BANK LOAN MONITORING AND LOAN PERFORMANCE: A STUDY OF DEPOSIT MONEY BANKS IN NIGERIA

BY

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DECLARATION

I declare that this thesis entitled "Bank loan monitoring and loan performance: A study of deposit money banks in Nigeria" has been carried out by me in the Department of Business Administration. The information derived from literature has been duly acknowledged in the text and a list of references provided. To the best of my knowledge no part of this thesis was previously presented in this or any other institution for the award of another degree or diploma.

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CERTIFICATION

This thesis entitled "Bank loan monitoring and loan performance: a study of deposit money banks in Nigeria" by Isma'il Tijjani IDRIS meets the regulations governing the award of the Degree of Master of Science in Business Administration of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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ABSTRACT

For banks to achieve their goals there is the need to put in place structures that will keep loans active within the acceptable ratios defined by regulatory authorities. Notable among these structures are the internal procedures designed to ensure appropriate procedure for credit appraisals, objective approvals of loan applications and proper credit administration of all disbursed funds. Despite these, empirical evidences portray a different and disturbing picture as consistently the Nigeria banking system is characterized with high ratio of non-performing loans, banks liquidity crises, shrinking profitability, general losses, eventual corporate failures and finally financial crises. These cast doubts as regards the institutionalization of loan monitoring mechanism in the banking system. This study sought to establish whether there is a relationship between bank loan monitoring and loan performance among Deposit Money Banks (DMBs) in Nigeria. The survey and correlational designs were adopted for the study. The research hypotheses were tested using Chi-Square and correlation techniques. The study found that there is a relationship between loan monitoring and loan performance among DMBs in Nigeria. It is therefore concluded that there is a relationship between bank loan monitoring and loan performance and that the more effective and efficient the monitoring the higher the loans will remain active. The study among other things recommended that DMBs should design more rigorous and effective mechanisms such as being proactive in handling the bad loan through restructuring and/or work out arrangements as the early warning signals of bad loans begin to set in or sell them to the secondary loan markets. The banks are also recommended to come up with reward and punishment system on their staff concerned with loan monitoring, which should also form part of their Key Performance Indicators (KPIs) as well as establishing a mutual collaboration with their borrowing customers in ensuring that their loans are made to remain active throughout the period of the loans.

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CHAPTER ONE

INTRODUCTION

1.1 Background to the study

The existence of banks suggests they perform functions of intermediation between borrowers and savers more efficiently than is available via direct exchange in capital markets, (Richard, Kim, Ma& Martin 2011). Deposit Money Banking (DBM) plays an important role in the development of world economies, where it serves as a vehicle that channels excess funds from those economic units that have surplus money in form of deposits and/or investments to those that are in need of ideal productive funds to boost their economic activities in form of loans and advances. This has made the role of DMBs in facilitating economic growth imperative. From this we can comfortably reach some level of generalization that the essence of these banks is taking deposits from liability customers and making same available to their assets customers by way of granting loans/credit facilities.

However, in Nigeria this role is being played through a well-guided credit process by banks under the checks of regulatory authorities such as Central Bank of Nigeria (CBN) and Nigerian Deposit Insurance Corporation (NDIC). Therefore, the banks and the regulatory authorities are charged with the responsibility of ensuring that the depositors' funds are not lost and that the desired level of economic growth and developments are achieved. For both the banks and the regulatory authorities to achieve the responsibilities conferred on them, all various loans offered by the banks must be kept at an acceptable performance level stipulated by the regulatory authorities.

Loan performance in Nigeria has been a major source of concern not only to commercial banks and the regulatory authorities but also to other stakeholders, be them funds depositors, stockholders and/or the general public, whether as individual and/or corporate citizens and potential foreign investors. This is due to the existence of huge ratio of non-performing loans that leads to liquidity crises.

The non-performing loans may also impact negatively on the overall profit of banks and their share prices. It may affect the banks' profits because the revenues derived by them will have to be backed out by way of provisioning of interests and other write offs. This may negatively affect the market value of their share prices. This might have been the reasons that the banks have undergone through series of reforms in the Nigerian banking history.

The history of banking in Nigeria can be traced to the early 1890s which came about with the sole purpose of supporting trading activities between London and what is today known as Nigeria. It all started with African Banking Corporation (ABC) which was a British Overseas bank that had its Headquarters in London but with virtually all its branches abroad. It was Mr. George William Neville of Elder Dempster& Co Ltd who took the initiative and approached ABC with the request to set up the branch. His proposal was accepted in 1891 by the London board of ABC and in 1891 ABC founded its branch in Lagos. Neville of Elder Dempster became its first Branch Manager. In 1893 ABC sold its Lagos newly-created branch to Elder Dempster and was renamed as Bank of British West Africa (BBWA) and became formally incorporated in 1894 in London. The bank had a very good time banking activities and spread to what it is today called Ghana and Sierra Leone. In the 1970s, indigenous exercise changed the ownership

structure of banking industry among others. Most of the banks were not nationalized until such a period under military rules that privatization and commercialization policies came on board and paved way for more exclusive private individual participations, Goldface (2007).

From 1990s to date the Nigerian banking system has been undergoing various restructuring and consolidations to the extent that we now have a new regime of Central Bank of Nigeria (CBN)'s new Banking Model. On continual basis, the banking sector has been running into one financial crises or the other revolving basically around liquidity risks, interest risk and/or credit risks, which eventually result into corporate failures of banks. These systemic risks, in most cases translate into general and bigger economic crises and dearth of the real sector.

Federal Government of Nigeria has also been playing the role of a stabilizing force through its fiscal and monetary policies which are always at the expense of tax payers and/or Nigeria's hard earned crude oil sales proceeds. A typical example was its response to the 2008 banks crises which were created out of negligence of some Chief Executive Officers (CEOs) of deposit money banks. The crises were indeed borne out of insider credits, none adherence to the prudential guidelines and/or none disclosure of the bad loan portfolios and lack of good Corporate Governance, which eventually landed the banking sector into another liquidity crises (CBN, 2010). The CBN promptly intervened in arresting the situation although at the initial expense of tax payers' money that ran to over Five Hundred Billion Naira (=N=500 billion) which has eventually led to the creation of Asset Management Corporation of Nigeria (AMCON) with over One Trillion Naira assets base.

It is on the above basis that the study investigates the relationship between bank monitoring and loan performance of DMBs in Nigeria.

1.2 Statement of the problem

Banks like any other profit oriented financial organisations are expected to achieve various goals. Some of these goals comprise of creating conducive atmosphere of ensuring the safety of depositors' funds, making loanable funds available to the real sector of the economy and meeting the expectations of other stakeholders.

For the banks to achieve their goals there is the need to put in place structures that will keep loans active within the acceptable ratios defined by regulatory authorities. Notable among these structures are the internal procedures designed to ensure appropriate credit appraisals, objective approvals of loan applications and proper credit administration of all disbursed funds. Despite these, the situation on ground portrays a different and disturbing picture as consistently the Nigeria banking system is characterized with high ratio of non-performing loans, banks liquidity crises, shrinking profitability or general losses and eventual corporate failures and general financial crises. These cast doubts as regards the institutionalization of loan monitoring mechanism in the banking system.

The regulatory authorities came up with series of measures aimed at maintaining a stable, vibrant and efficient banking system, yet the problem persists as banks that are thought to be solvent and efficient have proved otherwise compelling another regulatory intervention through bail-outs programmes, restructuring and abolishing of universal banking regime and other self-induced mergers and acquisitions amongst the banks in

2008/2009 financial years. These kinds of phenomena trigger set of questions as what might be the root cause of the problem.

There were attempts by various studies conducted to determine the root causes of financial crises in the Nigerian DMB banking system. However, conflicting views exist amongst the studies, and most of them were conducted before the emergency of the recent reform. Similarly, the studies did not focus on the relationship between bank loan monitoring and non-performing loans.

Although, there are number of studies carried out on DMBs and the general banking crises and the way forward, but to the best of our knowledge and the available information before us we have not come across a study that deals with bank loan monitoring and loan performance of deposit money banks in Nigeria. It is against the above backdrop that this evaluatesthe relationship between bank loan monitoring and loan performance in Nigeria.

1.3 Research Questions

In line with the statement of the problem, the study aims at answering the following questions at the end:

i) What is the relationship between loan monitoring and loan performance in the deposit money banks in Nigeria?

ii) Is there any relationship between bank's ratio of non-performing loans and deposit money bank's profitability in Nigeria?

iii) Is there any relationship between bank's non-performing loans and bank share price in Nigeria?

1.4 Objectives of the study

In order to guide the conduct of this study the following objectives were set for the study:

i. To determine whether there is any significant relationship between Loan Monitoring and Loan performance among deposit money banks in Nigeria.

ii. To examine whether any relationship exists between bank's ratio of non-performing loans and deposit money bank's profitability in Nigeria.

iii. To determine whether there is any significant relationship between bank's non-performing loans and bank share price in Nigeria.

1.5 Statement of Hypotheses

In order to achieve the objectives of this study, the following hypotheses have been formulated and tested:

$H0_1$: There is no significant relationship between Loan Monitoring and Loan performance among deposit money banks in Nigeria.

$H0_2$: There is no significant relationship between bank's ratio of non-performing loans and deposit money bank's profitability in Nigeria.

$H0_3$: There is no significant relationship between bank's non-performing loans and bank share price in Nigeria.

1.6 Significance of the study

The result of the study is expected to be of significance tothe practitioners and regulatory authorities who are usually confronted with the responsibility of managing the banking crises. Its findings, conclusions and recommendations can be relied upon in ensuring appropriate policy formulations and practices that will ensure effective and efficient DMBs system in Nigeria.

It is also expected that the research result will expand the frontier of knowledge on bank loan monitoring and loan performance and credit/Loan administration. The study will serve as a point of reference for researchers who might conduct studies in the same or related areas as well as students and/or academics in the field of banking and finance.

It is also envisaged that the result will be of help to banking policy makers in creating a sustainable framework of quality credit risks management in Nigeria. Its findings, conclusions and recommendations can be relied upon in ensuring appropriate policy formulations and practices that will ensure effective and efficient DMBs system in Nigeria.

1.7 Scope of the study

The study is restricted to evaluating the effect of bank loan monitoring on the performance of loans. It has also assessed the banks' monitoring in keeping the loans within the industry acceptable standards. The entire 20 DMBs in Nigeria were considered in the study. Various categories of loan performance and the tools available to the banks in monitoring their loanswere also considered. The study was also carried out within Nigeria. The time frame of the study was from 2005 to 2011. The choice of the time frame was on based on the need to examine the relationship between bank loan monitoring and loan performance post the 2004 bank

consolidation exercise that called for banks recapitalisation to the tune of 25 Billion Naira.

1.8 Limitations of the study

First, the study is partly (that is, for hypothesis II and III) restricted to only those banks that are quoted on the Nigerian Stack Exchange where private limited liability banks were filtered out due to non-existence of their data in the NSE, hence the non-existence of the share prices.

The second limitation was on the fact that the study relied heavily on secondary data of the banks for the period 2005 through 2008, for testing hypothesis II and III. The data were widely believed to be marred by inaccurate financial details on declaration of non-performing loans, inflated profitability and high share prices.They were sometimes considered to be smoothed by the concerned parties. Therefore smoothing effect may somehow create distortion on the actual situation on ground.

Despite the above limitations highlighted, it has in no way significantly affected the results of the study. These are due to the fact that the number of the private limited liability banks compared to those of quoted bank is trivial and that the former also operate in a similar way as the latter.

On the distortion effect that data smoothing might create, the study made use of primary data to supplement the secondary data. The study also made use of the regulatory authorities' reports, that is, CBN and NDIC on banks assessment.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter reviews various studies conducted in similar areas by other researchers covering loans monitoring, various tools used in loan monitoring and general credit administration, bank loan monitoring, credit appraisals and administration.

2.2 Concept of Loan Monitoring

The concepts of loan monitoring and loan performance are central to the study as they serve as the basis upon which the study is conducted. This is essential as the study investigated the relationship between bank loan monitoring and loan performance.

2.2.1 Loan Monitoring

Loan Monitoring is an integral part of quality credit that should ensure credit facilities remain within the performing loan circle. It is a system of bank control over the entire process of lending, which is usually manifested in the constant control of the passage of individual (personal and corporate) loans, as well as the quality of the loan portfolio as a whole. Kargi (2011) maintains that there is a significant relationship between bank performance (in terms of profitability) and credit risk management (in terms of loan performance). Loans and advances and non-performing loans are major variables in determining asset quality of a bank. These risk items are important in determining the profitability of banks in the world. Where a bank does not effectively manage its risk, its profit will be unstable. He opined that the profit after tax has been responsive to the credit policy of Nigerian banks. The deposit structure also affects profit performance. According toAremu, Suberu and

Oke (2010) loan monitoring which is the work of the relationship manager in most cases is not a choice but an imperative for effective and efficient credit (loan) administration in the banking sector. The banker's experience, knowledge of the customer's business (transaction dynamics) and above all, faith in the customer can be a guide in taking a decision as to how far the customer can be supported before declaring the loan as bad.

Lending is one of the major business activities for most money deposit banks. Loan portfolio is indeed the largest asset and the predominant source of banks' revenue. In the same logic it is one of the greatest sources of risk to banks' soundness and safety. As it has been observed over the years, whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of bank losses and failures. Effective loan monitoring is fundamental to bank's safety and soundness. This is usually achieved through Loan Portfolio Management (LPM), which by way of definition is a process by which risks that are inherent in the credit process are managed and controlled. In other words LPM involves the steps bank management takes to identify and control risks throughout the loan monitoring process. This assessment focuses on what management does to identify loan issues before they culminate into loan problems.

For decades, traditional practices rely heavily on trailing indicators of loan quality such as delinquency, nonaccrual, and risk rating trends. Today banks have found that these indicators do not provide sufficient lead time for corrective actions when there is a systemic increase in risk, hence, the need for careful monitoring of loans performances.

There are basically two types of loan monitoring. These are monitoring of the borrower(s) by the bank and monitoring of the lending bank(s) by the regulatory authorities.

This research and/or literature review is basically concerned with the first type, that is, themonitoring of the borrowers by the bank. All units of the bank should participate in the monitoring of the borrowers: legal, collateral security, operations, internal control and foreign exchange operations. The Credit department will always retain its dominant role of loan administration. The Relationship Managers (RMs) and Loan Officers (LOs) are obliged to fix the monitoring activities and report regularly about the progress made with the submission of the analytical conclusions about the level of risks for each loan, while the Chief Credit Managers on the other hand will be concerned about a bank's loan portfolio as a whole. The Customers/borrowers are not exempted from the monitoring function because the success or otherwise of loans depends partly on their credit culture. Ernst and Young (2010), report that creating and embedding an effective risk culture supported by a sustainable risk and control framework is one of the top agenda items for senior management. This calls for full institutionalization of a strong risk culture and making risk everyone’s business and making a significant shift in mindset, policies, systems and processes. Any monitoring failure on the part of either the lending bank or the borrowing customer could lead to provision, which devastate into liquidity crises. Historically in Nigeria, a liquidity crisis in one bank generates multiplier effect on other banks as well as the financial sector hence the need for banking reforms.

