# PROFITABILITY OF COMMERCIAL BANKS IN NIGERIA (1979 - 83)

BY

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DATE. . . . . .

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I hereby declare that this project has been written by me, and that it is a record of my own research work. It has not been previously presented in any applications for a higher degree.

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This research project has been read and approved as meeting the requirements of the Postgraduate School and the Department of Business Administration, Ahmadu Bello University, Zaria for an award of the degree of Master of Business Administration (MBA)

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D E D I C A T I O N

TO

KEME AND YUSUF

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ABSTRACT

This is an empirical study of Commercial Bank Profitability in Nigeria. Eleven Commercial Banks were critically examined, employing ratio analysis. The eleven banks were classified into three groups on the basis of size of deposits and loans and advances. Large banks with deposits exceeding ₦1000 million were classified as group I banks; Medium sized banks with deposits in the range of ₦500 - ₦1000 million were classified as group II and banks with deposits in the range of ₦100 - 500 million were classified as group III banks.

In the analysis, a set of measures were employed to determine profitability, while another set was used to establish the causal factors of the profitability differences. In profitability determination, measures including the following were used: Interest spread, the ratios of spread to deposits, spread to total assets, gross profit margin, net profit margin, gross yield on total assets and net profit on total assets. These measures were employed to test the hypothesis that larger banks were more profitable than smaller banks. The causal factor measures included among others, yield on investments, yield on loans and advances, provision for loan losses to loans and advances, interest paid to deposits and the cost structure of the banks.

TABLE OF CONTENTS


| | | PAGE |
|---|---|---|
| Title Page | .. .. | i |
| Declaration | .. .. | ii |
| Approval Sheet | .. .. | iii |
| Dedication | .. .. | iv |
| Acknowledgements | .. .. | v |
| Abstract | .. .. | vi |
| Table of Contents | .. .. | viii |
| List of Tables | .. .. | xi |
| Abbreviations | .. .. | xii |
| CHAPTER ONE: INTRODUCTION | | |
| 1.1 The problem | .. .. | 1 |
| 1.2 Objectives and Relevance of Study | .. | 3 |
| 1.3 Hypothesis | .. .. | 4 |
| 1.4 Methodology | .. .. | 5 |
| 1.5 Scope of the Study | .. .. | 7 |
| 1.6 Literature Review | .. .. | 8 |
| 1.7 Limitations of the Study | .. | 16 |
| 1.8 Schematics of the Study | .. | 17 |
| 1.9 Conclusions | .. .. | 18 |
| CHAPTER TWO COURCES AND USES OF BANK FUNDS AND CONSTRAINS | | |
| 2.1 Intoduction | .. .. | 19 |
| 2.2 Sources of Bank Funds and Constrains | | 19 |
| 2.2.1 Capital | .. .. | 20 |
| 2.2.2 Deposits | .. .. | 27 |
| 2.2.3 Loans and other Liabilities | .. | 30 |
| 2.3 Uses of Bank Funds and Constrains | | 30 |
| 2.3.1. Liquid Assets: Primary and Secondary Reserves | - - | 32 |
| 2.3.2 Loans and Advances | .. | 37 |
| 2.3.3. Investments | .. .. | 45 |
| 2.4 Conclusions | .. .. | 47 |

PAGE

CHAPTER THREE: LENDING POLICIES AND PRACTICES

3.1 Lending Authority .. .. 50
3.2 Credit Approval Procedures .. 51
3.3 Pricing Policies .. .. 54
3.4 Lending Strategies .. .. 57
3.5 Precedence and Verbal Communications 58
3.6 Conclusions .. .. 59

CHAPTER FOUR: DETERMINATION OF BUSINESS INCOME

4.1 Introduction .. .. 60
4.2 Economist and Accounting Concepts of Income 60
4.3 Accounting Profit Determination .. 67
4.4 Profitability Measures .. 70
4.5 Profitability Measures for the Study 75
4.6 Conclusions .. .. 80

CHAPTER FIVE: PROFITABILITY: DETERMINAL MEASURES

5.1 Introduction .. .. 83
5.2 Trend of Gross Operating Income .. 83
5.3 Trend of Operating Margin .. 85
5.4 Gross Profit Margin .. .. 87
5.5 Net Profit Margin .. .. 89
5.6 Gross Yield on Total Assets .. 90
5.7 Gross Profit Margin on Total Assets 93
5.8 Net Income on Total Assets .. 95
5.9 Interest Spread .. .. 97
5.10 Interest Spread to Deposits .. 99
5.11 Interest Spread to Total Working Funds 101
5.12 Spread to Total Assets .. 103
5.13 Spread Cover (Exposure) .. 104
5.14 Conclusions .. .. 107

PAGE

CHAPTER SIX: PROFITABILITY: CAUSAL FACTORS

6.1 Introduction .. .. 108
6.2 Causes Related to the Generation of Income 108
(a) Loans and Advances .. 108
(b) Investments .. .. 114
6.3 Cost Control Causes .. .. 119
6.4 Conclusions .. .. 130

CHAPTER SEVEN SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

7.1 Summary of Conclusions .. 132
7.2 Recommendations .. .. 142
7.3 Areas for Further Research .. 144

Bibliography .. .. 145
Appendix One:- List of Twenty Six Banks.. 150
Appendix Two:- Balance Sheets and Profit and Loss Accounts of the Sample Banks . 151

LIST OF TABLES


| TABLE | TITLE | PAGE |
|---|---|---|
| 1.1 | Growth in Deposits and Loans and Advances | 2 |
| 1.2 | Commercial Bank Deposits and Loans and Advances for the yaar 1983 | 6 |
| 2.1 | The percentage of Capital to total bank Funds of the Commercial Banking Industry and some selected Commercial Banks | 21 |
| 2.2 | Capital Adequacy .. .. | 24 |
| 2.3 | Ratio of Deposits to total Funds .. | 27 |
| 2.4 | Interest Rates on Deposits 1983 .. | 29 |
| 2.5 | Cash Reserve Requirement .. | 33 |
| 2.6 | Sectoral Distribution of Loans and Advances of Commercial Banks .. .. | 41 |
| 2.7 | Allocation of Credit to Nigerian Owned Small Scale Industries .. | 43 |
| 2.8 | Interest Rates Chargeable on Loans .. | 44 |
| 3.1 | Commercial Loan Yield Analysis Work Sheet | 56 |
| 5.1 | Trend of Operating Margin .. | 85 |
| 5.2 | Trend of Operating Margin .. | 86 |
| 5.3 | Gross Profit Margin .. | 88 |
| 5.4 | Net Profit Margin .. .. | 90 |
| 5.5 | Gross Yield on Total Assets .. | 92 |
| 5.6 | Gross Profit Margin on Total Assets | 94 |
| 5.7 | Net Income on Total Assets .. | 96 |
| 5.8 | Interst Spread .. .. | 99 |
| 5.9 | Interst Spread to Deposits .. | 101 |
| 5.10 | Interest Spread to Total Working Funds | 102 |
| 5.11 | Interest Spread to Total Assets .. | 104 |
| 5.12 | Interest Spread Cover (Exposure) .. | 105 |
| 6.1 | Yield on Loans and Advances .. | 111 |
| 6.2 | Loans and Advances to Deposits .. | 112 |
| 6.3 | Yield on Investments .. | 116 |
| 6.4 | Ratio of Investment to Deposits .. | 117 |
| 6.5 | Interest Spread Per Bank Branch .. | 118 |
| 6.6 | Revised Profit and Loss Accounts .. | 123 |
| 6.7 | Ratio of Provision for Loan Losses to Loans and Advances .. .. | 128 |
| 6.8 | Ratio of Interest Paid to Deposits . | 130 |

ABBREVIATIONS

FBN - First Bank of Nigeria Limited

UBN - Union Bank of Nigeria Limited

UBA - United Bank for Africa Limited

IBWA - International Bank for West Africa Limited

ACB - Africa Continental Bank Limited

SGBN - Societe Generale Bank of Nigeria Limited

NBN - National Bank of Nigeria Limited

BCCI - Bank of Credit and Commerce International

NNB - New Nigerian Bank Limited

NAB - Nigeria Arab Bank

MB - Marcantile Bank

CBN - Central Bank of Nigeria

CHAPTER ONE

# I N T R O D U C T I O N

## 1.1 THE PROBLEM

Commercial banks in Nigeria operate within a regulatory framework that uniformly affects all banks. The only exception is in the rates of growth allowed on aggregate credit, where small banks with outstanding loans of less than a ₦100million are allowed higher rates of growth over the previous years loans and advances, than larger banks. Besides this exception, banks have the same liquidity and reserve requirement imposed on them; the same regulations on granting of loans, operate within the same interest rate structure and so on.

Inspite of the uniform regulatory framework, Commercial banks differ in many respects. Banks differ as to asset size, deposit attraction capacity, the amounts of loans and advances they are able to grant, their ages, management attitude and policies, number of branches and in so many other respects. Each bank has its aims and objectives that may vary with others. Their investments and loans policies are also diverse. Do these give rise to differential opportunities for growth? Do they result in differing profit advantages? How have the banks fared under the regulatory framework? These are some of the vital questions to be answered.

In recent years, the banking industry has recorded significant growth which is amply clear from a look at Table 1.1.

...../2

TABLE 1.1

GROWTH IN DEPOSITS AND LOANS AND ADVANCES

| YEAR | DEPOSIT GROWTH | GROWTH IN LOANS AND ADVANCES |
|---|---|---|
| 1965 | 1.76 | 2.8 |
| 1970 | 3.7 | 3.3 |
| 1975 | 16.6 | 14.7 |
| 1980 | 58.4 | 66.7 |

NOTE: Growth rates are based on 1960 figures. Sources: computed from various issues of CBN. Economic and financial Reviews.

Considering the size of the country, its growing population and the number of people served by a bank branch, there is tremendous room for further expansion and growth. The Federal Governments economic policies also calls upon the banking industry to venture into new areas of operation like opening rural branches and financing of small and cottage industries. Furthermore, the imposed economic restrictions such as import control, is cutting off some of the banks sources of income, like income arising from foreign exchange transactions. How do these and many other factors affect the banks earnings and profitability? Do they affect them differently?

The aim of this study is to see if differential previlages exist and the extent to which profitability varies as a result of factors to be identified out of the above mentioned differences and some other new dimensions.

...../3

## 1.2 OBJECTIVES AND RELEVANCE OF STUDY

### OBJECTIVES

This study is aimed towards achieving the following specific objectives:

a) To identify and examine the sources of Commercial Bank profitability in Nigeria and factors affecting it.

b) To examine the extent to which banks are restricted by internal and external forces and what latitudes are available to banks for free operation.

c) To determine whether the same criteria of profitability as applied to trading and manufacturing concerns, can be applied to Commercial Banks.

d) To identify the limitations to the growth in profitability of commercial Banks in Nigeria, and

e) To suggest remedial measures that will enhance bank profitability.

### RELEVANCE OF STUDY

Commercial banks are constrained to operate branches in unprofitable areas with little banking awareness, and grant loans and advances that are in most cases, in little demand, with attendant low returns. Where the prescribed loans are not demanded, idle funds are kept with grave profit consequences. Banks are also made to grant loans to sectors that might not otherwise attract bank attention because of their low profits and risk. Banks are also restricted as to their interest charges on funds deployed and generally as to the way they deploy the funds at their disposal. From the foregoing, it is apparent that more

..../4

than ever before, management needs to identify sources of profits and tap them, to ensure sustained bank growth and profitability. It is hoped that by highlighting the latitudes available to commercial banks within the seemingly rigid rules, a direction might be given for strategy development that could enhance bank profits.

The study is also aimed at amplifying the impact of management judgement, attitude and actions on profitability and thus spotlight the important role of management in the banks profit generation, and to give managers an insight as to the necessary actions for profitability improvement.

The findings of this study will also be relevant at this time when Nigeria is poised for a change in direction. The governments objective of achieving fast economic growth and self sufficiency will be considerably affected by the way financial institutions, especially Commercial banks, operate. Increased bank profitability will help achieve this objective, it is also hoped that the study will direct attention to problem areas that might call for reorganising the Commercial Banking Industry in the Country.

The results of this study should also prove useful to policy makers and academicians and lay the foundation for further research work in this area.

1.3 HYPOTHESIS

The following are the hypotheses to be tested by this study:-

a) Profitability depends on bank ability to earn income. Income is earned by the bank deploying

..../5

the funds available to it, into profitable uses. Thus the more funds the bank has, the greater its opportunity to engage in profitable activities. Thus it is asserted that the greater a banks resources, the greater its profitability.

b) It is also said that loans and advances earn more income than investments. It is hypothisized therefore that the greater the proportion of a banks loans and advances in relation to investments, the more profitable the bank should be. Also, the larger a banks loans and advances, the more returns it should generate relative to a bank with lesser amounts of loans and advances and should thus prove more profitable.

## 1.4 METHODOLOGY

This is an empirical study based on the published financial statements of Commercial Banks from 1979 - 83. The methodology and sources of information for this study, has been divided into two stages:

1. The collection of necessary data, and
2. Choice of sample.

### 1. COLLECTION OF DATA

For the collection of necessary data, a letter was addressed to all twenty six Commercial Banks[1] operating in the country, requesting them to supply the five years financial statements along with other documents relevant to the research. However, this exercise proved unfruitful. Thus a number of visits were made to Lagos. The necessary data was obtained from the head offices of some of the Commercial Banks. Photocopies of some available financial

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1. See Appendix One for a list of the Commercial Banks.

.../6

statements were made from the CBN School of banking Library Lagos, to supplement. Furthermore, some of the Senior officials of the banks were interviewed. Some necessary information was obtained and their views on general banking operations in the Country also obtained.

2. CHOICE OF SAMPLE

Financial statements were obtained for the eleven banks as listed in Table 1.2. Since the required information was not available for all the twenty six Commercial Banks in Nigeria for determining a sample based on some statistical tool, it was decided to make a comprehensive study of the eleven banks mentioned in Table 1.2.

For the purpose of the analysis, the eleven banks were grouped into three categories based on their aggregate deposits and loans and advances for the year 1983. The choice based on deposits and loans is relevant because of their impact on profits and thus profitability.

TABLE I.2

COMMERCIAL BANK DEPOSITS AND LOANS AND ADVANCES FOR THE YEAR '83

| S/NO. | FULL BANK NAME | ABBREVIATION | DEPOSITS ₦(MILLION) | LOANS AND ADVANCES ₦(MILLION) |
|---|---|---|---|---|
| 1 | FIRST BANK OF NIGERIA | FBN | 3570.3 | 1376.7 |
| 2 | UNION BANK OF NIGERIA | UBN | 3275.8 | 1536.6 |
| 3 | UNITED BANK FOR AFRICA | UBA | 2939.9 | 1619.7 |
| 4 | INTERNATIONAL BANK FOR W.AFRICA | IBWA | 960.1 | 506.5 |
| 5 | AFRICAN CONTINENTAL BANK | ACB | 942.8 | 654.2 |
| 6 | SOCIETE GENERALE BANK | SGBN | 684.1 | 518.2 |
| 7 | NATIONAL BANK OF NIGERIA | NBN | 612.9 | 424.6 |
| 8 | BANK FOR CREDIT COMM. INTERNAT.* | BCCI | 482.2 | 220.0 |
| 9 | NEW NIGERIAN BANK | NNB | 268.2 | 170.0 |
| 10 | NIGERIAN ARAB BANK* | NAB | 209.9 | 95.6 |
| 11 | MARCANTILE BANK* | MB | 142.6 | 116.3 |

NOTE:- From now on, the abbreviated names will be used.
* 1982 figures

Sources: Annual Reports of these banks.

..../7

The above eleven banks were classified into three categories: Large medium and small. The classification was done on the following basis:

a) Banks having deposits in the range of ₦100 - 500 million were termed as small banks. They are: from henceforth referred to as Group III.

b) Banks having deposits in the range of ₦500 - 1000 million are termed medium sized banks. Henceforth, they are Group II banks.

c) Banks having deposits from ₦1000 - 4000 million are termed large banks. They are from now on referred to as Group I banks.

The sample is broken into the three groups as follows:-

| Group I | | Group II | | Group III | |
|---|---|---|---|---|---|
| 1. | FBN | 1. | IBWA | 1. | BCCI |
| 2. | UBN | 2. | ACB | 2. | NNB |
| 3. | UBA | 3. | SGBN | 3. | NAB |
| | | 4. | NBN | 4. | MB |

Our analysis of data will be based on this group classification.

1.5 SCOPE OF THE STUDY

The scope of the study is confined to the period from 1979 to 1983. It is based on the published data of the Commercial Banks and CBN. Thus the inferences drawn on the basis of these sources of information will be true to the extent that these data are authentic.

..../8

This study represents 65% of the aggregate deposits of the Commercial banking industry and 64% of the aggregate loans and advances for the year 1981. It is therefore hoped that the conclusions and recommendations drawn here will be applicable to the Nigerian Commercial banking sector as a whole.

## 1.6 LITERATURE REVIEW

In this section, we set out to review previous studies related to this study. A distinction is made between studies that analyse the general performance of Commercial Banks and those that specifically direct their attention to bank profitability. The former will be dealt with first, and appears as item (a). The latter is item (b) below.

### (a) STUDIES ON THE GENTRAL PERFORMANCE OF COMMERCIAL BANKS

The work of Asabia (1981) is foremost in this area. He examines the general performance of Commercial Banks employing such factors as equity structure, gearing and profitability. For his comparative analysis, he employs a sample of ten Commercial Banks and two Merchant banks. The Commercial Banks were classified into four categories: large, regional, medium and state owned banks. The profitability ratios employed in the study were profit (before and after tax) on total assets, profit on equity, profit per share and devidends per share. Asabia seems to be more concerned with profitability from the shareholders point of view. The study assess each groups performance, without pinpointing the causes of the variations. This is what the current study hopes to do, focussing attention on profitability,

..../9

In conclusion, Asabia recommended the following measures:-

a) That there is a need to increase commencement equity to ensure capital adequacy and improve profit retention rules to encourage banks to plough back more profits.

b) That small banks merge to increase their competitive position.

c) That there is a need for banks to be more profitable.

d) That there is a need for increased management integrity.

f) The need for increased efficiency in banking halls and better trained staff.

f) That given the improvement in rural presence in recent years; there is a need to turn attention to urban needs with a view to improving efficiency.

There is also another article by Oshikoya (1983) which evaluated the performance and efficiency of Nigerian Commercial banks from an industrial perspective, in terms of their mobilization of private savings, allocation of those savings to various sectors of the economy and the elimination of financial dualism by the growth in number of Commercial Bank branches in rural areas. He also measures bank efficiency in terms of how long it takes a customer to transact a given business within a bank.

Oshikoya's study, although it deals with Commercial bank performance, is not in line with the present study, which is essentially comparative of individual bank profitability.

The work of Akingbade (1981) sets out to prescribe

..../10

techniques of planning and decision making for enhancing bank profitability. It thus is not aimed at discovering the sources of profitability or meant to recommend ways of improving it.

(b) STUDIES ON PROFITABILITY

Gardner (1980) studied the variations in profitability that existed within the population of minority owned banks in America. He set out to identify and determine the relative importance of some selected financial and demographic differences among the least and most profitable minority owned banks for the period 1976 - 1978. Stepwise regression analysis was employed to relate profitability ratios from the sample banks to some independent variables chosen from previous banking literature. Gardner discovered that relatively few independent variables accounted for disproportionate variations in profitability. The following ratios appeared to be the most significant:

a) Provision for loan losses to operating expenses.

b) State municipal and other non federal securities to total assets,

c) Fixed and other assests to total assets and

d) equity to total assets.

The ratios a, c and d were found to be negatively related to profitability. The study also found that the educational attainment of managers in more profitable banks was higher.

The present study differs from Gardners study in the following respects.

a) The sample is not restricted to a section

...../11

of the commercial banking industry. It has a general appeal.

b) Regression analysis is not employed in this study. Simple ratio analysis is used.

c) In Nigeria, the following ratios
   i) Fixed and other assets to total assets, and
   ii) equity to total assets,
has no significance in explaining profitability being for all banks, within the region of 3 - 6% Thus the measures are not used in this study.

d) The provision for loan losses to operating expenses is also not used as the writer thinks it more relevant for explaining profitability causes, to relate provision for loan losses to income. It thus indicates what proportion of gross income is taken up in loan provisions.

e) The study made by Gardner is on American Minority banks. This study is based on Nigerian Commercial banks as a whole.

f) The work of Flucker (1980) was aimed at determining the relative impact of market area factors and management factors on profits. It also investigated the relationship between demographic variables and various bank characteristics, including the number and size of accounts, so as to determine possible paths of influence demographic factors may use in affecting bank profitability.

Minority and non - minority banks were paired for the study and regression techniques applied to determine the correlation of demographic factors with various bank characteristics in order to get an indication of the level of influence of demographic factors. The established relationship was used in conjunction with regression of profits on demographic factors and management performance

...../12

characteristics, to determine the probable relative impact of these factors on profits. Differences on profit on minority and non - minority banks were regressed on differences on demographic factors to determine how much of the variance in profits could be explained by differences in demographic factors.

The study showed that profits on minority banks were significantly lower than those of non-minority banks. Significant statistical relationships were established between the demographic factors and bank expenses and deposits. The number and size of accounts was found to be significant for profits and expenses. The relationship between profits and demographic factors were found to be insignificant. They were found to be less important than managerial characteristics. It was also found that some of the negative influences on profits, could be minimised or even overcome by management.

This study differs from that of Flucker (1980) in that it examines mainly financial and management related factors explaining profitability differences.

In his "profit performance of Major Bank Holding Companies", McDermott (1983), employs ratio analysis to asses the performance of twenty five bank holding companies. The study analyses profits using the following ratios:

a) return on assets,
b) return on equity,
c) net charge-offs to average loans,
d) Valuation reserves to loans and
e) non - performing assets to total loans.

...../13

He assess profit performance without specifying possible causes of the variations.

Two studies however proved very relevant to this study. These are studies by Verghese (1983) and Wood and Porter (1979).

Wood and Porter (1979), in their book "Analysis of Bank financial statements" devoted two chapters to the analysis of Bank profitability. They analysed the general performance of Insured commercial banks. The analysis was based on group averages. The banks were classified into five groups on the basis of size of deposits and size of assets. Several measures were used to indicate differences in profit performance. They include the following: gross profit margin, net profit margin, return on equity, return on assets, gross profit margin on assets, net income on assets and return on various assets (examples: treasury securities, municipal securities and so on).

In their sixth chapter, Wood and Porter engaged in Profit Sensitivity analysis. What they hoped will result in more accurate identification and measurement of cause and effect factors that influence bank profitability. One of the measures used is spread analysis. In this analysis, the balance sheet and profit and loss account were rearranged and restrated side by side. The various earning assets are outlined and the respective interest income from them. The income is then expressed as a yield on each category of the earning assets. Total interest income from all earning assets is then expressed as a percentage of the total earning assets to produce the yield on total earning assets. Other

...../14

non - earning assets are then outlined. Then the income from other sources are added to produce the operating income.

Next, the liabilities and equity are listed. Interest bearing liabilities are listed according to their respective categories (such as time and savings deposits, and so on), and the annual outlay of funds is matched with it. This expense is then expressed as a percentage of the liabilities. Interest costing liabilities are then summed up and the expenses on them expressed as a percentage of the liabilities. This is the effective interest cost of the funds. Other non interest earning liabilities are then outlined.

The spread is then expressed as the defference between the interest yield (%) on earning assets less the interest expense (%) on interest bearing liabilities.

Useful as this measure is, we find its application in Nigeria hindered by lack of detailed data for analysis which this measure requires. It is therefore not employed in this study.

Another measure postulated by Wood and Porter (1979), is what they call the Rate/Level analysis. The measure computes the percentage change in each of the balance sheet items and profit and loss account items. The result is that a change in income can be explained by a change in some interest earning asset and so on.

This measure is more relevant for a detailed study of a single bank over the years. For a study like ours, analysing eleven banks, this measure is cumbersome using

...../15

mannual computations.

The authors go on to develop a model for explaining the return on equity. This measure is however not of particular interest to this study as we are not concerned with analysing profitability from the share holders point of view.

We however employ some of the profitability measures and another version of spread analysis.

The work of Verghese (1983) is another leading work on profitability. In her analysis, she examines the trend of gross and net profits. Along with these, she also uses the ratios of gross profit to assets, net profit to assets, return on equity, gross yield on assets and also the trend of operating margin. In addition she employs spread analysis along with all these measures to indicate the profitability performance of the banks.

Other spread related ratios included net interest earnings to assets, net interest income to earning assets and yields on investments and loans and advances. She relates this to the average cost of funds to determine the causes of profitability.

Some of these measures are employed in this study. The study goes further to undertake a cost structure analysis to show which component cost items are critical. The study further analyses the cover provided by interest spread to see how the banks main activities sustains the operating expenses of banks, and contributes towards reported profits. Thus two sets of measures are used: the

...../16

first to assess profitability and the second set to identify the causes.

Thus to some extent, this study is wider in scope than most of the studies mentioned. In Nigeria, it is a maiden study. Ratio analysis techniques are employed through out the study. It is obvious that this indepth study will generate a lot of criticism and enthusiasm on the part of researchers in this area. Both are welcome.

## 1.7 LIMITATIONS OF THE STUDY

This is an empirical study of eleven banks in Nigeria. The sources of information are entirely published data by these banks. Whatever limitations apply to these statements therefore automatically apply to this study.

Reported accounting data on which this study is based, creates problems of comparison. Reported data are based on different assumptions and policies. For example, bad debt provisions and depreciation have an effect on profits reported and thus on ratios computed. These provisions are not uniform. They are greatly affected by management attitude and judgement. Such discrepancies, limit the comparative strength of the analysis and conclusions therefrom.

The conclusions drawn from this study will have been more meaningful and more definite, were more information available. Commercial bank published reports do not contain detailed information. Even so, there is no uniformity in disclosure or content of the published data. This creates a lot of comparative problems.

..../17

It is also imperative to mention here that a study covering only a five year period does not give a firm basis for far reaching conclusions. It would have been more desireable to study the trend of profitability over a ten year period. Again, the constrain is the availability of relevant information.

## 1.8 SCHEMATICS OF THE STUDY

The study is divided into seven chapters. The first chapter introduces the study. The second examines the sources and uses of bank funds. In the third chapter, we examine the lending policies and practices of commercial banks.

