X_4^2\ (0.05)$ i.e. $1.88 < 9.48$. Therefore, we have to accept the earlier hypothesis that the Loans and Advances management strategies of the African Continental Bank Plc during the study period (1980 - 1989) was not effective as our finding has shown.

<u>Summary</u>

Our finding here reveals that the big-sized banks, namely; the United Bank for Africa Plc and the First Bank of Nigeria Plc, are better managers of Loans and Advances than the medium and small-sized banks, the co-operative and Commerce Bank Plc and the African Continental Bank Plc and therefore are much more liquid and able to grant further Loans and Advances to potential applicants. This is probably so because of the relative ages, sizes and the nature of the clientele these banks maintain.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION, AND RECOMMENDATIONS

5.1 Summary

This study tried to appraise the effectiveness of commercial banks' Loans and Advances management strategies over the period 1980 to 1989. A period in the Nigerian economy that was characterised with various policy measures among which is the current Structural Adjustment Programme (SAP).

We traced the history and the development of the banking industry in Nigeria. The emergence of indigenous commercial banking and their eventual collapse in the fifties received attention. Again, the new era of banking boom in the economy, the emergence of new products, the increased competition in the industry and the various policy measures adopted by these banks to remain afloat were considered.

This work also examined the requirements for bank lending and established that among the canons of good lending include, the knowledge of the amount for which a loan is sought, the purpose of the loan, duration, repayment ability, strength of the business, security and who the borrower is. Also, the types of credit facilities offered by commercial banks and the risks associated with bank lending, namely the risk of possible default and illiquidity were emphasised.

The securities for bank lending and the loans management, administration and recovery strategies including the possibility of fraudulent practices among bankers were identified.

Again, the new accounting requirements made possible through the prudential guidelines for licensed Banks in Nigeria was highlighted.

We were able through a simple and multiple regression analyses to show that Loans and Advances are an important and significant item in the asset portfolio of commercial banks and that if properly managed a bank can continuously remain liquid and profitable. The study further revealed that in general banks should try to reduce the amounts provided as bad and doubtful debts, Assets and Reserves in their yearly operations.

The study also showed through a correlation analysis that there exists a direct relationship between the Loans and Advances granted by commercial banks and their net.earnings. Specifically, we saw that the big banks - (big in terms of their spread, Assets, Loans and Advances and Deposits, that is the so called SALD index) namely, the United Bank for Africa Plc, and the First Bank of Nigeria Plc, had high positive degree of association between their Loans and Advances and their net earnings over the study period. The African Continental Bank Plc had a negative correlation implying that the bank has had difficulty over the years in managing its Loans and Advances.

Further investigations from questionnaire responses from three categories of staff of credit departments of the case study banks revealed that the big banks have effectively managed their loans and advances better than the small and medium-sized banks. Specifically, the African Continental Bank had been the most ineffectively managed bank in terms of profit generation over the period under consideration.

.2 Conclusion

This work has endeavoured to appraise the effectiveness of the Loans and Advances management strategies of commercial banks. It was able to show that the big-sized banks are better managers of Loans and Advances and that as a result they remain much more liquid than the small and medium-sized banks. We were also able to establish that Loans and Advances are quite important in the asset portfolio of commercial banks, and should therefore be well managed.

The increased provision for Bad and Doubtful debts and of the Reserves of banks, although an excellent hedge against possible loan default from bank borrowers, they by themselves reduce the potentials of the banks in making more Loans and Advances available to would be customers. Therefore, this study recommends a reduction in their yearly provisions.

5.3 Recommendations

From the findings of this study the following policy recommendations are made to help commercial banks in the management of their credits for maximum profit.

Commercial banks should reduce their provisions for bad and doubtful debts, their fixed assets figures while at the same time increasing the value of their "other assets". Their reserves figure should also of necessity be reduced. All these measures are intended to increase the amount of lonable funds available to commercial banks thus making it possible for them to maximize to their net benefit the reward of their business.

Banks should recognize that Loans and Advances is an important item in their asset portfolio and should therefore device every means of managing it effectively. They should thus ensure that their customers pay back loaned fund as and when due by among other things enforcing the terms of the agreement on each lending contract. They should also monitor the projects for which they have loaned out to ensure compliance and also assess the viability and profitability of a given project for which money is being committed.

While not violating any of the canons of good lending, banks should increase the value of their Loans and Advances made to their customers. Firstly, it makes more money available to investors and businesses thus increasing their ability to carry on their businesses. Secondly, it increases the net profit of the bank as they depend mainly on the Loans and Advances granted for their profit earnings. Lastly, the national economy benefits as every sector ultimately benefits and the economy is booming. A booming economy raises the living standard of its citizens and their general welfare.