2.2.2 Loan Performance

Loan performance revolves around the extent to which the loans being disbursed by the banks are being repaid as at when due. This is made up of the repayment of the principal amount involved in the loan and the ability of the borrower to service the loans through the payment of interests and other bank charges, which might have been stated in the loan offer letter as covenant. The said repayments of the principal as well as the interest as at when due are key indicators of whether the loan is performing or not. Various countries around the world have developed different methods of loan classifications and have charged different organs of the banking sector with the responsibilities of keeping the loans within the acceptable limits set by the regulatory authorities

2.3 Objectives of Monitoring Loans

The essence of every monitoring is to ensure full compliance with the loan agreement such as ensuring that the loan is being used for the eligible purposes, the quality of the loan will be maintained in the future and its repayment sources are protected in order to guard against unacceptable deterioration of the credit. Strahan (1999) argued that once a loan is made, banks monitor the actions of borrowers to protect their investment. In practice, monitoring comes down to refusing to renew a loan that has reached its maturity (or "calling" a loan early when a borrower has failed to meet the terms of the loan contract), reconstructing with distressed borrowers, and efficiently salvaging collateral when borrowers default. Haas and Horen (2010) stated that the subprime crisis and subsequent global crisis have brought bank finances firmly to public attention, with many calling for stronger

regulation. They argue that the crisis offered a “wake-up call” for banks, prompting them to screen and monitor their corporate borrowers more carefully without the need for more regulation. It should be noted that the “wake-up call” cannot and should not be restricted to corporate borrowers but all borrowers whether in consumer banking or public sector banking.

The following are some of the objectives of bank loan monitoring: Ensure timely repayment of the loan, protection of the bank's assets from losses, compliance with loans covenants, fulfillment of regulatory requirements of apex bank, improving the quality of lending bank's loan portfolio and timely management of troubled borrowers.

The essence is to identify and respond to problems, so as to help borrowers to succeed and minimize defaults, loan losses, protect unsuspected depositors as well as protect the collapse of the financial system in particular and the economy at large.

2.4 Monitoring Tools and structure

There are various tools that are used by banks in monitoring loans; notable among them are transaction account monitoring, relationship management, regular reporting requirements, loan covenants, loan stress testing, and internal credit rating and scoring. These tools are briefly explained thus:

i.. Transaction account monitoring is a system whereby the lending bank monitors the activities of the borrower by keeping a consistent tract of all inflows and outflows of funds in his account. Nakamura (1993) argues that a lender, who monitors the borrower’s account and is able to detect losses, may be able to create incentives for the borrower to take actions that improve expected return. Bank loan

Officer has access to fine-grained information about a borrower's activities through its operating account, as he or she can observe transactions on item-by-item basis and compare them to the borrower's pro forma business plan (Loretta, Nakamura & Renault, 2007). To them the continuing operation of a business demand that the business be able to meet its financial requirements, which means that the business must have enough cash to pay its employees, suppliers, and others. The cash flows are ideally routed through its transaction action. This account information is likely to be one of the timeliest sources of information available to the lender. Nakamura (1993) also opined that, checking account information is relatively more transparent and complete for a borrower whose banking relationship is exclusive to a single lender. This technique is important as a source of reliable first-hand information that the bank can easily and transparently access without depending on the borrower's financials. It should be noted that the borrowers may be tempted to cut off the flow of information by opening and operating a checking account with a different bank without informing the lending bank. This can be detected when the bank did not see him/her making payments for inventory and/or receiving payments from account receivables.

ii. Relationship management on the other hand is a method of monitoring loan where experienced marketing, loan and loan recovery officers are attached to various accounts. Banks can therefore monitor their clients' loans through adequate relationship management by the various account officers, relationship managers, loan officers and/or loan recovery officers, that is, loan adjusters. This is normally done through the following tools options: phone calls, physical visit to client's factory,

store, and so forth, written letters, calling the client to the bank for discussions as well as continuous surveillance of client's external environment

There are so many signs a client can portray that indicate problems. An experienced relationship manager will be able to recognize these problems and react before clients' financials are received.

c.. Regular reporting. The banks also make use of regular reporting requirements tool and insist that all borrowing customers must comply with them. The most common requirements are financial statements, account receivables, aging report and guarantor financials. These are usually collected monthly, quarterly or annually. Once these financials are obtained, the bank will have them analysedfor corrective actions and negative trends and other indicators that the business is having problems are reviewed and appropriate proactive actions are taken. This includes tracking financial covenants of the loan which could be used to flag problem loans. The covenants can be based on a countless number of financial ratios that can set limits on leverage, cash flow, net profits, owner's compensation, and dividends among others.

d. Loan Covenants is another monitoring tool that the banks use in ensuring loan performances. Strahan (1999) maintained that most bank loans contain affirmative and negative covenants. The affirmative covenants compelling the borrowers to meet certain basic standards such as making timely payments, providing accurate financial disclosure, maintaining adequate insurance, complying with applicable laws, paying taxes and so forth. While the negative covenants put restrictions on the borrower's ability to engage in asset substitution that could harm the banker. For example,

negative covenants often limit acquisition activity and asset sales. Some bank loans often attach financial covenants requiring the borrower to maintain sufficient cash flow to service the loan and thereby minimize the probability of future insolvency. The financial covenants may also limit the firm's ability to pay out cash dividends to shareholders.

e. Loan stress-testing is also applied on loans to determine their strengths. Loan can also be monitored by the bank by performing stress tests to see what impact will be made if interests were to change at the same time the creditworthiness of the borrower were to change, the banks can get a better understanding of the risk picture. Banks do stress testing to examine what could go wrong and what combinations of events could be too extreme for the institution. They will then go ahead and determine if they are comfortable that those events will not occur or they take the steps necessary to preserve the bank's assets in a worst-case scenario, (Intrater, 2002).

The challenge with Intrater's view is that the stress tests can only find what you look for but if there is another risk that exists or an intervening factor and you do not recognize it as a risk, then you will not find it. Therefore, stress testing works as a complement, rather than as a supplement, to major risk management tools such as value at risk, (Bank for International Settlement (BIS) 2005).

f. Internal credit risk rating and scoring system. Internal credit risk rating systems are becoming an increasingly important element of large commercial banks' measurement and management of the credit risk of both individual exposures and portfolios (Treacy and Carey, 2000). The specifics of internal rating systems

currently differ across banks. Various comprehensive software solutions are developed and used in meeting banks' requirement for automating the internal credit rating process, such as Risk Assessment Model (RAM)- a workflow-based solution for hosting internal rating models with the capability to assess the credit risk of borrowers. The number of grades and the risk associated with each grade vary, as do decisions about who assigns ratings and about the manner in which rating assignments are reviewed. The risk management process should not stop after the loan approval. A structured approach should be put in place for loan monitoring through the use of a monitoring scorecard. This will ensure the availability of portfolio information in real time and a better time management for the loan officers.

2.5 Risks factors affecting loan performance

According to the Office of the Comptroller of Currency (OCC, 1998), risk is the potential that events, expected or unexpected, may have an adverse impact on the bank's earnings or capital. The OCC (1998) went further and defined nine categories of risk for bank supervision purposes. These risks are credit, interest rate, liquidity, price, foreign exchange, transaction, compliance, strategic, and reputation. While banks with foreign operation outside their home bases are confronted with two additional risks subject to transfer risk and country risk. It should be noted that these risk elements are not mutually exclusive; any loan or portfolio of loans may expose the bank to multiple risks.

2.5.1 Credit risks

This is a risk due to uncertainty in a counterparty's or obligor's ability to meet its obligations. In other words, it is the risk of loss of principal or loss of a financial

reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation. It arises whenever a borrower is expecting to use future cash flows to pay a current debt. Loans are therefore the largest and most apparent source of credit risk to banks. This does not exclude other credit risks both on and off the balance sheet, such as the investment portfolio, overdrafts and letters of credit. Other activities, products and services, such as derivatives, foreign exchange and cash management services, also expose a bank to credit risks. The tendency that a borrower/obligor will fail to perform as agreed or expected, is either lessened or increased by the bank's credit risk management practices. The practice amongst banks is the first defense mechanism of the initial credit-granting process, that is, sound underwriting standards, is having an efficient balanced approval process, and an experienced and competent credit officer. However, management of credit risk must continue after a loan has been made, because a sound initial credit decision can be undermined by improper structuring or inadequate monitoring.

2.5.2 Interest rate risk

Interest rate risk is the exposure of a bank's financial condition to adverse movement in interest rates. Accepting this risk is a normal part of banking and can be an important source of profitability and shareholder value while excessive interest rate risk can pose a significant threat to a bank's earnings and capital base. Changes in interest rates affect a bank's earnings by changing its net interest income and the level of other interest-sensitive income and operating expenses. Changes in interest rates also do affect the underlying value of the bank's asset, liabilities and off-balance sheet instruments because the present value of future cash flow (and in some

case, the cash flows themselves) change when interest rates change(Basel Committee, 2001).

The level of interest rate risk attributed to the bank's lending activities depends on the composition of its loan portfolio and the degree to which the term of its loans (for example, maturity, rate structure and embedded options) expose the bank's revenue stream to changes in rates. When significant individual credits or portfolio segments are especially sensitive to interest rate risk, they should be periodically stress-tested. Banks usually shift interest rate risk to their borrowers by structuring loan with variable interest rates. Borrowers with marginal repayment capacity may experience financial difficulty if the interest rates on these loans increase. As part of the risk management process, banks should identify borrowers whose loans have heightened sensitivity to interest rate changes and develop strategies to mitigate the risk.

2.5.3 Liquidity risk

The Basel Committee of banking supervision defines 'funding Liquidity' as the ability of banks to meet their liabilities, unwind or settle their positions as they may come due (BIS, 2008). Similarly, the International Monetary Fund's (IMF) provides a definition of funding liquidity as the ability of solvent institutions to make agreed upon payments in a timely fashion. According to the IMF (2008), funding liquidity risk captures the inability of a financial intermediary to service their liabilities as they fall due.

Other definitions of funding liquidity risk usually involve a time horizon, that is, the probability of becoming illiquid is typically measured for a given period ahead and

can differ significantly according to the length of period (Matz and Neu, 2006; Drehmann and Nikolaou, 2008). According to OCC (1998), due to the size of the loan portfolio, effective management of liquidity risk requires that there be close ties to and good information flow from the lending function. As part of liquidity planning, a bank's overall liquidity strategy should include the identification of those loans or loan portfolio segments that may be easily converted to cash.

Funding risk lies in the heart of banking. Banks are considered to be fragile due to the maturity transformation they undertake by using liquid short-term deposits to fund illiquid long-term loans (European Central Bank-Eurosystem, 2009). More specifically, the main role of banks in the financial system is to provide liquidity through intermediation. Banks intermediate between depositors and investors and provide illiquid loans to the latter, which are funded with liquid deposits from the former Kashyap, Rajan and Stein (2002). In so doing, banks transform short maturities (deposits) into longer maturities (investments) in order to create funding liquidity for investors (Strahan, 2008) and to promote the efficient allocation of resources in the system. This leaves the banks exposed to an inherent maturity mismatch. This mismatch can cause instability to the bank in its role as provider of liquidity upon demand to depositors, that is, through deposit transactions, or borrowers, that is, through committed lines of credit (eurosystem, 2009)

2.5.4 Price risk

Most of the developments that improve the loan portfolio's liquidity have implications for price risk. Traditionally, the lending activities of most banks were not affected by price risk. The reason being that loans were customarily held to

maturity, accounting doctrine required book value accounting treatment. However, as banks develop more active portfolio management practices and the market for loan expands and deepens, loan portfolio will become increasingly sensitive to price risk. Also banks that engage in international lending may be affected by price changes in the secondary market for such loans.

2.5.5 Foreign exchange risk

This kind of risk is present where a loan or portfolio of loans is denominated in a foreign currency or is funded by borrowings in another currency. In some cases, banks will enter into multi-currency credit commitments to permit borrowers to select the currency they prefer to use in each rollover period. Foreign exchange risk can be worsened by adverse economic, social, and political development. The consequences can be unfavorable if one of the currencies involved becomes subject to stringent exchange controls or is subject to wide exchange-rate fluctuations.

2.5.6 Transaction risk

Transaction risk is primarily inherent in the loan disbursement and credit administration processes. The quantum of transaction risk depends on the adequacy of information systems and controls, the quality of operating procedures, and the capability and integrity of bank's employees. Banks do incur losses because they fail to perfect or renew collateral lines; to obtain adequate information to identify early warning signs of credit failures or even expired facilities.

2.5.7 Compliance risk

Lending activities encompass a broad range of compliance responsibilities and risks. By legal requirement, a bank must observe limits on its loans to a single borrower or

obligor, to insiders, and to affiliates; limits on interest rates, and the array of consumer protection and collection practices.

2.5.8 Strategic risk

A primary objective of loan portfolio management is to control the strategic risk associated with a bank's lending activities. Inappropriate strategic or tactical decisions about underwriting standards, loan portfolio growth, new loan products, or geographic and demographic markets can compromise a bank's future. Banks should be particularly attentive to the new business and product ventures. These ventures require significant planning and careful oversight to ensure the risks are appropriately identified and managed. During their evaluation of the loan portfolio management process, bankers should ensure that they are realistically assessing strategic risks.

2.5.9 Reputation risk

Whenever a bank experiences credit problem, its reputation with investors, the community and even the individual customers usually suffers. Inefficient loan delivery systems, failure to adequately meet the credit needs of the community, and lender-liability law-suits are examples of how a bank's reputation can be tarnished because of problems within its lending division. Reputation risk can damage a bank's business in many ways. The value of the bank's stock falls, customers and community support is lost, and business opportunities evaporated.

2.6 Types of loans facility

In its circular of 2010 on prudential guidelines for deposit money banks in Nigeria, the CBN has classified loans (financing) into: Commodities finance, retail financing,

project finance, specialized loans in form of; agricultural finance, mortgage loan, margin loan, object finance, real estate loan and Small and Medium Enterprise loans.

i. Commodities finance is short-term in nature usually used in financing receivables such as agricultural farm produce, crude oil, and metals. The facility is normally repaid from the proceeds of sales of the commodities in question.

ii. Retail financing is more of consumer banking where individuals are extended facilities to meet their personal, household and/or family needs. It could take the form of assets accusation, credit cards, housing loan/mortgage loans and other personal loans.

iii. Project finance is more of public sector financing than commercial or retail financing. It covers projects like construction of roads, fly-over, bridges, rail-bed, power generation projects, dam construction, water supply, irrigation, petroleum extractions and so forth. The loans are very large in quantum and long-term in nature and are usually repaid through the revenues accrued from their use.

iv. Specialised loans could take the form of agricultural finance; for inputs like fertilizers, pesticides, seeds, orchards, agricultural machinery such as tractors, as well as financing for poultry, fisheries, and dairy. It is usually seasonal in nature and of average time frame. Mortgage loan is a facility that covers real property through the use of title document while noting the bank's interest on it in the land registry until when the loan is fully repaid. It is of long-term in nature and the sum being highly substantial, hence the need for the encumbrance. Miscellaneous loans are other loans that include margin loans, SME and so on.