The fourth chapter sets out the criteria for profitability determination to be employed in the study. Chapters five and six analyses the data of the banks studied. The study is concluded by a summary of the conclusions and recommendations. This is the seventh chapter.

## 1.9 CONCLUSION

In this chapter introducing the study, we set out the objectives of the study and our working hypothesis. We also stated the methodology of the study and chose the sample for the study. We then reviewed the relevant liturature of previous work in this area of profitability and other related areas. On this basis we concluded that no serious work has been done in the area of profitability in Nigeria. The limitations of this study was then specified and the schematics of the study set out.

In the next chapter, we will be considering the sources and uses of bank funds and the various constrains that apply.

..../18

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CHAPTER TWO

THE SOURCES AND USES OF BANK FUNDS AND CONSTRAINS

## 2.1 INTRODUCTION

The sources of bank funds have implications for their cost, stability, and in the end influence the use to which these funds can be put. The use of bank funds on the other hand, have implications for bank Liquidity, solvency and profitability. An examination of a banks sources and uses of funds, is actually a look at how the bank operates within the regulatory framework, In Nigeria, the principal law is the Banking Act 1969, as subsequently ammended. The implimentation of the law and the imposition of sanctions to defaulters is done by the Central Bank.

As the sources of bank funds and the various uses to which they can be put are examined, the specific regulations that apply will be discussed. The role of the Central Bank within the regulatory framework will also be discussed. References will be made to the various sections of the Banking Act and the Monetary Policy circulars, which are the Central Banks major regulatory tool.

This chapter is divided into two major sections. Section 2.2 deals with the sources of funds, viz; capital, deposits and other loans and liabilities. The second section, 2.3, deals with the use of bank funds which results in the acquisition of various assets, viz, liquid assets such as primary and secondary reserves, loans and advances and investments. The sources of bank funds will now be discussed.

## 2.2. SOURCES OF BANK FUNDS AND CONSTRAINS

Commercial banks obtain their funds from th

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Sources. Their relative importance however varies. These sources will be discussed thus: Capital, section 2.2.1., Deposits, section 2.2.2. and other liabilities under section 2.2.3.

2.2.1 CAPITAL

Capital is the portion of bank funds contributed by its shareholders. This definition of capital also incorporates statutory reserves which are allowed in Nigeria as part of Bank capital. In some Countries, for example Amerioa, capital is the Bank's net worth. It thus includes besides capital and statutory reserves, undistributed profits, general reserves and general provisions. The argument for the exclusion of these items in Nigeria, is that they are subject to the whims of management decisions and are thus transcient.[1]

As a source of bank funds, Capital provides generally, much less than five percent of total funds (see Table 2.1). This will tend to imply that Capital is of little importance to Banks. The importance of Capital however, lies in the other functions it performs other than the provision of funds.

Bank capital serves as (1) a cushion for the absorption of unexpected losses. It is also argued that capital serves (2) the purpose of preventing bank failure. Besides :: enabling the Bank to acquire infrastructure necessary for competitive entry into business and operation, bank ca also serves the purpose of acting as (3), a "guarant

1. Adekanye F.A., Elements of Banking, Bedforshi Graham Burn, 1983, P.121

TABLE 2.1

THE PERCENTAGE OF CAPITAL TO TOTAL BANK FUNDS OF THE COMMERCIAL BANKING INDUSTRY AND SOME SELECTED COMMERCIAL BANKS

| YEAR | COMMERCIAL BANKING INDUSTRY | BANKS | | | | | |
|---|---|---|---|---|---|---|---|
| | | UBN | FBN | ACB | IBWA | NNB | NAB |
| | % | % | % | % | % | % | % |
| 1979 | 2.97 | 5.1 | n.a. | 2.0 | 3.8 | 3.1 | n.a. |
| 1980 | 2.6 | 3.66 | 3.5 | 1.7 | 3.2 | 2.7 | 7.5 |
| 1981 | 2.4 | 2.89 | 4.8 | 1.4 | 3.2 | 2.67 | 7.7 |
| 1982 | NA | 3.2 | 4.2 | 1.5 | 3.5 | 5.4 | 4.98 |
| 1983 | NA | 2.87 | 3.3 | 1.2 | 3.5 | 4.66 | n.a. |

SOURCES: Economic and Financial Review, vol 19, No2, December 1981.

Financial Reports of the various Commercial Banks.

for ensuring the safety of depositor's funds. The safety of deposits ensures confidence in the banking system.

CAPITAL ADEQUACY

In the performance of the functions enumerated above controversies have arisen as to what amounts of capital should be considered adequate for a particular bank. In Nigeria, capital adequacy is measured by the ratio of capital to loans and advances, while some countries measure it as a ratio of capital to deposits.

While banks prefer minimum levels of capital, the government or the regulator wants higher levels. The banks argue that lower capital levels or increased leverage, will allow banks earn higher returns without affecting the safety of the banking system. The regulator on the other hand wants higher capital levels to serve as a cushion of protection to

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depositors. The goal of the regulator, is bank safety. Safety they assert, calls for higher capital levels.

Golembe thinks the government is interested in adequacy measures for two reasons:

a) That the government wants to arrive at a judgement as to the ability of the bank under supervision to withstand unexpected losses and thus prevent bank failure and

b) That the government is concerned over the low ratio of equity to total assets prevalent in the banking industry and fears that if this ratio continues to decline, the public might think the owners have an inadequate interest in the enterprise they control, with a possible loss of confidence in the banking industry.[2]

The question then remains, what amounts of Capital is adequate to perform effectively, the functions enumerated earlier?

If capital is to serve as a cushion against unexpected losses, what amounts will be adequate? The problem here is the lack of certainty about the nature, extent and timing of losses. Thus, what will be adequate capital for any bank will depend on subjective opinion.

Another function of capital is the prevention of bank failure. Proponents of this notion claim that capital will serve as a source of financial strength, enabling the bank to withstand abnormal losses that are not covered by current earnings. Capital thus enables the bank to weather the vissisitudes of bank operations and re-establish normal levels of profitability. Earnings are important because they increase

2. Golembe C. H., Capital Adequacy and Bank Losses, Journal of Commercial Lending, August 1975, P.17

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the buffer for loss absorption and also increase the n networth or capital, thereby expanding the extent of protection against abnormal loss, and thus possible failure.

The fallacy in this argument is that no important study on failure has so far linked the incidence of bank failure to levels of capital. Most bank failures have been caused by loss of liquidity, poor management and dishonesty.[3]

It will appear therefore th t the functions proponents of increased capital levels, claim for capital, are held suspect. Further more, the determination of adequate levels is not succeptible to objective measure. Even if the required levels of capital are known with certainty by the banker, Golembe is of the opinion that this will not help much in the determination of adequate capital as the opinion of others is more important. He quotes Frank Willie (The American FDIC chairman) as saying, "adequate capital is the least amount necessary for others to have confidence in your bank and its operations."[4] The question is, how does a bank determine what amounts of capital will maintain public confidence in its operations?

From the foregoing, it is therefore not surprising that some critiques consider the capital adequacy ratio as no more than an arbitrary screening device for discovering banks requiring closer supervision. They argue for the removal of the ratio or its lowering. P. A.

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3. See the works of Anderson R.E., Bank Lending and Capital Adequacy in an Environment of shortages, The Journal of Commercial Lending, August 1974, Pp. 22 - 23 and Golembe, op cit p.15
4. Golembe, op Cit, p.15

Ogwuma[5] is of the opinion that this ratio (capital to loans and advances), which was one to ten in 1980 and one to twelve in 1983, be lowered to say one to twenty.

The control of capital levels in Nigeria is done in four ways. Three of them are expressly provided for in the Banking act, while the fourth is a derivation of the Central Bank using the powers inposed upon it by the banking act 1969. The four ways are treated as item (a) to (d) below:

a) Section 6(1) specifies a minimum paid up capital of ₦600,000. for indigenous banks and ₦1.5million for foreign controlled banks.

b) Section 6(2) empowers the Central Bank to prescribe the minimum ratio of capital to loans and advances. The Central Bank does this through the monetary policy circulars. Circular No.16 of 1983 specifies a ratio of one to twelve.

c) Section 13(1,a) limits lending to any one person, to 33⅓% of the banks paid - up Capital and statutory reserves and

d) The weighted Risk Asset Ratio: This method of determining Capital adequacy depends on the quality of the banks assets. It relates shareholder funds with the total of risky assets, Banks with a high risk portfolio of assets will need more capital than a bank with a safe, liquid portfolio of assets.[6] Levels of capital prescribed therefore is in cognisance of assets at risk and liabilities

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5. Ogwuma P.A., the growth of the Banking Industry in Nigeria, A paper presented at the 15th Annual Banking Seminar in Port Harcourt, under the auspices of the Nigerian Institute of Bankers Novermber 30 - December 6, 1980.

6. Nadler P.S., Bank Capital shortage and the Lending officer, The Journal of Commercial Bank lending, April 1976, P.23

> subject to withdrawal.[7] Assets are grouped according to their relative degree of liquidity and risk. Depending on the degree of liquidity, capital support or cover will vary from zero for cash items, t◆ 100% for bank fixed assets. The Central Bank has designed a form for this purpose (see specimen on page 24 ). The form is used by its Bank examiners.

The problems of capital adequacy are further compounded by the dynamism of banks. As a bank grows, experiencing expansion in its deposits and loans, more capital is needed to back up its increased activities. Thus Bank growth erodes prior capital adequacy. In addition to growth, pace mentioned inflation as another cause of capital impairment.[8] Issues are are worsened by the lack of capital planning by management. Since a bank with excess or adequate capital in one period * might experience capital impairment as a result of growth or inflation, management needs to plan and anticipate capital short falls and rectify them. Failure, will be inuiting the regulators squeeze.

Pace suggests for methods or ways of improving capital inadequacy:-

a) By a rise in bank profits

b) By decreasing devidend and increasing retained earning

c) By slowing the banks growth rate and

d) By raising new share capital.[9]

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7. Vojta G. J., A Dynamic view of Capital Adequacy, to The Journal of Commercial Bank Lending, December 1974, P. 17

8. Pace E., Bank growth and Capital Adequacy, Jaurnal of Commercial Bank Lending, April 1980, P.13

9. Pace E., Ibid.

Another method of combating capital adequacy problems will be to vary the asset composition from the risky and illiquid to less risky and a more liquid portfolio of assets.

Having considered Capital and issues related to it, we now consider deposits.

2.2.2. DEPOSITS

Bank customers for various reasons, keep their money in banks. These deposits place upon the bank, the obligation to make payments when demanded or according to the terms of the agreement between the bank and the depositor.

Deposits are important to Commercial Banks for a number of reasons. Firstly, they are the largest single source of bank working funds. See Table 2.3.

TABLE 2.3

RATIO OF DEPOSITS TO TOTAL FUNDS

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| FBN | .74 | .81 | .86 | .88 | .86 |
| UBN | .95 | .95 | .96 | .95 | .95 |
| UBA | .94 | .95 | .96 | .95 | .95 |
| IBWA | .78 | .97 | .76 | .68 | .58 |
| ACB | .88 | .83 | .79 | .76 | .83 |
| SGBN | NA | .75 | .75 | .69 | NA |
| NB | .82 | .82 | .80 | .86 | .84 |
| BCCI | NA | .91 | .80 | .68 | NA |
| NNB | .89 | .92 | .91 | .84 | NA |
| NAB | .88 | .90 | .92 | .94 | NA |
| MB | .65 | .68 | .71 | .65 | NA |

Sources: Computed from various annual reports of these bank.

.../28

It can be seen from table 2.3 that deposits constitute on the average, no less than 70% of bank assets. The importance of deposits as a source of bank funds lies in the experience of bankers that only a small proportion of the deposited funds are demanded or claimed by customers at any one point in time. "Provided therefore that a small proportion (of the funds) are kept to satisfy the depositors withdrawal requirements and provided the Bank continues to enjoy the depositors confidence in his ability to honour his obligations, the banker fells free to lend (and invest) the balance."[10]

Secondly, the composition or structure of deposits have implications for bank resource management. Deposits structure determines the stability or the period of time deposit funds are at the disposal of the bank. This has implications for what purposes the funds can be employed. The nature of deposits determines the structure of bank assets, its loan profile and to what extent the bank can undertake term lending. This has implications for profits.

Thirdly, Nwankwo[11] posits that deposit structure influences manpower needs. He assets that more stable deposits will require fewer personnel to service them, as opposed to more when the deposits are unstable. The resultant staff costs, has implications for profitability.

Fourthly, the structure of deposits also has implications for the cost of these funds to the bank. If classified by

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10. Nwankwo G.O., The Nigerian Financial System, London & Basing stroke: Macmillan, 1980, p.56

11. Ibid p.57

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the type of contract between the bank and the depositor, three types of deposits are recognised. These are demand, time and savings deposits, but no interest is payable on demand deposits. The relative size of each in relation to the others, therefore has an impact on the amounts of no interest payable.

Finally, deposits are important as they form one of the major source of money on the economy. This arises from the process of debt monetization by the commercial banking systems, using primary deposits to create derivative deposits.

The only regulation applicable to deposits is that on the interest payable. Not much room is available for competetive interest setting, as most banks will pay the maximum rates allowable. This does not however preclude banks from attracting deposrts by other means such as publicity etc.

TABLE 2.4

INTEREST RATES ON DEPOSITS 1983

| TYPE OF DEPOSIT | RATE |
|---|---|
| a) Savings Deposits | 7½ |
| b) Time deposits with 7 days notice | 6½ |
| c) Time deposit for one month | 7 |
| d) Time deposits for one to three months | 7¼ |
| e) Time deposits for 3 - 6 months | 7½ |
| f) Time deposits for 6 - 12 months | 7¾ |
| g) Time deposits for over 12 months | 8 |

Source: Monetary Policy Circular No. 16

..../30

2.2.3 LOANS AND OTHER LIABILITIES

Banks often supplement deposits and capital by borrowing. Banks often borrow from other banks. These take the form of rediscounts and bills payable. A rediscount is a sale by the borrowing bank with its endorsement, of loans it holds. They are regarded as contingent liabilities of the bank. Bills payable are promissory notes issued by the borrowing bank and secured either by its loans or by other assets, mainly bonds, which the bank owns. There are also acceptances. Acceptances arise when a bank accepts bills drawn on it for a commission that is payable at a later date under the terms of a commercial letter of credit or acceptance agreement. The sale of the bill or acceptance to some other bank guarantees the funds.

Banks also supplement their funds with long term loans. There are often debentures flated by the bank.

2.3. USES OF BANK FUND AND CONSTRAINS

The use of bank funds results in the acquisition of various types of assets, and is influenced by several factors. Banks are influenced by their obligation to shareholders to be profitable. This conflicts with their obligation to depositors to be liquid. The pursuit of profitability is generally counter to the drive for liquidity, as high income earning uses of Bank funds often result in relative illiquidity. Loans and advances which are the highest earning assets, are the most illiquid of bank assets. On the same vein, the pursuit of liquidity will result in low profits. The most liquid assets, cash, earns no income. Similarly, the more liquid investments earn low incomes.

...../31

A second factor influencing the use of bank funds is the prevailing market conditions. The market situation determines whether bank funds are held in cash, short term investments or in other forms. The existence of a lender of last resort or a rediscount mechanism is important because they can enhance liquidity by monetizing illiquid assets. 12

A third factor is the existence of a regulatory framework and the extent of the regulation. The regulatory framework in Nigeria, is a by - product of the governments development goals or other economic objectives. The resultant regulations creates constrains for banks free operations. Related to this is the structure of the economy in terms of sectoral dominance and the relative unimportance of some sectors considered vital for exonomic growth in comparison to other sectors. It is this differences in sectoral importance that often gives rise to the need for regulation of bank operation to ensure adequate attention to sectors considered necessary for even development. Regulation of banks in Nigeria, is done through the Central Bank of Nigeria (from now CBN), who in turn give directives through their annual Monetary Policy Circulars.

Finally, the use of bank funds is a function of the banks goals and objectives and its operational philosophy.13 This depends very largely on management philosophy, which in turn is influenced by the managers personality, exposure, training attitude towards risk and so on. Bank goals and management attitude determines which sectors of the economy are most

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12. Nwankwo op Cit p.58

13. Nwankwo op Cit P. 58

...132

favoured, in terms of lending, extent of fund utilization and so on.

A study of a banks asset structure (use of bank funds), gives an insight as to how the bank has operated within the regulatory framework. It indicates the banks goals, objectives and management priority as indicated by what use the bank funds have been put to. Bank asset structure is used to measure capital adequacy, liquidity and is also an indicator of bank profitability. The use of bank funds also gives an insight as to the trade - off between liquidity and profitability. It also indicates management attitude to risk.

Bank assets are normally composed of the following :- Liquid assets, Loans and advances and investments. We shall now consider each of these and the constrains applicable.

2.3.1. LIQUID ASSETS: PRIMARY AND SECONDARY RESERVES.

Liquid assets are normally divided into Primary and Secondary reserves. We shall take each in turn.

PRIMARY RESERVES:

These are the banks cash assets. Banks hold primary reserves to protect their solvency. Sufficient cash is needed to meet possible depositors withdrawals and thus ensure depositors continued confidence in the bank. Liquidity is also required to accommodate the demand of customers for loans and advances and to take advantage of investment opportunities that might develop. The need for cash is especially critical in Nigeria where the undeveloped banking habit has resulted in an emphasis for cash in most transactions. Banks therefore require adequate cash for possible withdrawals by depositors and its debtors.

In many countries, the government imposes a cash reserve requirement on banks. The aim is to maintain bank liquidity. In Nigeria, S.12 of the Banking Act 1969 empowers the CBN to set cash reserve levels. The CBN requires banks to maintain a non - interest earning reserve with it, computed as a percentage of demand deposits. The classes and the minimum rates of cash to demand deposits as per the 1983 Monetary Policy circular issued by the CBN are contained in Table 2.5

TABLE 2.5

CASH RESERVE REQUIRMENT

| CLASS | TOTAL DEPOSIT LIABILITIES | RATIO OF CASH TO DEMAND DEPOSITS (%) |
|---|---|---|
| A | ₦300m. or more | 5 |
| B | ₦100m. or more but less than ₦300m. | 4 |
| C | ₦30m. or more, but less than ₦100m. | 3 |
| D | Less than ₦30m. | 2 |

Source: CBN Monetary Policy Circular No. 16 of 1983

These reserves are non interest earning deposits with the CBN. These reserves aid the CBN in the settlement of inter and intra bank transactions.

Generally, besides the statutory reserves banks maintain some cash reserves adequate for its operations. The amount to be maintained requires careful planning based on past experience. Cash positions should be closely monitored to see what lending and investment capacity is available and whether cash shortages are developing or likely to develop in the future. It also requires a monitoring of the deposit

...../34

position and forecasting the cash demand by customers in the ordinary course of business. Cash management also involves the forecasting of excess cash balances and planning their profitable use. This is imperative as idle cash earns no income. Care should however be taken to maintain adequate liquidity.

Deficiencies in cash reserves often occur. Section 12(4) of the Banking Act 1969, imposes a Penalty for bank failure to meet the required cash reserve level. There is thus a presure on banks to maintain the required cash ratio. So how will a bank make up for a short fall in cash reserves? Raymond Kent suggest four possible ways:-

a) A bank could purchase the excess reserves of another bank.

b) A bank could recall its outstanding call loans.

c) Secondary reserve assets could be sold and

d) The bank could borrow from the CBN.[14]

A fifth alternative is for the bank to withhold the granting of further loans and advances and investment of funds. This will stem the withdrawals of cash imminent with the granting of new loans. Thus the bank is able to gradually build up cash reserves.

Banks are often reluctant to hold cash as it does not generate income. The thrust therefore is to maintain as low a cash balance as possible in excess of the cash reserve requirement.

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14. Kent R.P., Money and Banking, New York: Holt Rinchart and Wiston Inc., 1972 p.314.

SECONDARY RESERVES

Commercial banks frown on statutory cash reserve requirement as they think bank liquidity and solvency can be equally and adequately maintained by holdings of readily marketable short term securities, which can be easily converted into cash on requirement and at the same time earn income. These short term securities are what are termed secondary reserves.

To qualify as secondary reserves, securities must be backed by a high quality credit standing of the issuers. It must be readily marketable and free of default risk. It is often recommended that they be short term to insulate them from market and interest rate fluctuations.

These securies often form the outlet for absorving excess liquidity of banks. These outlets for excess fund employment include investments in money at call, bills discounted, treasury bills and certificates, bills of exchnge and so on.

The Banking Act 1969 in section 12 imposes a liquidity ratio of 25% on all banks. Liquid assets must attain 25% of current liabilities. This ratio is computed by taking into account primary and secondary reserves. The aim of the ratio is again to safeguard banks from the risks of illiquidity and the resultant public loss of confidence in banks and the banking system.

For purposes of computation, Section 12(5) of the Banking Act 1969 enumerates the assets that could be termed liquid. These consist of any or all of the following:-

...../36

a) Notes and coins which are legal tender in Nigeria.

b) Balances at the CBN.

c) Net balances at any licensed bank (excluding uncleared effects) and money at call in Nigeria.

d) Treasury bills and treasury certificates issued by the Federal Government.

e) Inland bills of exchange and promisory notes rediscountable at the CBN

f) Stocks issued by the Federal Government with such dates of maturity as may be approved by the CBN.

g) Negotiable certificates of deposits approved by CBN.

h) Such other negotiable instruments as may from time to time be approved by the CBN for the purposes of this subsection.

Femi Adekanye lists the constituent components of current liabilities to include the following:

a) Deposits of all types

b) Certificates of deposits issued (not more than 18 months to maturity)

c) Excess balances held for internal banks

d) Excess money at call held for other banks

e) Balances held for external offices less any balances held with external office (if the net is minus, ignore).[15]

Shortfalls in the liquidity ratio must be rectified or the bank is penalised. Liquidity problems can be rectified in one of the following ways:

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15. Adekanye Op Cit Pp. 115 - 116

..../37

a) Sales to other banks or the market of investments and maturing securities.

b) Demand for repayment of maturing loans by the bank.

c) Withholding the granting of loans and advances and the making of investments.

d) Attraction of new deposits.

e) The bank issuing money market liabilities and negotiable and non - negotiable certificates of deposits.

f) Borrowing, either from the CBN or other Banks.

2.3.2 LOANS AND ADVANCES

Loans and advances constitute the most important fraction of bank assets. They are preferred to investments, because they earn higher rates of interest that more than covers the higher costs incurred in loan administration than in the management of investment portfolios.[16] In the absence of cash and liquidity requirements, banks will tend to loan out all their available funds for maximum Profitability.

Commercial bank loans and advances can be classified in various ways. Shapiro and Steiner[17] recognise four ways:

a) Classification By form
Three types are recognised under this category: loans, discounts and overdrafts. In a loan, the bank buys an interest bearing note for its face value. The interest payable is either collected at maturity or periodically. In a discount the bank buys for its present value (usually

16. Kent R. P., Op Cit p.325

17. Steiner W. H. and Shapiro E., An Introduction to the Financial System: Money and Banking, New York: Henry Holt and Co., 1956, Pp. 182 - 185.

..../38

less than the face value) a non - interest bearing note payable in the future (at par). An overdraft on the other hand, is granted when a bank honours a cheque written in excess of a depositor's balance.

b) Classification by Maturity
These are of two types
i) Demand loans: These have no definite maturity date. They are callable at any time by the lender and are repayable at any time, at the option of the borrower.
ii) Time loans: These have a definite maturity period. often, the interest rate is also fixed at the time of negotiation. They are normally repaid by installments at intervals, though they can also be repaid in full at maturity with interest payment at intervals.

c) Classification by security:
Two types are possible:
i) Secured loans: These are loans secured by collaterals or endorsement or guarantees by other parties.
ii) Unsecured Loans: For these loans, no security, endorsement or guarantee is offered.

d) Classification by Borrower
These include:
i) Loans to bank customers or regular depositors
ii) Loans to outsiders made in the open market and
iii) Loans to other banks and to a banks subsidiary.

A fifth classification can be made with respect to the use to which the loaned funds are put. This is

e) Classification by use

Under this classification, loans could be

...../39

i) Commercial loans
ii) Agricultural loans
iii) Loans for manufacturing activities
iv) Construction loans
v) Loans for mining purposes
vi) Loans for services - utilities, transport and Communication.
vii) Loans for exports and imports and
viii) Consumer loans.

Bank loans and advances are important for other reason other than they being the major source of a banks income when related to deposits, it indicates the extent to which the bank can grant or meet future loan re/uirements. Loans and advances also have implications for bank liquidity. A banks loan policies also influence borrower attitude.

The area that is considered most important however, is the banks ability through the granting of loans, to influence the course of a country's economic development by it allocation of funds. The granting of loans to a large extent determines what is produced, where and, how much of it is produced. It is for this reason that the Nigerian Government considers it crucial to regulate the granting of loans by banks, and thus put within its control, the future destiny of this Country.

REGULATIONS GOVERNING LOANS AND ADVANCES

Section 13 of the Banking Act 1969, imposes a number of constrains on bank lending. Section 13(1 a) restricts a bank from granting loans or advances to any one person or the giving of financial guarantees or the incurring of other liability on behalf of the person, to not more than 33⅓% of

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the sum of paid up capital and statutory reserves of the bank. Section 13 (1,b) prohibits the granting of advances against the security of the banks own shares. The section also regulates the granting of loans by the bank to associated persons or corporations. These are aimed at preventing the dependence of a banks future on a single debtor.

Further controls are imposed by the CBN through its annual Monetary Policy Circulars.

The Monetary Policy Circulars restrict the growth of aggregate bank credit to a fixed percentum annually. In 1980, as in the previous year, the ceiling on Bank credit expansion was pegged at 30% of previous years loans. An exception was made for small banks whose loans and advances do not exceed ₦100m. to expand their credit by up to 40% of the previous years loans or up to 70% of total deposit liabilities. The same rates were maintained in 1981 and 1982. In 1983, the credit expansion rate was lowered to 25% for large banks and up to 35% or 60% of deposits for small banks. The aim here seems to be that of restraining banks from over lending and thus rendering themselves illiquid. In the computation of credit expansion, loans granted for purchase of shares towards implimenting the indiginisation scheme and loans in excess of limits set for agricultural, residential buildings and car loans, are exempt.