The era of arm-chair banking is over, therefore banks should be more aggressive in their attitudes to deposits generation. The keen competition that is variously discussed should not just be on the pages of papers, it should be real. It is not a question of the opening of several banks and several bank branches nation-wide, that in itself does not mean competition. The competition in customer deposits should be seen in terms of the work attitudes of bankers, their ability and willingness to render prompt and efficient services to their customers and their ability to attract new and intending ones. Banks that do not pay interest on customer accounts on a monthly basis and at a competitive interest rate still stand to loose their biggest customers. Also, the issue of new products now introduced by most banks, should be adequately monitored in order not to create room for fraudulent staff and customers who always want to cash in on any potential loophole perceived to exist in any system.

The marketing parlance which holds that "the customer is always right" should stand out in the work ethics by bankers in order to enhance their business. They should regard the customer as the sole and only reliable partner in their business who should therefore be treated with every politeness he deserves.

Because the worker should be seen as the person who ultimately creates wealth and value, the banker should be adequately taken care-of by the management. Bank management should create welfare schemes for their staff. The banker is exposed to a lot of temptation on a daily basis by the volume of monetary transactions that pass through him. In order to diminish his urge to defraud, management should institute enough safe-guards in the system, possibly by way of enhanced pay packet and other non-monetary rewards and incentives.

Moreover, banks should try to demphasize the current "man-know-man" syndrome in their recruitment exercises. Highly qualified personnel should be scouted for and recruited. Orientation and regular training programmes should be organized for staff on a continuous basis to acquaint them with current trends and developments in the industry.

5.4 Suggestions for Future Work

The study we have just carried out is by no means exhaustive and comprehensive. What we have succeeded in achieving here within the limits of available time and funds is to give an insight into the major variables that contribute to or limit the effectiveness of credit departments of banks and by extention the profit generating capacity of commercial banks. We here suggest that further research into this area of study whould go beyond what we have done here by including the following:

(1) Further breaking down of the Assets variable into the "fixed Assets" and "other assets" and "Liquid Assets" as variables in the regression equations.

(2) The Customers deposit should be broken into current accounts, savings account and other accounts of Customers to see which of them best explains or accounts for the net profit generated by commercial banks.

(3) The share capital of the bank should be included as one of the variables to be tested in future research work.

(4) Questionnaire administration should possibly include the customers of the banks on their perception of the operations of the banks under consideration.

(5) The econometric technique of analysis should go beyond the simple and multiple regression approaches adopted in this study to the semi-log and double-log techniques to subject the work to further investigations.

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APPENDIX

School of Project Management
Technology,
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Imo State.

Dear Sir/Madam,

QUESTIONNAIRE

AN APPRAISAL OF THE EFFECTIVENESS OF COMMERCIAL BANKS' LOANS AND ADVANCES MANAGEMENT STRATEGIES: A CASE STUDY OF SOME SELECTED BANKS IN NIGERIA (1980-1989)

I am a post-graduate student of Banking & Finance in the School of Project Management Technology, Federal University of Technology, Owerri. I am carrying out a research on the above topic in partial fulfilment of the requirements for the award of the Master of Science (M.Sc.) degree in Banking and Finance.

I would be most grateful if you could kindly complete the questionnaire below for me. Your response will be treated strictly as confidential because the research is exclusively for academic purposes.

You can mark "X" in the box provided /X/ where appropriate.

Thanks in anticipation.

Yours faithfully,

Bernard O. Enwereuzor

(1) In which of these banks do you work?

(a) UBA (b) FBN

(c) CCB (d) ACB

(2) How long have you worked with the bank?

(a) 1-2yrs (b) 3-5yrs

(c) 6-10yrs (d) 11yrs and above

(3) In what capacities have you worked?

(a) Clerk (b) Supervisor

(c) Officer (d) Manager

(4) In which departments have you been exposed to?

(a) Savings Account (b) Current Account

(c) Loans & Advances (d) Foreign Exchange

(e) Bills (f) Others

(5) If you have worked with the Loans and Advances department, for how long did you or have you been working there?

(a) 6months-1½yrs (b) 1½yrs-2yrs

(c) 2yrs-3yrs (d) Above 3yrs

(6) What factors influence your mode of advancing Loans to customers?

(a) Personal Relationships (b) Good-will

(c) Collaterals (d) Others(Please specify)..

....

(7) If your answer to (6) above is (c), what type of Collaterals do you normally ask for?

(a) Landed Property (b) Share Certificates

(c) Life Policies (d) Guarantees

(e) Debentures

(8.) How do you perceive the effectiveness of your bank's Loans and Advances management strategies over the period (1980-1989)?

(a) Extremely effective /__/ (b) Quite effective /__/

(c) Slightly effective /__/ (d) Neither effective nor ineffective /__/

(e) Slightly ineffective /__/ (f) Quite ineffective /__/

(g) Extremely ineffective /__/

(9) Who are your major customers?

(a) Private Individuals /__/
(b) Corporate Bodies /__/
(c) Private businesses /__/

(10) Apart from the items in (7) above what other things may you require from your customers while granting Loans and Advances?

....

(11) In the event of a customer failing to repay his/her loan as and when due, what measures do you take to recover your loan?

(a) Persuasion /__/ (b) Legal Action /__/

(c) Auctioning of Collaterals /__/

(d) Others (Please specify)..............................