2.7 Loan Performance

The performance of a Loan or otherwise can be determined through credit portfolio classification system. Banks are always in a state of classifying their individual loan and loan portfolios as active, substandard, doubtful and loss loans in order to monitor and manage the credit risks in the said loans. Various countries around the world through their banking supervision agencies or units have introduced standardized requirements for classifying loans in specified categories based on the loan credit quality. In some countries, the classifications are used for regulatory reporting to facilitate regulators' assessment of the level of credit risk in bank's portfolio and to quantify provisioning requirements.

World Bank Finance forum (2002), defined 'loan classification' as the process banks use to review their loan portfolios and assign loans to categories or grades based on the perceived risk and other relevant characteristics of the loan. It was also argued at the forum that, the process of continual review and classification of loans enables the banks to monitor the quality of their loan portfolios and, when necessary, to take remedial action to counter deterioration in the credit quality of their portfolios. These classifications are utilized by broad range of developed, emerging and developing countries in relation to classification of individual loans and loan portfolios, treatment of guarantees and collateral, bank loan review processes, restructured troubled loan, loan loss provisions, disclosure standards, and the role of external auditors.

2.7.1 Loan Classification

Loan classification system differs from country to country but the approaches used are considered either a management responsibility or a regulatory matter or both. For

countries with no detailed regulatory classification regime, bank managements are normally responsible for developing necessary internal policies and procedures to classify loans. In a paper presented at the World Bank Forum (WBF) 2002 entitled "Bank loan classification and provisioning practices in selected developed, and emerging countries" (WBF 2002) a survey was conducted amongst G-10 banking regulators, where it was found that United States of America and, to some extent, Germany use a detailed regulatory classification approach. The paper maintained that a typical view in such countries with no detailed regulatory classification regime, the role of external parties including supervisors and external auditors should be restricted to providing an opinion on whether the banks' policies are adequate and if they are implemented in a satisfactory and consistent way.

In Nigeria, the detailed regulatory classification approach is adopted through the banking supervision activities of Central Bank of Nigeria (CBN). The Nigeria apex bank, CBN (2010) has come up with the following classifications in it its circular entitled "Prudential guidelines for deposit money banks in Nigeria".

a. Active Loans: These are facilities on which unpaid principal and/or interest remain outstanding for less than ninety (90) days.

b. Sub-Standard Loans: facilities on which unpaid principal and/or interest remain outstanding for more than ninety (90) days but less than one hundred and eighty (180)days.

c. Doubtful Loans: facilities on which unpaid principal and/or interest remain outstanding for at least one hundred and eighty (180) days but less than three hundred and sixty (360) days and are not secured.

d. Lost Loans: facilities on which unpaid principal and/or interest remain outstanding for three hundred and sixty (360) days or more and are not secured.

2.8 Loan Recovery/Restructuring

Banks use different methods and strategies in managing problem loans. The responsibilities for such loans lie with the originating branch or division or the Loan Recovery Unit (LRU), that is, specialized work-out division at corporate level of the bank, (Comptroller's Handbook, 1998). While routine loan recovery activities are handled by the relationship officer or managers, when such recovery efforts persists or credit weakness become more pronounced and the risk ratings deteriorate, many banks transfer the problem loans to LRU and may even proceed to court action. Where problems are not solved within the bank cycle it can then be sold to Loan Secondary Market (LSM).

2.8.1 Tools of Loan Recovery

For loans that have remain inactive for period of more than ninety (90) days the banks are put on high alert, for it is a an early warning sign that the loan is getting bad. When the situation gets so unbearable the banks could institute loan recovery actions in place and/or get its non-performing loan restructured. Some of the recovery tools available at the disposal of the banks include the following:

i.. Relationship Management (Set-off): the first level of loan recovery is through effective relationship management by the relationship officers or managers as the case may be. Where this fails then the bank can go ahead to combine borrower's accounts by crystallizing the pre-signed letter of set-off. All the customer's rightly

owned accounts that have credit balances can be used to upset his outstanding amount owed to the bank. This is normally handled at branch level.

ii. Loan Recovery Unit/Departments: when loans cannot be recovered at branch level they are then transferred to Loan Recovery Unit (LRU) that is situated at head office. The LRU is a specialized unit that is made up of experienced credit managers, internal control officers, legal officers, compliance officers and relationship managers whose duty is loan recovery. The unit is responsible for recovering bank's delinquent assets by getting directly in touch with the customers and convincing them to repay back the loans. However, the primary responsibility of the LRU being that of loan recovery, it first explore all avenues in restructuring the facility, that is, the non-performing loan so that the customer could be availed second chance of getting back to normal business and be in a position to honor his obligations as at when due. Where all these fail the unit can then initiate legal proceedings that the loans can be recovered through court actions.

iii. Loan Recovery Agencies: these are agencies that specialise in recovering of loan from customers on behalf of the banks. The edge these agencies have over the convention bank LRUs is that their methods are devoid of any prior personal touch with the customers. This method eliminates compromises that are usually exhibited by the bank's loan recovery staff. It has been relied upon by several banks in getting the bad loans recovered without litigations.

iv. Realization of collateral securities: the banks in compliance with regulatory bodies tend not to 'lend clean' without getting their facilities covered. Depending on the type of the facility the banks may demand for one or more of the following

collateral securities: Legal Mortgage (LM), Cash backed (personal and/or 3rd party), Stocks/Shares (Certificates and/or lien on CSCS account), Life Policies (personal and/or enterprise loans), Personal Guarantees (for 3rd party/surety or PG of MD/Chairman of an incorporated firm) and so forth.In the event that the customers fail in honouring their obligations, the banks can then fall back on collateral securities that the loans are secured with, by realizing pledged securities.

v. Law enforcement agencies: in Nigeria the banks do employ the services of Economic and Financial Crimes Commission (EFCC), Nigerian Police Force (NPF) and so on in recovering the bad loans.

vi. Courts and/or Tribunals, for the banks thathas not succeededin recovering its loan with the use of any of the above tools can institute legal proceedings against them. This happens when the customers have been issued with reasonable demand notice. What is reasonable is normally based on the nature of customer's trade and the surrounding circumstances which are considered on case-by-case basis. Sometimes the services of special tribunals of bank loan recovery are employed by the government. This was the case in Nigeria in mid-1990s when the banking industry was faced with serious liquidity issues and possible collapse. Hence the government of the day came up with the tribunals to recover loans from defaulters.

vi. Loan Secondary Markets: these are made up of organizations that buy loans from banks and other lending institutions. They buy and recycle loans from the original lending institutions. The affected loans are usually the non-performing loans which the deposit money banks sell to the secondary markets so that they can be managed as delinquent loans while the banks concentrate on performing loan and other

traditional banking activities. In Nigeria we have Assets Management Corporation of Nigeria (AMCON) in place which was established on July 19, 2010 that has the troubled loans/classified assets sold to it through the efforts of CBN and Nigerian Deposit Insurance Corporation (NDIC).The organizations, that is, the investors who purchase the loans take steps to understand the quality of the loans they acquire. It is important that they conduct due diligence on the banks and the loan pools themselves, in some case the loan purchasers employ the services of credit rating agencies, which are independent firms that rate the credit worthiness of asset-backed and other securities as well as provide a further review of the loans in pools.

2.8.2 Determinants of loan recovery

In the views of Aremu*et al.* (2010) 'regardless of the genuine efforts of parties to a loan, default can still occur. The recovery of loans should be a prerogative of the recovery unit to ensure that appropriate recovery strategies are implemented. However, assistance may also be sought from Corporate Banking/Relationship Management.' They also maintain that the Loan Recovery Unit (LRU), should perform the following functions:

i. Regular review of deteriorating loans to allow for early warning systems to set in.

ii. To make timely and adequate loan loss provisions based on expected and/or actual loan losses.

iii. To come up with loan recovery options to the management that will maximize repayment of the loan.

Arindam and Pratima (2009) opined that loan recovery rate is dependent on five determinants:

i. The bank's attitude in terms of debt renegotiation with debtors, compromise and settlement.

ii. Quality of collateral securities attached to loans borrower's firm specific capital structure.

iii. Seniority standing of debt in the firms overall capital structure.

iv. Industry tangibility: The worth of the firm's liquidated assets depending on the industry of the borrower.

v. The macro economic factors: These include interest rates, Gross Domestic Product (GDP) growth and so on.

2.9 Strategies for improving loan repayment

Aremu*et al*. (2010) believed that in some occasions all the customers may need from the bank is more support to get him repay its loan. They therefore suggested any or a combination of the following strategies as the way out:

A favourable review or waiver of some stringent conditions of loan covenants as may be approved by the CRM. Taking of additional collateral security from the customer in exchange for some concessions.Restructuring of the loan facility by giving additional fund/credit to the customer that can put him back to profitable business.Extension of loan tenure if well supported by borrower's fresh cash flow statement.Cadena and Schoar (2011), concluded that financial markets in developing

countries are often hampered by a severe lack of even basic financial infrastructure such as functioning credit bureaus, uniform disclosure rules or the ability to use collateral, hence the need for banks to come up with strategies for improving loan repayment.

Cadena and Schoar (2011) suggested the following as strategies of improving the repayment:

a.. The banks can use Short Messages (SMS): These are to remind their borrowing customers of up-coming repayments. This can make the borrowing firms to keep track of their upcoming payment by as soon as they receive the SMS reminders every month, at least three (3) days before the payments are due. The SMS reminders could have an impact on ensuring better payment behavior and help borrower firms to improve their cash management.

b.. Future Interest Rate Reduction strategy: It involves providing longer repayment period and future interest reduction. Customers are given a 25% reduction in the interest rate of their next loan if current loan payments are all made in time.

c.. Cash Back Incentives: Under this strategy, customers will receive at the end of the loan period, a cash back payment equivalent to 25% of the interest that they paid on their loan if they have paid all their loan installments on time.

According to them the impact of the three different treatments on these proxies for repayment outcomes could be estimated, using an equation developed by them. Their study found out that a large size of borrowers do pay late not for strategic reasons but because they are unable to keep track of their payment schedules, if they are not reminded. The results of their study suggest that financial incentives of cash back

promise or interest rate reduction promise for the next loan cycle had a similar impact in terms of magnitude on customer repayment behaviour than an SMS reminder. The study was a field experiment with a lender in Uganda meant to test the effectiveness of privately implemented incentives for loan repayment.

2.10 Five C's of Credit

Loan applications are subjected to the 5 C's of Credit criteria as they have impact on loan performance. Bankers usually subject their potential borrowers to various examinations before making their lending decisions. The 5 C's method is adopted in determining the credit worthiness of their potential borrowers. This evaluation method is made up of both quantitative and qualitative measures.

The 5 C's of Credit are:

(i) Character: Is the borrower of good character? The character here is that of the borrower and is defined in the context of moral hazard and adverse selection, (Turvey, Guengwen, kong, Jiujie& Meagher2011).The bank is interested in knowing if the borrower is reliable, and of high integrity and a solid reputation. Customer's credit history is checked to determine his character. Does he repay as at when due or he default? The character of the directors and other principal staff of the firm are equally important in credit evaluation. Their reputations, honesty, dignity nobility, quality, worth, and integrity should all be evaluated. If the firm is family owned then risk factors such as "Key Man" risk factor should be evaluated in the light of succession plan. The character primarily deals with the willingness to pay and probably the most difficult of the 5 Cs to ascertain.

(ii) Capacity: What is the capacity of the borrower? This touches on the customer's ability to repay the new debt. Here debts are reviewed against income. Does the business generate enough cash flow to cover the new debt? What are other secondary means of repaying the loan should the business cash flow suffer any setback or cover any short fall? In other words capacity of the borrower deals with its ability to operate the business successfully and get enough cash flow required to repay loans as at when they fall due. This requires training, experience, and technical competence/skills to manage the business successfully. The repayment capacity of the borrower is one of the most critical factors in the lenders' decision to make loan. This should not be limited to the borrower's business cash flow but also to any of his secondary sources that could be fallen back on if the business is not in a position to repay the loan.

(iii) Capital: What is the capital of the borrower in the business? The bank is interested in knowing the borrower's stake in the business and/or credit facility. The banks are comfortable when the borrower has a vested interest in the business and/or credit facility so that he will not easily abandon the business or loan and walk away. The net-worth of the customer needs to be established so that the lender does not over lend to him.

(iv) Collaterals: There is the need for borrowers to provide collaterals for their loans. As stated earlier it is very important that the bank does not lend clean. It has to secure the loan by way of collateral securities as second

way out of problem loans. These are guarantees, security, pledges/cash-backs, life assurance/policies, insurance policies, surety and so forth given by the borrower to protect the interests of the lender and serves as protection against loan loss. Again care has to be taken as empirical evidences have demonstrated that the historical collateral securities such as real estate and stocks can no longer be taken for granted given the experience of 2008 global financial crises.

(v) Condition: Conditions can be viewed from two angles. First, it can be seen from the condition set in the credit offer letter, such as terms and conditions of the facility, conditions precedence to draw down, repayment plans and so on. The second angle is related to market conditions that can impact on the business or industry of the borrower that is taking the loan. Are the conditions favourable? What are the risks factors? How can the risks be mitigated against? Conditions denote the business environment influences on the company's financial conditions and performances that are normally beyond the borrowers' direct control. According to Turvey*et al.*, (2011) it relates to the attribute of the economy in which the borrower operates.

The above 5 C's of credit must be taken into consideration in lending decision whether we are dealing with start-ups or established businesses seeking growth or restructuring/remodeling.

An important question that remains to be answered on these 5Cs is, why these loans are failing despite going through these evaluation processes. What is responsible for

the loans going bad and non-performing? Are the quantitative and qualitative evaluations enough? What is it that is really left out and/or needs to be done? Turvey*et al.* (2011) attempted to provide answers to these questions by improving the 5Cs to 7Cs in a study conducted in rural China. They included Credit and Capability. The credit was referred to the credit environment in which loans are demanded and credit supplied while capability was measured in terms of extraneous factors affecting household capability to repay loan such as household consumption, medical issues, schooling and so on. While weagree entirely with the above extension to 7Cs as advanced by Turvey*et al.*(2011), however, this has not solved the problem of loan going bad and non-performing loan issues. Could it be that an equally important C has been omitted by previous scholars?Could it be the issue of Control that is absent of which led to failure of many loans / credits in recent times? This perhaps explains why the issue of corporate governance has gained a lot of recognition and support in present day economic, political and other discussions. Even in the midst of the 7 factors as added by Turvey*et al.*, (2011), the study notices that credit and other loan facilities extended out by these deposit money banks tend to turn out to be bad if the issue of control of the credit/loans by the borrower has not been given careful attention.