The sectoral allocation of loans and advances is also regulated. Minimum levels are set for preferred sectors and maximum levels fixed for less preferred sectors.

.../41

Table 2.6 shows a four year trend of sectoral allocation of loans imposed by CBN on Commercial Banks.

TABLE 2.6

SECTORAL DISTRIBUTION OF LOANS AND ADVANCES OF COMMERCIAL BANKS

| SECTOR | YEAR | | | |
|---|---|---|---|---|
| | 1980 % | 1981 % | 1982 % | 1983 % |
| PREPERRED SECTOR/SUBSECTOR (MINIMUM) | | | | |
| I. PRODUCTION | 56 | 56 | 56 | 61 |
| Agricultural Production | 8 | 8 | 8 | 10 |
| Mining | 2 | 2 | 2 | 2 |
| Manufacturing: | 36 | 36 | 36 | 36 |
| a) Agro-allied Industries | 3 | 3 | 3 | 3 |
| b) Other Manufacturing | 33 | 33 | 33 | 33 |
| Construction: | 10 | 10 | 13 | 13 |
| a) Residential Building | 6 | 6 | 6 | 6 |
| b) Others | 4 | 4 | 7 | 7 |
| II. SERVICES | 12 | 12 | 12 | 12 |
| Public Utilities | 3 | 3 | 3 | 3 |
| Transportation & Communication | 9 | 9 | 9 | 9 |
| III. EXPORTS | 5 | 5 | 3 | 2 |
| IV. DEVELOPMENT AND FINANCE INST. | 2 | 2 | 1 | 1 |
| | 75 | 75 | 75 | 76 |
| LESS PREFERRED SECTOR/SUBSECTOR (MAXIMUM) | | | | |
| V. GENERAL COMMERCE | 17 | 17 | 17 | 16 |
| Imports | 6 | 6 | 6 | 6 |
| Domestic Trade | 11 | 11 | 11 | 10 |
| VI. OTHERS | 8 | 8 | 8 | 8 |
| Credit & Financial Institutions | 1 | 1 | 1 | 1 |
| Government | 2 | 2 | 3 | 3 |
| Personal & Professional | 3 | 3 | | 4 |
| Miscellaneous | 2 | 2 | 4 | - |
| | 25 | 25 | 25 | 24 |
| | 100 | 100 | 100 | 100 |

Sources: CBN Monetary Policy Circulars

The government hopes that by defining the percentage of loans banks should give to each sector/subsector, no sector will be given disproportionate attention. This will ensure fast economic development by directing funds to sectors critical to industrial take - off. The need for this regulation arose because of Commercial Bank preference for Commercial loans to the detriment of agricultural, industrial and other sectors.

The government also wants to place the ownership, direction and management of the Nigerian economy into indigenous hands. To achieve this, funds must be made available to Nigerians. Thus banks are required to allocate a certain percentage of their loans and advances to indigenous borrowers. This direction is contained in the yearly monetary policy circulars. In 1979/80, it was directed that 70% of loans and advances be granted to indeginous borrowers. The same ratio was maintained in 1980 and 81. In 1982, the ratio was raised to 80% of loans and advances. This ratio was maintained in 1983. Besides this, a certain proportion of loans is to be preserved exclusively for small scale industries, wholly owned by Nigerians. This allocated credit was to be shared according to the proportions indicated in Table 2.7, which is related to the turnover of the ventures. Note that in 1980, 1981 and 1982, banks failed to meet this requirement.

.../43

TABLE 2.7

ALLOCATION OF CREDIT TO NIGERIAN OWNED SMALL SCALE INDUSTRIES

| TURNOVER | PERCENTAGE SHARE | | | |
|---|---|---|---|---|
| | 1980 | 1981 | 1982 | 1983 |
| A. Up to ₦25,000. | 1.6 | 1.6 | 1.6 | 1.6 |
| B. ₦25,000. - 50,000 | 1.6 | 1.6 | 2.0 | 2.0 |
| C. ₦50,000. - 100,000. | 3.2 | 3.2 | 3.2 | 3.2 |
| D. ₦100,000. - 200,000. | 4.0 | 4.0 | 4.0 | 4.0 |
| E. ₦200,000. - 500,000 | 5.6 | 5.6 | 5.2 | 5.2 |
| TOTAL | 16.0 | 16.0 | 16.0 | 16.0 |
| Total Loans to Indigenes | 70.0 | 70.0 | 80.0 | 80.0 |

Sources: CBN Monetary Policy Circulars

Banks operating in rural areas are also constrained to lend a certain percentage (30% in 1983) of deposits collected from rural areas to customers in those areas. The aim is to enhance rural area development and encourage the development of a rural banking habit.

Finally, the CBN also controls the amount of interest chargeable by banks on loans and advances granted by them. This is a big constrain on the banks income earning capacity. Table 2.8 shows the applicable rates for preferred sectors. The Monetary Policy circulars specify whether the rates are maximum or minimum.

..../44

TABLE 2.8

INTEREST RATES CHARGEABLE ON LOANS

| | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|
| | % | % | % | % |
| Lending Rates: | | | | |
| Minimum | 6½ | 7½ | 8½ | 9½ |
| Maximum | 11½ | 11½ | 12 | 13 |
| a) Preferred sector maximum | 9½ | 9½ | 10½ | 11½ |
| b) Less Preferred sector maximum | 11½ | 11½ | 12 | 13 |
| c) Agric Credit guarantee scheme | 5-6 | 5-6 | 5-6 | 6-7 |
| d) Residential Housing costing less than ₦100,000. | 6 | 6 | 6 | 7 |
| e) Agricultural Production | 6 | 6 | 6 | 7 |

Sources: CBN monetary policy circulars

From the above discussion, it is apparent that Commercial banks operate under strict regulations. One then wonders what free hand they have in running their affairs. It is therefore tempting to conclude that banks have no freedom or latitude to operate as they wish. This conclusion is however misleading as a Commercial Bank is free to "grant or deny a loan, charge or not charge service fees to customers, compete for small depositors funds or just concentrate on large accounts.....(Banks) operate in the same manner as a business concern and attempts to optimize its return given the resources at its disposal."[18] This strategy and policy development are still possible within the seemingly impossible constrains. This is especially so confirmed as no two banks portfolios are

18. Magen S. D., The Cost of Funds of Commercial Banks: An Economic Analysis, New York: Cambridge University Press, Dunellen, 1971 p.34

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exactly the same or yield the same income. Banks could and should develop unique lending policies to meet their respective goals and objectives within the regulatory framework. This is the subject of the next chapter.

2.3.3. INVESTMENTS

Investments it has been said, earn lower yields than loans and advances. For this reason, banks prefer lower levels of investments in comparison to loans. Inspite of the low returns, banks still need to invest for the following reason:- (1) when there is a need to hold assets readily convertible into cash. Thus investments serve as a buffer between liquid assets (that earn no interest) and loans (which earn high interests but with attendant illiquidity). (2) When the demand for loans is slack and excess liquidity develops.

Thus the volume or size of investments depends on three factors:

a) the availability of investment outlets, which depends on the prevailing market conditions;

b) the demand for loans and advances which could either lead to increased investments or sale of securities, and

c) the state of the banks liquidity

Thus the level of investment will vary from period to period depending on the prevailing circumstance. A look at Table 6.4 confirms this. The table relates investments to deposits.

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Investments here are distinguished from secondary reserves. Secondary reserves are short term, high quality and readily marketable securities. Investments, ordinarily, have longer maturity periods and the emphasis on marketability is less than with secondary reserves. Investment outlets include various kinds of debt instruments like notes, mortgages, debentures and so on. Generally however, banks in Nigeria confine their investments to holdings of securities issued by the government. These are mostly government development stocks.

Commercial bank investments are also regulated. Section 13 (1,f) disallows Commercial banks to hold share capital in any undertaking without the approval of the CBN. Even where approval is given, the shareholding must not exceed 25% of the sum of the banks paid up capital and statutory reserves. Shares acquired in the course of debt satisfaction must be disposed of at the earliest possibility. S.13 (1,i) of the Banking Act 1969.

Commercial banks are also prohibited from owning subsidiaries other those in the banking business. (S.13: 1,h) Banks may however hold shares, with the approval of the CBN, in a statatory corporation set up for the purpose of promoting the development of a money market or a securities market or improving the financial machinery for financing economic development (S.13. F, ii). Commercial banks are also not allowed to acquire or lease real estate except for the purpose of conducting its business and staff housing.

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## 2.4 CONCLUSIONS:

We saw in this chapter that capital is not an important source of bank funds and was also on the decline over the years. We also saw that deposits were the most important single source of bank working funds. We also noted that loans and advances constituted the major outlet of bank funds and that the level of investments depended very much on the demand for loans and advances. We also saw that the banking industry was highly regulated and that inspite of this high degree of regulation, there was still room for banks to develop lending policies and practices and policies as to how they deploy their funds.

In the next chapter, we will consider the lending p policies and practices of banks.

..../48

CHAPER THREE

## LENDING POLICIES AND PRACTICES

Commercial banks grant loans and advances in the hope of making profit from the transactions. Banks in their planning, should therefore set overall profitability goals, which are usually based on expected returns on capital employed. To achieve this desired return on assets, returns on various earning asset portfolios necessary to achieve the overall objective, should be computed. The loans officer is then left with a specific goal of contributing his quota toward the attainment of the set objective.

The attainment of set objectives calls for the establishment of policy guidelines to enhance their achievement. Policy decisions are necessary to indicate the kind and number of loans a bank will make and to also specify whom the bank will lend to and under what circumstances.

Certain issues need to be considered in the development of a loans policy. These are :-

1) Any meaningul loans policy should take cognisance of the legitimate credit needs of the community or credit market in which the bank operates. This should then be incorporated into the loans policy. Credit needs can be determined by actual demand or Survey.

2) The bank should then assess its ability to meet the credit needs of the market. This should be done from the point of view of its available funds and the banks set

.../49

objectives. It is obvious that a bank cannot meet all the credit needs of the Community. In this case, the bank should direct the customer to some alternative source. Banks should not withhold loans on some whimsical reason. The constrains should be the ability to expand loans and to recover them.

3) Management should determine the general character of loans it hopes to grant. Sectoral ceilings should be established on the various forms of lending, taking cognisance of community needs and the prevailing regulations. This credit planning is to prevent the deprivation of one sector and supplying liberal amounts to other sectors. It should be stressed here that the concern should not be so much on the form, but on the soundness of the loan. The banks main concern should be with the granting of safe loans.

Robert Maloane[1] suggests that each loans policy should address five basicissues. These are:-

a) The delegation of individual lending authority.

b) Procedural matters for handling the approval process.

c) Current Pricing Policies

d) Current lending strategies that management believe to be appropriate and

e) Precedence and verbal communication

These issues are discussed under sections 3.1 - 3.5 below.

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1. Maloane R.B., Written Loan Policies, The Journal of Commercial Bank lending, June 1976, P.19.

## 3.1. LENDING AUTHORITY

A lending policy must specify who has authority to sanction loans and advances. As a general rule, the authority to approve loans lies with the Board of Directors. Very often, the board delegates the responsibility of supervising the lending function to either a loans committee or the executive committee. The lending officers then report their lending activities to the committee or executive (from now, the supervising authority). The supervising authority ensures that loans are issued within the laws confines and the banks lending policies and objectives.

Generally, the lending function becomes specialized, requiring particular appraisal techniques, skills and abilities. This results in the organisation of lending activities into departments such as mortgage department, commercial loans department and so on. The loans policy must specify an organisational and administrative hierarchy. Responsibilities must be specified. Each loan officer should be assigned a specific amount of lending authority. In practice, he should be allowed latitude for independent decision within the limits of his authority. Each officers limit should reflect the officers level of competence and judgemental ability. Cognisance should be taken of the officers training and experience. In all cases, authority must be accompanied with responsibility and accountability.

Banks should safeguard against creating a feeling in customers that the loans officer or manager is not

..../51

responsible for the final loan decision. Adequate authority should be given to branch managers to grant loans without reference to the head office. They should bear full responsibility for their actions.

3.2 CREDIT APPROVAL PROCEDURES

Each loans policy should state the rules and regulations under which the loans officers are to operate. The role of the supervising authorities, their responsibility and when a loans officer needs to refer to it, must be specified.

The procedure brochure should specify the duties and responsibilities of loans officers, credit departments, and the processes to be followed in obtaining the approval of the supervising authority, and should specify the limits or levels requiring their approval. The procedure mannual should also specify what kind of information should be obtained from prospective debtors and what collaterals or security is necessary and how the transaction should be documented. The procedures should also specify the size of loans to be approved by each officer or credit committee and when audits and appraisals will be required. All the details necessary for the maintainance of a sound credit approval procedure should be stated.

In the granting of loans, the lending officer should concern himself with the following issues:-

a) Soundness of the loan; here the concern of the loan officer is to obtain the assurance that whatever money is loaned out, will flow back

..../52

to the bank. Here the loans officer sets out to ensure that the loan is collectible from anticipated income or profits of the borrowers.

b) Purpose of the loan: The concern of the loan officer here is with establishing a repayment schedule. The purpose of the loan is important for the determination of a repayment schedule which takes into consideration the peculiarities of the loan. This is so because investments have varying gestation periods. The incomes generated are not similarly distributed. This must be taken into account. This is also required in determining what collatuals are necessary.

As established loans policy should enable the loan officer, by following the procedures, to accept loans and establish repayment schedules and demand collaterals that are all acceptable within the context of the banks objectives.

It should be noted in repayment consideration that not all borrowers should be required to clean up their accounts annually or periodically before they are considered for further credit. Repayments could be differed where a loan is utilised for expansion without any risk of the principal being in default. Time should be allowed for the venture to mature.

Loans made for sound purposes, with realistically drawn repayment schedules, often go awry. Default risk cannot be predicted with any amount of certainty. Thus to minimize the risk of default, banks, after examining the credit worthiness of the borrower and the viability of the project,

..../53

demand collateral as security in the event of default. The loans policy should specify the criteria relevant in the determination of individual or corporate credit worthiness. It should also specify circumstances in which security will be required and the extent and type of security.

Credit worthiness is based largely on individual character and reputation. It is also greatly influenced by the financial power of the borrower and his earning record. The determination of financial and earning power often involves the analysis of financial statements, through the use of various ratios. Loan procedures should provided adequate tools to enable the officers appraise loans effectively. It should specify the information required for the analysis, how it should be obtained and how the obtained data is to be analysed.

The best lending officer is sometimes misled into making wrong credit decisions. Major losses could result. For this reason, it is necessary for banks to conduct credit reviews. Where the transactions are large enough, a credit review department could be created, otherwise the role could be played by a senior officer or a small committee. The aim is to investigate actual and potential borrowers and make necessary recommendations. This review requires the maintainance of customer files with the necessary financial and other information. The file should contain the borrowers business history, previous transactions with the bank and the loan officers comment. The review is to show whether sound lending is in operation or not. They review and

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re-evaluate outstanding loans as to their default potential and security adequacy. These reviews serve as a control measure to ensure that loans are issued within the confines of the law and the banks policy and objectives.

Credit approval procedures must be explicit, exact, concise and leave no room for confusion.

3.3 PRICING POLICIES

Each bank should have a laid down policy, establishing the basis for charging interest on loans. Interest must not be charged arbitrarily.

The importance of interest lies in the fact that it greatly influences the volume and character of the banks loan, portfolio. It also determines the bank income. They should therefore be set cautiously. There are three ways or approaches of setting interest rates on loans. These are:-

a) Here the bank establishes an interest rate schedule for various kinds of loans from the on set. The established rate are then charged when the loan is made.

b) The bank charges the rates specified by the regulating authority - CBN. and

c) Pricing loans on the basis of their yield or income.

The first method (known as the traditional approach), is not realistic as it does not allow a consideration of the peculiarities of each loan. It charges a blanket rate. The same shortcoming is applicable to the second method.

Loan pricing based on loan yield takes into account the return from the loan and compares it with cost of

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using such funds before arriving at an appropriate interest charge. This method takes into account:-

a) the cost of funds loaned out

b) the cost of making and servicing the loan, that is, overhead expenses.

c) a risk cost factor which should cover probable losses that might arise with time and

d) the provision of a reasonable profit margin.[2]

With this method, banks will charge low interest for loans that result in low cost or risk and more for riskier loans and those that generate high overhead and interest costs. This method rejects the notion that banks operate in a tight corner with no room for operational discretion and strategy development.

The loan yield method of pricing loans has been recommended by Thomas M Flyn[3] and James A Hoeven and Jerome S. Old ham[4].

These writers in their articles established formats for analysing loan yields. The format developed by Hoeven and Oldham was found to be better than that suggested by Flyn. It is easier to understand and more detailed. See a copy of the format appearing as Table 3.1. It is recommended here that banks employ this method.

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2. Crosse H.D., Management Policies for Commercial Banks (New York: Prentice Hall Inc, Englewoods Cliffs., 1962), P.205

3. Flyn T. M., Loan Profitability - A method to the madness?, The Journal of Commercial Bank Lending, March 1978, Pp.3-11

4. Hoeven J. A. and Oldham J.S., Commercial Loan profitability Pricing Analysis, Journal of Commercial Bank Lending, June 1976, Pp. 44 - 57.

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Banks must price their loans. This pricing should result from analysis of the peculiarities of the loan. Adequate pricing procedures should be established. On the whole, the purpose of a pricing policy is to

a) determine the profit contribution of the lending function involving both new and a review of existing loans. It allows a day to day appraisal of loan performance.

b) to produce results which are consistent with set objectives and produce the desired return on capital.

c) to result in the equitable and objective pricing of loans by various loans officers, thus serving as a realistic standard and precluding bias.

Each bank should set pricing policies that adapt easily to its peculiarities and directs the whole organisation towards the achievement of its set objectives.

3.4 LENDING STRATEGIES

Each bank should have a lending strategy, documented and understandable to all loans officers. A lending strategy should state clearly the goals it aims to achieve and how these goals are to be achieved. It should state which loans are desireable and which loans are not. It should specify sectors singled out for special attention and how the bank wishes to go about achieving its aim. A strategy should guide the lending officer towards the desired bank objectives.

A strategy should state the area of emphasis, the basis of pricing the loans and whether its rates are flexible or fixed and when it is appropriate to float them.

.../58

TABLE: 3.1

COMMERCIAL LOAN
YIELD ANALYSIS WORKSHEET

Borrower's Name _____

☐ New Loan ☐ _____ Review Date _____

**SOURCES OF FUNDS EMPLOYED**

| | | |
|---|---|---|
| 1. Average Loan Balance | | $ _____ |
| 2. Demand Deposit Contribution (Average Balance x (1 – Reserve Requirement _____%)) | $ _____ | |
| 3. Time Deposit Contribution (Average Balance x (1 – Reserve Requirement _____%)) | $ _____ | |
| 4. Other Deposit Contribution (Average Balance x (1 – Reserve Requirement _____%)) | $ _____ | |
| 5. Total Deposit Contribution (Total of Lines 2 through 4) | | $ _____ |
| 6. Net "Pooled Funds" Required (Line 1 – Line 5) | $ _____ | |

**TOTAL GROSS LOAN INCOME**

| | |
|---|---|
| Loan Interest (Line 1 × Interest Rate Charged _____%) | $ _____ |
| 8. Service Charges and Other Fees | $ _____ |
| 9. Total Gross Loan Income (Line 7 + Line 8) | $ _____ |

**TOTAL LOAN EXPENSE**

| | | |
|---|---|---|
| 10. Cost of Funds Required (Line 6 × Appropriate Cost Rate _____%) | | $ _____ |
| . Time Deposit Interest Expense | | $ _____ |
| 2. Loan Servicing Costs (Non recurring) | | |
| A. Initial Costs | $ _____ | |
| B. Term Costs | $ _____ | TOTAL $ _____ |
| 13. Total Direct Expense (Subtotal of Lines 10 through 12) | | $ _____ |
| 14. Departmental Overhead Expense | | $ _____ |
| 15. Cost of Risk (Line 1 × Appropriate Risk Rate Factor _____) | | $ _____ |
| 16. Demand Deposit Activity Costs | | $ _____ |
| 17. Total Loan Expense (Total of Lines 13 through 16) | | $ _____ |

**NET LOAN INCOME AND YIELD**

| | |
|---|---|
| 18. Net Loan Income (Line 9 – Line 17) | $ _____ |
| 19. Net Loan Yield (Line 18 ÷ Line 6) | _____% |

**NOMINAL RATE CALCULATION**

| | |
|---|---|
| 20. Required Net Loan Income (Line 6 × Desired Yield on Pooled Funds Employed _____%) | $ _____ |
| 21. Required Gross Loan Income (Line 20 + Line 17) | $ _____ |
| 22. Interest Rate Required (Line 21 ÷ Line 1) | _____% |

## 3.5 PRECEDENCE AND VERBAL COMMUNICATION

A Loans policy should state the extent to which precedence should guide current loan decisions. It must also explicitly discourage verbal communication as a basis for granting loans.

A loan policy should be written; the advantages are obvious. A loans policy must be implimented by competent credit personnel who can evaluate the quality of credits and and identify weakeness in a loan portfolio. They must be skilled in credit analysis. This might call for training. They must be able to collect the necessary information, analyse it and require adequate amounts of collateral. They must also ensure proper documentation of all loans transaction.

In summary, each written loan policy should contain the following points:-

a) Types of loans and collaterals considered desireable for the banks portfolio.

b) Types of loans and collateral considered inappropriate

c) Lending Limits for each loan officer

d) desired aggregate loan level

e) Loan mix and their proportions

f) benefiting geographical area and circumstances under which the boundaries can be exceeded.

g) Kind and extent of information required for each loan.

h) written acknowledgements of the borrower at the inception of the loan regarding his understanding of repayment provisions and

i) Provisions for periodic review, inspection and administration of loans after they have been made.

## 3.6 CONCLUSION

In this chapter we have shown the need for banks to establish lending policies with stated objectives to achieve. We discussed the need to specify lending authority and establish credit approval procedures in clean and concise terms. We also mentioned that a bank must have a strategy for achieving its set objectives. The current strategy must be specified and be clear to all. We also stated that pricing policies should be established to ensure uniformity and equity in the pricing of loans. Finally, we mentioned that a loans policy must state the extend to which precedent should guide future loan decisions and expressly discourage verbal communication in the granting of loans.

In the next chapter, we will consider various concepts of business income, and establish profitability measures to be used in this study.

CHAPER FOUR

## DETERMINATION OF BUSINESS INCOME

### 4.1 INTRODUCTION

Any study on profitability, pre-supposes the existence of income. Since no one measure of income is universally acclaimed, the method adopted for this study must be specified. In this chapter, we shall discuss the economists and accounting concepts of income. Profit determination is then handled. We then discuss profitability, appraise the measures applied to non financial firms and their inapplicability for the study. The chapter ends with a prescription of profitability measures to be used in the study and some causal factor measures.

### 4.2 ECONOMISTS AND ACCOUNTING CONCEPTS OF INCOME

There is no agreement as to the definition of business income or reverue. There is no consensus as to the nature of income, the timing of its measure and the mode of its measure. Economists and Accountants, even though their disciplines are related, hold divergent concepts of income and employ dissimilar tools or modes of measurements. We shall now discuss each of the two concepts of business income.

#### 4.2.1 THE ECONOMISTS CONCEPT OF INCOME

The economists conception of income is posited by Hicks, who defined a mans income as the "Maximum value which he can consume during a week, and still expect to be as well off at the end of the week as he was at the beginning."[1] This concept of income was extended and applied to the determination of business income. When

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1. Hicks J.R., Value and Capital, (Oxford: Claredon Press, 1946) P.172.

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applied to business, it implies the measurement of business assets at the beginning and end of a chosen period; the computation of present values of enterprise assets and liabilities at the begining and end of that period and reporting the the defference.

Income in the context of Hicks definition is comprised of two factors:

a) the increase or decrease in net assets that were the result of operations, and

b) the increase or decrease in net asset values that were the result of changes in the expected future value of those assets.[2]

Because of (b) above, Hicks definition of income poses two operational problems.

a) The determination of future outflows and inflows which the definition requires, can at best be a subjective exercise with a highly suspect element of certainty and thus uniformity. This will result in income computation being highly dependent on subjective management judgement.

b) The applicable discount factor for present value computation is also not known and is subject to the uncertainties of future conditions.

It is as a result of these operational constrains, that accountants reject the economists concept of income. Accounting has therefore chosen the more operationally beneficial course by delaying the timing of income reporting, until substantial evidence exists that income

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2. McCullers L.D. and Schroeder R.G., Accounting Theory: Text and Readings, (Toronto: John Wiley and Sons, 1978) P.47

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has been earned. We now discuss the Accounting concept of income.

4.2.2 ACCOUNTING INCOME

Income is generally conceived in accounting as an increase in assets. This view is shared by the American Accounting Principles Board[3], Dohr[4], Vatter[5] and Paton[6]. Dohr limits this definition of income as an increase in assets. This increase in wealth, he asserts, should not result from a gift or appreciation in asset values or be the result of additional investment in the business. Vatter recognises that this increase in assets need not necessarily becash. Suffice it that there are no specific restrictions applicable to the new assets for example, right to devidend payments, interest, and so on). Patton and Littleton[7] further posit that income should be the result of an exchange of the product of the business, be it commodities or services.

Paton goes on to list the tests of revenue: that revenue arise from business activities and be recognised

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3. Accounting Principles Board statement No.4, Basic Concepts of Accounting Principles, (New York; AICPA) 1970.
4. Dohr J.L., Income Divorced from reality, Journal of Accountancy, LXVI, No.6, 1938, P.362
5. Vatter W. J., The Fund theory of Accounting and its Implications for Financial Reports, chicago and London: University of Chicago Press, 1969, Pp.25
6. Paton W.A., Advanced Accounting (New York: Mcmillan Co., 1941) P. 441
7. Vatter Op cit, quoting Paton and Littleton P.

..../63

and measured in terms of the essential features of the operation; that revenue be evidenced by genuine asset values, preferably in liquid form and that with firms dealing in commodities, the requirements are met by accepting the completed sale as a test of revenue.

Enterprise regular product sales are the largest group of transactions adding to the firms assets. Sales are generally recognised as revenue. Care should however be taken in this generalisation as a "sale, of itself, does not establish revenue conclusively....."[8]. It should then be noted that conditional sales donot result in revenue, inspite of cash transfers. Revenue could only be recognised when the restriction is removed. Similarly, sales with commitments such as guarantees, after sale service undertaking and so on, result in revenues only to the extent that these commitments cease to apply. It is customary to net out from sales the estimated cost of these guarantees and report the balance as net sales. For utilities and service firms, revenue is recognised at the rendering of the service.