2.11 Credit Processing Management and Non-Performing Loan

Credit processing and management is indeed an integral component of credit risks management. Loan applications are subject to appraisals and approval processes before they are eventually disbursed. The business environment faced by credit institutions especially deposit money banks is challenging and unpredictable hence

the need for proper credit management. The banks and regulatory authorities have minimum standards for credit processing management ranging from receipt of borrower's loan application to appraisals, credit rating, approvals, disbursement and administration. The first thing that is required is for the lending bank to take a close look at the borrower's economic and legal situation as well as the other relevant environmental factors.

When granting a loan an effective credit approval process should be guided by: a transparent and comprehensive presentation of the risks; and an adequate assessment of the said risks, (Josef and Kurt, 2004).

2.11.1 Credit approval process

Josef and Kurt (2004) suggested the following credit approval process which should form the basis for the design of credit approval process:

(i) Acquisition/credit-specific customer service: This deals with establishing contacts, evaluation of customer information, having meeting with the customer and debriefing. Collect and review data. It involves collecting and reviewing customer's request letter and other request documents, obtaining additional information, conducting completeness/plausibility review of such data and follow-up.

(ii) Credit review: It entails reviewing the data obtained during the above stage (i), follow up with the loan officer/account manager, standardized credit rating, and documentation of other credit related factors.

(iii) Collateral and risk assessment: This calls for object inspection, determine loan-to-value and evaluation of exposure.

(iv) Documentation: Complete loan application, prepare credit vote and finally hand over credit file to credit Risk Management (CRM) department.

(v) Approval: This has to do with follow ups with credit approval officers or credit approval committee and then the final approval is given by the decision makers.

(vi) Implementation of the credit decision: Here the bank needs to check compliance with authority structure, prepare contacts, get signatures, and provide security, disbursement review and then final disbursement into customer's account.

2.11.2 Credit review process

It is also the opinion of Josef and Kurt (2004) that the credit-review is based on internal and external information of the borrowing customer. This process is also made up of sequential steps ranging from data collection, checking for completeness and plausibility of the collected data, and the passing the data to credit risk management department of the bank.

(i) Data collection: The focus here should be on the loan applicant's standing. Comprehensive Information concerning his personal situation and economic standing have to be gathered. The bank must be interested in both his quantitative and qualitative data.

(ii) Review for Completeness and Plausibility check: All relevant information obtained on the credit applicant, whether provided by him or obtained by the loan officer must be subject to review to ascertain the completeness and guard against plausibility. The essence of doing this is to minimize

any process loops and minimize errors and ultimately prevent unnecessary and avoidable exposures. At this level the bank can decide on outright rejection of the exposure if dissatisfied with the result of its checks on customer's information.

(iii) Passing on Data to Credit Risk Management (CRM). The loan officer is duty bound to pass on the data in its entirety to credit risk management department for its further review and credit approval processes. The reason for this is to protect the CRM in the event that 'joint-responsibility' clause needs to be applied where loans fail on processing ground.

(iv) Exposure assessment. This is an extension of credit review process to a valuation of the pledged collateral based on the information provided by the loan applicant. This step is meant at making the risks resulting from the exposure transparent and giving room for a final analysis of the exposure. What need to be considered in collateral evaluation are; the independent estate surveyor's valuation report especially the Forced Sales Value (FSV) and the possibility of getting a buyer.

2.11.3 Credit agreement

Once a favorable credit decision has been taken by the bank then a credit agreement is drawn by the bank which stipulates the conditions upon which the facility is to be run. The loan agreement is contained in the credit facility offer letter which the loan applicant has to sign as well as provide a formal acceptance letter on the company's letter head paper as board resolution as the case may be signifying the acceptance.

The credit agreement states: conditions precedent to draw down, pricing, loan covenants, tenure of the facility, repayment plan, charges on past due obligations, call up of the facility, termination, charge on collateral, letter of set-off, periodic reviews of the conditions of the offer, roll-overs and so on.

2.11.4 Loan review

The loans extended by the banks are subjected to periodic reviews as provided under regulatory authority's prudential guidelines or as dictated by the internal credit policies of the banks. This covers the following:

(i) Reviewing transaction account movements.

(ii) Checking customer's debt service capacity

(iii) Receiving and analyzing customer's financial statements

(iv) Checking and assessing significant deviations of actual financial figures against projections

The reason for this review is to create an early warning structure in place that can protect the bank against loan default, that is, non-performing loans.

2.11.5 Credit risk management

This is another dimension of credit management that involves a continuous check on the identified lending risks that can hamper the borrower's ability to repay its loan. The functions of Credit risk management is all about:

(i) Identification of risks such as market risks, credit risks, operational risks and so on.

(ii) Measurement through forecasts and stress tests

(iii) Aggregation by way of assessment of overall risks

(iv) Planning and management, which can be achieved through risk-adjustment prices, sales and so forth; and,

(v) Monitoring through risk control and/or reporting of all the risks associated with the bank's overall business, which is that of lending.

2.12 Principles of Lending

The banker-customer relationship of Debtor-Creditor changes as soon as a lending relationship is established between them, thereby reversing the legal relationship to that of Creditor-Debtor relationship. The bank needs to exercise great care in lending funds as it remains responsible to its depositor whose monies are used in the trading. Shekhar and Shekhar (2011) came up with following principle of bank lending as precautions to be taken by the banks in lending:

(i) Safety: The primary concern of a bank in lending is the safety of its depositors' monies. The question that needs to be addressed is 'How safe is my funds?'. The borrower must have the ability to ensure that the funds lent to it are kept lent and not diverted into too risky and illegal activities that could put the entire money into jeopardy. This should be a dual responsibility on both part of the banker and the borrower. The former must ensure that the credit policy of the bank and the lending guidelines of the regulatory authorities are abided by while extending the credit facility to a level that will assure the safety of the principal and guarantee interest payment. While the latter trades with the principal borrowed based on the terms and conditions stipulated in the offer letter and comply with the terms of repayment.

(ii) Liquidity: The banker must be guided by the principle of liquidity while lending. It is expected that the bank will match its liabilities with its assets to an extent that it will not be cash trapped. Long term loans must be matched with long term liabilities while short term funds should be used in funding short term loans otherwise the bank may not be able to meet its cash obligations as at when due. Failure by the banker to maintain liquidity to a margin of safety can make him suffer in his credit on which the very foundation of his business stands. The objective of this principle is to ensure that the bank remains as liquid as possible.

(iii) Profitable: The banks should ensure that their lending is profitable enough to absorb their costs of funds to a level where they can pay interests to depositors and cover their operating costs and pay dividends as return to capital of their shareholders. The lending should also be strong enough to allow for full prudential provisioning; however, not too excessive that could undermine societal economic development.

(iv) Purpose: It is expected of the banker to carefully examine his borrower's purpose of the loan before it is extended. The purpose has to be legal and in tune with the nation's economic policies. This has to equally comply with the bank's credit policies. The purpose of the loan must have that ability to generate enough cash flow that will guarantee repayment and interest servicing. The borrower has to be supervised so that the funds will not be diverted to other purposes other than those intended. Here the

banker can make the conditions precedence to withdrawals tight enough that can block all forms of diversions.

(v) Diversification of Risk: It is also strongly desirable for a bank to avoid concentration risk in their lending by fully diversifying the loan portfolio across industries and geographical regions. The diversification should be spread as widely as possible over different industries and geographical locations. This can help in diluting loan losses that could be sustained in one particular industry or location, with other good loans in other industries or locations. The amount of credit facility to be extended to single-obligorshould also be moderate so that loan portfolio can be made up of large number of borrowers than just advancing large sum to a small number of borrowers.

(vi) Security: This principle calls for bankers to avoid cleanlending. There should always be a second way out of problem loans. This means that the banks should take adequate collateral security of say at least 120% value over and above the loan sum. The banks can now fall back on the securities if the means of loan repayment fails. The critical question today is what qualifies to be adequate collateral security given the Mortgage foreclosures of 2008 in United States of America and the subsequent global meltdown in the capital markets. However, the point is that the banks should take collateral securities and keep them on continuous checks against tendencies of fluctuations in their values.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter is concerned with the methodology of the study. In every research, the source of data used as a basis for findings is very important. The section elaborates on the sources of data used by the study, the instruments of data collection, population and sampling design and finally the techniques that were used in analysing the data.

3.2 Research Design

This study employs the survey and correlational research designs as the platform upon which the research is anchored. The choice of the survey design is warranted by the fact that the study, by the nature of its problem, can best be tackled by collecting data from the field. In the same vein, the choice of correlational design was necessary because the study also sought to establish association between some variables.

3.3 Population of the Study

The population of this study is in three categories, that is, the relevant bank staff, the borrowing customers and the DMBs. The first category of the population of the study was made up of relevant staff of the entire twenty (20) Deposit Money Banks' main branches across the six geopolitical zones of Nigeria. As at 2011, it consists of a total of Seven Hundred and Fourteen (714) Relationship/Account Officers/Managers, and Loan Officers (LOs). The information was sourced from the websites of the banks as at 31st December 2011. The second category of the population of the study consists of Five Hundred and Twenty Three (523) delinquent borrowing customers as at 31st December 2011. This information was retrieved from the Loan units of the said

various main branches of the banks across the zones. The third category consists of all the 20 DMBs operating in Nigeria as at 31st December 2011.

3.4 Sample Size and Sampling Technique

The study employed the sample size formula developed by Yamane (1967) to draw appropriate sample from the two categories of the population. The sample size formula developed by Yamane (1967) is presented below:

$$n = \frac{N}{1 + N(e)^2}$$

Where:
n=Denotes the adjusted sample size
N=Denotes the study population
e= Denotes the allowable sampling error which is sometimes called level of precision. In most cases, the precision rate of ±5% is used.

The risk of selecting a bad sample, that is the risk of committing type 1 error denoted by α, is set at 5% (**α**= 5%). The choice of this sample size determination approach is motivated by the research's aim of drawing an unbiased sample size. Table 3.1 provides a summary of the characteristics of the population and the sample size for category 1 and category 2.

Table 3.1 Sample Size for Category 1 and Category 2 Population

Population category	Population Size	Risk (Type I Error, α)	Confidence Interval	Sample Size (n)
Category 1	714	0.05	0.95	256
Category 2	523	0.05	0.95	226

Source: Research Study 2011

An application of the formula to the first category of the population of the study resulted in a sample size of 256. Furthermore, the application of the same formula to the second category of the population gave a sample size of 226. Thus, the sample size of the study was 256 relevant bank staff and 226 borrowing customers.

For category 3 population, all the 20 DMBs were considered as part of the sample. For a bank to qualify as part of the sample however, it must meet the following criteria:

(i) The bank must be listed on the floor of the Nigerian Stock Exchange (NSE). This filter resulted in the elimination of 2 banks.

(ii) Data relating to the share price, profitability and loans and advances of the bank must also be available and accessible. Four banks were unable to meet this criterion.

Application of the aforementioned systematic elimination criteria resulted in a sample of 16 DMBs. Thus, the study employed the filtering criteria to arrive at the appropriate sample for this category of the population.

An important consideration in research is the technique employed in sampling. To mitigate the effect of bias, the study largely utilized probability sampling techniques. For category 1 sample, the sample size of 256 weincreased the number of questionnaires to 300 and was proportionately allocated across the six geo-political zones. Thus, by this technique, the North/West got 50, the North/East 31, North/Central 69, South/West 72, South/East 41; and South/South 37. Furthermore, the study employed the simple random technique to draw one state to represent each of the geo-political zones. The study therefore distributed the 300 questionnaires to the branches of the banks across the regions according to their contributions to the general population as captured in Appendix I and II. The relevant bankstaff were selected using the simple random sampling technique

The same approach was employed for the category 2 sample. Accordingly, for category 2 samples, the sample size of 226 was equally increased to 300 and was proportionately

allocated across the six geo-political zones where by the sametechnique, the North/West got 48, the North/East 33, North/Central 72, South/West 67, South/East 38; and South/South 42.Therefore, the 300questionnaireswere distributed to the branches of the banks across the regions according to their contributions to the general population as captured in Appendix II and IV. As in the case of category 1, the relevant borrowing customers were also selected using the simple random sampling technique. For category 3, the systematic elimination (filtering) criterion was employed.

3.5 Sources of Data

Data for the study was sourced from both primary and secondary sources.

i.. Primary data: Data from the primary sources were essentially collected with the aid of the questionnaire. The questionnaire was favoured as against the interview approach because of the need to ensure confidentiality. The interview technique in most cases requires contact between the researcher and the respondents. Given the sensitive nature of the subject matter, interview may compromise the confidentiality of borrowing customers since their loans are classified as non-performing. Against this background, the study exclusively utilized the questionnaire as a source for collecting primary data. Two sets of the questionnaire were designed and applied in collecting the relevant data for the study. The first set of questionnaire was applied in collecting data from the relevant bank staff, while the second set was for the borrowing customers.

ii. Secondary data: The study collected data from secondary sources in the form of share prices of the banks, their non-performing loans, gross earnings and other related data. Data on share prices were collected from the database of the Cashcraft Asset Management Limited and Capital Asset Management Limited. On the other hand, data

relating to the non-performing loans and gross earnings of the banks were collected from the financial statements of the banks.

3.6 Administration of Data Collection Instruments

As earlier stated, the study collected data with the aid of the questionnaire. In order to achieve the objective of the study, the questionnaire was designed by raising questions that the respondents answered from a set of likely options provided by the researcher. As a result, the questions directly dealt with the subject matter of the research. Even though the category 1 sample size arrived at through the use of the Yamane (1967) sample size formula was 256, the study administered 300 copies of the first set of the questionnaire to the respondents (relevant bank staff).

The reason for this approach is necessitated by the fact that if the exact number is administered, the chances of retrieving all the copies are very slim. Even where all the copies are retrieved, the tendency is that some of such copies may be returned unfilled, and this could have had an adverse effect on the study. Since the sample size arrived at through the application of the Yamane (1967) sample size formula was considered the "minimum return sample size," generalization on the population can only be possible if the minimum sample size is met. On the other hand, there is no harm in exceeding the minimum sample size (Israel, 1992). In line with the approach for category 1 sample size, the study also administered 300 copies of the questionnaire to category 2 respondents.

3.7 Techniques of Data Analysis

There are various methods available in analysis of data for the purpose of making generalisation and drawing conclusion. For the purpose of this research, the study used the following techniques for analysing the data collected.

3.7.1 Descriptive Evaluation Method

This involves a proportion or number in each hundred. It is a tool used to illustrate the proportion of a given sample size of respondents or other subjects/variables that is, usually taken out of a hundred. The choice of using percentage is to enhance simple and straight forward analysis for easy understanding and accuracy. This deals with the study of the distribution of variables of the study in relation to subjects that are of relevance to the research. Descriptive analysis may be either qualitative, verbally summarising the information generated in the study by the use of frequency distribution, measures of central tendency and measures of dispersion.

3.7.2Chi-Square

The study used Chi-square statistic to test hypothesis I. Hypothesis I was subjected to testing using the Chi-square ($\chi 2$) because the data analyzed were qualitative in nature and were drawn exclusively from the questionnaire administered. The Chi-square ($\chi 2$) was computed on the results of cross tabulation between two sets of responses relating to the problem being investigated. The Chi-square was used in testing hypothesis concerning the difference between the self-observed frequencies of a sample and a corresponding set of expected frequencies. The Chi-square, denoted by X^2 is defined by the following expression.

$$\chi 2 = \frac{(0_1 - e_1)^2}{e_1} + \frac{(0_2 - e_2)^2}{e_2} + \frac{(0_3 - e_3)^2}{e_3} + = \sum_{j=1}^{k} \frac{(0j - ej)^2}{ej}$$

Source: (Connor, 2006: 58)

Where

$\chi 2$ = Measurement of Discrepancy between observed and expected frequencies

o_j = Observed frequency

e_j = Expected frequency.

Where the value of $X^2 = 0$, we say that the observed values and theoretical frequencies agree exactly. If $X^2 \neq 0$,it implies that they do not agree exactly. The larger or the smaller away the value of X^2 is from 0, the greater the discrepancy between observed and expected frequencies.

3.7.3 Decision Rule

If the computed value of chi-square exceeds the critical value of x² at (r -l) (c -1) degree of freedom and α level of significance we reject the null hypothesis and accept alternative hypothesis and vice-versa. Where: r = No of rows, c = No of columns.

3.7.4 Pearson Correlation Coefficient

The Pearson's correlation coefficient was used to test hypotheses II and III. The Pearson's correlation coefficient helped to determine the strength and direction of association between the two variables and by so doing helped in determining whether or not a significant relationship existed between them. The Pearson's correlation coefficient was calculated using the formula below:

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}}$$

Where:

n = number of periods being considered
x = (Independent variable)
y = (dependent variable)

The value of r lies between –1 to +1 inclusive. If the value of r is equal to one (1) or minus one (-1) there is a perfect correlation in same or opposite directions respectively. If the value of r is equal to zero then there is no correlation between the two variables. Sabo (2007) adopted the following criteria for interpreting the value of r.

The study adopted similar criteria used by Sabo (2007) in interpreting the value of r.

Table 3.2 Interpretation Procedure of Correlation Coefficient

Value of r	**Interpretation**
Between 0 and ±0.25	Zero or weak correlation
Between ±0.25 and ±0.50	Moderately weak correlation
Between ±0.50 and ±0.75	Moderately strong correlation
Between ±0.76 and ±1.00	Strong to perfect correlation

Source: Sabo (2007: 95-115).

For the purpose of this study we adopted these criteria for interpreting r. In order to form and establish the significance of the computed r, the study used the t-test for the significant difference of correlation to establish the statistical significance of the computed correlation coefficient. This enabled the study to either reject or accept hypotheses II and III.

According to Gupta (1996), in order to further substantiate the results of correlation (value of r), there is need to perform a t-test for the significance of an observed correlation coefficient. This test is performed using the formula: $t = \frac{r\sqrt{n-2}}{\sqrt{1-r^2}}$

Where:
r = coefficient of correlation
n = number of observations

The study performed this test using level of significance of $\alpha = 0.05$ and the degree of freedom of n-2. The critical value for the t-test was obtained from tabulated values for the purpose of acceptance or rejection of the hypotheses. The null hypothesis was the calculated value is greater than critical value and accepted where the calculated value is less than critical value.

3.8 Justification of the Methods

Hypothesis I was tested using Chi-square because the data collected were qualitative in nature obtained from the field through the use of questionnaire. The data were collected on the basis of Likert scales scores which were later converted to appropriate values for hypothesis testing. Hypotheses II and III were tested using Pearson's correlation coefficient because the data used were time series-based.

3.9 Summary

This chapter presented the research design, method of data collection, and population of the study, sampling selection techniques, method of data analysis, justification of the

methods. As regards data analysis, the tools adopted for the study are the Pearson's correlation coefficient and the Chi-square tools of analysis.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter contains the analysis and interpretation of the data collected from both the questionnaire administered the research respondents as well as the secondary data obtained on the DMBs. The data collected through the questionnaire were meant to guide the researcher in drawing appropriate and meaningful conclusions on the respondents' perception on Bank loan monitoring and loan performance:A study of deposit money banks in Nigeria.

4.2 Administration of Questionnaire

This section deals with the administration of the two set of questionnaires that wereadministered on the relevant bank staff and the customers of the banks. It also captured analyses of the entire responses received from the respondents.

Table 4.1 Summary of bank staff's administered questionnaires

Table 4.1 givesa general information on the total copies of the questionnaire distributed to the banks staff and those that were both returned and unreturned.

	Frequency	Percentage
Questionnaires distributed	300	100
Questionnaires returned	258	86
Questionnaire unreturned	42	14

Source: Field Survey November, 2012

A total number of 300 copies of the questionnairewere distributed to the relevant bank staff as indicated in the sampling method adopted by the research. Out of this number as indicated in the table 4.1 only 42 questionnaires remained unreturned representing 14%

while 258 copies were successfully retrieved which represents 86% of the respondents which was adequate for the purpose of the research.

4.3 Presentation of Data

The questionnaire was made up of two sections of closed-ended questions and open-ended questions.

4.3.1 Closed-ended questions

These are questions that were structured with options given to the respondents which sought for the various opinions of the respondents on the various areas under study.

Table 4.2

Loan monitoring effectiveness

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very Effective	71	27.5	27.5	27.5
	Effective	56	21.7	21.7	49.2
	Ineffective	75	29.1	29.1	78.3
	Highly Ineffective	56	21.7	21.7	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.2 is on a question set for the staff of the bank to find out their perceptions on the effectiveness of their loan monitoring activities. Out of the 258 questionnaires returned, 127 respondents are of the opinion that their banks loan monitoring are effective while 131 are of the view that the monitoring activities of their banks were ineffective representing 49.22% and 50.78% respectively.

The result of this means that majority of the banks were not absolutely effective in their loan monitoring functions. A further analysis of the frequencies shows that 71

respondents perceived their banks loan monitoring to be very effective which is represented by 27.50% of the total respondents. For those who hold on to the view that their banks loan monitoring is effective constitute 21.70%.

However, those respondents that said their loan monitoring is ineffective are 75 as against those that perceived those monitoring to be highly ineffective are 56 in numbers therefore constituting 29.10% and 21.70% respectively. This shows that the banks are not doing much in monitoring their loans effectively after loans disbursement.

The implication is that 50.78% of our total respondents perceived their monitoring to be generally ineffective which is not acceptable going by the CBN's provision of credit policy guidelines. The CBN credit policy guidelines provide that the banks should take full charge of loan monitoring activities after disbursement which could make them abide by the acceptable 5% non-performing loan ratio, CBN (2010).

As regards where credit facilities granted by the bank are approved, the following table gives a breakdown of the subject matter.

Table 4.3 Level at which creditfacilities are approved

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Branch Level	33	12.8	12.8	12.8
	Regional level	74	28.7	28.7	41.5
	Head office level	82	31.8	31.8	73.3
	Multiple levels	69	26.7	26.7	100.0
	Total	258	100.0	100.0	

Source: field survey November,2012

Table 4.3 shows responses of the bank staff on where their credit facilities are being approved. The options range through the branch level approvals, regional level and head

office level approvals as well as those approvals being granted at more than one layer of their credit administration structure. As indicated in Table 4.3, 33 respondents agreed to the option that their loans are approved at the branches while 74 hold the view that the approval are given at the regional offices representing 12.80% and 28.70% respectively. Head office and multiple approval levels on the other hand constitute 82 and 69 responses representing 31.80% and 69% respectively. This means that vast majority of the loans are approved outside the branches with most of the credit facilities being approved at the corporate head offices.

The implication of this is that the branches where the loan accounts are domiciled do not feel much responsible and accountable for the loans given out, after all the loans are not approved by them, hence, the loans are left ineffectively monitored. The situation would have been different if the loans are approved by the branches, hence, the inability of bank management to hold the branches responsible and accountable should the loans go bad and the burden of recovery to be taken by the branches. Empirical evidences have proven that the relationship officers and managers tend to take loan monitoring very seriously when the banks hold them responsible for the non-performing loans and sometimes withhold their salaries and their promotions against the bad loans.

Table 4.4 Liability- Deposit ratio

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	80:20 ratio	51	19.8	19.8	19.8
	50:50 ratio	133	51.6	51.6	71.3
	20:80 ratio	57	22.1	22.1	93.4
	Others, (please specify)	17	6.6	6.6	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.4reveals the composition of banks total loans compared to their total deposits, that is, their liability-deposit ratios. As it has been revealed in the said table 4.4 a total of 133 respondents say banks are giving just 50% of all their total generated deposits to their borrowing customers as loans which represent 51.60% of the total responses.

Other responses on the two extremes perceived the liability-deposit ratios as 80:20 and 20:80 with 51 and 57 frequencies with 19.80% and 22.10% respectively but other respondents hold on to the believe that their liability-deposit ratios are outside the range of optionsgiven in the questionnaire although representing just 6.60% with a frequency of 17 responses.

The implication of this finding is that banks are not efficient in employing customers' deposits in creating quality risks assets. It shows that only 19.80% of the total deposits of the banks are in the category of the most desired ratio of 80:20 while 80.20% fall outside the 80:20 liability-deposit ratios.

Table 4.5 Non-performing loan-Loan portfolio ratio

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	5:95	62	24.0	24.0	24.0
	10:90	58	22.5	22.5	46.5
	15:85	80	31.0	31.0	77.5
	20:80	50	19.4	19.4	96.9
	25:75	8	3.1	3.1	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.5 presented responses on the banks ratio of non-performing loan. Out of the total 258 responses received only 62 agree to the fact their banks were operating within the acceptable ratio of 5:95 of non-performing loans in relations to the general total loan portfolio. The 62 respondents represented just 24.00 percent while 196 which represent 76% of the total respondents concurred to the facts that their banks were operating outside the acceptable minimum benchmark set by the regulatory authority. A ratio of 15:85 constituted the group amongst others with a 31.00% while a ratio of 25:75 had the least responses constituting 3.10% of the total. The above distributions clearly showed a non-compliance with the prudential guidelines that could have reduced weight of bad loans in the balance sheets of the Deposit Money Banks.

The Table 4.5 implies that only 24% of the total banks non-performing loans are within the acceptable range of 5:95 non-performing loan-total loan portfolios ratio as recommended by CBN for DMBs. However, 76% of the non-performing loans fall outside the acceptable ratio. The general implication is that the banks may be faced with liquidity as well as profitability challenges.

Table 4.6 Implication above 5% of Nonperforming loan-Loan portfolio ratio

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Liquidity problems	101	39.1	39.1	39.1
	Recovery Problems	92	35.7	35.7	74.8
	Profitability Problems	60	23.3	23.3	98.1
	Reduced market Share	5	1.9	1.9	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.6 was the implications to the banks on non-compliance with the non-performing loan ratio of 5:95. The table has four options and the distributions are: 101 respondents perceived liquidity problems as a major consequence of exceeding the acceptable limit, this constitutes 39.10%; Recovery problems constitutes 35.70% as 92 of the responses perceived the anticipated problems to be related to challenges of recovery of banks assets. The responses of those that saw the problems from profitability angle are 60 in number while those who looked at it from drop in market shares are having 5 responses representing 23.30% and 1.90% respectively.

The respondents have expressed differing opinions of what the consequences of carrying non performing ratios which are over and above the acceptable ratio of 5:95. The majority of the respondents who are 101 in numbers that constitute 39.10% believe that the banks will be confronted with liquidity problems which can hamper the ability to pay deposit customers their funds as at when requested. It could also affect their ability to create additional quality risks assets, thereby causing recovery problems and most likely a shrinking profitability of the banks as well as serious consequences on their market shares.

Table 4.7Response on the Level of bank profitability

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very High	48	18.6	18.6	18.6
	High	95	36.8	36.8	55.4
	Low	62	24.0	24.0	79.5
	Very Low	53	20.5	20.5	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.7 gives the distribution of responses on what was perceived to be the banks levels of profitability. The responses of those who hold on to view that the level of their banks profitability to be very high are 48 in frequency representing 18.60% while those with just high profitability are 95 responses with 36.80 %. Those with the opinion that their banks level of profitability to be low are 62 constituting 24.00% while those who chose very low levels of profitability are 53 in number with 20.50% respectively.

The vast majority of respondents that constitute 143 respondents representing 55.43% are of the opinion that their banks are making high profit as against those with the view that their banks are making low profits who are 115 in number representing 44.57%. This implies that the majority of the banks are in the profit making category.

Table 4.8 Assessment of DMB's loan performance

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very High	54	20.9	20.9	20.9
	High	69	26.7	26.7	47.7
	Low	69	26.7	26.7	74.4
	Very Low	66	25.6	25.6	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.8 gives an analysis of the distribution of our respondents' perception of the banks' loan performances. In other words it investigated the loan performances of their banks.

Out of the total responses as indicated in the said table 54 respondents are of the view that their banks loan performance are very high therefore representing 20.90% while 69

respondents differed by saying that their loan performances are only high constituting 26.70% of the total distribution. However, 135 responses perceived their banks loan performance to be low: out this 69 respondents representing 26.70% are of the opinion that their loan performances are low while 66 respondents indicated that the loan performances are very low representing 25.60 %.

The implication of this table 4.8 is that the majority of the respondents who are 135 and representing 52.40% believed that the level of their banks loan performance are generally low as against 123 respondents constituting 47.60% who perceived that their loan performance as generally high. Empirical evidences have proven that the high the level of banks loan performances the lower their bad loans and the greater their chances of remaining liquid and have the ability to lend more and making substantial interest income and posting profit.

Table 4.9 Reasons for low level of loan performance

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Downturn of business activities	72	27.9	27.9	27.9
	High bank charges	66	25.6	25.6	53.5
	Funds diversion	78	30.2	30.2	83.7
	Negative Changes in the business environment	42	16.3	16.3	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.9 is linked to table 4.8 which is meant to find out what could have been responsible for the nonperforming loans. The question wants to find out if the loan performance is neither very high nor high, then what caused the loan performance to be

low or very low. Out of the total 258 responses 72 associated the nonperformance of the loan with downturn of business activities of the economy which constitutes 27.90% of the total responses. A total of 66 respondents linked the problem of the nonperforming loans to high bank charges on their credit facilities which also represent 25.60%. Those respondents who are of the views that funds diversions on the part of the borrowing customers and negative changes in the business environment impacting negatively on the cash flow of the borrowing customers have the following frequency distributions: 78 responses with 30.20% and 42 responses with 16.30% respectively.