Problems often arise as to the treatment of funds flowing from the sale of items that are not the normal products of the enterprise and other transactions of a non-recurring nature. There are scholars that advocate that items of a non-recurring nature be included in the determination of enterprise revenue, as the revenue will not accrue in the first place, if the enterprise were not operating. Opponents of this view counter by arguing that

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8. Vatter op cit, P.27

the inclusion of such revenues distorts the firms "normal" results from operations as they are of a non-recurring nature. The latter view is the one currently used in the reporting of enterprise income in Nigeria.

Some tests are conventionally applied to aid the determination of revenue. These are the earning, realization and distributability tests.

Income is said to be earned, "with the process of operation or, more precisely, with the accumulation of costs assignable to the product. The alternative view considers revenue to be effectively earned only when the final product is delivered or furnished."[9] Thus for income to be earned, expense must be released; a service rendered or the tittle of goods passed to a buyer. Thus no income is earned when deposits are paid in advance without the title of goods passing to the buyer. When a sale does occur, income is earned irrespective of whether cash payments occur or not.

The realization principle is closely related to the concept of accounting or reporting periods. Income is said to be realized if within the accounting period, "the corporation need do nothing further to enjoy the benefit of them."[10] Paton further states thus, "revenue is fully realized .....when it is represented or supported by cash receipts, and it has become conventional to treat bona-fide current receivables as the equivalent of cash in

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9. Paton op cit Pp. 453 - 455.
10. Kester B.R., Principles of Accounting, (New York: Ronald Press Co., 1939) P.17

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this connection."[11] Thus in realization, income is recognised when the earning Process is complete or virtually complete and an exchange has taken place. It is this exchange transaction that determines both the timing and amounts of revenue to be recognised.

The realization concept results in the recognition of revenue at the point of sale, but the timing of such recognition will depend on the nature of the transaction. Where the production process or service rendered, spreads over two or more periods, revenue is recognised by the percentage of completion; revenue is also recognised at the completion and sale of the product. For service firms, revenue is recognised as cash is received and in some cases, revenue is recognised at the occurrence of some event.[12]

It is apparent therefore that the timing of revenue recognition can differ substantially according to management whims, as there are no specific criteria for proper time identification. It should be noted that it is often possible for revenue to be earned without being realized. With sale and the collection of the proceeds, revenue is both earned and realized.

The contention of the distributability concept is that recognised revenues should be distributable. This view is championed by Cotter when he state thus, "the ability of one company to pay out all the profit it shows without impairment of original assets, and the inability of the

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11. Paton op cit Pp.453 - 55

12. McCullors and Schroeder op cit Pp. 54 -55

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other to do the same, indicates quite clearly which had the reals and which had the fools profit."[13] Business exigencies however, often require the retention of revenue within the firm. A firms non - payment of devidends, does not negate the existence of profit. A distinction should therefore be made between "income performance and income administration."

Vatter further argues that the distributability test to revenue is logically impossible, since it is assets that are distributed and not revenues. That since assets are not created by the mere recognition of revenue, but with the corresponding recognition of expense, this test is further rendered inapplicable.[14]

From the foregoing it is apparent that the accounting income, although less susceptible to speculation and judgemental whims when compared to the economists income, it is still subject to uncertainties. Controversies still abound. Some accounting scholars see the adequacy of current operating income as fully reflecting current business performance. Other insist that the current operating profit does not give a comprehensive picture of the enterprise well-offness. Edward and Bells require three further measures:-

a) The measure of income from realizable cost savings which accrues as a result of an increase in the prices of assets held during a period;

b) Income from realized cost savings which is the difference between the historical cost

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13. Vatter op cit quoting Cotter P. 37
14. Vatter Ibid P.37

and the current purchase cost/price of goods sold and

c) Realized capital gains, which is the excess of sales proceeds over historical costs on the disposal of long term assets.[15]

Suffice it in this study, that an awareness of the controversy is created.

The major difference between the accounting and the economists concept of income is that the economists require the valuation of the whle enterprise at the beginning and end of some chosen period in order to compute its present value. The current operating Accounting income however, requires only the measure of assets generated in the current period from current effort. It is this accounting concept of income that will be used in this study.

In the next section, we will consider the determination of current accounting profit from current accounting income.

## 4.3 ACCOUNTING PROFIT DETERMINATION

Profit is the difference between revenue and expenditures incidental to the generation of the revenue. while revenue refers to the inflow of funds or assets, profit is a measure of how efficiently those funds or assets were generated with reference to the incidental costs. Basic to the recognition of accounting profit are two concepts: the accounting period convention and the matching concept.

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15. Edwards E.O., and Bell P.W., The Theory and Measurement of Business Income, Berkeley and Los Angeles, University of California Press, 1961, Pp.113 - 115.

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Any exact measure of business profits is possible only when the business is liquidated. Gilmans[16] quotations from the works of Kester and Cannings succintly portray this idea. Kester opines thus: "Profits are accurately and definitely determinable only when a business ceases a and is liquidated. Profits of a going concern are always estimates." Canning, in agreement to this idea states as follows: "No measure of gross income made before an enterprise is wound up either is, or purports to be a precisely determined matter of fact ..... All measures of income for periods.....less than the duration of an enterprise are approximate indexes only."

For various reasons however, the determination of profits cannot be deferred till business liquidation. Owners of enterprises require returns, manager require performance reports for planning and administration and taxing authorities will not wait indefinitely until business liquidation. Thus out of expediency, the accounting period convention developed for periodic income measurement. In Nigeria the normal reporting period is one calender year.

The matching concept requires that business effort be associated with business accomplishments. It requires that cost be related to revenues realized within a given accounting period. For costs to be deductable from current period revenue, they must be expired costs, having no further future benefit.

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16. Gilman S. Accounting concepts of Profits, New York: The Ronald Press Co., 1966, Pp. 75 -76

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The determination of expenditures chargeable against current revenue, depends on the definition of the terms cost, expense and loss. McCuller and Schroeder quote the American Terminology Bulletin No4 as defining the terms as follows:-

> Cost: "These are the amounts given in consideration of goods received or to be received. Costs can be classified as unexpired (assets), which are applicable to production of furture revenues, and expired costs, those not applicable to the production of future revenues and thus deductable from revenues and retained earnings in the current period."
>
> Expense: "are revenue Producing cost expirations."
>
> Loss: "non revenue producing cost expiration."[17]

It is thus required that expired and unexpired costs be determined. Only expired costs are charged to current revenue. A distinction needs also be made between revenue and non - revenue yielding cost expirations. To aid accountants, a distinction is further made between product or direct cost and period costs, which are not directly related to the product and are more related to the expiration of time. Period costs are released to expense on the basis of the period of benefit. All losses are charged to revenue in the period their future uselfulness becomes questioned, according to the concept of conservatism. Product costs are normally released on the basis of the

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17. McCullers and Schroeder op cit P.56

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number of products sold. For service industries like banks, this will be the cost incurred in the discharge of the service. This will be released on the extent of service rendered.

To summarize, accounting profit is consequent upon the ability to measure inflows (revenues) and associating to them the corresponding outflows (expense). The net effect is profit. Where the inflows and outflows are not susceptible to measure, the timing of profit recognition is deferred to a later period.

Having discussed the determination of profits, we shall then concern ourselves in the next section with the measures of profitability.

## 4.4. PROFITABILITY MEASURES

4.4.1 While the measure of profit is an absolute amount within its own limitations, profitability is a relative measure. Most often, the tools of ratio analysis are employed. Profitability measures are relative measures undertaken to aid comparative analysis, either of the same firm from year to year, or with another firm. They aid the evaluation of a firms operational performance.

Profitability measures often vary with the person undertaking the analysis, depending on his relationship with the firm analysed. The criterion measures of the following, Investor, Creditor, employee, management and an impassionate analyst, often differ from each other because of their different interests and reference points. The aim of this study is to analyse bank profitability generally, without any bias to an interest group. In a later section, the profitability measures for the study

will be given. Meanwhile, the measure generally applied to non - financial firms will be discussed and their relevance for this study specified.

4.4.2. PROFITABILITY MEASURES OF NON FINANCIAL FIRMS

These measures are discussed under items (a) to (c)

a) NET PROFIT TO NET SALES

In computing this ratio, profit after tax (before extra-ordinary items).is divided by net sales. The ratio shows the operational efficiency of a firm in the manufacture, storage, selling and distribution of its products. This ratio has been used by a number of scholars in their researches. They include Beaver (1966) and Altman (1968) who used it in the prediction of firm failure; Harrigan (1966) and Pinches and Mingo (1973) who used it in bond ratings and Stevens (1973) who employed the ratio in predicting firm mergers.

This ratio cannot be applied to commercial Banks as banks do not sell products, but render financial service. In its place the gross profit margin will be used to show the same effect. The gross profit margin is computed as the difference between operating income and expenses, divided by operating income.

b PROFIT TO TOTAL ASSET RATIOS

Three varients of profit to asset ratios are possible: gross yield on total assets, gross profit margin to total assetss. These ratios have been found useful by the following researchers and

...../72

authors: Tamari (1966), Beaver (1966), Pogue and Soldofsky (1969), Deakin (1973), Pinches and Mingo (1973), Lev (1974), Libby (1975), Wood and Porter (1979) and Verghese (1983).

The ratio gross yield on total assets is given as follows:-

$$\text{Gross Yield on Total Assets} = \frac{\text{Total Operating Income}}{\text{Total Assets.}}$$

This ratio is indicative of managements ability to generate income that will cover all operating costs and still generate an acceptable surplus. This ratio is affected by a number of factors when applied to Commercial banks: and increase or decrease in assets employed which earn income; changes in the portfolio to higher or lower yeilding assets; an increase or decrease in the general level of interest rates; management push for higher yeilds on loans and other assets or an increase or decrease in fees and other income not related to the employment of assets. Changes in this ratio as can be seen, is greatly affected by management behaviour in asset management.

The gross profit margin on total assets shows not only managements ability to generate income, but also its ability to control expenses. It is computed thus:-

$$\text{Gross Profit Margin on Total Assets} = \frac{\text{Income before tax - Operating Expenses}}{\text{Total Assets}}$$

The ratio of Net Profit to total assets is a measure of overall profitability and the efficiency of Management. It indicates management ability to

..../73

generate income, control expenses and obtain a favourable tax status. It is calculated as follows:-

$$\text{Net Income on total Assets} = \frac{\text{Net Income}}{\text{Total Assets}}$$

The above mentioned measures will be employed in this study.

When applied to non - financial firms, these profit to asset ratios are indicative of the impact of leverage. Two variants are recognised here. The first has as its profit, income after taxes but excluding interest charges and devidends, while the second has as its numerator profit after taxes, devidends and interest. Lev (1974), argues that the exclusion of financing charges in the first variant, allows a "more appropriate interfirm comparison because differences among firms in capital structure, reflected in differenct interest charges, will not affect the ratio."[18] This meaning cannot however be applied to commercial Banks as they are not levered in the conventional usage of the word leverage as applied to non - financial firms. Very few Nigerian Banks have long term debt. The proportion of share capital to total funds is also comparatively too small. So also long term debt. Bank funds are mainly composed of deposits which are not similar in contractual obligations as long term debt. Furthermore, Magen quotes Silverberg as positing that, "there is no apparent evidence that increased bank leverage (reduced capital to deposit ratio), Significantly raise the capital cost

18. Lev B., Financial statement Analysis: A New Approach, (New Jersey: Prentice Hall Inc., 1974) P.15

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to commercial banks."[19] Thus these ratios are not used in this study.

c) SHAREHOLDER RELATED RATIOS

Profitability measures for non-financial firms lays a lot of emphasis on shareholder related ratios. This is because shareholder funds are often the major source of business funds. For Commercial banks, this is not the case. So these measures will not be used in this study. It had earlier been mentioned that this study is not aimed at analysing profitability from the focal point of an interest group, but from a general perspective. We shall however, briefly mention the ratios. They appear as items (i) to (iii) below:

i) Return on Shareholders funds

This ration show the profitability of the funds contributed by shareholders. It is computed as:-

$$\text{Return on Shareholders funds} = \frac{\text{Net Income}}{\text{Share Capital + Retained Earnings.}}$$

This ratio was either used or recommended by the following: - Beaver (1966), Elam (1975), Harrigan (1966), Pinches and Mingo (1973), Martin (1971), O'Connor (1973), Lev (1974) and Wood and Porter (1979)

ii) Earnings per Share

This is computed as net income after Preference devidend, divided by the outstanding number of common shares.

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19. Magen S. D., The cost of funds to Commercial Banks: An Econometric Analysis, (New York: Dunellen, 1971) Pp. 97 - 98.

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(iii) Price Earning Ratio

This is the ratio of the market price of a share to its earnings per share. Besides the earlier reasons given for these ratios not being used, this has the added disadvantage that only three banks are quoted with the stock exchange and thus have a share price.

4.5 PROFITABILITY MEASURES FOR THE STUDY

4.5.1. The peculiarities of Commercial Banks calls for relevant alternative measures of profitability. These shall presently be discussed.

This study as the topic will suggest, requires the use of measures that will firstly indicate profitability and secondly, ratios that will indicate the causal factors of varied profitability. Some ratios will naturally serve the dual roles. The measures of profitability will be stated first, then the causal factors will be discussed later. The profitability measures are disassed under items (i) to (iv) below.

Profitability Measures

i) Income Trends

The trend of operating income will be examined to see how bank profits have fared over the study years.

ii) Operating Margin

The operating margin is the difference between operating income and operating expenses before taxation. This results in the operating earnings which indicates managements ability to earn a

...../76

surplus after providing for expenses of operation. Its behaviour over the years will indicate the behaviour of earnings and expenses.

iii) Gross Profit Marging

This ratio is given below as follows:-

$$\text{Gross profit Margin} = \frac{\text{Operating Income - Operating Expenses}}{\text{Operating Income}}$$

If viewed over time, this ratio reveals whether or not the bank is sustaining an adequate mark-up and/or coontrolling operating costs.

iv) Net Profit Margin

This is defined by the ratio:

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Operating Income}}$$

The net profit margin is affected not only by factors affecting revenue and costs, but the applicable tax rates. It thus reflects general management ability to maintain or generate a surplus.

Ratios (iii) and (iv) were used in a study by Wood and Porter (1978)

v) Profit to Total Asset Ratios

These ratios have been discussed earlier under section 3.5.2.(b) The ratios of gross yield on assets, gross profit margin on assets and net profit on assets will be used in this study.

vi) Interest Spread

Commercial Banks main business is fund related. They acquire funds by issuing claims on themselves (deposits, loans etc), and in return, promise to pay interest. Banks in turn earn their income by granting loans and advances, investing, discounting bills, creating deposits with other banks and so on. There are non-fund related earnings and these consist

...../77

> mainly of exchange, commission, fee, etc. In the analysis of bank profitability, it is therefore necessary to distinguish between fund related earnings (which are the banks principal activity) and non-fund earnings. Thus interest spread is a criterion developed to judge the profitability of the fund-related business of commercial banks. Spread is defined as the difference between the average gross interest earned from earning assets and the average gross interest paid on liabilities. Interest spread has been used by Wood and Porter and Verghese (1983), in their studies on profitability.

When expressed as a percentage of gross interest, spread indicates the efficiency of management in the generation of revenue to cover interest costs from funds employed by them and indicates what margins are available towards meeting operating expenses and generating a surplus.

Since the deployment of funds is the main business of Commercial banks, it should be interesting to see how this principal activity sustains the banks operating expenses and what contribution it makes towards profit. Operating expenses are thus deducted from interest spread. The difference will indicate whether the banks expenses are within the limits of the revenue generated by their main activity or operation.

For further analysis, interest spread will be expressed as a ratio of items (i) (ii) (iii) below:

1) Total Working funds

> This will indicate how profitably management is employing the deployable funds at their disposal. Working funds are defined as Capital and reserves, plus deposits, plus other

..../78

liabilities minus the statutory cash reserve requirement.

2) Deposits

This measure will indicate how profitably deposits are employed by the bank.

3) Total Assets

Spread to total assets will indicate the return on assets employed from the banks main operations.

Having discussed the indicators of profitability, the measures that will indicate the causes of the differences in profitability will be now tackled. It should however be noted that the author does not make any claim to absolutes. The interpretation of ratios are largely judgemental and subjective. We now discuss the ratios.

4.5.2. PROFITABILITY: CAUSAL FACTOR MEASURES

The measures to be considered here, are meant to give an insight into the causes of bank differential profitability. The following measures listed below as items (i) to (viii), will be used.

i) Loans and Advances to Deposits

This ratio, when studied in conjunction with the ratio of investments to deposits will indicate management attitude to risk and its impact on returns. This ratio will also indicate management attitude towards maintaining liquidity and its dampening effect on profit. It will pitch management as either conservative or aggressive in the granting of loans.

ii) Investment to Deposits

See item (ii) above.

...¢79

iii) Interest Paid to Deposits

This will indicate the differential interest burden borne by banks as a result of the composition of the deposits they attract. Further analysis could be undertaken by excluding demand deposits and computting the ratio as interest paid to interest attracting deposits. This shows the average cost of deposits (interest bearing).to the bank. Adequate data was however not available.

iv) Cost Structure

The trend of bank expenses, their growth (or decline) over the years is another indicator of why bank profits vary. When compared to the trend of income growth (or decline) another phase to profitability differences will be unravelled.

v) Provision for Loan Losses to Loans and Advances

This ratio shows the quality of loans granted by the bank. It also gives an insight as to the quality of staff, loan policies and of judgement used in the granting of loans. It also shows the extend to which loans policies are complied with.

vi) Interest Spread to Branches

It is aimed here to indicate the average profitability of bank branches.

vii) Yield on Loans and Advances

Management decisions influence loans portfolios. It is aimed to show the difference in yield arising from loan portfolio differences. This is interest on loans divided by total loans and advances.

.../80

viii) Yield on Investments

As in (vii) above, the yield on investments is to whow the impact of investment portfolio difference. This is the interest on investments, expressed as a percentage of total investments.

The above ratios will be computed for each of the sample banks, subject to the availability of relevant data.

## 4.6 CONCLUSIONS

In this chapter, we examined the economists and accountants concept of income and decided that even though if too was subject to some uncertainties, accounting income is more appropriate for this study. We also found that the criteria used in measuring profitability in the manufacturing/ trading sectors are generally not applicable to the banking industry. This we found was because the banking industry draws its funds mainly from outside sources (other than from shareholders), and its revenue consests mainly of income arising out of the deployment of funds. Thus alternative measures had to be prescribed. These measures are: (i) gross and net profit margin (ii) profit (gross, net and gross profit margin) to total assets and (iii) interest spread and spread related ratios. Spread is a unique measure developed to serve the peculiarities of the banking industry.

In addition to these measures we also specified some measures to explain the causes in profitability variations.

Having prescribed the profitability measures, we will in the next two chapters undertake an indepth analysis, using the specified measures.

...../81

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..../32

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CHAPTER FIVE

## PROFITABILITY: DETERMINAL MEASURES

### 5.1 INTRODUCTION

In the last chapter, criterion measures were specified for (a) determining profitability and (b) ascertaining the causes. The sample analysis is therefore split into two chapters along these lines. In this chapter. we shall concern ourselves with the determination of profitability. The next chapter will be concerned with the analysis of the causes.

In this chapter, two trends and nine ratios will be employed. They appear in Table 5.1 to 5.11.

In the process of the analysis, each trend or ratio will be examined within each of the three groups. The aim is to see which bank is outperforming members of its group. Then a comparison of the group averages will be made, where applicable, with the intent of showing which group is doing better than the other.

We now proceed with the analysis of the individual measures. They appear as items 5.2 - 5.12 below.

### 5.2 TREND OF GROSS OPERATING INCOME

The study of profitability is dependent on the abiflity of the firm studied to generate income. It is pressumed that the firm that generates more income, all things being equal, should prove more profitable. We now proceed to examine the trend of gross operating income given in Table 5.1. The growth rates are computed with 1979 as the base year.

..../84

It can be seen that group I banks generally experienced a growth in their operating incomes. Incomes, according to the group average, grew 23% in 1980, 85% and 145% in 1981 and 82 respectively and 186% in 1983. Looking at the banks individually, it can be seen that UBN recorded the highest growth rates, leading the group in all the years studied. It can also be seen that FBN growth rates were better than UBA's.

For group II banks also, incomes have grown steadily over the years. The leading bank in this group is IBWA. IBWA produced the leading growth rates in all the years except in 1983, when NBN recorded a 193% growth rate that beat its 187%. NBN outperformed the other two banks. Between ACB and SGBN, SGBN produced higher rates in two years (1982 and 1983). SGBN's results are therefore more desireable.

In group III, BCCI produced the leading growth rates. It is closely followed by MB. NNB growth rates were the least desireable in the group as NAB did not disclose the necessary figures.

Comparing the groups, we find that Group III produced the highest growth rates. We also find that group I rates were better than group II growth rates. Generally, all rates were on the increase over the years.

TABLE 5.1

TREND OF GROSS OPERATING INCOME (TOTAL INCOME FROM ALL SOURCES)

| BANK | YEAR | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1979 | 1980 | % | 1981 | % | 1982 | % | 1983 | % |
| GROUP I | | | | | | | | | |
| FBN | 111203 | 129445 | 16 | 209598 | 88 | 266024 | 139 | 306771 | 176 |
| UBN | 102372 | 138942 | 36 | 201817 | 97 | 284838 | 178 | 323178 | 216 |
| UBA | 106025 | 124699 | 18 | 178835 | 69 | 232195 | 119 | 281387 | 165 |
| G.Average | 106653 | 131028 | 23 | 196750 | 85 | 172433 | 145 | 303779 | 186 |
| GROUP II | | | | | | | | | |
| IBWA | 40058 | 61906 | 55 | 85336 | 113 | 104112 | 160 | 115104 | 187 |
| ACB* | NA | 46457 | - | 63087 | 36 | 74228 | 60 | 82247 | 77 |
| SGBN* | NA | 42074 | - | 42557 | 1 | 73218 | 74 | 86677 | 106 |
| NB | 25663 | 35329 | 38 | 37887 | 48 | 63157 | 146 | 75138 | 193 |
| G.Average | 32861 | 46442 | 47 | 57217 | 50 | 78678 | 110 | 89792 | 141 |
| GROUP III | | | | | | | | | |
| BCCI* | NA | 9050 | - | 35106 | 288 | 65844 | 628 | NA | |
| NNB | 13956 | 18070 | 29 | 22860 | 64 | 26091 | 87 | 25641 | |
| NAB | NA | NA | | NA | | NA | | NA | |
| MB | 8317 | 11394 | 37 | 16047 | 93 | 25573 | 207 | NA | |
| G.Average | 11137 | 10123 | 33 | 24671 | 148 | 39169 | 307 | NA | |

NOTE: The percentage increases are computed with 1979 figures as the base year.

* No 1979 figures, 1980 used as base year

Sources: Computed from the annual reports of these banks.

5.3 TREND OF OPERATING MARGIN

The operating margin shows both the ability of a bank to generate income and its ability to control operating expenses. In examining the trend of the operating margin, we want to see whether banks have been able to better proceeding years performance. Refer to Table 5.2.

...../86

It can be seen for group I banks that the operating margin has been growing steadily over the years. UBN growth rates were the highest for the group in all the years. The growth rates of UBA bettered those of FBN which in 1980, experienced a 4% decline.

For group II banks, SGBN produced the best growth rates. It is closely followed by IBWA. The NBN growth rates have experiend great fluctuations, while ACB recorded no margins in all the years.

In group III, BCCI produced the leading growth rates. NNB recorded negative growth rates in all the years. MB reparted a 100% growth rate in 1981 and an 89% decline in 1982.

On the whole, the performance of group I was the best. Its operating margins grew steadily over the years.

TABLE 5.2

TREND OF OPERATING MARGIN

| BANK | YEAR | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1979 | 1980 | % | 1981 | % | 1982 | % | 1983 | % |
| | ₦(000) | ₦(000) | | ₦(000) | | ₦(000) | | ₦(000) | |
| Group I | | | | | | | | | |
| FBN | 40613 | 39117 | (4) | 50704 | 25 | 43953 | 8 | 48297 | 19 |
| UBN | 22914 | 35121 | 53 | 60197 | 163 | 64970 | 184 | 61241 | 167 |
| UBA | 35366 | 41367 | 17 | 42865 | 21 | 52410 | 48 | 55969 | 58 |
| G.Average | 32964 | 38535 | 22 | 51255 | 70 | 53778 | 80 | 55169 | 81 |
| GROUP II | | | | | | | | | |
| IBWA | .16345 | .23793 | 46 | 30214 | 85 | 28435 | 73 | 28729 | 78 |
| ACB | NIL | NIL | - | NIL | - | NIL | - | NIL | - |
| SGBN | NA | 5511 | - | 7483 | 36 | 12146 | 104 | 12843 | 131 |
| NB | (66) | 2878 | 102 | 1262 | (57) | 8796 | 199 | 2856 | (1) |
| G.Average | 5426 | 8046 | 74 | 9740 | 16 | 12344 | 94 | 11107 | 52 |
| GROUP III | | | | | | | | | |
| BCCI | NA | 3468 | - | 17182 | 495 | 31196 | 800 | NA | |
| NNB | 2416 | NIL | (100) | 166 | (93) | 120 | (95) | 341 | (86) |
| NAB | NA | NA | | NA | | NA | | NA | |
| MB | NIL | NIL | - | 2390 | 100 | 252 | (89) | NA | |
| G.Average | 1208 | 1156 | - | 6579 | - | 10524 | - | - | |

Operating Margin = Operating Income minus operating expenses.

NOTE: Figures in paranthesis represent either a naira amount loss or a percentage decline over a base years figures. The Trend is Computed with 1979 figures as the base year.

Sources: Computed from the annual reports of these banks.

5.4. THE GROSS PROFIT MARGIN

The gross profit margin shows the impact of management in income generation and cost control. Its main emphasis is on cost control. The ratio indicates what proportion of operating income is available to cover other expenses like taxation. It thus also indicates what proportion of operating income is taken up by operating expenses. The ratio thus indicates the efficiency of bank operations, and general management control of operations. The computed ratios are given in Table 5.3.