There could be several factors that may be responsible for low performance of loans. However, empirical evidence have also shown that downturn of business activities can negatively impact on firms' abilities in generating sufficient cash-flows and subsequently damaging their abilities to repay back loans as at when due. Other factors could be sudden up changes in interest rates in the financial system which can force the banks to review their lending rate upwards and apply them to existing credit facilities thereby hampering their borrowing customer ability to repay back their loans. Customers can also divert the disbursed funds to other unintended uses especially if the loan monitoring is ineffective.

Table 4.10Response on the Bank's Liquidity position

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Highly Adequate	43	16.7	16.7	16.7
	Adequate	69	26.7	26.7	43.4
	Inadequate	94	36.4	36.4	79.8
	Highly Inadequate	52	20.2	20.2	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.10 presents the opinion of respondents on banks liquidity positions. The options range from a highly adequate liquidity position to a highly inadequate liquidity positions. The responses of those who hold on to the view that their banks liquidity positions to be highly adequate are 43 in number constituting 16.70% while those that see the positions as just adequate are 69 in number representing 26.70% of the total distribution. For those who are of the view that their banks liquidity positions to be inadequate are represented as: those who responses are on just adequate are 94 in number while the remaining are in the category of those who hold on to the view that their banks liquidity positions as highly inadequate are 52 in number therefore representing 36.40% and 20.20% respectively of the total 258 respondents.

The liquidity positions of banks are important not only to the DMBs but also to the financial system as a whole. It is for this reasons that apex banks globally set liquidity ratios for all DMBs operating within their domain, that is, their territories. In Nigeria the CBN has set 30% as the liquidity ratio of all DMBs in the country without any exception as to whether a bank is a limited or public liability company.

Table 4.10 has indicates that 56.60% of the respondents perceived their banks' liquidity to be inadequate which is too risky for the corporate existence of the banks and their successes. The implication of this is that banks will be challenged in meeting their deposits' of funds as at when due and adversely affecting their ability to lend.

The following table 4.11 on the other hand,presents the frequencies of contacts the banks made with the customers that have repayment difficulties.

Table 4.11 Frequency of bank contacts with borrowing customers after loan disbursement

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1 to 3 times in a month	59	22.9	22.9	22.9
	1 to 3 times in every 3 months	34	13.2	13.2	36.0
	1 to 3 times in every 6 months	95	36.8	36.8	72.9
	1 to 3 times in every 12 months	70	27.1	27.1	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.11 is made up of responses meant to investigate the rate at which the banks are monitoring their loans after disbursement. The entire 258 respondents answered the question on the frequency or rate at which the banks get in touch with their borrowing customers after loans have been disbursed to them.

Out of the total responses 59 in number constituted 22.90% said they do contact the customers 1 and 3 times in a month. But 34 respondents are of the view that such contacts are made 1 to 3 times in every three months, that is quarterly, constituting 13.20% of the total respondents. For those that said 1 and 3 times in every six months, that is half yearly, are 95 in number representing 36.80% while the remaining 70 respondents who are 70 in number opined that the contacts with the borrowing customers are made 1 and 3 times in every twelve months, that is, yearly which constitutes 27.10% of the entire respondents.

There is no differing view among both practitioners and scholars on the need for remaining in contact with the customers especially those that the banks have credit relationships with them. Also, empirical evidences have proven that the higher rate of

contacts the banks are making with their borrowing customers the better the performance of their loans, as this gives room for the early warning signals of loans going bad to be seen and mitigated against. Table 4.11 shows that only 22.90% of such contacts are made 1 to 3 times in a month which discouraging.

Table 4.12 Mode of contact with the borrowing customers

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	By Phone call	103	39.9	39.9	39.9
	By written letter	72	27.9	27.9	67.8
	By visiting the customer	49	19.0	19.0	86.8
	By inviting customer to the bank	34	13.2	13.2	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.12 is also related to the monitoring exercise carried out by the bank staff by way of making contacts after loan disbursements. It is a follow up on table 4.11 above but with the aim of finding out the mode of the contacts with the customer.

A total of 103 respondents indicated that the contacts are done through phone call to the customers which constitute 39.90% of the total responses. Contacts by way of writing letters to the customers has 72 responses which represent 27.90% as against making contacts by way of paying a visiting to the customers representing 19.00% with a total responses of 49 persons. However, the total of contacts by a way of inviting the customers to the bank has 34 responses constituting 13.20% of the total responses.

The choice of method (s) of reaching out to the customers after loan disbursement is equally important as some have proven to be more effective in loan monitoring than others. As it has been indicated in the above table 4.12 the vast majority of the respondents, that is, 103 of them reported that their banks were depending on phone calls to the customers therefore relying on what they choose to tell the bankers. Others depended on writing letters to the customers and they are 72 in total.

However , the best practices as supported by empirical evidence has been those of engaging the customers on face to face discussion basis, where the customers can be visited at their business premises or being invited by the bankers to the bank premises.

Table 4.13Suggestions on how to handle the nonperforming loans

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Provisioning for nonperforming loans	71	27.5	27.5	27.5
	Sales of customers collateral securities	89	34.5	34.5	62.0
	Loan restructuring	64	24.8	24.8	86.8
	Loan walkout	34	13.2	13.2	100.0
	Total	258	100.0	100.0	

Source: field survey November, 2012

Table 4.13 shows the opinion of the respondents on how the banks intend to handle their nonperforming loans. Depending on the circumstances and the customers under consideration, some banks depend on the regulatory requirements of making provisioning of the affected nonperforming loans, while others go for the second way out of the nonperforming loans by falling back on the collateral securities. However, other banks go for loan restructuring or arranging for loan walkouts.

A total of 71 respondents said they handle the nonperforming loans through normal provisioning which represents 27.5% of the total respondents. The distribution shows that 89 respondents believe in crystallizing their customers' collateral securities by selling them off or calling on their rights of set-off, this constitutes 34.50%. But others hold on to the belief that loan restructuring is the best way of handling the nonperforming loans and they are 64 in number representing 24.80%. However, 34 of the responses go for loan walkout option which represents 13.20% of the entire responses.

4.3.2 Open-ended question

These are questions which sought for respondents various opinions on the issues under study. This generated responses on the possible suggestions for the way forward out of the non-performing loans trouble.On the single open ended question in the questionnaire of the bank staff which sought for possible suggestions on improving the situation, the following are the summarized views of those respondents who attempted the question.

It was strongly suggested that the banks should strengthened the principle of 'Know Your Customer' while entering into credit relationship. They emphasized additional layers of background checks on the character of the key persons of any borrowing relationship and their general attitudes towards credit. This should involve the relationship managers understanding their customers and their businesses dynamics.

It was also opined that a lot should be brought to bear on credit documentations that are done during credit application, credit appraisal and approvals. These documentations will certainly be relied upon throughout the periodicity of the credit. Some are of the view that strict enforcement of CBN's guidelines on credit documentations and filing should be maintained without allowing any room for deviations.

Other respondents recommended strict penalties for credit defaults by way of upward review of interest for all past due obligations. This recommendation was based on the clauses contained in credit offer letter that states the penalties for all form of credit defaults such as past due obligations. However, other considered positive sanctions in form of rewards for customers that pay promptly by way of reduction in interest payable.

It is the view of other respondents that continuous monitoring of their borrowing customers' business environment is a key success factor so that credit problems can be detected in good time and appropriate mitigants are put in place. The assumption is that the business circles of various sectors are predictable and early warning signals can be seen and prepared against. The banks can simply adjust their credit facilities and restructure bad loans or simply arrange for loan walkout options.

Few respondents spoke on measures that need to be taken on collateral securities. Perhaps this might be connected with the 2008 global credit crises that rendered mortgages and shares virtually unreliable means of loan collateralisations. However, those that spoke on it suggested a continuous valuation of the collateral securities in question as well as taking appropriate insurance policies and their subsequent renewals where applicable.

There are indeed those bank staff that spoke basically on loan restructuring. They are of the view that instead of the banks to depend on provisioning and loan write-offs, they should hold on to the option of restructuring the loan facilities. The customers will be assisted in turning around their businesses and generate sufficient cash flow that can take care of loan obligations as they fall due, that is, of both the interest and the principal.

Table 4.14 Summary of bank customers' questionnaires

	Frequency	Percentage
Questionnaires distributed	300	100
Questionnaires returned	229	76.33
Questionnaire unreturned	71	23.67

Source: Field Survey November, 2012

Table 4.14 above shows the total number of questionnaires distributed and returned and those that remained unreturned. As stated in the chapter three a total of 300 questionnaires were distributed for the borrowing customers of the bank but only 229 were responded to, constituting 76.33% while 71 remained unreturned which also constituted 23.67% of the total copies of questionnaire distributed.

The table shows a drop of the number of respondents to this set of questionnaire which was meant to obtain the views of the banks customers. The number of the returned customers' copies of questionnaire dropped to 229 which was 76.33% of the total respondents compared to those of the bank staff which was 258 representing 86% of the 300 questionnaires distributed. However, 76.33% of the returned questionnaire from the customers is adequate for the purpose of this research as only 23.67% unreturned questionnaires were recorded.

Table 4.15Years of operation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-5 years	61	26.6	26.6	26.6
	6-10 years	78	34.1	34.1	60.7
	11-15 years	52	22.7	22.7	83.4
	16-20 years	27	11.8	11.8	95.2
	21 years and above	11	4.8	4.8	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.15 gives the results of the banks customers' responses on years of operating their various business activities, that is, for how long they have been in business. Customers that have been in business between the period bracket of day one to 5 years are 61 in number which represent 26.60%, while those with 6 to 10 years are 78 by number which constitutes 34.10%. The situation is different with customers falling within the range of 11 to 15 years and those with 16 to 20 years with 52 and 27 respondents constituting 22.70% and 11.80% respectively. The customers with 21 years and above are only 11 in number constituting 4.80%.

The majority of the respondents which is made up of 139 customers constituting 60.70% have been in their businesses for a period of less than 1 year to 10 years while those with over and above 10 years experiences are 90 customers representing 39.30%. However, taking a critical look at the table shows that 168 customers constituting 73.36% of the total respondents fall within the range of 6 years and above 21 years relevant business experiences in their various fields.

Therefore, the table implies that the banks were basically lending for growth and/or diversification with very little percentage going to the startups.

The expectation will therefore mean that the vast majority of the borrowing customers have the required skills and experiences to manage their loans effectively.

Table 4.16 Number of bank(s) patronized

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1 Bank	54	23.6	23.6	23.6
	2 Banks	81	35.4	35.4	59.0
	3 Banks	78	34.1	34.1	93.0
	4 Banks	8	3.5	3.5	96.5
	More than 4 Banks	8	3.5	3.5	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.16 shows the customers' responses on the number of banks they patronize. The results indicate that all options had responses recorded against them with those customers patronizing just 1 bank with a total number of 54 which is represented by 23.60% of the total. For those operating their banking transactions with 2 and 3 banks at a time were 81 and 78 in number represented by 35.40% and 34.10% respectively. But for those with 4 banks are 8 in number and those customers with more than 4 banks at a time are all having 8 responses 3.50% and 3.50% respectively.

The analysis shows that only 54 customers representing 23.60% of the total (100%) respondents have and stick to 1 bank at a time while the majority of the customers who are 175 in number constituting 76.40% maintain 2 or more banks at a time. There are chances that some customers can go into round-tripping of funds amongst the many

banks they work with. It might indeed become very difficult for the banks to rely on transaction account monitoring as advocated by Nakamura (1993).This is very true as banks may not have access to full information of their customers' accounts transactions especially those that are routed through other banks.

Therefore, the Table 4.16 concurs with the position of Strahan (1999) who held the view that transaction account monitoring as a strategy of loan monitoring is not sufficient in keeping loans within the acceptable ratios and that it should be used as a complement to other monitoring tools.

Table 4.17Response on major credit facility from main banker

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Temporary overdraft	31	13.5	13.5	13.5
	Documentary import finance facility	28	12.2	12.2	25.8
	Term loan	48	21.0	21.0	46.7
	Asset Finance	36	15.7	15.7	62.4
	Margin Finance	31	13.5	13.5	76.0
	Multiple Loans	55	24.0	24.0	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.17 reveals that banks customers enjoy all types of credit facilities from the bank. Some of the customers who are 55 in number and represented by 24.00% are enjoying multiple credit facilities. Others are enjoying temporary overdrafts constituting 13.50% of the total respondents.

For those who are into international trading especially importation enjoyed documentary import finance facility, there were 28 responses in this category representing 12.20%

while those that go for term loans were 48 in number with 21.00%. But for those with asset finance facilities were 36 in number as against those margin finance facilities had 31 responses representing 15.70% and 13.50% respectively. The final category is that of customers who have more than one type of credit facility at a time and this category has 55 responses constituting 24.00% of the total respondents.

The result shows that those customer with multiple loans are 55 in number therefore constituting 24% of the total and the highest amongst the other categories which can make monitoring difficult especially if the loans are on the same line of business of a single customer.

Table 4.18 Frequency of contacts made by the banks after loan disbursement

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1 to 3 times in a month	32	14.0	14.0	14.0
	1 to 3 times in every 3 months	60	26.2	26.2	40.2
	1 to 3 times in every 6 months	76	33.2	33.2	73.4
	1 to 3 times in every 12 months	61	26.6	26.6	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.18 gives responses on the frequency of contacts the banks are making with them after loan disbursements. Out of the total number of 229 customers whose questionnaires were returned 32 said that their banks contact them 1 to 3 times in every one month period represented by 14.00%. Other respondents indicate that the banks get in touch with them 1 to 3 times in every 3 months as against those that are contacted between 1 to

3 times in every 6 months represented by 60 and 76 responses constituting 26.20% and 33.20% respectively. However, the last category of respondents claimed that the banks only get in contact with them 1 to 3 times in every 12 months with their number of responses 61 in total represented by 26.60%.

This Table 4.18 is related to the question that bank staff were asked and responded in Table 4.14. The two tables show that the banks were mostly contacting their customers 1 to 3 times in every 6 months and 12 months. This implies that the rate of contacts the banks are making is very low and has the tendency of creating a gap that can be misused by borrowing customers who have a very low credit culture.

Table 4.19Mode of contacts with customers

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	By Phone call	63	27.5	27.5	27.5
	By written letter	73	31.9	31.9	59.4
	By visiting the customer	66	28.8	28.8	88.2
	By inviting customer to the bank	27	11.8	11.8	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

The banks have several methods of making contacts with their borrowing customers after disbursement. The above Table 4.19 gives the nature of these methods ranging from phone calls, written letters, visiting the customers and inviting the customers to the bank. Going by table 4.19 the customers who said their banks contacted them through phone calls are 63 in number which is represented by 27.50% while those that were contacted by way of written letters from the banks constitute 31.90%. However, the categories of those that are contacted through a visitation by the bank staff to their premises are 66 in

number representing of 28.80% of the total respondents while those that are invited to the banks are 27 in number constituting 11.80% of the 229 respondents.

The result in Table 4.19 is similar to that of Table 4.12 where both categories of respondents, that is, the customers and the bank staff were asked to indicate the methods of such contacts. The two tables indicated that the banks were over 50% relying on methods of phone calls and written letters of contacting the customers as against face to face discussion with the customers through visitations of their premises.

Table 4.20 Methods of loan repayment preferred by the customers

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	I cannot pay back	43	18.8	18.8	18.8
	Sales of my collateral securities	70	30.6	30.6	49.3
	Loan restructuring	82	35.8	35.8	85.2
	Loan walk out	34	14.8	14.8	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.20 represents opinions on how they intend to pay back their loans with the banks. Those that said they cannot pay back their loans are 43 in number represented by 18.80% of the total respondents of 229. There are those that hold on to the view of selling collateral securities with the bank are 70 respondents constituting 30.60%. Others call for loan restructuring of their credit facilities that will give more time to generate enough cash flow that will keep their business going and be able to pay their loans back, representing 35.80% while those that are of the opinion of getting loan walkout arrangement from the banks constitute 14.80%.

This implies that majority of the customers prefer loan restructuring and loan walkouts arrangements as the way out which contradicts the position of the banks in Table 4.13 where they favoured provisioning of nonperforming loans and sales of customers' collateral securities.

Table 4.21 Methods of Safeguarding of borrowed funds by the customers

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	By using it for the purpose for which it was intended	37	16.2	16.2	16.2
	By paying back as at when due	48	21.0	21.0	37.1
	By taking insurance cover on my business	67	29.3	29.3	66.4
	By monitoring my business closely	77	33.6	33.6	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.21 above presents the views of respondents on how they do imbibe credit risk culture in their organizations. The question was asked as to how do they protect the banks borrowed funds and they gave different opinions and they are presented in Table 4.21.

Out of the 229 customers that responded,37,expressed their opinion on how they protect the borrowed funds against losses by saying that they use the loan proceeds for the purposes of which they are intended 48 respondents that opted for paying the loans as they fall due representing 21.00%. There are those customers whose view is squarely on taking insurance covers against business risks which usually hamper businesses' ability to repay loans and they are 67 in number constituting 29.30%.Again 77 respondents say

proper business monitoring can help them in protecting the borrowed funds representing 33.60% of the total customers who responded to the questionnaires.

Thesefindings of this table agree with that of Ernst and Young (2011) that call for greater involvement of borrowing customers in keeping bank loans performing where they advocated for the customers to imbibe good credit risk culture in handing the borrowed funds.

Table 4.22 Frequency of demand for pay-down of facility

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very Frequent	164	71.6	71.6	71.6
	Frequent	35	15.3	15.3	86.9
	Not Frequent	28	12.2	12.2	99.1
	Not at all	2	.9	.9	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.22 shows the views of respondents on the frequency at which their banks asked them to pay down their loan facilities. The table reports that 164 of the respondents report that their banks asking them very frequently for pay down of the facilities representing 71.60% while those that were frequently asked to pay down are 35 in number constituting 15.30%. The situation was highly different for those that were not frequently asked to pay down as their number was just 28 with 12.20% only while those that were never asked to pay down with just 2 respondents representing 0.90% of the total respondents.

Table 4.22 shows that the banks were under heavy pressure of liquidity problems, dropping profitability, short of loanable funds and/or CBN's pressure to recover or

combination of these factors. Over 99% of the customers acknowledge the fact that they were asked to pay down their facilities.

The study further asked the respondents to indicate the reasons given by the banks on why they are asked to pay them, which they stated in the Table 4.23 below.

Table 4.23 Reasons for Being Asked to Pay Down

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	It has liquidity problems	67	29.3	29.3	29.3
	It is eroding its profitability	76	33.2	33.2	62.4
	Its loanable funds are being eroded	70	30.6	30.6	93.0
	CBN instructed it to do so	16	7.0	7.0	100.0
	Total	229	100.0	100.0	

Source: Field Survey November, 2012

Table 4.23 presents the reasons given by the banks as to why they were seeking for down payment from their borrowing customers. What this means is that all those that expressed their opinions among options (a), (b), (c) and (d) were given any of the above reasons. Customers whose banks gave them reason of liquidity problems were 67 in number representing 29.30% while those that were given reason of an eroding profitability were 76 in number signifying a total percentage of 33.20%. However, for customers that were given eroding loanable funds and CBN's instructions to recover were 70 and16 respondents each representing 30.60% and 7.00% respectively.

Thus, it is clear that there are several factors responsible that compelled the banks to demand for pay down of facilities from their borrowing customers. It revealed that there

was little pressure from CBN for recovery of nonperforming loans. The prominent reasons given by the banks were those of falling profitability, shortage of loanable funds as well as liquidity problems.

4.4 Hypotheses Testing

Below are the various tests conducted upon the three hypotheses developed for the study, that is, hypothesis I, II and III

HYPOTHESIS I

The below table 4.24 is used in testing hypothesis I, which states that: there is no significant relationship between bank loan monitoring and loan performance among deposit money banks in Nigeria.

Table 4.24.1 Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	80.342[a]	9	.000
Likelihood Ratio	86.108	9	.000
Linear-by-Linear Association	27.691	1	.000
N of Valid Cases	258		

Source: Field Survey November, 2012

Table 4.24.2 Symmetric Measures

		Value	Approx. Sig.
Nominal by Nominal	Phi	.558	.000
	Cramer's V	.322	.000
	Contingency Coefficient	.487	.000
N of Valid Cases		258	

Source: Field Survey November, 2012

From Tables 4.24.1 and 4.24.2, the Pearson chi-square is calculated to be 80.34. Checking the critical values at 9 degree of freedom and 5% level of significance, it is found 3.325.This implies that the calculated Pearson chi-square value is greater than the critical value and in line with the interpretational procedure; there is sufficient evidence to reject the null-hypothesis.

This result is also consistent with the level of p-value of 0.00 as indicated in the table which is lower than the chosen level of significance of 5% hence the null-hypothesis is hereby rejected. What this implies is that from the perceptions of the respondents on the two variables, that is, the dependent and the independent variable, there is evidence of a significant relationship between bank loan monitoring and loan performance. It also implies that the more effective the bank loan monitoring policies and procedures put in place the more we should expect the banks loans in the banks under study to also perform.

HYPOTHESIS II

Table 4.25 was used in testing hypothesis II which states that there is no significant relationship between banks ratio of non-performing loans and DMBs profitability in Nigeria.

Table 4.25 Correlations

		Ratio of NPL	Profitability
Ratio of NPL	Pearson Correlation	1	-.344**
	Sig. (2-tailed)		.001
	N	91	91
Profitability	Pearson Correlation	-.344**	1
	Sig. (2-tailed)	.001	
	N	91	91

** Correlation is significant at the 0.01 level (2-tailed)

Source: Field Survey November, 2012

As it can be seen in table 4.25, the Pearson Correlation Coefficient is -0.344 which is a moderately weak correlation. However, this demonstrates the fact that there is an evidence of weak correlation between ratio of non-performing loans and profitability.

In line with our methodology we will test for significance of this correlation as follows:

Where: r = the correlation coefficient

n = the number of periods being studied

on the basis of which: r = -0.344, n = 7 years, Computing this t = -0.82

However, computing this with critical value at n = 7 and degree of freedom of 6 (7-1=6) and a level of significance of 5% it follows that the critical value **t** is 1.96, using the 2-tailed test. This means that the critical value is greater than the calculated value of -0.82. Therefore, we uphold the null hypothesis which says that there is no significant relationship between non-performing loan and profitability.

This position is upheld because the hypothesis established a weak relationship which has been found to be insignificant by the corresponding t-test for the significance of correlation. Therefore, there is sufficient evidence of upholding and accepting the null-hypothesis.

Hypothesis III

Table 4.26 titled hypothesis III is used in testing the hypothesis III, which states that there is no significant relationship between bank's non-performing loans and bank share prices in Nigeria.

Table 4. 26 Correlations

		Bank's Share Prices	Non-Performing Loan
Bank's Share Prices	Pearson Correlation	1	-.083
	Sig. (2-tailed)		.434
	N	91	91
Nonperforming Loan	Pearson Correlation	-.083	1
	Sig. (2-tailed)	.434	
	N	91	91

Source: Field Survey November, 2012

As it can be seen the Pearson Correlation Coefficient is -0.083 which is a moderately weak correlation. However, this demonstrates the fact that there is an evidence of weak correlation between banks non-performing loans and their share prices in Nigeria.

In line with our methodology, we tested for significance of this correlation as follows:

Where:

r = the correlation coefficient

n = the number of periods being studied

on the basis of which:

r = -0.083

n = 7 years

Computing this t = -0.186

However, computing this with critical value at n = 7 and degree of freedom of 6 (7-1=6) and a level of significance of 5% it follows that the critical value **t** is 1.96, using the 2-tailed test.

This means that the critical value is greater than the calculated value of -0.186. Therefore, we uphold the null hypothesis which says that there is no significant relationship between non-performing loan and share price.

This position is upheld because the hypothesis established a weak relationship which has been found to be insignificant by the corresponding t-test for the significance of

correlation. Therefore, there is sufficient evidence of upholding and accepting the null-hypothesis.

4.5 Discussion of the findings

i. The results show that there is indeed significant relationship between bank loan monitoring and loan performance.

ii. Bank staff who are charged with the responsibilities of loan monitoring and management tend to give very little attention on loan monitoring activities as customer are left alone without contacting them after loan disbursement. This has been the case with majority of our respondents as they have suggested that the contacts made with the customers after loan disbursement have been in the range 1 to 3 times in every 6 to 12 months period which is grossly inadequate as so many things could go wrong with the banks funds. The results are in sharp contrast with the policy of banks that require a minimum of 3 contacts in every month.

iii. The results have also shown that very little attention was given to customers' visitation as a tool of bank loan monitoring. The bank staff focused more on distance contacts such as putting phone calls to the customers and/or sending written letters to the customers as advocated by Turvey*et al* (2011), although he used the concept of SMS.Empirical evidence have proven that visiting customer and having one-on-one discussions with them on the position of their loans are much more effective in keeping bank loans within the acceptable non-performing loan ratio of 5% (CBN, 2010).

iv. The results also unfold the fact that the borrowing customer are not all that involved in the activities of loan monitoring as suggested by Earn and Young (2011), who advocated for carrying the borrower along in the loan monitoring exercise. They hold on to the view that a credit culture should be embedded in all organizations to a level where every staff is made to participate in protecting the borrowed funds.

v. The resultsreveal that there is no significant relationship between ratio of non-performing loan and profitability. This position contradicts the result ofKargi (2011) who believed in the existence of a significant relationship between bank performance and loan performance.

vi. The results also show that there is a relationship between bank non-performing loan and bank share prices but the significance of the relationship is also weak.

The reasons for these weak relationships might perhaps be explained by the fact that empirical evidences have proven that most of the figures published by the banks were revealed to be doctored by the banks as reveled by CBN stress-tests during its extra-ordinary examination of the banks. The CBN's examinations indeed revealed that many banks were not declaring the true positions of their non-performing loans and when they were made to absorb the bad loans in their profit and loss accounts they ended up with loss positions,hence, the reason for the weak relationship between the non-performing loans and bank profitability. While the weak relationship between the non-performing loans and share price might also be connected to the fall

in the banks profitabilities, hence, the fall in share price but without a strong significance.

vii. Another possible explanation for the weak relationships between non-performing loans and the share prices and the relationship between ratio of non-performing loans and the bank profitability could be due to the fact that those banks that withstood the stress-tests of CBN's extra-ordinary examinations were never quoted in the Nigerian Stock Exchange. If they had been quoted and the shares prices taken into consideration and their profitability being part of the study, then the relationships would have been significant enough to have rejected the research's hypotheses II and III.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMEDATIONS

5.1 Summary

The first chapter centered on the introductory aspect of the research work which gaveIt gave the research work the foundation upon which other chapters were built upon. In it there contained the statement of the problem, research questions, objectives and hypotheses.

Chapter two covered the review of related literatures on bank loan monitoring and loan performance. The chapter, among others areas reviewed the various methods of bank loan monitoring, strategies of such loan monitoring, loan performance, objectives of loan monitoring, risk factors affecting loan performance. It also touched on areas such as types and classifications of loans, credit appraisals and approval processes, strategies of improving loan repayments, loan recovery and/or loan restructuring and loan walkout strategies, credit risks management, loan administration as well as principles of lending of the banks.

The third chapter was on research design, population and sampling technique which resulted in selection of two categories of respondents, that is, relevant bank staff and bank borrowing customers. A sample size of 256 for category I and 226 for category II were selected but 300 copies of the questionnaire were distributed to respondents of each category. The bank staff population was 714 respondents whilecustomers' population was 523 respectively cutting across the six geopolitical zones of Nigeria. The research

used both primary and secondary data which were analysed using Pearson chi-square and Pearson correlation coefficients respectively.

Chapter fourcentered on data presentation, and analysis, it also discussedthe research findings. In the chapter, it was established that there exists a strong relationship between bank loan monitoring and loan performance among deposit money banks of Nigeria, the result which rejected the null-hypothesis I. However, the research findings showed weak relationship between banks ratio of non-performing loans and banks profitability as well as weak relationship between banks non-performing loans and banks share prices, therefore upholding the research hypotheses II and III. The weak relationships among the last variables that led to the upholding of hypotheses II and III might have been connected to the incorrect reporting of the banks financials were non-performing loans were not fully declared and/or the exclusions of the private limited liability banks that were not included in the secondary data.

5.2 Conclusion

The following are the conclusions drawn from the findings of this research:

First, the findings revealed that there is a significant relationship between banks loan monitoring and loan performance. This denotes that the more proficient the bank monitors its disbursed loans the better their loan performance otherwise they will end up as bad loans. The choice of tool of monitoring and frequency of monitoring as well as the mode/methods of such monitoring also do count in keeping the loans within the acceptable performance levels. This means that loans that are left unmonitored by the banks stand to fall within the substandard, doubtful and loss classifications.

The Second conclusion is based on the findings that there is weak relationship between ratio of banks non-performing loan and banks profitability. Although the finding of the study has established weak relationship between the ratio of banks non-performing loans and banks profitability, it does not rule out the impact of quality of banks risk assets on their profitability. The lower those ratios of non-performing loans to loan portfolio are kept the more loanable funds are made available to the banks to lend and the lower the provisions that will be made on the non-performing loans.

The third conclusion is that there is also weak relationship between banks non-performing loans and banks share prices. This weak relationship notwithstanding, it is not totally discounted that there is no relationship between banks non-performing loans and bank share prices. The study has established a relationship between bank non-performing loans and banks share price.

The fourth conclusion is that positive credit culture on the part of the borrowing customers has a direct bearing on the performance of banks loans. This indicates that the borrowing customers are important elements in keeping bank loans within the acceptable level of loan performance. The impact of positive credit culture of the borrowing customers in keeping the loans performing is also important as much as the bank's loan monitoring function.