It is apparent from the group averages that group I produced higher margins than the other two groups, in all the years; that with the exception of 1981, the medium sized banks produced higher margins than the small banks. Note also that the profit margins of small sized banks have been declining. Observe also that the decline was sharper for the smaller banks than for the medium or large sized banks.

In group I, UBA produced on the average, better margins. It trailed behind FBN's 0.365 with a 0.334, but surpassing UBN's 0.224. In 1980, UBA produced the best margins of 0.332, which was ahead of UBN's 0.253 and FBN's 0.0245. In 1981 UBN led the group with a ratio of 0.298 to UBA's and FBN's 0.242 each. In 1982, UBA came close with 0.226 to UBN's 0.228, while FBN lagged behind with a 0.165. UBA again led the group in 1983 with a ratio of 0.199. To choose between UBA and UBN, which was the better performer, reference was made to the group average. In all the years of study, UBA fell below the group average only once in 1981. UBN fell below the average twice; in 1979 and 1980. Thus UBA is the better performer of the group.

.../88

In group II, there is no despute about IBWA's better performance. It produced the best margins in all the years, but at a declining rate. SGBN's margin came second. The two other banks (ACB and NB), even though older, produced lower margins than IBWA and SGBN. NB's highest margin was 0.139 and ACB's, 0.103. These ratios are far cries from IBWA's ratios which range from 0.25 and above.

Results were gloomier in group III. In years when they were not reporting a loss, NNB and MB, mostly reported margins less than 0.02. This dismal performance does not compare with BCCI's 0.383 in 1980, 0.489 in 1981 (which is the highest single gross profit margin recorded by the study) and 0.474 in 1983. BCCI therefore ranks as the most profitable in all groups, followed by IBWA. This is of course based on the results of the gross profit margins alone.

TABLE: 5.3

THE GROSS PROFIT MARGIN (THE RATIO OF INCOME BEFORE TAXES TO OPERATING INCOME)

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | .365 | .245 | .242 | .165 | .157 |
| UBN | .224 | .253 | .298 | .228 | .189 |
| UBA | .334 | .332 | .242 | .226 | .199 |
| G.A. | .308 | .277 | .261 | .206 | .182 |
| GROUP II | | | | | |
| IBWA | .408 | .384 | .354 | .273 | .246 |
| ACB | NA | .025 | .103 | .079 | .063 |
| SGBN | NA | .131 | .176 | .166 | .148 |
| NE | (.003) | .081 | .033 | .139 | .038 |
| G.A. | 0203 | .155 | .166 | .164 | .124 |
| GROUP III | | | | | |
| BCCI | NA. | .383 | .489 | .474 | NA |
| NNB | .175 | NIL | 007 | .005 | .013 |
| NAB | NA | N.A | N.A | N.A | N.A |
| MB | NIL | NIL | .149 | .012 | N.A |
| G.A | .088 | .128 | .215 | .164 | .013 |

Sources: Computed from annual reports of these Banks.

5.5 NET PROFIT MARGIN

The ratio of net profit margin, shows the proportion of the operating income that is available for bank disposal as management deems fit. It can pay devidends or retain the profits within the bank. Being net of all expenses and taxation, this is a crucial test of profitability. The higher this ratio, the more profitable a bank is. See Table 5.4.

After a close examination of the gross and net profit margins, it was discovered that they follow the same pattern; and the same conclusions about profitability can be drawn from the two measures.

Thus group I banks proved the most profitable. The best performers remained the same in all the groups and their best year performances remained the same. All banks experienced the same high points, then the decline, as they did with the gross profit margin. This would seem to suggest that taxation does not distort the trend of bank profitability in Nigeria.

In group I, margins ranged from 0.095 to 0.185. Whereas in group II, margins ranged between 0.019 to 0.207. For group III the range was between 0.006 and 0.223. It is therefore concluded that the larger banks were better at controlling operating costs. We do not here, seek to specify the most dominant cause of this variation.

...../90

TABLE: 5.4

NET PROFIT MARGIN (THE RATIO OF NET INCOME TO OPERATING INCOME)

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .185 | .142 | .136 | .095 | .097 |
| UBN | .132 | .149 | .148 | .115 | .095 |
| UBA | .167 | .161 | .128 | .115 | .104 |
| G.A. | .161 | .151 | .137 | .108 | .099 |
| GROUP II | | | | | |
| IBWA | .207 | .186 | .173 | .141 | .126 |
| ACB | NIL | NIL | NIL | NIL | NIL |
| SGBN | NA. | .088 | .084 | .080 | .069 |
| NF | NIL | .076 | .030 | .069 | .019 |
| G.A. | .069 | .117 | .096 | .097 | .071 |
| GROUP III | | | | | |
| BCCI | N.A | .190 | .223 | .217 | N.A |
| NNB | .089 | NIL | NIL | NIL | NIL |
| NAB | N.A | N.A | N.A | N.A | N.A |
| MB | NIL | NIL | 0.87 | .006 | N.A |
| G.A. | .044 | .063 | .103 | .074 | N.A |

Sources: Computed from annual reports of these Banks

5.6 GROSS YIELD ON TOTAL ASSETS

The gross yield on total assets shows the efficiency of the banks management in the generation of income. In chapter four, we mentioned that this ratio is affected by a number of factors such as changes in income earning assets, changes in the portfolio to higher or lower yielding assets. changes in the interest rates, management push for higher yeilding loans and other assets and changes in the amounts of income earned from sources not related to the employment of funds. This changes in this ratio indicates management success or failure in profitably employing the funds at t

..../91

their disposal. The trend of this ratio over the years studied for the sample banks is given in Table 5.5.

In group I, FBN and UBA experienced fluctuations in their gross yield on assets. Though FBN experienced a rise from 0.048 in 1980 to 0.079 in 1981, UBA had a slight decline from 0.073 to 0.070. Both FBN and UBA had a rise in their ratios in 1982 and a decline in 1983. For UBN, it was a steady rise from 0.071 in 1979 to 0.089 in 1982, It had a slight decline to .086 in 1983. With exception of 1979, when UBA bettered UEN's .071 with a 0.082, UBN had the highest ratios from 1980 to 1983. UBN also produced higher ratios than the group average in all the years, except 1979.

In group II, all banks experienced fluctuations in their ratios. NB however experienced steady increases in their yield on assets for all the years, except in 1981 when its ratio declined slightly to 0.071 from 1980's 0.075. NB also produced the best ratios in all years with the exception of 1981. IBWA had a steady rise from 1979 to 1981. In 1982, it had a minor decline, then major fall in 1983 to 0.070. For SGBN, its ratio fell in 1981, rose sharply in 1982 and settled for a further rise to 0.099 in 1983. On the whole, NB was the most profitable of the banks in group II.

In its first year of operation, BCCI produced quite a commendable yield on its assets of .053. In the subsequent year, 1981, BCCI even got to produce the best ratio in group III, 0.094. It maintained this ratio in 1983. The leader of the group is MB. MB led the group in 1979 with a ratio of .076. NNB had a ratio of .067.

In 1980 MB again led the group with its .078 return on assets. NNB followed close with 0.073. As was mentioned earlier, BCCI led the group in 1981 with a ratio of 0.094 to NNB's .089 and MB's .083. The leader in 1983 was again MB with 0.108 to NNB's 0.101 and BCCI's .094.

On the whole, group III produced better yields on total assets than the other two groups. It led the other two groups in 1981 and 1982 and was slightly beaten by group I in 1979. The banks in group II slightly outperformed the banks in group I. Group II produced better results in 1980, 1982 and 1983 than group one banks. The ratios in those years were 0.072, 0.092 and 0.087 to group ones .066, .085 and .081 respectively. For all groups, ratios rose between 1980 and 1982 and all groups experienced a decline in 1983.

TABLE: 5.5

GROSS YIELD ON TOTAL ASSETS (THE RATIO OF OPERATING INCOME TO TOTAL ASSETS).

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .067 | .048 | .079 | .083 | .074 |
| UBN | .071 | .076 | .079 | .089 | .086 |
| UBA | .082 | .073 | .070 | .082 | .083 |
| G.A. | .073 | .066 | .076 | .085 | .081 |
| GROUP II | | | | | |
| IBWA | .066 | .075 | .082 | .081 | .070 |
| ACB | N.A | .065 | .072 | .088 | .077 |
| SGBN | N.A | .075 | .058 | .095 | .099 |
| NF | .066 | .075 | .071 | .102 | .102 |
| G.A. | .066 | .072 | .071 | .092 | .087 |
| GROUP III | | | | | |
| BCCI | N.A | .053 | .094 | .094 | N.A |
| NNB | .067 | .073 | .089 | .101 | .084 |
| NAB | N.A | N.A | N.A | N.A | N.A |
| MB | .076 | .078 | .083 | .108 | N.A |
| G.A. | .072 | .068 | .089 | .101 | .084 |

Gross Yield = total income from all sources
Source: Computed from annual reports of these Banks.

## 5.7 THE GROSS PROFIT MARGIN ON TOTAL ASSETS

This ratio, besides showing managements ability to generate income and control expenses, shows the efficiency of total assets in the generation of gross profits of the bank. When this ratio is compared with the "gross yield on total assets" ratio, the impact of operating expenses on profits should become apparent. The performance of banks using this ratio, is given in Table 5.6.

Based on our examination of the ratio of gross yield on total assets (Table 5.5), we concluded that UBN was more profitable than the two other banks in group I. The ratio of gross profit margin on total assets however produced a different result. From an examination of this ratio, UBA proved the more profitable. It produced the highest ratios in 1979, 1980 and 1983 along with UBN. Even though UBN led the group in 1981, 1982 and 1983 along with UBA, UBA results are generally slightly better. FBN never led the group based on this ratio. But its results were however satisfactorily within range of the leading ratios.

Group II produced the surprises. NB that led this group in the ratio of yield on assets, produced surprisingly low gross profit margins on assets. In 1979, NB reported a negative margin. Its highest margin was recorded in 1981 when it had a ratio of 0.02. ACB's ratios were even lower. Its highest ratio was 0.008, recorded in 1981. SGBN's low margins in 1980 and 81 were understanble. It is natural that in formative years, initial expenses must be borne. The ratios rose markedly in 1982 when it peaked at 0.016. It dropped a point in 1983 to record a ratio of 0.015.

..../94

This thus left IBWA as the most prudent manager of costs. It led its group with impressive ratio of 0.027, 0.029, 0.029, 0.022, 0.018 in 1979, 1980, 1981, 1982 and 1983 respectively.

The results of group III banks are even more pathetic when compared with group II results. MB had no gross profit margin in 1979 and 1980. So also NNB in 1980. NNB's highest ratio was 0.011 in 1979. In the other years, its ratios ranged between 0.0005 to 0.001. MB did produce a fair 0.013 in 1981 only to sink to a low 0.001 in 1982. This thus clearly left BCCI as the most profitable of the group and indeed the whole banks being studied. In its first reported year, BCCI produced an impressive 0.021 ratio. This was greatly bettered by 0.046 in 1982. This ratio fell slightly in 1983 to 0.044.

Generally, group I banks were more profitable than all the other groups banks. The ratios also declined generally over the years for all groups.

TABLE: 5.6

GROSS PROFIT MARGIN ON TOTAL ASSETS (THE RATIO OF INCOME BEFORE TAXES TO TOTAL ASSETS)

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .025 | ,019 | .019 | .014 | .012 |
| UBN | .016 | .019 | .023 | .020 | .016 |
| UBA | .028 | .024 | .017 | .019 | .016 |
| G.A. | .023 | .020 | .020 | .018 | .015 |
| GROUP II | | | | | |
| IBWA | .027 | .029 | .029 | .022 | .018 |
| ACB | N.A | .002 | .008 | .007 | .005 |
| SGBN | N.A | .009 | .010 | .016 | .015 |
| NE | (.00014) | .006 | .020 | .014 | .004 |
| G.A. | | .012 | .012 | .015 | .010 |
| GROUP III | | | | | |
| BCCI | N.A | .021 | .046 | .044 | N.A |
| NNB | .011 | NIL | .0007 | .0005 | .001 |
| NAB | N.A | N.A | N.A | N.A | N.A |
| MB | NIL | NIL | .013 | .001 | N.A |
| G.A. | .0056 | .007 | .020 | .015 | .001 |

Source: Computed from annual reports of these Banks.

## 5.8 NET INCOME ON TOTAL ASSETS

This ratio relates income after all operating expenses and appropriate taxes to total assets. It is the net income which is distributable and which the bank can use for future expansion in its activities and use as a buffer against any losses from future operations. Thus, this is the ultimate measure of bank overall profitability and managerial efficiency. The other two measures (gross yield on total assets, and gross profit margin on total assets), were necessary to (a) show banks ability to generate income, and (b) control operating expenses. Computations of the ratio of net income on total assets is shown in Table 5.7.

Again, UBA has proved the more profitable in group I. It led the group in 1979 with a 0.014 to FBN's 0.013 and UBN's 0.009; in 1980 with 0.012 to UBN's 0.011 and FBN's 0.007 and in 1983 with 0.009 to UBN's 0.008 and FBN's 0.007. UBN led in 1981 and 1982. In 1981 it recorded 0.012 to FBN's 0.011 and UBA's 0.009. In 1982, UBN had a ratio of 0.010, closely followed by UBA's 0.009 and FBN's 0.008. On the average, the group ratios declined from 0.012 in 1979 to 0.008 in 1983.

In group II, ACB reported zero net profits in all the five years of analysis. Of SGBN and NB, the new SGBN proved more profitable. The two banks returned the same ratio, 0.006, in 1979. In 1980, SGBN beat NB by three points when it reported a ratio of 0.005. SGBN beat NB in the two subsequent years. The most profitable in group II however, was IBWA. It generated a ratio of 0.014 in the years 1979 to 1981, recorded a 0.011 in 1982 and 0.009 in 1983. Generally, the group ratios decline over the years.

..../96

As for group III, NNB reported a net profit only in 1979. This gave it a ratio of 0.006. Similarly, MB reported net profits only in 1981 and 82 when it had ratios of 0.007 and 0.0006 respectively. Of BCCI and NAB, NAB showed ratios that declined over the years while BCCI reported increasing net incomes to total assets. BCCI is therefore considered more profitable in this group. Its low ratio in 1980 is considered to be due to the initial expenses of coming into banking business. The improvement in its ratio in the next year confims this.

Considering the group averages, group I is the most profitable of the three. And group II proved more profitable than group III. Note also that the ratios declined generally over the years. For group I, it has been a steady decline all through. For group II, the decline was slightly interupted by a slight rise in 1982, only to persist in 1983. For group III banks, the riseccame in 1981 after the decline. The decline commenced again in 1982.

TABLE: 5.7

NET INCOME ON TOTAL ASSETS (THE RATIO OF NET INCOME TO TOTAL ASSETS

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 9182 | 1983 |
| GROUP I | | | | | |
| FBN | .013 | .007 | .011 | .008 | .007 |
| UBN | .009 | .011 | .012 | .010 | .008 |
| UBA | .014 | .012 | .009 | .009 | .009 |
| G.A. | .012 | .010 | .010 | .009 | .008 |
| GROUP II | | | | | |
| IBWA | .014 | .014 | .014 | .011 | .009 |
| ACB | NIL | NIL | NIL | NIL | NIL |
| SGBN | N.A | .006 | .005 | .008 | .007 |
| NI | N.A | .006 | .002 | .007 | .002 |
| G.A. | .014 | .009 | .007 | .009 | .006 |
| GROUP III | | | | | |
| BCCI | N.A | .010 | .021 | .020 | N.A |
| NNB | .006 | NIL | NIL | NIL | NIL |
| NAB | .021 | .019 | .014 | .010 | NA. |
| MB | NIL | NIL | .007 | .0006 | N.A. |
| G.A. | .009 | .007 | .011 | .008 | N.A. |

Sources: Computed from annual reports of these Banks

5.9 INTEREST SPREAD

The aim of the interest spread analysis is to see how banks have fared in their main operations. The interest earned from the use of funds is compared to that amount of interest paid to obtain the use of the funds. Interest spread analysis indicates management efficiency in the use of funds for profitable ends. It also indicates the ability of management to control interest costs. A higher interest margin will therefore indicate a highly profitable deployment of funds by management or interest cost control. The interest spread for the banks studied is contained in Table 5.8.

Interest spread analysis indicates that UBN produced the most consistent ratios. For the period 1979 to 1983, its ratios ranged from 0.64 to .67, while FBN's ranged from 0.58 to 0.76, and UBA, from 0.52 to 0.66 for the same period. For the period 1979 to 1980 FBN produced the best interest spread. The group was led by UBN from 1981 to 1983. FBN ratios were declining every year while UBN ratios rose slightly in 1981 and 82 before declining in 1983. UBA also produced declining ratios. On the whole therefere, UBN is considered the most profitable of the three.

The group II banks that proved the more profitable in our earlier analysis, produced suprisingly low spread margins. The ratios recorded by IBWA were all below 0.45, with the exception of in 1983, when its spread rose to 0.54. ACB, which reported no net profits on the other hand recorded spreads from 0.61 to 0.68.

..../98

The NB which recorded very low net profit to assets ratios produced spread margins of up to 0.77. Its lowest margin is 0.57. Going by this measure, NBN will be considered the most profitable, followed by ACB.

Similar conclusions can be drawn for group III. BCCI which was the most profitable, considering earlier measures, produced the least spread in the group in 1980 and 81. NNB showed higher, but declining spreads than BCCI. MB showed increasing high spreads over the years. BCCI spreads were increasing over the years. On the whole, MB's increasing spread will be more desireable to NNB's declining ratios.

Comparing the gross profit margin on total assets and the net income on total assets, it is apparent for group I as for the other two, that those banks that produced the highest spread, did not necessarily produce the highest ratios of gross profit margin on total assets or the net income to assets. Compare also the spread with the gross profit margin and the net profit margin. The same results are obtained. Frequently, banks that produced the highest interest spreads, produced the lowest profit margin ratios. This leads us to conclude that although interest payments affect profits, other operating expenses are more crucial to bank profitability.

Generally, group I banks produced the best results. Group III came next.

..../99

TABLE: 5.8

INTEREST SPREAD: THE RATIO OF NET INTEREST EARNINGS TO GROSS INTEREST EARNED

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .76 | .73 | .64 | .58 | .58 |
| UBN | .65 | .65 | .66 | .67 | .64 |
| UBA | .66 | .62 | .51 | .52 | .52 |
| G.A. | .69 | .67 | .60 | .59 | .58 |
| GROUP II | | | | | |
| IBWA | .45 | .42 | .41 | .43 | .54 |
| ACB | NA | .67 | .68 | .62 | .61 |
| SGBN | NA | .38 | .46 | .51 | .47 |
| NE | .73 | .77 | .69 | .70 | .57 |
| G.A. | .59 | .56 | .56 | 0.57 | .55 |
| GROUP III | | | | | |
| BCCI | NA | .37 | .53 | .63 | N.A. |
| NNB | .74 | .68 | .64 | .58 | .54 |
| NAB | N.A | N.A | N.A | N.A | N.A |
| MB | .64 | .63 | .68 | .70 | N.A |
| G.A. | .69 | .56 | .62 | .64 | .54 |

Sources: Computed from annual reports of these banks.

5.10 INTEREST SPREAD TO DEPOSITS (DEPOSIT RETURN)

As has been shown earlier, deposits are the most important single source of bank operating funds. We are interested in finding which bank uses the deposit funds at its disposal most profitably. Table 5.9 gives the performance of the banks studied.

FBN generated the highest ratios in 1979, 1980 and 1981, UBN in 1982 and 83. FBN ratios showed a consistent declining trend, broken by a small rise in 1982. UBN on the other hand, showed a consistent rise from 0.0364 to 0.535 for the same period. As for UBA, the trend of

.../100

decline was halted in 1981 and a rising trend commenced. It is not clear which should be considered the more profitable between FBN and UBN. The temptation is to consider the ratios of that bank which rise over the years and drop the declining ratios. For our decision, the group average was considered. FBN bettered the group average in four years to UBN's three. FBN is therefore considered the better performer of the two and thus the best of group one.

In its formative years, SGBN's ratio fell below the group average in the first two of its four reporting years. In the other two, 1982 and 1983, it produced the best interest spread return on deposits for group II of 0.0566 and 0.0513 respectively. SGBN generated higher ratios than IBWA's 0.0212 in 1980 and 0.0236 in 1981. In fact, in all the years studied, IPWA produced the lowest deposit returns. The leading performance of the group was by NB. In 1979 NB's 0.0383 outperformed IBWA's 0.0209. In 1980, the ratio of .0469 recorded by NB, was clearly ahead of ACB's 0.0357. In 1981, ACB performed better with a ratio of 0.0415 to NB's 0.0383. NB however regained its lead in 1982 and maintained it in 1983. It recorded 0.0566 and 0.0513 in 1982 and 83 respectively.

In group III, the best ratios were recorded by MB for all the years to 1982. It produced the single highest ratio for all the period in 1982, when it recorded a returne of 0.0827. NNB produced better ratios than PCCI.

Going by the spread to deposit ratios, group III were making the best use of the deposit funds at their di[illegible]

../101

Group I made more profitable use of deposits than group II banks. For groups I and III, the ratios have been fluctuating. For group I, they fall in 1980 and 81, then rose in each of the subsequent years. As for group III, it was a decline in 1980, a rise in each of 1981 and 82, then a decline in 1983. For group II it was a steady rise up to 1982, then a slight decline.

TABLE : 5.9

THE RATIO OF INTEREST SPREAD TO DEPOSITS

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .0632 | .0417 | .0422 | .0444 | .0418 |
| UBN | .0364 | .0376 | .0388 | .0515 | .0535 |
| UBA | .0426 | .0356 | .0275 | .0365 | .0415 |
| G.A. | .0474 | .0383 | .0362 | .0441 | .0456 |
| GROUP II | | | | | |
| IBWA | .0209 | .0212 | .0236 | .0341 | .0444 |
| ACB | NA. | .0357 | .0415 | .0491 | .0438 |
| SGBN | NA. | .0229 | .0273 | .0566 | .0513 |
| ML | .0383 | .0469 | .0383 | .0501 | .0485 |
| G.A. | .0296 | .0317 | .0327 | .0475 | .0470 |
| GROUP III | | | | | |
| BCCI | NA. | .0108 | .0356 | .0607 | NA. |
| NNB | .0396 | .0378 | .0414 | .0503 | .0403 |
| NAB | NA. | NA. | NA. | NA. | NA. |
| MB | .0574 | .0507 | .0557 | .0827 | NA. |
| G.A. | .0485 | .0331 | .0442 | .0645 | .0403 |

Sources: Computed from the annual reports of these Banks.

5.11 SPREAD TO TOTAL WORKING FUNDS

This measures is meant to show how profitably banks employ their total deployable funds. Working funds include deposits, share capital and reserves and other loans to the bank, minus the statutory cash reserve requirement.

The analysis of this ratio is given in Table 5.10.

In group I, FBN generally produced the higher returns on working funds. UBN produced better result than UBA.

In group II, NB produced the leading returns for the group, leading the group in all the years. ACB follows closely. IBWA produced the least returns, being beaten by SGBN.

In group III, the leading results were recorded by MB, closely followed by NNB. The least returns were reported by BCCI.

Comparing the groups averages, it can be seen that generally, group III made most profitable use of their total working funds. Group II banks made better use of their funds than group I banks.

TABLE: 5.10

THE RATIO OF SPREAD TO TOTAL WORKING FUNDS

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .050 | .044 | .037 | .040 | .036 |
| UBN | .033 | .034 | .035 | .047 | .047 |
| UBA | .039 | .033 | .027 | .033 | .036 |
| G.A. | .041 | .037 | .021 | .040 | .040 |
| GROUP II | | | | | |
| IBWA | .020 | .020 | .022 | .032 | .042 |
| ACB | NA | .033 | .038 | .045 | .041 |
| SGBN | NA | .022 | .025 | .036 | .033 |
| NB | .038 | .047 | .038 | .049 | .048 |
| G.A. | .029 | .031 | .031 | .041 | .041 |
| GROUP III | | | | | |
| BCCI | NA | .011 | .031 | .047 | |
| NNB | .05 | .037 | .041 | .048 | .038 |
| NAB | NA | NA | NA | NA | NA |
| MB | .040 | .040 | .053 | .072 | NA |
| G.A. | .045 | .029 | .042 | .056 | .038 |

Sources: Computed from the annual reports of these Banks

## 5.12 SPREAD TO TOTAL ASSETS

The ratio of spread to total assets is supposed to show the profitability of the banks main business activities, which are fund related. The analysis is shown in Table 5.11.

With the exception of 1979, UBN and FBN produced better ratios than UBA in all the other years. Thus the search for the better performer will be between FBN and UBN. FBN produced higher ratios in 1979, 1980 and 81. In 1982 and 1983, UBN recorded the better ratios of the two. For three years (1979, 1980 & 81), FBN results were better than the group average. UBN bettered the group average in 1981, 82 and 83 and equalled the average in 1979. We consider UBN the more profitable of the two.

NBN produced the best ratios for group II. It produced the highest in all years except in 1981 when its ratio of 0.0308 was surpassed by ACB's 0.0361. IBWA finished last with a 0.0181 to SGBN's 0.0205. On the group average, the ratio rose steadily from 1979 to reach 0.0368 in 1982 and decline to 0.0364 in 1983.

In group III, NNB was clearly the best performer of the group. MB bettered its ratios only in 1982. BCCI seems to have been grappling with formative expenses in 1980. Its ratios rise confidently.

In comparing the groups, group I was the most profitable in the employment of assets to perform its main activities. The performance of group III was more desireable to group II. Like all other ratios, the decline was apparent even though the ratios fluctuate.