5.3 Recommendations

Going by the above stated findings and the conclusions drawn from them, the following recommendations are hereby made by the study:

i. The banks should put policies in place that will stipulate the number of contacts and the modes of such contacts that should be made with their borrowing customers as they have significant impact on keeping loans within the acceptable 5% ratio of non-performing loans.

ii. The Deposit Money Banks should also come up with reward and punishment system on their staff concerned with loan monitoring. A failure of a loan and its recovery should be made to be a joint responsibility between the borrowing customers and the account relationship staff as well as those staff that are concerned with loan monitoring. This should form part of their Key Performance Indicators (KPIs).

iii. It is also recommended to the banks to sell their bad loans to the secondary market so that they will have more loanable funds available at their disposals and have more time to manage their good loans.

iv. The banks are also advised to establish mutual collaboration with their borrowing customers in ensuring that their loans are made to remain active throughout the period of the loans. This can be done through inculcating positive and responsive credit culture among the borrowing customer and their staff, so that they will protect the banks borrowed funds by keeping the loan active and protecting them against going bad.

5.4 Suggestion for Further Research

The following suggestion is for further research:

i. Future research should be conducted on the private limited liability banks, that is, the unquoted banks, so as to investigate the significance of ratio of non-performing loans on their profitability.

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Appendix I Population Distribution of Category 1 of the Study

S. No	Banks	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/Bank
1	Access Bank (Access+Intercon)	5	4	10	8	7	6	**40**
2	FCMB (FCMB+Finbank).	6	4	11	5	4	5	**35**
3	Enterprise Bank Ltd.	5	3	9	8	4	4	**33**
4	EcoBank (Eco+Oceanic).	4	4	8	8	5	4	**33**
5	Diamond Bank PLC	6	4	10	7	8	5	**40**
6	Fidelity Bank PLC	5	3	7	8	7	4	**34**
7	First Bank Plc	10	7	11	12	9	6	**55**
8	GT Bank PLC	9	5	10	9	7	6	**46**
9	Keystone Bank Ltd.	6	3	7	9	4	3	**32**
10	Mainstreet Bank Ltd	5	7	8	7	3	4	**34**
11	Nigeria International Bank Ltd.	4	0	6	8	0	3	**21**
12	Skye Bank PLC	6	3	7	9	4	5	**34**
13	StanbicIBTC (Stanbic+IBTCChrd)	4	2	6	6	4	3	**25**
14	Standard Chartered Bank	4	0	6	7	0	2	**19**
15	United Bank of Africa	9	5	11	12	7	6	**50**
16	Sterling Bank (Starling+ETB).	6	3	7	9	6	5	**36**
17	Union Bank PLC	8	5	9	12	8	6	**48**
18	Unity Bank PLC	9	6	6	5	3	2	**31**
19	Zenith Bank PLC	9	5	12	14	7	7	**54**
20	Wema Bank Plc	0	0	3	9	0	2	**14**
	TOTAL/GEOPOL ZONE	**120**	**73**	**164**	**172**	**97**	**88**	**714**

Source: Extracted from the websites of the various banks as at 31st December 2011

Sample Size of Category 1 of the Study Population

SAMPLE SIZE	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/ Bank
$X_1/714*256$	**43**	**25**	**59**	**61**	**35**	**32**	**256**

Appendix II Distribution of 300 Questionnaires to Category 1 of the Study Population

S. No	Banks	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/Bank
1	Access Bank (Access+Intercon)	2	1	5	3	3	2	**16**
2	FCMB (FCMB+Finbank).	2	1	5	2	2	2	**14**
3	Enterprise Bank Ltd.	2	1	3	3	2	2	**13**
4	EcoBank (Eco+Oceanic).	2	1	3	3	2	2	**13**
5	Diamond Bank PLC	2	1	5	3	3	2	**16**
6	Fidelity Bank PLC	2	1	3	3	3	2	**14**
7	First Bank Plc	4	3	5	5	4	3	**24**
8	GT Bank PLC	4	3	5	4	3	3	**22**
9	Keystone Bank Ltd.	2	1	3	4	2	1	**13**
10	Mainstreet Bank Ltd	2	3	3	3	1	2	**14**
11	Nigeria International Bank Ltd.	2	0	2	3	0	1	**8**
12	Skye Bank PLC	2	1	3	4	2	2	**14**
13	StanbicIBTC (Stanbic+IBTCChrd)	2	1	2	3	2	1	**11**
14	Standard Chartered Bank	2	0	2	3	0	1	**8**
15	United Bank of Africa	4	3	5	5	3	2	**22**
16	Sterling Bank (Starling+ETB).	2	1	3	4	2	2	**14**
17	Union Bank PLC	4	3	4	5	3	2	**21**
18	Unity Bank PLC	4	3	2	2	1	1	**13**
19	Zenith Bank PLC	4	3	5	6	3	3	**24**
20	Wema Bank Plc	0	0	1	4	0	1	**6**
	TOTAL/GEOPOL ZONE	**50**	**31**	**69**	**72**	**41**	**37**	**300**

Source: Derived from Appendix I above

Adjusted number of Questionnaires applied to Category 1 of the Study Population

SAMPLE SIZE	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/ Bank
X_1/714*300	**50**	**31**	**69**	**72**	**41**	**37**	**300**

Appendix III Population Distribution of Category 2 of the Study

S. No	Banks	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/Bank
1	Access Bank (Access+Intercon)	5	3	8	5	4	4	**29**
2	FCMB (FCMB+Finbank).	4	2	5	4	3	5	**23**
3	Enterprise Bank Ltd.	6	4	5	3	4	7	**29**
4	EcoBank (Eco+Oceanic).	3	5	7	4	6	3	**28**
5	Diamond Bank PLC	7	3	9	5	3	2	**29**
6	Fidelity Bank PLC	3	1	7	9	3	4	**27**
7	First Bank Plc	5	6	8	7	6	4	**36**
8	GT Bank PLC	7	4	7	6	5	3	**32**
9	Keystone Bank Ltd.	3	3	9	4	2	4	**25**
10	Mainstreet Bank Ltd	4	2	6	6	3	6	**27**
11	Nigeria International Bank Ltd.	3	0	4	4	0	2	**13**
12	Skye Bank PLC	4	2	5	7	5	4	**27**
13	StanbicIBTC (Stanbic+IBTCChrd)	2	3	6	5	3	4	**23**
14	Standard Chartered Bank	2	0	3	5	0	1	**11**
15	United Bank of Africa	6	4	6	7	4	5	**32**
16	Sterling Bank (Starling+ETB).	4	3	7	6	4	5	**29**
17	Union Bank PLC	4	4	7	9	3	3	**30**
18	Unity Bank PLC	6	3	5	4	3	2	**23**
19	Zenith Bank PLC	5	5	9	8	6	4	**37**
20	Wema Bank Plc	0	0	2	9	0	2	**13**
	TOTAL/GEOPOL ZONE	**83**	**57**	**125**	**117**	**67**	**74**	**523**

Source: Extracted from the loan units of the various banks as at 31st December 2011

Sample Size of Category 2of the Study Population

SAMPLE SIZE	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/ Bank
$X_1/523*226$	36	25	54	50	29	32	226

Appendix IV Distribution of 300 Questionnaires to Category 2 of the Study Population

S. No	Banks	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/Bank
1	Access Bank (Access+Intercon)	3	2	4	3	2	2	**16**
2	FCMB (FCMB+Finbank).	2	1	3	2	2	3	**13**
3	Enterprise Bank Ltd.	3	2	3	2	2	5	**17**
4	EcoBank (Eco+Oceanic).	2	3	4	2	3	2	**16**
5	Diamond Bank PLC	4	2	6	3	2	1	**18**
6	Fidelity Bank PLC	2	1	4	6	2	2	**17**
7	First Bank Plc	3	3	4	4	3	2	**19**
8	GT Bank PLC	4	2	4	3	3	2	**18**
9	Keystone Bank Ltd.	2	2	6	2	1	2	**15**
10	Mainstreet Bank Ltd	2	1	3	3	2	3	**14**
11	Nigeria International Bank Ltd.	2	0	2	2	0	1	**7**
12	Skye Bank PLC	2	1	3	4	3	2	**15**
13	StanbicIBTC (Stanbic+IBTCChrd)	2	2	3	3	2	2	**14**
14	Standard Chartered Bank	2	0	2	3	0	1	**8**
15	United Bank of Africa	3	2	3	4	2	3	**17**
16	Sterling Bank (Starling+ETB).	2	2	4	3	2	3	**16**
17	Union Bank PLC	2	2	4	6	2	2	**18**
18	Unity Bank PLC	3	2	3	2	2	1	**13**
19	Zenith Bank PLC	3	3	6	4	3	2	**21**
20	Wema Bank Plc	0	0	1	6	0	1	**8**
	TOTAL/GEOPOL ZONE	**48**	**33**	**72**	**67**	**38**	**42**	**300**

Source: Derived from Appendix III above.

Adjusted Sample Size of Category 2Of The Study Population

SAMPLE SIZE	N/west (Kano)	N/East (Bauchi)	N/Central (Abuja)	S/West (Lagos)	S/East (Enugu)	S/South (Rivers)	Total/ Bank
$X_1/523*300$	48	33	72	67	38	42	300

APPENDIX V: QUESTIONNAIRE

Department of Business Administration,

Faculty of Administration,

Ahmadu Bello University,

Zaria.

01st May, 2012.

Dear Respondent,

I am Postgraduate student pursuing M.Sc. Business Administration in the above mentioned department. I am undertaking a research on *"Bank Loan Monitoring and Loan Performance:A study of Deposit Money Banks in Nigeria."*

The research is in partial fulfillment of the requirement for the award of Master of Science in Business Administration in Ahmadu Bello University, Zaria. Please complete the attached questionnaire and be

as frank as possible. I wish to assure you that all Information provided would be treated with strict confidentiality and your name and/or identity will never be revealed. The data collected will only be used for academic purposes.

Thank you very much in anticipation for your usual cooperation.

ISMA'IL TIJJANI IDRIS

M.SC./ADMIN/1902/09-10

1. For how long have you been in business?

   (a) 0 – 5 years ( )

(b) 6-10 years ( )

(c) 11- 15 years ( )

(d) 16 –20 years ( )

(e) 21 and above ( )

2. Indicate the number of banks you patronise.

(a) 1 bank ( )

(b) 2 banks ( )

(c) 3 banks ( )

(d) 4 banks ( )

(e) More than 4 banks ( )

3. What type of Credit Facility do you have from your (major) bank?

(a) Temporary Overdraft ( )

(b) Documentary Import Finance Facility ( )

(c) Term Loan ( )

(d) Assets Finance ( )

(e) Margin Finance ( )

(f) Multiple ( )

4. How frequently has the bank contacted you after the loan disbursement?

a) 1 to 3 times in a month ( )

b) 1 to 3 times in every 3 months ( )

c) 1 to 3 times in every 6 months ( )

d) 1 to 3 times in every 12 months ( )

5. What is the mode of such contact?

(a) By phone call ( )
(b) By written letter ( )
(c) By visiting my me ( )
(d) By inviting me to the bank ( )

6. How do you intend to pay back?

(a) I cannot pay Back ( )
(b) Sales of my collateral security ( )
(c) Loan restructuring ( )
(d) Loan walkout ( )

7. Have do you protect the borrowed funds?

(a) ( )

(b) ( )

(C)

8. Has your bank ever asked you to pay down your facility?

(a) Agree ( )

(b) Disagree ( )

(c) Not sure ( )

9. If your answer to question 8 above is (a), what reason (s) has the bank given you?

(a) It has liquidity problem ( )
(b) It is eroding its profitability ( )
(c) Its loanable funds is being eroded ( )

10. What suggestions could you offer as to this problem can be averted in the future?……

……

……

……

APPENDIX A: QUESTIONNAIRE

Department of Business Administration,

Faculty of Administration,

Ahmadu Bello University,

Zaria.

01st May, 2012.

Dear Respondent,

I am Postgraduate student pursuing M.Sc. Business Administration in the above mentioned department. I am undertaking a research on *"Bank Loan Monitoring and Loan Performance: A study of Deposit Money Banks in Nigeria"*

The research is in partial fulfillment of the requirement for the award of Master of Science in Business Administration in Ahmadu Bello University, Zaria. Please complete the attached questionnaire and be as frank as possible. I wish to assure you that all Information provided would be treated with strict confidentiality and your name and/or identity will never be revealed. The data collected will only be used for academic purposes.

Thank you very much in anticipation for your usual cooperation.

ISMA'IL TIJJANI IDRIS

M.SC./ADMIN/1902/09-10

1. How will you assess effectiveness of loan monitoring in your DMB?

   (a) Very effective
   ( )

   (b) Effective
   ( )

   (c) Ineffective
   ( )

   (d) Highly ineffective
   ( )

2. Where are your credit facilities approved?

   (a) Branch level
   ( )

   (b) Regional level
   ( )

   (c) Head office
   ( )

   (d) Multiple
   ( )

3. How will you describe your liability-deposit ratio?

(a) 80 :20 ratio
( )

(b) 50:50 ratio
( )

(c) 20:80 ratio
( )

(d) others (please specify)……..

4. What is your bank's ratio of nonperforming loans to loan portfolio?

(a) 10:90
( )

(b) 20:80
( )

(c) 30:70
( )

(d) 40:60
( )

(e) 50:50
( )

5. If your answer to question 4 above is not (a). What is the implication to your bank?

(a) Liquidity problems
( )

(b) Recovery problems
( )

(c) Profitability problems
( )

(d) Reduced market share
( )

6. What is the level of your bank profitability?

(a) Very high ( )

(b) High
( )

(c) Low
( )

(d) Very Low ( )

7. How will you assess the level of your DMB's loan performance generally?

(a) Very high
( )

(b) High
( )

(c) Low
( )

(d) Very Low
( )

8. If your response to question 7 above is not option (a). What is responsible?

(a) Downturn of business activities
( )
(b) High bank charges
( )
(c) Funds diversion
( )
(d) Negative changes in the business environment
( )

9. What is your bank's liquidity position?

(a) Highly adequate
( )

(b) Adequate
( )

(c) Inadequate
( )

(d) Highly inadequate
( )

10. How frequently does your bank contact its borrowing customers after the loan disbursement?

a) 1 to 3 times in a month
( )

b) 1 to 3 times in every 3 months
( )

c) 1 to 3 times in every 6 months
( )

d) 1 to 3 times in every 12 months
( )

11. What is the mode of such contact?

(e) By phone call
( )
(f) By written letter
( )
(g) By visiting the customer
( )
(h) By inviting him to the bank
( )

12. How do you intend to handle the nonperforming loans?

(e) Provisioning for non-performing facilities
( )
(f) Sales of customers' collateral security
( )
(g) Loan restructuring
( )
(h) Loan walkout
( )

13. What suggestions could you offer as to how this problem can be averted in the future?……

……
……
……
…