TABLE : 5.11

THE RATIO OF SPREAD TO TOTAL ASSETS

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | . | . | . | . | . |
| FBN | .0465 | .0342 | .0362 | .0389 | .0361 |
| UBN | .0323 | .0334 | .0350 | .0461 | .0465 |
| UBA | .0375 | .0327 | .0263 | .0329 | .0358 |
| G.A. | .0387 | .0334 | .0326 | .0393 | .0394 |
| GROUP II | | | | | |
| IBWA | .0162 | .0163 | .0181 | .0231 | .0259 |
| ACB | NA | .0311 | .0361 | .0414 | .0388 |
| SGBN | NA | .0171 | .0205 | .0395 | .0402 |
| N' | .0314 | .0383 | .0308 | .0433 | .0405 |
| G.A. | .0238 | .0257 | .0264 | .0368 | .0364 |
| GROUP III | | | | | |
| BCCI | NA. | .0099 | .0284 | .0417 | NA. |
| NNB | .0350 | .0347 | .0376 | .0423 | .0354 |
| NAB | NA. | NA. | NA. | NA. | NA. |
| MB | .0310 | .0323 | .0367 | .0505 | .0354 |
| G.A | .033 | .0256 | .0342 | .0448 | .0354 |

Sources: Computed from the annual reports of these Banks.

5.13 : SPREAD COVER/EXPOSURE

Having considered spread and spread related ratios, we now want to see what contribution spread makes towards covering operating expenses and contributing towards generating a surplus. This analysis is justified because the deployment of funds is the banks main business. Operating expenses were therefore deducted from the interest spread to show the extent of spread cover or exposure. See Table 5.12.

In group I, UBA returned the most favourable spread cover. Next came FBN. UBA trailed behind.

..../105

In Group II all banks returned negative spread cover except SGBN in 1983. The same thing in group III, except BCCI in 1981 and 1982.

On the basis of this, we conclude as follows:

(a) That bank operating expenses are disproportionate to their income earning ability.

(b) That banks are not profitable and are staning on shaky grounds. Their dependence on other income rather than income from the deployment of funds, exposes banks to the risk of fluctuations in revenue.

(c) That banks should control their operating cost or sink, in the near future.

TABLE 5.12

EXTENT OF COVER PROVIDED BY INTEREST SPREAD TO OTHER OPERATING EXPENSES

| | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I FBN. | | | | | |
| Interest Spread | 77,982 | 89,215 | 95,536 | 124,130 | 149,279 |
| Other Expenses | 46,746 | 57,742 | 104,010 | 130,234 | 151,056 |
| Spread Cover(Exposure) | 31,236 | 31,473 | (8,474) | (6,104) | (1,777) |
| Other Income | 9,377 | 7,644 | 59,178 | 50,057 | 50,074 |
| Profit Margin | 40,613 | 39,117 | 50,704 | 43,953 | 48,297 |
| UBN | | | | | |
| Interest Spread | 46,749 | 61,047 | 89,965 | 146,838 | 175,407 |
| Other Expenses | 54,280 | 70,621 | 96,002 | 147,869 | 162,080 |
| Spread Cover(Exposure) | (7,531) | 9,574 | (6,037) | (1,031) | 13,327 |
| Other Income | 30,445 | 44,695 | 66,234 | 66,001 | 47,914 |
| Profit Margin | 22,914 | 35,121 | 60,197 | 64,970 | 61,241 |
| UBA | | | | | |
| Interest Spread | 48,245 | 56,157 | 66,256 | 92,906 | 122,073 |
| Other Expenses | 45,588 | 48,200 | 70,429 | 93,904 | 110,687 |
| Spread Cover(Exposure) | 2,657 | 7,957 | (4,173) | (998) | 11,386 |
| Other Income | 32,709 | 33,410 | 47,038 | 53,408 | 44,583 |
| Profit Margin | 35,366 | 41,367 | 42,865 | 52,410 | 55,969 |

TABLE 5.12 Cont'd

| | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP II | | | | | |
| IBWA | | | | | |
| Interst Spread | 9,804 | 13,424 | 18,754 | 29,670 | 42,589 |
| Other Expenses | 12,352 | 19,695 | 28,644 | 37,744 | 50,283 |
| Spread Cover(Exposure) | (2548) | (6271) | (9890) | (8074) | (7694) |
| Other Income | 18,893 | 30,064 | 40,104 | 36,509 | 26,423 |
| Profit Margin | 16,345 | 23,793 | 30,214 | 28,435 | 28,729 |
| ACB | | | | | |
| Interest Spread | NA, | 22,265 | 31,494 | 34,044 | 41,292 |
| Other Expenses | NA | 38,864 | 52,248 | 56,618 | 59,328 |
| [illegible] Cover(Exposure) | NA | (16599) | (20754) | (22574) | (18036) |
| Other Income | NA | 16,599 | 20,754 | 22,574 | 18,036 |
| Profit Margin (Loss) | NA | NIL | NIL | NIL | NIL |
| [illegible]GPN | | | | | |
| Interest Spread | NA | 10,083 | 14,981 | 30,487 | 35,072 |
| Other Expenses | NA | 19,812 | 18,553 | 31,124 | 34,484 |
| Spread Cover(Exposure) | NA | (9729) | (3572) | (637) | 588 |
| Other Income | NA | 15,240 | 11,055 | 12,783 | 12,255 |
| Profit Margin | NA | 5,511 | 7,483 | 12,146 | 12,843 |
| [illegible]B | | | | | |
| Interest Spread | 11,752 | 17,920 | 16,431 | 26,869 | 29,742 |
| Other Expenses | 22,740 | 27,050 | 29,390 | 42,637 | 49,583 |
| Spread Cover(Exposure) | (10988) | (9130) | (12959) | (15768) | (19841) |
| Other Income | 10,922 | 12,008 | 14,221 | 24,564 | 22,697 |
| [illegible] Margin (Loss) | (66) | 2,878 | 1,262 | 8,796 | 2,856 |

TABLE 5.12 Cont'd.

| | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP III | | | | | |
| BCCI | | | | | |
| Interest Spread | NA | 1,683 | 10,608 | 29,280 | |
| Other Exenses | NA | 2,743 | 8,579 | 17,395 | |
| Spread Cover(Exposure) | NA | (1060) | 2,029 | 11,885 | |
| Other Income | NA | 4,528 | 15,153 | 19,311 | |
| Profit Margin | NA | 3,468 | 17,182 | 31,196 | |
| NNB | | | | | |
| Interest Spread | 7,666 | 8,644 | 9,653 | 10,970 | 10,796 |
| Other Expenses | 8,841 | 14,082 | 17,236 | 17,950 | 16,179 |
| Spread Cover(Exposure) | (1175) | (5438) | (7583) | (6980) | (5383) |
| Other Income | 3,590 | 5,438 | 7,749 | 7,100 | 5,724 |
| Profit Margin | 2,416 | NIL | 166 | 120 | 341 |
| MB | | | | | |
| Interest Spread | 3,842 | 4,981 | 7,526 | 11,808 | NA |
| Other Expenses | 6,141 | 8,467 | 10,170 | 18,175 | NA |
| Spread Cover(Exposure) | (2299) | (3486) | (2644) | (6367) | NA |
| Other Income | 2,299 | 3,486 | 5,034 | 6,619 | NA |
| Profit Margin | NIL | NIL | 2,390 | 252 | NA |

Sources: Computed from the annual reports of these Banks

## 5.13 CONCLUSIONS

In this chapter, we examined two trends: gross oerating income and the operating margin. We saw that trends showed some growth over the years. For gross operating income, we saw the group III produced the highest growth levels, over the years. The operating margins generally showed growths at much slower rates over the years. This shows the impact of operating expenses on income.

With the gross profit margin we concluded that group I results were the best of the three groups. This was followed by group II. The same pattern of results was obtained when

..../108

the net profit margin was examined. It showed group I again as the best performer, with group II coming next. This given us an indication that taxation does not distort the trend of profitability in Nigeria.

On the basis of the gross yield on assets, group III produced the best results, followed by II and then I. When this is compared to the gross profit margin on assets, the trend is reversed. Group I are the more profitable followed by groups II and III in that order. The last results were maintained for the ratio of net income on assets. The groups performance appeared in the counting order: I, II and III.

Considering interest spread, group I again produced the best results, followed by groups III and II. Relating spread to deposits, group III was the most profitable, followed by group I and II in that order. Examining the ratio of spread to total assets, group I was the most profitable. Group III's performance was better than group II's.

Thus generally group one was the most profitable of the three groups, followed by group II.

Having analyeed profitability, we shall now proceed to the next chapter where we shall try to establish the causes of the variations in profitability.

.../109

CHAPTER SIX

## PROFITABILITY: CAUSAL FACTORS

### 6.1 INTRODUCTION

In the last chapter, we concerned ourselves with determining which bank or group of banks was the most profitable. In this chapter, we hope to find the reason(s) for such profitability. No pretensions are made of pinpointing any absolute cause(s) or of highlighting all the possible causes. The causes that are dealt with are those which data constrains permit analysis. Were more detailed information available, more specific conclusions will have been arrived at.

Broadly, the causes are divided into two main groups. These are: (1) causes related to the generation of income and (2), causes related to cost control. We shall discuss them in turn.

### 6.2 CAUSES RELATED TO THE GENERATION OF INCOME

Causes related to the generation of income can also be broadly divided into two main sections: (a) those related to loans and advances and (b) causes related to investments.

(a) LOANS AND ADVANCES

It was discovered that generally, loans and advances produced higher yields when compared with investments. This can be ascertained by reference to Tables 6.1 and 6.3. It is logical to think therefore that banks which had higher ratios of loans and advances to deposits (Table 6.2), should produce higher yields on loans and advances (Table 6.1) and consequently, higher gross yields on total assets (Table 5.5). It was however found that generally, banks with higher ratios of loans and advances to deposits did not actually produce higher

yields on loans and advances. (Refer to the tables). This leads us to conclude that this anomaly is accounted for by the differences in loan portfolio composition and the differential yield on component loans. It would have been desireable to analyse the loan portfolios of each bank and confirm this conclusion. But banks in Nigeria do not disclose the structure of loans in their financial reports. This conclusion is therefore held tentatively until a further study proves otherwise. This conclusion then directs our attention to the loans department and its general management.

A brief discussion of the relationship between the ratios of loans to deposits and yield on loans will be undertaken before we consider the relationship between the ratios of loans to deposits and gross yield on total assets.

For Group I Banks, the ratios produced in 1979 agreed with the proposition that banks with higher loans to deposit ratios should produce higher yield on loans. The results of 1980 disagreed. UBN, which recorded the highest ratio of loans to deposits, produced the least return on loans. Furthermore, UBA, which recorded a higher loans to deposit ratio than FBN, returned lower yields on loans. The 1981 results did not also confirm the proposition. In 1982, only UBA's yield countered the the proposition. UBN's higher loans to deposit ratio, produced higher yields when compared with FBN. In 1983, only UBA disproved the proposition. Between UBN and FBN,

..../111

the results conformed with the proposition.

For Group II banks, only 1979 results agreed with the proposition. The following years produced results counter to it: 1980, 1981, 1982 and 1983. Some results in some years however conformed with the proposition. These are SGBN in 1982 and 1983 and ACB in 1981.

The proposition was overwhelmingly confirmed by
G Group III banks in all the years. This is contrary to the findings for Groups I and II. Why should it be so?

In trying to find the reason for Group III's dissent, it was again found that adequate data was not available to

TABLE 6.1

YIELD ON LOANS AND ADVANCES: THE RATIO OF INTEREST ON LOANS TO LOANS AND ADVANCES

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | .108 | .112 | .079 | .104 | .116 |
| UBN | .095 | .075 | .081 | .111 | .128 |
| UBA | .104 | .104 | .108 | .086 | .107 |
| G.Average | .102 | .097 | .089 | .100 | .117 |
| GROUP II | | | | | |
| IBWA | .078 | .080 | .082 | .113 | .111 |
| ACB | NA. | .075 | .089 | .085 | .095 |
| SGBN | NA. | .061 | .057 | .115 | .121 |
| NBN | .077 | .095 | .077 | .089 | .110 |
| G.Average | .0775 | .0777 | .0762 | .100 | .109 |
| GROUP III | | | | | |
| BCCI | NA. | .112 | .067 | .094 | NA |
| NNB | .031 | .113 | .111 | .115 | .117 |
| NAB | NA | NA | NA. | NA. | NA. |
| MB | .106 | .120 | .121 | .146 | NA |
| G. Average | .068 | .115 | .099 | .118 | .117 |

Sources: Computed from the annual reports of these banks.

....112

TABLE 6.2

THE RATIO OF LOANS AND ADVANCES-TO DEPOSITS

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | .568 | .437 | .592 | .533 | .386 |
| UBN | .494 | .573 | .602 | .579 | .469 |
| UBA | .620 | .549 | .482 | .596 | .550 |
| G.Average | .561 | .519 | .558 | .569 | .468 |
| GROUP II | | | | | |
| IBWA | .549 | .586 | .666 | .619 | .528 |
| ACB | .791 | .723 | .666 | .826 | .786 |
| SGBN | NA | .722 | .703 | .908 | .757 |
| NBN | .547 | .504 | .595 | .685 | .700 |
| G. Average | .629 | .634 | .658 | .759 | .693 |
| GROUP III | | | | | |
| BCCI | NA | .250 | .298 | .456 | NA |
| NNB | .447 | .487 | .581 | .756 | .634 |
| NAB | .428 | .315 | .436 | .460 | NA |
| MB | .800 | .660 | .670 | .820 | NA |
| G. Average | .558 | .428 | .496 | .623 | .634 |

Sources: Computed from the annual reports of these banks.

allow a definite conclusion. Possible reasons are however specified all the same. These are as follows:-

(a) The banks in Group I and II are relatively more established than Group III banks. In view of their firmer asset base, they might seek to diversify their loan partfolios to new areas where the recovery rates both in interest and principal amounts are lower. Smaller banks would not venture into such risky areas.

(b) As a result of the recession and the restriction on importation and transfer of funds in settlement of foreign obligations,

..../113

GroupI and II banks experienced a lower demand on them for loans and advances. They consequently had to switch over such funds to investments, which return lower yields.

(c) The opening of rural branches put an unequal burden on Group I and II banks in comparison to Group III banks. Rural loan demands are mainly agricultural, which attracts lower rates of interest when compared to other commercial loans.

Relating the ratio of loans to deposits to the ratio of gross yield on total assets, it is also proposed that a higher ratio in the former, should result in a higher ratio in the later.

Generally, this proposition was proved true from the analysis conducted. We now consider the proposition on a group basis.

The proposition received unanimous confirmation in Group I. Group II bank provided neither a confirmation or a rejection of the proposition. It is confirmed by Group III. From this, it could therefore be generally concluded that all things being equall, the bank that deploys more of its deposits funds in loans and advances should prove more profitable, given proper loan planning and management.

Further analysis was conducted to confirm this conclusion, On the basis of ratios shown in Tables 5.3 to 5.7 it was decided that UBA was the most profitable in group I, IBWA in Group II and BCCI in Group III. It

..../114

was decided to examine their ratios of loans to deposits and their gross yield on total assets to see if they confirm the proposition that a higher loan to deposit ratio should produce a higher yield on assets.

For Group I, UBA did produce the higher loans to deposit ratios, but did not generate the best yield on assets. In Group II, IBWA did not produce the highest loan to deposit ratios, but its yield on assets were quite close t. the group leaders ratio. In Group III, the low loan to deposit ratios of BCCI resulted in impressive yields on assets. Its results were however not the groups best.

The findings above leads us to conclude as follows:-

(a) Higher loans to deposit ratios do not necessarily lead to higher yields on assets. this suggests the significance of loan pricing.

(b) It was discovered that of the three leading banks of the three groups which proved the most profitable, none produced the highest yield on assets of their respective groups. This leads us to conclude that in profitability analysis of a regulated banking industry, income generation is not of as much importance as cost control.

(a) <u>INVESTMENTS</u>

In analysing investments, we relate the ratio of investment to deposits to the yield on investment. These are Tables 6.4 and 6.3 respectively. We will also relate the ratio of investment to deposit to the gross yield on total assets (Table 5.5). Relevant conclusions will be

..../115

drawn therefrom.

From Table 6.3 and 6.4 we make the following observations: (1) Group I banks devoted a greater proportion of their deposits to investments than groups II and III. Similarly, Group III devoted more of their deposits to investments than Group II banks. It is also observed that Group II banks generated higher yields on investments than group I banks. No adequate data was obtained for all banks in Group III. Thus no ratios could be computed.

Relating the investments to deposit ratio with the yield on investments it was observed that generally, banks with a higher ratio of investment to deposits did not actually produce higher yields on investments. This was found to be true for Group I and II. The same conclusion is arrived at if Group I average was compared with Group II average. Again the cause of such differential yield is related to the composition of the portfolio. The bank with the portfolio composed of higher yielding investments should return the higher yield even though it devotes a smaller proportion of its deposits to investments. The analysis of bank portfolio components is however not possible due to data constrains.

A note should be made here in passing. It was mentioned earlier that banks with higher Proportions of investments were either risk averse or concerned with maintaining liquidity. For Group I banks however, this might not be entirely true. Owing to the economic recession and the restriction on importation and transfer of funds in

settlement of foreign obligation, lower demands for loans and advances were made during a greater part of the period studied. Asabia sums it up in the Chairmans report contained in the 1983 annual report of First Bank as follows: "These increases in funds for investments are due to the reduced opportunity for prudent lending and the slowing down in foreign exchange releases for import payments."

Relating the ratio of investment to deposits with the gross yield on total assets, it was found that the proposition that a higher investment to deposit ratio should result in higher gross yield on assets was unanimously refuted by all bank groups studied. This confirms our earlier conclusion that size of investments alone does not ensure higher yields. We also conclude that higher investment deposit ratios does not result in higher yields on assets. This therefore implies the importance of portfolio management.

TABLE: 6.3

YIELD ON INVESTMENTS: THE RATIO OF INCOME FROM INVESTMENTS TO INVESTMENTS

| BANK | YEAR | | | | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| GROUP I | | | | | |
| FBN | .039 | .032 | .058 | .053 | .055 |
| UBN | .019 | .045 | .040 | .044 | .049 |
| UBA | NA | NA | .057 | .082 | .060 |
| G.Average | .029 | .039 | .052 | .060 | .055 |
| GROUP II | | | | | |
| IBWA | .033 | .041 | .097 | .051 | .060 |
| ACB | NA | .0087 | .028 | .125 | .034 |
| SGBN | NA | NA | NA | .065 | .054 |
| NBN | .066 | .043 | .046 | .084 | .075 |
| G. Average | .0495 | .0309 | .057 | .081 | .056 |

Note: For group III banks, relevant data was not available

Sources: Computed from the annual reports of these Banks

TABLE 6.4

RATIO OF INVESTMENTS TO DEPOSITS

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | .428 | .603 | .316 | .379 | .469 |
| UBN | .282 | .289 | .224 | .260 | .470 |
| UBA | .208 | .291 | .377 | .301 | .403 |
| G. Average | .306 | .394 | .306 | .313 | .447 |
| GROUP II | | | | | |
| IBWA | .114 | .096 | .029 | .184 | .389 |
| ACB | .044 | .185 | .152 | .079 | .104 |
| SGBN | NA | .147 | .041 | .124 | .314 |
| NGN | .161 | .302 | .208 | .126 | .124 |
| G. Average | .106 | .183 | .108 | .128 | .233 |
| GROUP III | | | | | |
| BCCI | NA | .393 | .452 | .377 | NA |
| NNB | .247 | .263 | .163 | .156 | .115 |
| NAB | NA | NA | NA | NA | NA |
| MB | .273 | .089 | .159 | .099 | NA |
| G. Average | .260 | .248 | .258 | .211 | .115 |

Sources: Computed from annual reports of these Banks

SPREAD PER BRANCH

It is a popular belief that the more branches a bank has, the more interest spread it will generate. If we examine this proposition (see Table 6.5), it should add credence to our earlier conclusions. It can be seen from the table that UBA leads in Group I, where as SGBN leads in group II. In Group III, since most of the banks have not disclosed the relevant figures, we are unable to give definite conclusions on this issue.

In Group II, SGBN's lead contradicts our earlier findings, that IBWA was the most profitable in group II. This we believe

...../118

is because SGBN is a newly established bank and has its branches mainly in the metropolitan areas where there are higher and more profitable transactions. On the other hand, IBWA is older, with brances spread all over the country.

We are hesitant to draw conclusions on the basis of our spread per branch proposition. This proposition must be considered in relation to other factors. These factors include the following:-

(a) the age of the branch (b) the area of branch operation (c) the naiure of activities it can carry out and any other constrains imposed by the regulating authorities on the operational side of the branch. These factors are not susceptible to detailed examination because of data constrains. We however still posit a tentative conclusion that the higher the spread per branch, the higher the profitability.

TABLE 6.5

SPREAD PER BRANCH: THE RATIO CF INTEREST SPREAD TO NUMBER OF BRANCHES.

| BANK | YEAR 1979 N(000) | 1980 N(000) | 1981 N(000) | 1982 N(000) | 1983 N(000) |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | 595 | 628 | 605 | 630 | 728 |
| UBN | 305 | 452 | 647 | 918 | 985 |
| UBA | 893 | 906 | 895 | 1044 | 1185 |
| G. Average | 618 | 662 | 716 | 864 | 966 |
| GROUP II | | | | | |
| IBWA | 338 | 407 | 447 | 631 | 819 |
| ACB | NA | 314 | 437 | 405 | 459 |
| SGBN | NA | 1440 | 1665 | 2772 | 2698 |
| NBN | 168 | 233 | 211 | 328 | 358 |
| G. Average | 253 | 598 | 690 | 1034 | 1084 |
| GROUP III | | | | | |
| BCCI | NA | NA | NA | NA | NA |
| NNB | 284 | 309 | 345 | 366 | NA |
| NAB | NA | NA | NA | NA | NA |
| MB | NA | NA | NA | NA | NA |
| G. Average | NA | NA | NA | NA | NA |

Sources: Computed from the annual reports of these banks

## 6.3 COST CONTROL CAUSES

In our analysis of profitability in chapter five (other than spread analysis), we found that Group I bank were generally more profitable than other group banks. Similarly, group II banks were more profitable when compared to Group III. This was not true however when the gross yield on assets was analysed. It was discovered that Group III banks generated more revenue per asset employed than the other two groups. On the same vein, group II banks returned higher ratios than Group I banks. When it comes to other profitability measures however, the picture is different. The groups took their position in the counting order. It did not require much effort to discover that the other four ratios took cognisance of operating costs. A combined analysis of cost and revenue will reveal the picture more clearly.

Table 6.6 contains the revised profit and loss accounts of the banks studied. Besides showing the component parts of revenue, the table also gives the structure of costs and their impact on revenue.

From the analysis, it was discovered that generally, Group II and III banks had higher costs in relation to their revenues, when compared to group one banks.

Group I banks produced profit margins within the range of 15% to 36.5% of their gross income (or 15k to 36.5k per naira of income). This shows that up to 85% of revenue is taken by operating costs. The best results in this group was produced by UBA. Its profit margin was the most consistent. UBA's margins ranged from 19.8% to 33.4%. Compare this with FBN's 15.7% to 36.5% and UBN's 18.9% to 29.8%.

Taking the cost components one by one, it was contrarily discovered that UBA paid the highest proportion of revenue as interest charges. The least interest costs of the group was that shown by UBN. FBN paid a lesser proportion of its revenue as interest charges, when compared with UBA, but paid slightly more than UBN. It was found that UBA paid more in inteerest charges because it had a higher proportion of time and savings deposits to its total deposits when compared to the other two banks in the group.

As for staff costs, UBA produced the least costs. The maximum amount taken up by staff costs was 29.9%. UBN lost 41.4% of its revenue in staff expenses in 1979. Its least loss was 26.8%, in 1983. It should be noted that through the years from 1979, UBN staff costs kept declining. As for FBN staff costs, they were on the increase and ranged from 22.3% and 35%.

Generally, UBA made the least provision for loan losses. UBN made the largest. This suggests that UBA had the higher quality loans. This confirms its lead in the group. We therefore conclude that the more profitable the bank, the higher the quality of its loans.

An examination of group II banks led to the following observations. With the exception of IBWA, operating costs took up 80 - 100% of group II banks income. ACB had no profit margin in all the years of study. The proportion of SGBN's cost to revenue ranged from 82.4% to 86.9%. As for NB, costs took from 86% to 102% of revenue. Only IBWA reported margin that were comparable to Group I margins or even better in this group. The apparent cause is that a very large proportion of

the other three banks revenue is consummed by staff and other costs. For ACB, this took 61% and above of its revenue.

As for SGBN, it was more the interest costs than the staff costs that resulted in its low margins. This is caused by the large proportion of time deposits it has in relation to other deposits. SGBN also made more provisions for loan losses than all the banks in this group. ACB's lower provision for loan losses is however due to its nil profit margins rather than higher loan quality. NB has 27% of its revenue consummed by staff costs, It also has other costs that take up upwards of 23.3% of its revenue. Other costs combined with staff costs take up upwards of 53.% of NB's revenue. Note also that IBWA and NB produced quite commendable interest costs. This is because they have more of demand than time and savings deposits.

With exception of BCCI, Group III banks fared no better than Group II Banks. For NNB and MB, costs ranged from 85% to 100% of revenue. Staff and other expenses took upwards of 57% of income. BCCI on the other hand, produced progressive profit margins. They ranged from 38 - 49% of income. BCCI staff costs is the least so far of the study. The maximum staff costs it recorded was 7.9% of gross income.

From the above analysis, the following conclusions are drawn:

(a) That bank profitability is not much affected by revenue generation as by operating costs.

(b) That interest costs are not crucial to bank profitability, being generally within a given range. That a higher spread, although

..../122

desireable, does not guarantee profitability. See Table 5.12 in chapter five.

(c) That costs other than interest were more crucial to profitability and that staff costs is one of the most important components.

(d) That group one banks were more profitable than the other group banks because they maintained on the average lower costs to revenue than the other two groups. Similarly, that the same holds true for UBA in Group I, IBWA in group II and BCCI in group III, in their being chosen as the most profitable in their respective groups.

When the provision for loan losses is related to loans and advances, it gives an insight as to the quality of loans the bank grants and their prospect for generating revenues. It is generally taken that lower provisions indicate higher quality loans with a great degree of certainty as to interst payment and subsequent recovery of the Principal. It is in thinking along these lines that we concluded earlier that lower provisions for loan losses should be the landmark of the more profitable banks. It should be noted however, that there are instanses when provisions are made for precautionary reasons other than apparent loan loss.

Provision for loan losses are often made for one of two reasons: (1) when there is actual belief that the loan might end in default and (2) as a precautionary measure by management, even though there is no clear suspection of loan loss. This second reason accounts for UBN's provisions in 1983. The Chairmans report states as follows, "We emphasise that this does not mean we have suffered losses to this extent but have

..../123

TABLE 6.6

REVISED PROFIT AND LOSS ACCOUNTS

| BANK | YEAR | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | |
| | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % |
| FBN | | | | | | | | | | |
| Interest Income | 101,826 | 91.6 | 121,801 | 94.1 | 150,420 | 71.8 | 215,967 | 81.2 | 256,697 | 83.7 |
| Other Income | 9,377 | 8.4 | 7,644 | 5.9 | 59,178 | 28.2 | 50,057 | 18.8 | 50,074 | 16.3 |
| Gross Income | 111,203 | 100 | 129,445 | 100 | 209,598 | 100 | 266,024 | 100 | 306,771 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | 24,831 | 22.3 | 32,663 | 25.2 | 54,968 | 26.2 | 91,896 | 34.5 | 107,109 | 35 |
| Staff Costs | 26,800 | 24.2 | 34,303 | 26.5 | 64,556 | 30.8 | 80,605 | 30.3 | 93,250 | 30.4 |
| Provisions for Doubtful Debts: | 8,040 | 7.2 | 6,314 | 4.9 | 16,859 | 8.1 | 16,855 | 6.4 | 21,324 | 7 |
| Others | 10,919 | 9.8 | 17,048 | 13.2 | 22,511 | 10.7 | 32,715 | 12.3 | 36,783 | 12 |
| Total Expenses | 70,590 | 63.5 | 90,328 | 69.8 | 158,894 | 75.8 | 222,071 | 83.5 | 258,474 | 84.4 |
| Profit Margin | 40,613 | 36.5 | 39,117 | 30.2 | 50,704 | 24.2 | 43,953 | 16.5 | 48,297 | 15.7 |
| UBN | | | | | | | | | | |
| Interest Income | 71,927 | 70.3 | 94,247 | 67.8 | 135,583 | 67.2 | 218,837 | 76.8 | 275,264 | 85.2 |
| Other Income | 30,445 | 29.7 | 44,695 | 32.2 | 66,234 | 32.8 | 66,001 | 23.2 | 47,914 | 14.8 |
| Gross Income | 102,372 | 100 | 138,942 | 100 | 201,817 | 1000 | 284,838 | 100 | 323,178 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | 25,178 | 24.6 | 33,200 | 23.9 | 45,618 | 22.6 | 71,999 | 25.3 | 99,857 | 30.9 |
| Staff Costs | 42,404 | 41.4 | 43,109 | 31 | 57,253 | 28.4 | 77,637 | 27.3 | 86,601 | 26.8 |
| Provision for Doubtful Debts: | 8,486 | 8.3 | 8,303 | 6 | 13,930 | 7 | 28,955 | 10.2 | 34,739 | 10.7 |
| Others: | 3,390 | 3.3 | 19,209 | 13.8 | 24,819 | 12.3 | 41,277 | 14.5 | 40,740 | 12.6 |
| Total Expenses | 79,458 | 77.6 | 103,821 | 74.7 | 141,620 | 70.2 | 219,868 | 77.2 | 261,937 | 81.1 |
| Profit Margin | 22,914 | 22.4 | 35,121 | 25.3 | 60,197 | 29.8 | 64,970 | 22.8 | 61,241 | 18.9 |

TABLE : 6.6 CONT

| BANK | YEAR | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | |
| | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % |
| UBA | | | | | | | | | | |
| Interest Income | 73,316 | 69.1 | 91,289 | 73.2 | 129,797 | 72.6 | 178,787 | 77 | 236,804 | 84.2 |
| Other Income | 32,709 | 30.9 | 33,410 | 26.8 | 47,038 | 27.4 | 53,408 | 23 | 44,583 | 15.8 |
| Gross Income | 106,025 | 100 | 124,699 | 100 | 178,835 | 100 | 232,195 | 100 | 281,387 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid: | 25,071 | 23.6 | 35,132 | 28.2 | 63,541 | 35.5 | 85,881 | 37 | 114,731 | 40.8 |
| Staff Costs: | 19,241 | 18.2 | 23,715 | 19 | 41,001 | 22.9 | 48,248 | 20.8 | 57,837 | 20.6 |
| Provision for Doubtful Debts: | 8,272 | 7.8 | 2,335 | 1.9 | 6,073 | 3.4 | 14,812 | 6.4 | 17,997 | 6.4 |
| Others | 18,075 | 17 | 22,150 | 17.8 | 25,355 | 14.2 | 30,844 | 13.3 | 34,853 | 12.4 |
| Total Expenses | 70,659 | 66.6 | 83,332 | 66.9 | 135,970 | 76 | 179,785 | 77.4 | 225,418 | 80.2 |
| Profit Margin | 35,366 | 33.4 | 41,367 | 33.2 | 42,865 | 24 | 52,410 | 22.6 | 55,969 | 19.8 |
| II | | | | | | | | | | |
| IBWA | | | | | | | | | | |
| Interest Income: | 21,789 | 54.4 | 32,065 | 51.8 | 45,530 | 53.4 | 69,166 | 66.4 | 78,681 | 68.4 |
| Other Income | 18,893 | 45.6 | 30,064 | 48.2 | 40,104 | 46.6 | 36,509 | 33.6 | 36,423 | 31.6 |
| Gross Income | 40,058 | 100 | 61,906 | 100 | 85,336 | 100 | 104,112 | 100 | 115,104 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | 11,985 | 30 | 18,641 | 30.1 | 26,776 | 31.4 | 39,496 | 38 | 36,092 | 31.4 |
| Staff Costs: | 5,959 | 14.9 | 9,942 | 16.1 | NA | | 17,724 | 17 | 20,236 | 17.7 |
| Provision for Doubtful Debts: | 866 | 2.2 | 1,156 | 1.9 | 2,854 | 3.3 | 4,251 | 4.1 | 10,825 | 9.3 |
| Others | 4,903 | 12.2 | 8,374 | 13.5 | 25,492 | 29.9 | 14,206 | 13.6 | 19,222 | 16.6 |
| Total Expenses | 23,713 | 59.2 | 38,113 | 61.6 | 55,122 | 64.6 | 75,677 | 72.7 | 86,375 | 75 |
| Profit Margin | 16,345 | 40.8 | 23,793 | 38.4 | 30,214 | 35.4 | 28,435 | 27.3 | 28,729 | 25 |
| ACB | | | | | | | | | | |
| Interest Income | NA. . | | 33,067 | 71,2 | 46,288 | 73.4 | 55,208 | 74.4 | 67,565 | 82.1 |
| Other Income | NA | | 16,599 | 28.8 | 20,754 | 26.6 | 22,574 | 25.6 | 18,036 | 17.9 |
| Gross Income | | | 46,457 | 100 | 63,087 | 100 | 74,228 | 100 | 82,247 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | | | 10,802 | 23.2 | 14,794 | 23.5 | 21,164 | 28.5 | 26,273 | 32 |
| Staff Costs: | NA | | NA | | NA | | NA | | NA | |
| Provision for Doubtful Debts: | NA | | 1,141 | 2.5 | 6,516 | 10.3 | 5,873 | 8 | 5,149 | 6.2 |
| Others | - | | 34,514 | 74.3 | 41,777 | 66.2 | 47,191 | 63.6 | 50,825 | 61.8 |
| Total Expenses | - | | 46,457 | 100 | 63,087 | 100 | 74,228 | 100 | 82,247 | 100 |
| Profit Margin | NIL | | NIL | | NIL | | NIL | | NIL | |

..../125

TABLE 6.6 CONT

| BANK | YEAR | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | |
| | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % |
| SGBN | | | | | | | | | | |
| Interest Income | NA | | 26,834 | 63.8 | 31,502 | 74 | 60,430 | 82.5 | 74,422 | 85.9 |
| Other Income | - | | 15,240 | 36.2 | 11,055 | 26 | 12,783 | 17.5 | 12,255 | 14.1 |
| Gross Income | - | | 42,074 | 100 | 42,557 | 100 | 73,213 | 100 | 86,677 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | - | | 16,751 | 39.8 | 16,521 | 38.8 | 29,950 | 41 | 39,350 | 45.4 |
| Staff Costs | - | | NA | | NA | | NA | | NA | |
| Provision for Doubtful Debts: | - | | 4,976 | 11.8 | 10,300 | 24.2 | 11,731 | 16 | 11,074 | 12.8 |
| Others: | - | | 14,836 | 35.3 | 8,253 | 19.4 | 19,386 | 26.5 | 23,410 | 27 |
| Total Expenses: | - | | 36,563 | 86.9 | 35,074 | 82.4 | 61,067 | 83.4 | 73,834 | 85.2 |
| Profit Margin | NA | | 5,511 | 13.1 | 7,483 | 17.6 | 12,146 | 16.6 | 12,843 | 14.8 |
| NBN | | | | | | | | | | |
| Interest Income | 16,202 | 63.1 | 23,321 | 66 | 23,666 | 66 | 38,593 | 61.1 | 52,441 | 69.8 |
| Other Income | 9,461 | 36.9 | 12,008 | 34 | 14,221 | 34 | 24,564 | 38.9 | 22,697 | 30.2 |
| Gross Income | 25,663 | 100 | 35,329 | 100 | 37,887 | 100 | 63,157 | 100 | 75,138 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | 4,450 | 17.3 | 5,401 | 15.3 | 7,235 | 19.1 | 11,724 | 18.6 | 22,699 | 30.2 |
| Staff Costs: | 7,382 | 28.8 | 9,399 | 26.6 | 12,037 | 31.8 | 17,048 | 27 | 21,168 | 28.2 |
| Provision for Doubtful Debts | 7,910 | 30.8 | 5,446 | 15.4 | 5,192 | 13.7 | 4,614 | 7.3 | 2,346 | 3.1 |
| Others | 5,987 | 23.3 | 12,205 | 34.5 | 12,161 | 32.1 | 20,975 | 33.2 | 26,069 | 34.7 |
| Total Expenses: | 25,729 | 160.2 | 32,451 | 91.9 | 36,625 | 96.7 | 54,361 | 86. | 72,282 | 96.2 |
| Profit Margin: | (66) | .2 | 2,878 | 8.1 | 1,262 | 3.3 | 8,796 | 14. | 2,856 | 3.8 |
| III | | | | | | | | | | |
| BCCI | | | | | | | | | | |
| Interest Income | NA | | 4,522 | 50. | 19,953 | 56.8 | 46,538 | 70.7 | NA | - |
| Other Income | - | | 4,528 | 50 | 15,153 | 43.2 | 19,311 | 29.3 | - | - |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | - | | 2,838 | 31.4 | 9,344 | 26.6 | 17,253 | 26.2 | - | - |
| Staff Costs: | - | | 714 | 7.9 | 1,698 | 4.8 | 3,842 | 5.8 | - | - |
| Provision for Doubtful Debts: | - | | - | | 2,009 | 5.7 | 3,992 | 6.1 | - | - |
| Others | - | | 2,030 | 22.4 | 3,873 | 11. | 9,561 | 14.5 | - | - |
| Total Expenses: | - | | 5,582 | 61.7 | 17,924 | 51.1 | 34,648 | 52.6 | - | - |
| Profit Margin | - | | 3,468 | 38.2 | 17,182 | 48.9 | 31,196 | 47.4 | - | - |

...../126

TABLE 6.6 CONT

| BANK | YEAR 1979 | | 1980 | | 1981 | | 1982 | | 1983 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % | ₦(000) | % |
| NNB | | | | | | | | | | |
| Interest Income | 10,364 | 74.3 | 12,633 | 70 | 15,111 | 66.1 | 18,991 | 72.8 | 19,917 | 77.7 |
| Other Income | 3,590 | 25.7 | 5,438 | 30 | 7,749 | 33.9 | 7,100 | 27.2 | 5,724 | 22.3 |
| Gross Income | 13,956 | 100 | 18,070 | 100 | 22,860 | 100 | 26,091 | 100 | 25,641 | 100 |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | 2,698 | 19.3 | 3,989 | 22.1 | 5,458 | 23.8 | 8,021 | 30.7 | 9,121 | 35.6 |
| Staff Costs | NA | | NA | | NA | | NA | | NA | |
| Provision for Doubtful Debts: | 860 | 6.2 | 2,149 | 11.9 | 2,623 | 11.5 | 1,774 | 6.8 | 1,228 | 4.8 |
| Others | 7,982 | 57.2 | 11,932 | 66 | 14,613 | 64 | 16,176 | 62 | 14,951 | 58.3 |
| Total Expenses: | 11,540 | 82.7 | 18,070 | 100 | 22,694 | 99.3 | 25,971 | 99.5 | 25,300 | 98.7 |
| Profit Margin | 2,416 | 17.3 | NIL | | 166 | 0.7 | 120 | 0.5 | 341 | 1.3 |
| MB | | | | | | | | | | |
| Interest Income | 6,018 | 72.4 | 7,909 | 69.4 | 11,013 | 68.6 | 16,954 | 66.3 | NA | |
| Other Income | 2,299 | 27.6 | 3,486 | 30.6 | 5,034 | 31.4 | 6,619 | 33.7 | NA | |
| Gross Income | 8,317 | 100 | 11,394 | 100 | 16,047 | 100 | 25,573 | 100 | NA | |
| Operating Expenses: | | | | | | | | | | |
| Interest Paid | 2,176 | 26.2 | 2,927 | 25.7 | 3,487 | 21.7 | 5,145 | 20.1 | NA | |
| Staff Costs: | NA | | NA | | NA | | NA | | NA | |
| Provision for Doubtful Debts | 876 | 10.5 | 1,479 | 13. | 550 | 3.4 | 5,848 | 22.9 | NA | |
| Others | 5,265 | 63.3 | 6,988 | 61.3 | 9,620 | 60 | 14,328 | 56 | | |
| Total Expenses | 8,317 | 100 | 11,394 | 100 | 13,657 | 85.1 | 25,321 | 99 | NA | |
| Profit Margin | NIL | | NIL | | 2,390 | | 252 | 1 | NA | |

Source: Computed from the Annual Reports of these banks.

..../127

felt it prudent to increase our reserves to guard against possible set backsin the face of the present economic uncertainties."[1]

Analysis of the ratio of provision for loan loss to loans and advances is given in Table 6.7.

In group I, UBA generated the least ratios. FBN ratios came next on the favourable side. UBN of course made the highest provisions. This measure again confirms UBA's higher performance. UBA combines an aggressive loans policy with strict loan quality control with an effective cost control machinery, which makes it standout in group I.

The lead of IBWA in group II is again confirmed by this ratio. It produced the least ratios in four of the years studied. Note that although SGBN performed better than ACB, its ratio here is higher than ACB's. This we pointed out earlie earlier was because ACB could not generate enough revenue to provide adequately for its loan losses. For the five year period studied, all of ACB's gross profits are taken up in loan provisions.

In group III, the result of this ratio did not single out BCCI as the leader. Its ratios were not the best. This might be because BCCI made no provisions in 1980 and may be had to compensate in subsequent years.

Generally, we could confidently conclude that the more profitable a bank is, the lower its ratio of loan provision to loans.

TABLE 6.7

RATIO OF PROVISION FOR LOAN LOSSES TO LOANS AND ADVANCES.

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | .0116 | .0085 | .0059 | .0113 | .0155 |
| UBN | .0133 | .0089 | .0099 | .0174 | .0226 |
| UBA | .0177 | .0027 | .0052 | .0097 | .0111 |
| G. AVERAGE | .0142 | .0067 | .007 | .0128 | .0164 |
| GROUP II | | | | | |
| IBWA | .0033 | .0031 | .0054 | .0079 | .0021 |
| ACB | .0213 | .0028 | .0140 | .0108 | .0079 |
| SGBN | NA | .0112 | .0190 | .024 | .0210 |
| NBN | .047 | .0283 | .0203 | .013 | .0055 |
| G. AVERAGE | .0239 | .0113 | .0147 | .0139 | .0091 |
| GROUP III | | | | | |
| BCCI | NA | NA | .022 | .0273 | NA |
| NNB | .0380 | .0190 | .021 | .0108 | .007 |
| NAB | NA | NA | NA | NA | NA |
| MB | .015 | .022 | .006 | .050 | NA |
| G. AVERAGE | .0265 | .0205 | .0163 | .029 | .007 |

Sources: Computed from annual reports of these Banks

In our analysis of interest spread (Table 5.8), we found that generally, Group I and III produced higher margins than Group II banks. It is also found for Group I that generally, FBN and UBN recorded higher spreads than UBA. For Group II, NB generated the highest interest spreads in four of the five years studied for its group. In Group III, NNB and MB produced the leading margings.

In a bid to find the reasons for the differential spreads, the interest payments were related to deposits (Table 6.8). The aim was to arrive at a rudimentary idea of the differential

..../129

idea of the differential costs of deposits to each bank.

From Table 6.8, it was discovered that Group II banks paid the highest interest rates. Group III banks also paid more interest on deposits than group I banks.

In group I, UBA paid the highest interest rates. UBN paid lower rates than FBN. The reason for these differentials in interest payments is because time deposits attracts more interest than savings, while demand deposits attracts no interest. UBA has more of time deposits than either of savings or demands; and in greater proportions than either UBN or FBN has. Thus it pays more in interest.

In Group II SGBN paid the highest interest, followed by IBWA. This is also because these banks have a higher proportion of time deposits (and savings) than other banks in the group have.

In Group three, MB pays higher interest for the same reasons.

From the above discussion, we can draw the following conclusions:

(a) That higher spreads do not necessarily result in higher profitability. See the results of FBN, NB, NNB and MB from Groups I, II and III respectively. Compare them with UBA in group I, IBWA in Group II and BCCI in Group III.

(b) That a lower proportion of time deposits in a banks deposit composition, results in lower interest costs.

(c) That more profitable banks did not necessarily pay lower interest rates.

..../130

TABLE 6.8

RATIO OF INTEREST PAID TO DEPOSITS

| BANK | YEAR 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| GROUP I | | | | | |
| FBN | .0204 | .0198 | .0243 | .0329 | .0300 |
| UBN | .0196 | .0204 | .0197 | .0252 | .0304 |
| UBA | .0221 | .0223 | .0263 | .0337 | .0390 |
| G. Average | .0207 | .0207 | .0234 | .0306 | .0331 |
| GROUP II | | | | | |
| IBWA | .0255 | .0294 | .0337 | .0453 | .0376 |
| ACB | NA | .0173 | .0195 | .0305 | .0278 |
| SGBN | NA | .0379 | .0301 | .0556 | .0575 |
| NBN | .0114 | .0140 | .0169 | .0218 | .0370 |
| G. Average | .0220 | .0246 | .0250 | .0383 | .0399 |
| GROUP III | | | | | |
| BCCI | NA | .018 | .031 | .036 | NA |
| NNB | .014 | .017 | .023 | .037 | .034 |
| NAB | NA | NA | NA | NA | NA |
| MB | .031 | .029 | .025 | .036 | NA |
| G. Average | .023 | .021 | .026 | .0363 | .034 |

Sources: Computed from the annual reports of these Banks.

## 6.4 CONCLUSIONS

In this chapter, we examined several measures and draw conclusions therefrom. We examined the yield on loans and advance in conjunction with the ratio of loans and advances to deposits. On this basis, we concluded that (a) that a h higher loans to deposit ratio does not necessarily lead to higher yields on assets and (b) that profitability does not depend so much on the generation of income, than in the control of costs. Also, relating yield on investments to the ratio of investments to deposit and the gross yield on assets, we also found that a higher investment to deposit

.../131

ratio did not result in a higher gross yield. Which means that higher investment do not automatically ensure higher yields. This leads us to see the importance of fund management.

We were not able to draw any definite conclusion on the basis of spread per branch because of uncertanties.

On examination of the banks cost structure and relating it to revenue, we drew the following conclusions:-

a) Profitability is affected more by operating costs than by income generation.

b) that interest cost in Nigeria was not crucial to profitability, since higher spreads did not guarantee higher profitability.

c) that group I and the leading banks of the three groups were more profitable than others, becuase they maintained on the average, lower costs per naira of revenue.

We also concluded in this chapter, that the more profitable banks generally had lower provisions for loan losses to loans and advances. Furthermore, we concluded that the proportion of time deposits to total deposits, has significant impact on interest costs and thus on profitability. And also that the more profitable banks did not necessarily pay lower interest charges.

Having concluded this pennultmate chapter, we now go on to the final one, where we will summarise all the findings of this research work and make appropriate recommendations.

..../132

## CHAPTER SEVEN

## SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

### 7.1 SUMMARY OF CONCLUSIONS

In this chapter, we summarise the major findings of this research work, and based on the analysis and findings, we make certain recommendations for the improvement of our banking industry.

During the period 1979 - 1983, the banking industry has operated under great stresses and strains. This period has been one of the most turbulent and critical periods in our banking annals. Not only the banking industry, infact, the whole economy has witnessed unprecedented events.

The economic scene has been largely dominated by the following factors:

i) Marked decrease in our oil exports

ii) Too high levels of import

iii) Fast increase in the volume of external debt and service charges

iv) Growth of budget deficits both at the federal and state level

v) An accute acceleration in the inflation rate and

vi) Slackness in industrial productuion and the consequent high rates of unemployment.

To revamp the deteriorating state of the economy, stringent measures, popularly known as "austerity measures" were introduced in April, 1982. As a part of these measures, the CBN introduced some monetary control measures. These measures resulted in certain positive gains.

.../133

The economic scene briefly discussed above, has had a strong impact upon the whole Nigerian Banking Industry. The essential consequences were:-

a) decreased availability of deposits

b) slow down in the growth of loans and advances

c) reductions in the earnings from foreign exchange operations, due to the restrictions on import.

d) Slight increase in the average cost of deposits and

e) a noticeable increase in the provisions for bad and doubtful debts.

A study of the banking industry cannot be made in isolation of the economic conditions. Hence, our findings and conclusions should be read in conjunction with the economic and banking scenario described above.

This study is a maiden study on the profitability of Nigerian commercial banks. It is based on the analysis of eleven banks out of twenty six in the country. Thus numerically, this represents 43% of the Commercial banking industry. But in terms of deposits, it represents 65% and in terms of loans and advances 44%

For the purpose of conducting a meaningful analysis, we have chosen a sample of eleven banks and group them into three:

| GROUP I | GROUP II | GROUP III |
|---|---|---|
| 1. FBN | 1. IBWA | 1. BCCI |
| 2. UBN | 2. ACB | 2. NNB |
| 3. UBA | 3. SGBN | 3. NAB |
| | 4. NBN | 4. MB |

...../134

The main objectives of the study has been to study factors affecting the profitability of Commercicial Banks and the extent to which it is affected by the size of a bank. In chapter one, objectives, methodology and literature have been described. It would be clear from the literature review that no serious attempt has been made in Nigeria to study the various aspects of profitability. Some stray articles, with different objectives have however appeared in some economic journals.

The sources and uses of bank funds have been examined in chapter two. We have noticed that capital as a source of bank funds in terms of total funds was negligible and has gradually declined over the years. We also saw that bank deposits constituded the major source of bank working funds.

We also concluded that loans and advances constituted the major outlet of bank funds. We concluded in the chapter that the banking industry was highly regulated. That despite this regulation, banks still had some room for developing lending policies and practices. We also concluded that the volume of investments was very dependent on the demand for loans and advances.

In chapter three, we considered bank lending policies and practices. We have seen that the credit approval procedure is very cumbersome and lengthy. It is of utmost importance that it should be explicit, exact, concise and leave no room for ambiguity and confusion. We also specified three lending policy options available to banks. These are, (i) establishment of interest rate schedules for various kinds of loans, (ii) specify rates established by the regulating authority, and

...../135

(iii) yield on loans. Every bank must price its loans properly, based on the analysis of the peculiarities of the loan. The pricing policy should be adequate, so as to achieve the objectives of the organisation. The loans policy should be clear and flexible.

In chapter four, two concepts of income - economists and accountants - have been examined. We concluded that accounting income is more appropriate to this study. Thus even though it is subject to some uncertainties, we used the accounting concept of income in this study.

We also examined the profitability measures used on the manufacturing/trading concerns. We found that the criteria used for determining profitability of manufacturing/trading concerns, are generally not applicable to the banking industry. This is becuase the banking industry draws its funds mostly from outside scurces and its revenue consists mainly of income arising out of the deployment of those funds within the general economic policy in operation. For a banking industry, and particularly for this study, the following measures of profitability have been used: (i) gross profit margin, (ii) net profit margin, (iii) profit (gross, net, gross profit margin) to total assets and (iv) interest spread and spread related ratios.

Spread is a unique measure used in determining the profitability of Commercial Banks. We defined spread as "the difference between the average gross interest earned from earning assets and the average gross interest paid on liabilities." The profitability of a bank depended on whether it is capable of generating a large or narrow spread. In the

Nigerian context, we found that our banking sector has not paid much attention to maximising the spread, largely because other sources of income are available, for example, foreign exchange income.

In addition to these measures of profitability, we have also made use of causal factor measures which also affect the profitability of banks. These measures we used in the interpretation part of our research in chapter six.

In chapter five, we examined extensively the profitability of Nigerian Commercial Banks, using ratio analysis techniques. For the purpose of our study, the data analysis was split into three stages:

(a) In the first place, we examined extensively, recent trends in the operating income and trends in the operating margins. Gross operating income is defined as the total income from all sources. In examining this trend, we found that there is an increasing trend of income growth for all the three groups under the period studied. We however found that this increasing trend was more prominent for group III banks. Group II followed closely.

In terms of the operating margin, we found that Group III's performance was the poorest. Here group one gives the lead. On further analysis, we found the reasons for the poor performance of group III was due mainly to the following reasons:-

i) the impact of the monetary policy measures during the period which seemed to affect the smaller banks more,

...../137

ii) resources or funds were comparatively costlier because most of the deposits with these banks were fixed deposits.

iii) reduced amounts of commission chargeable on accounts due to low levels of operations, and

iv) sharp decreases in foreign exchange transactions because of import restriction.

Operating margin is the difference between the gross operating income and operating expenses.

(b) In the second stage, we made use of the following ratio measures: (i) gross profit margin, (ii) net profit margin, (iii) gross yield on total assets, (iv) gross profit margin on total assets and (v) net income on total assets.

Using the gross profit margin, we found that group I ratios were the highest over the years. This was closely followed by group II. The performance of group III was the poorest. In terms of the net profit margin, we found the same trend, that is, group I leading, followed by group II and group III at the bottom. This close similarity in the results of the two ratios clearly indicates that the taxation in Nigeria does not distort the trend of bank profitability.

In another measure of profitability, that is, gross yield on total assets, we found that the performance of group II was generally better as compared to other groups. This measure indicates the effectiveness of banks in the use of bank assets. However, in terms of the gross profit margin to total assets, that is, relating income before

..../138

taxes to total assets, group I gives a comfortable lead. Analysis revealed that operating expenses were responsible for the low gross profit margin to total asset ratios of groups II and III.

The ratio of net income to total assets also produced similar results to the gross profit margin to total asset ratio. That is to say that group I leads the other two groups. Within groups II and III, the results of group II was better.

(c) Taking interest spred into consideration, we found that generally, group I produced higher ratios, followed by group III. Further analysis revealed that a higher interest spread ratio did not necessarily translate into higher profits during the period studied.

Considering deposit yield (the ratio of interest spread to deposits) showed group III as the better performer. However, there was no clear cut trend. Relating spread to total assets, group I was found to be the most profitable. The performance of group III was more desireable to group II's results.

In terms of the contribution interest spread makes towards covering operating expenses and generating a surplus, we found that:-

(a) bank operating expenses were disproportionate to their income earning ability

(b) banks generally are not profitable and are standing on shaky grounds. Their dependence on other income rather than interest income to generate profits, exposes banks to the risk of fluctuations in their profits, and

.../139

(c) that banks should control their operating costs or in the forseeable future become unprofitable or even liquidate.

In chapter six, we analysed profitability in terms of causal factors. Taking yield on loans and advances and the ratio of loans to deposits, we concluded as follows:-

a) Higher loans to deposits ratio do not necessarily lead to higher yields on assets

b) that higher yields on assets does not necessarily lead to higher profitability. This leads us to conclude that cost control is very significant in profitability.

Examining the yield on investment and the ratio of investments to deposits, we also found that a higher allocation of funds to investments, does not necessarily result in higher yields.

This leads us to pay attention on the management of funds. This clearly shows that the size of funds is not as important as more profitable use of the funds. This shows the importance of management.

We were not able to draw any conclusions on the basis of spread per branch because of several variables affecting the measure, which were unknown.

Analysing the cost structure of banks, the following conclusions were drawn:-

a) That bank profitability is not much affected by revenue generating ability as by operating costs

b) That interest costs in Nigeria are not crucial to profitability; since higher interest spread did not guarantee profitability.

..../140

We also concluded after examining the ratio of provision for loan losses to loans and advances that more profitable banks generally had lower ratios of loan provisions to loans. Examining the ratio of interest paid to deposits, we also concluded that

a) a lower proportion of time deposits in a banks deposit composition, results in lower interest costs and vise versa.

b) more profitable banks did not necessarily pay lower interest rates.

In terms of the objectives and hypothesis of the study, we draw the following conclusions:-

(a) In terms of profitability sources, we found that income from interest gradually increased over the years. On the other hand, income from other sources gradually declined over the years of study.
In view of the present economic policy of the governmet, this decline is likely to increase sharply in the near future. Banks will therefore have to depend more on interest income and develop other sources of income.

(b) The profitability of Commercial banks in Nigeria is greatly influenced by the monetary policy options exercised by CBN. We found that a large proportion of bank funds were earmarked for one sector or the other by the CBN. Banks do not have much freedom in their operation. But however, we found that in a developing economy like ours, regulatory measures are necessary for a proper functioning of financial institutions.

..../141

(c) We also conclude that the criteria determining the profitability as applied to manufacturing and trading organisations are not strictly applicable to the banking industry. We have suggested some criteria which are suitably applicable in the Nigerian context.

(d) It was also found that the operating costs of the banking sector has been gradually increasing over the years studied. This has consequently affected profitability. More loans and advances were written off as bad over the years. The answer is in cost reduction. Bad debt can be amply reduced to a minimum percentage.

In testing our hypothesis, we also draw some conclusions. We conclude that larger banks were generally more profitable than smaller bank groups. Among the three groups, group I was more profitable than the other two groups. And group II was more profitable than group III. This simple finding proves our hypothesis that larger banks should prove more profitable than smaller banks.

Our second hypothesis which posited that banks with a larger proportion or size of loans and advances should prove more profitable than those with lesser amounts, was not proved. We found that having a greater proportion of loans and advances does not necessarily lead to greater profitability. It however found that those with larger absolute naira amount, generally proved more profitable than those with smaller amounts. Thus group I proved more profitable than group II and group II proved more profitable than group III.

..../142

7.2 RECOMMENDATIONS

On the basis of our findings and conclusions, we suggest the following measures for improving profitability and the Nigerian Banking Industry.operations:

1. Commercial banks should devise various schemes of deposits mobilization with differential rate of interests, so as to argument their investble funds.

2. With Nigeria's drive for economic self - sufficiency, we are likely going to witness further restrictions on such activities as foreign exchange transaction. Banks should therefore, as a matter of priority, reduce their dependence on these other sources of income and produce their profits from interest income and other sources.

3. Banks must control and reduce operating expenses, while at the same time increasing their revenues. This for example could be done by expanding without engaging new staff.

4. Commercial banks should not confine their activities to meet the present demands of the existing clients, but also strive to generate credit demand. This is of special relevance to rural branches.

5. There is also a need to reorganise our banking industry. The banking industry in our opinion should be reorganised taking into consideration national interest, geographical spread and operating costs. We recommend that banks be grouped into three categories, viz;

...../143

(a) banks which can operate on a national basis. These should be banks whose resources can undertake and sustain such national spread.

(b) Banks whose resources permit only a regional or a geographically restricted area of operation and

(c) Banks who given their resources can operate efficiently only within a state or two.

6. We believe each bank should have a loans policy that specifies an objective to be achieved. The policy should specify lending authority, procedural matters, pricing policies and the current lending strategies.

7. That for efficient formulation and efficient implimentation of a credit plan, it is essential to

i) have properly trained managerial personnel

ii) bridge the communication gap between borrowing units and lending branches, between a branch and its head office and between head office and the CBN.

..../144

## 7.3 AREARS FOR FURTHER RESEARCH

The following areas could be further looked into by research students:-

1. Analysis of the composition of loans and advances and investments with a view to discovering the causes of the differential returns.
2. Analysis of the cost structure of Commercial Banks with a view to identifying areas that costs could be reduced.
3. An examination of the impact of the preferential treatment given to the preferred sectors (such as agricultural, housing sectors etc), with a view to assessing whether these sectors need concessional financing or not.
4. Research into deposit mobilization methods and
5. Research into the impact and results of the rural banking scheme.

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..../147

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..../148

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## APPENDIX ONE

### LIST OF COMMERCIAL BANKS OPERATING IN NIGERIA

1. Africa Continental Bank Limited
2. Allied Bank of Nigeria Limited
3. Bank of Credit and Commerce Internation (Nig) Limited
4. Bank of the North Limited
5. Co-operative Bank Limited
6. Co-orperative & Commerce Bank (Nig) Limited
7. First Bank of Nigeria Limited
8. Habib Nigeria Bank Limited
9. International Bank for West Africa Limited
10. Kaduna Co-operative Bank Limited
11. Kano Co-operative Bank Limited
12. Lobi Bank Nigeria Limited
13. Marcantile Bank of Nigeria Limited
14. National Bank of Nigeria Limited
15. New Nigerian Bank Limited
16. Nigeria - Arab - Bank Limited
17. Owena Bank Nigeria Limited
18. Pan African Bank Limited
19. Progress Bank of Nigeria Limited
20. Savannah Bank of Nigeria Limited
21. Societe Generale Bank Nigeria Limited
22. Sokoto Co-orperative Bank Nigeria Limited
23. Union Bank of Nigeria Limited
24. United Bank for Africa Limited
25. Wema Bank Limited
26. Commercial Bank (Credit Lyonnais Nigeria) Limited

# Five Year Record

| Year ended 31st | | December 1983 ₦'000 | December 1982 ₦'000 | December 1981 ₦'000 | December 1980 ₦'000 | March 1980 ₦'000 |
|---|---|---|---|---|---|---|
| Assets | Cash, bank balances and bills discounted | 1,658,364 | 1,052,426 | 755,092 | 935,467 | 967,877 |
| | Investments | 227,280 | 217,304 | 205,029 | 392,976 | 215,186 |
| | Loans and advances | 1,376,705 | 1,490,132 | 1,339,420 | 1,039,239 | 739,306 |
| | Fixed assets | 89,526 | 73,874 | 61,909 | 47,584 | 38,891 |
| | Other assets | 783,469 | 356,507 | 280,097 | 195,621 | 123,593 |
| Total assets | | 4,135,344 | 3,190,243 | 2,641,547 | 2,610,887 | 2,084,853 |
| Less: | | | | | | |
| Liabilities | Deposits | 3,570,313 | 2,793,200 | 2,262,066 | 2,141,980 | 1,692,358 |
| | Taxation | 18,823 | 19,656 | 22,881 | 5,317 | 8,062 |
| | Dividends | 6,113 | 6,113 | 6,113 | 10,754 | 6,021 |
| | Other liabilities | 369,744 | 217,519 | 208,711 | 353,458 | 289,721 |
| | | 3,964,493 | 3,036,488 | 2,499,771 | 2,511,509 | 1,996,162 |
| Shareholders' funds | | 170,351 | 153,755 | 141,776 | 99,378 | 88,691 |
| Gross earnings | | 306,771 | 266,024 | 209,598 | 126,633 | 129,445 |
| Net Profit before taxation | | 48,297 | 43,953 | 50,704 | 31,007 | 39,177 |
| Net profit after taxation | | 29,850 | 25,233 | 28,402 | 17,967 | 21,166 |
| Dividends – Ordinary shares | | 11,004 | 11,004 | 11,004 | 10,754 | 8,331 |
| | – Preference shares | 2,250 | 2,250 | – | – | – |
| Return on shareholders' funds | | 18% | 16% | 20% | 18% | 24% |
| Earnings per share (adjusted) | | 45.1k | 37.6k | 46.5k | 29.4k | 34.6k |
| Dividends per ordinary shares (adjusted) | | 18.0k | 18.0k | 18.0k | 17.6k | 13.6k |

Note: 1. Earnings per share are based on profits after tax and after deducting preference dividend and are calculated on the number of issued ordinary shares at 31st December, 1983.

2. Dividends per share are calculated on the number of issued ordinary shares at 31st December, 1983.

UNION BANK OF NIGERIA LIMITED

# Five Year Financial Summary for the year ended 30th September,

| | 1983 ₦'000 | 1982 ₦'000 | 1981 ₦'000 | 1980 ₦'000 | 1979 ₦'000 |
|---|---|---|---|---|---|
| Cash and short term funds | 362,600 | 494,278 | 254,950 | 201,926 | 245,698 |
| Bills discounted | 1,537,601 | 740,761 | 516,747 | 468,946 | 361,791 |
| Quoted investments | 2,364 | 1,518 | 1,393 | 893 | 16 |
| Unquoted investments | 600 | 100 | — | — | — |
| Loans and advances | 1,536,949 | 1,654,710 | 1,395,593 | 931,654 | 633,933 |
| Other assets | 274,390 | 245,285 | 367,922 | 199,047 | 183,907 |
| Fixed assets | 52,507 | 45,574 | 30,561 | 22,896 | 19,861 |
| Total assets | 3,767,011 | 3,182,226 | 2,567,166 | 1,825,362 | 1,445,206 |
| *Less:* Other liabilities | 299,388 | 167,474 | 143,968 | 119,127 | 92,637 |
| | 3,467,623 | 3,014,752 | 2,423,198 | 1,706,235 | 1,352,569 |
| Represented by: | | | | | |
| Share capital | 54,432 | 54,432 | 36,288 | 36,288 | 36,288 |
| Statutory reserve | 53,755 | 46,102 | 37,947 | 30,497 | 25,300 |
| General reserve | 43,000 | 28,500 | 10,000 | — | — |
| Profit and loss account | 635 | 342 | 20,683 | 14,864 | 5,805 |
| Shareholders' funds | 151,822 | 129,376 | 104,918 | 81,649 | 67,393 |
| 11¼% loan stock 1988/1992 | 40,000 | 31,831 | — | — | — |
| Capital funds | 191,822 | 161,207 | 104,918 | 81,649 | 67,393 |
| Customers' deposits | 3,275,801 | 2,853,545 | 2,318,280 | 1,624,586 | 1,282,176 |
| Negotiable certificates of deposit | — | — | — | — | 3,000 |
| Funds employed | 3,467,623 | 3,014,752 | 2,423,198 | 1,706,235 | 1,352,569 |
| Acceptances, etc. | 460,165 | 579,764 | 755,790 | 487,246 | 230,211 |
| Gross earnings | 323,178 | 284,838 | 201,817 | 138,942 | 102,372 |
| Profit before taxation | 61,241 | 64,970 | 60,197 | 35,121 | 22,914 |
| Profit after taxation | 30,611 | 32,623 | 29,801 | 20,788 | 13,547 |
| Dividends | 8,165 | 8,165 | 6,532 | 6,532 | 4,536 |
| Earnings per share (adjusted) | 56k | 60k | 55k | 38k | 25k |
| Dividends per share (adjusted) | 15k | 15k | 12k | 12k | 8k |
| Dividend cover | 3.8 times | 4 times | 4.6 times | 3.1 times | 3.0 times |
| Total assets per share (adjusted) | ₦69.21 | ₦58.46 | ₦47.16 | ₦33.53 | ₦26.55 |

# Five-Year Financial Summary

## year ended 31st March

| | 1983 ₦'000 | 1982 ₦'000 | 1981 ₦'000 | 1980 ₦'000 | 1979 ₦'000 |
|---|---|---|---|---|---|
| **BALANCE SHEET** | | | | | |
| **USE OF FUNDS** | | | | | |
| Cash and short term funds | 313,161 | 358,197 | 293,475 | 313,785 | 212,662 |
| Cash reserve deposits | 35,277 | 34,835 | 32,006 | 30,243 | 49,531 |
| Stabilisation securities | – | – | – | – | 38,919 |
| Bills discounted | 1,102,057 | 686,791 | 824,891 | 418,963 | 234,976 |
| Investments | 83,399 | 79,210 | 82,314 | 39,883 | 1,042 |
| Loans and advances | 1,619,691 | 1,519,426 | 1,161,294 | 864,836 | 703,004 |
| Other assets | 210,448 | 110,214 | 92,656 | 21,420 | 22,080 |
| Fixed assets | 45,671 | 38,262 | 32,334 | 26,753 | 22,954 |
| Total assets | 3,409,704 | 2,826,935 | 2,518,970 | 1,715,883 | 1,285,168 |
| **Deduct:** | | | | | |
| Accounts payable including items in transit, taxation and dividends | 306,975 | 135,466 | 17,440 | 62,061 | 86,106 |
| | 3,102,729 | 2,691,469 | 2,501,530 | 1,653,822 | 1,199,062 |
| **SOURCE OF FUNDS** | | | | | |
| Share capital | 70,000 | 65,000 | 30,000 | 30,000 | 30,000 |
| Reserves | 92,818 | 78,239 | 64,312 | 47,597 | 35,590 |
| Shareholders' funds | 162,818 | 143,239 | 94,312 | 77,597 | 65,590 |
| Current, deposit and other accounts | 2,939,911 | 2,548,230 | 2,407,218 | 1,576,225 | 1,133,472 |
| | 3,102,729 | 2,691,469 | 2,501,530 | 1,653,822 | 1,199,062 |
| **PROFIT AND LOSS ACCOUNT** | | | | | |
| Gross earnings | 281,387 | 232,195 | 176,835 | 124,699 | 106,025 |
| Profit before taxation | 55,969 | 52,410 | 42,865 | 41,367 | 35,366 |
| Taxation | ( 26,690 ) | ( 25,808 ) | ( 20,150 ) | ( 21,331 ) | ( 17,612 ) |
| Profit after taxation | 29,279 | 26,602 | 22,715 | 20,036 | 17,754 |
| Transfers to reserves | ( 19,445 ) | ( 19,150 ) | ( 16,776 ) | ( 14,009 ) | ( 12,938 ) |
| Dividends | | | | | |
| – Preference | ( 2,700 ) | ( 675 ) | ( – ) | ( – ) | ( – ) |
| – Ordinary | ( 7,000 ) | ( 7,000 ) | ( 6,000 ) | ( 6,000 ) | ( 5,000 ) |
| Brought forward | 105 | 328 | 389 | 362 | 546 |
| Carried forward | 239 | 105 | 328 | 389 | 362 |
| BONUS ISSUED | 5,000 | 5,000 | – | – | 10,000 |
| ASSETS PER SHARE (Adjusted) | ₦85.25 | ₦70.68 | ₦62.98 | ₦42.90 | ₦32.13 |
| EARNINGS PER SHARE (Adjusted) | 66k | 65k | 57k | 50k | 44k |
| DIVIDENDS PER ORDINARY SHARE (Adjusted) | 17.5k | 17.5k | 15k | 15k | 13k |
| DIVIDEND COVER | 3.8 times | 3.7 times | 3.8 times | 3.3 times | 3.6 times |

NOTES:
1. The earnings per share are computed on profits after taxation and preference dividend and based on the number of issued ordinary shares at 31st March, 1983.
2. The earnings per share and dividends per share prior to 1983 have been adjusted for the bonus issue on 28th July, 1982.

# Five Years at a Glance

(AMOUNTS IN ₦MILLIONS)

| | 1983 | 1982 | 1981 | 1980 | 1979 |
|---|---|---|---|---|---|
| *Liquid Assets* | *678,54* | *416.81* | *168.15* | *247.71* | *158.37* |
| *Loans & Advances Net* | *506.52* | *539.03* | *528.48* | *370.81* | *257.54* |
| *Other Assets* | *426.28* | *304.46* | *325.37* | *189.84* | *180.72* |
| *Fixed Assets* | *18.29* | *13.72* | *6.84* | *5.22* | *3.81* |
| *Total Assets* | *1,641.79* | *1,283.24* | *1,037.30* | *818.77* | *604.52* |
| *Share Capital* | *36.00* | *27.00* | *18.00* | *15.00* | *15.00* |
| *Reserves* | *21.81* | *27.20* | *23.51* | *10.82* | *7.94* |
| *Profit & Loss Account* | *7.83* | *4.15* | *7.54* | *9.05* | *3.42* |
| *Shareholders' Funds* | *66.00* | *58.34* | *49.05* | *34.87* | *26.36* |
| *Total Deposits* | *960.08* | *870.97* | *793.21* | *633.25* | *469.47* |
| *Taxation, Dividends & Other Liabilities* | *616.19* | *353.93* | *195.04* | *150.64* | *108.68* |
| *Acceptances etc.* | *727.98* | *554.25* | *507.04* | *406.01* | *201.01* |
| *Balance Sheet Total* | *2,369.88* | *1,837.48* | *1,544.34* | *1,224.78* | *696.84* |
| *Gross Earnings* | *115.10* | *104.11* | *85.33* | *61.90* | *40.05* |
| *Profit before Taxation* | *28.73* | *28.44* | *30.21* | *23.79* | *16.34* |
| *Profit after Taxation* | *14.50* | *14.69* | *14.78* | *11.50* | *8.30* |
| *Dividends* | *7.20* | *5.40* | *3.60* | *3.00* | *3.00* |
| *Retained Profit* | *3.67* | *5.62* | *7.49* | *5.63* | *3.42* |

APPENDIX TWO

AFRICAN CONTINENTAL BANK

BALANCE SHEET, PROFIT AND LOSS ACCOUNT

AS AT 30TH SEPTEMBER (N000)

| | 1983 | 1982 | 1981 | 1980 | 1979 |
|---|---|---|---|---|---|
| Cash & Call Money | 159,311 | 117,811 | 231,568 | 141,329 | 135,795 |
| Tresury Bills & Certificate | 68,270 | 25,503 | 83,415 | 97,540 | 13,539 |
| Investments | 22,840 | 25,335 | 25,244 | 19,408 | 38,494 |
| Loans & Advances & Other accounts | 723,701 | 631,226 | 534,466 | 438,298 | 401,174 |
| Fixed Assets | 28,224 | 24,270 | 20,557 | 18,433 | 13,834 |
| Other Assets | 131,900 | 86,305 | 61,173 | 72,471 | 53,487 |
| TOTAL | 1,134,246 | 910,450 | 956,423 | 787,479 | 656,324 |
| FUNDED BY | | | | | |
| Share Capital | 12,002 | 12,000 | 12,000 | 12,000 | 12,000 |
| Statutory Reserve | 500 | 500 | 500 | 500 | 500 |
| Prov. for Bad debts | 5,149 | 5,873 | 6,516 | 1,141 | 8,534 |
| Deposits & Other a/cs. | 942,798 | 692,771 | 758,595 | 650,231 | 576,790 |
| Other Liabilities | 173,797 | 199,306 | 178,812 | 123,607 | 58,499 |
| | 1,134,246 | 910,450 | 956,423 | 787,479 | 656,324 |
| Gross Earning | 82,247 | 74,228 | 63,087 | 46,457 | -- |
| Less Interest | 26,273 | 21,164 | 14,794 | 10,802 | -- |
| | 55,974 | 53,064 | 48,293 | 35,655 | -- |
| Other Income | 3,354 | 3,554 | 3,955 | 3,209 | |
| Net Earnings | 59,328 | 56,618 | 52,248 | 38,864 | -- |
| Overhead Expenses | 59,328 | 56,618 | 52,248 | 38,864 | -- |
| Profit before taxes | NIL | NIL | NIL | NIL | NIL |

APPENDIX TWO

SOCIETE GENERALE BANK OF NIGERIA

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AS AT 31ST DECEMBER (N000)

| ASSETS | 1983 | 1982 | 1981 | 1980 |
|---|---|---|---|---|
| Cash & Short Term funds | 79,998 | 148,407 | 144,545 | 60,272 |
| Bills & Cirtificates | 214,491 | 66,705 | 22,416 | 64,728 |
| Investments (Unquoted) | 100 | 100 | -- | -- |
| Loans & Advances | 518,225 | 488,809 | 385,606 | 318,396 |
| Fixed Assets | 10,639 | 9,700 | 8,127 | 5,451 |
| Other Assets | 48,051 | 56,069 | -- | -- |
| Total Assets | 871,504 | 772,790 | 560,694 | 448,847 |
| LIABILITIES (Less) | | | | |
| Deposits | 684,076 | 538,534 | 548,425 | 440,945 |
| Taxation | 6,751 | 6,543 | -- | -- |
| Proposed Devidends | -- | 3,529 | -- | -- |
| Other Liabilities | 156,931 | 209,562 | | |
| | 847,758 | 758,168 | 548,425 | 440,945 |
| Net Assets | 23,746 | 14,622 | 12,269 | 7,902 |
| Share Capital | 10,374 | 7,286 | 7,286 | 6,486 |
| Statutory Reserve | 7,879 | 6,370 | - | - |
| Bonus Shares | 5,187 | - | - | - |
| Profit & Loss a/c | 306 | 966 | 4,983 | 1,416 |
| Shareholders funds | 23,746 | 14,622 | 12,269 | 7,902 |
| Gross Earning | 86,677 | 72,213 | 42,557 | 42,074 |
| Interest Paid | 39,350 | 29,950 | 16,521 | 16,751 |
| | 47,327 | 43,263 | 26,036 | 25,323 |
| Overheads | 34,484 | 31,124 | 18,553 | 19,574 |
| Taxation | 6,807 | 6,257 | 3,916 | 1,800 |
| Profit after taxation | 6,036 | 5,882 | 3,567 | 3,949 |
| Transfer to Staturyo Reserve | 1,509 | 1,470 | 3,500 | 1,400 |
| Proposed Devidends | - | 3,529 | - | - |
| Retained Profit | 4,527 | 883 | 67 | 2,549 |

APPENDIX TWO

NATIONAL BANK OF NIGERIA

BALANCE SHEET, PROFIT AND LOSS ACCOUNTS

AS AT 31ST MARCH, (₦000)

| RESOURCES EMPLOYED | 1983 | 1982 | 1981 | 1980 | 1979 |
|---|---|---|---|---|---|
| Cash & Short Term funds | 180,374 | 148,147 | 168,616 | 118,686 | 126,231 |
| Bills Discounted | 30,663 | 23,656 | 32,792 | 81,692 | 28,066 |
| Cash reserve Deposits | 12,862 | 11,669 | 11,669 | 12,532 | 9,867 |
| Investments | 20,566 | 18,841 | 19,253 | 18,611 | 19,011 |
| Loans & Advances | 424,642 | 367,393 | 255,250 | 192,769 | 167,965 |
| Other Assets | 35,668 | 25,687 | 26,881 | 28,286 | 14,408 |
| Fixed Assets | 29,206 | 24,697 | 19,244 | 15,911 | 8,650 |
| Total Assets | 733,981 | 620,090 | 533,705 | 468,487 | 374,198 |
| FUNDED BY | | | | | |
| Share Capital | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 |
| Statutory Reserve | 4,095 | 3,037 | 1,937 | 1,654 | 977 |
| General Reserve | 6,000 | 5,800 | 2,800 | 2,000 | - |
| Retained Earnings | 310 | 68 | 319 | 269 | 240 |
| Share holders Funds | 20,405 | 18,905 | 15,056 | 13,923 | 11,217 |
| Deposits | 612,888 | 536,247 | 428,751 | 382,262 | 306,953 |
| Other Liabilities | 100,688 | 64,938 | 89,898 | 72,302 | 56,028 |
| TOTAL | 733,981 | 620,090 | 533,705 | 468,487 | 374,198 |
| Gross Earnings | 75,138 | 63,157 | 37,887 | 35,329 | 25,663 |
| Interst Paid | 22,699 | 11,724 | 7,235 | 5,401 | 4,450 |
| | 52,439 | 51,433 | 30,652 | 29,928 | 21,213 |
| Overhead Expenses | 47,237 | 38,023 | 24,198 | 21,604 | 14,830 |
| Provision for doubtful Debts | 2,346 | 4,614 | 5,192 | 5,446 | 7,910 |
| Taxation | 1,425 | 4,395 | 129 | 172 | - |
| | 1,431 | 4,401 | 1,133 | 2,706 | (1,527) |
| Transfer to Staturory Reserve | 1,058 | 1,100 | 283 | 677 | - |
| Transfer to Gen.Reserve | 200 | 3,000 | 800 | 2,000 | - |
| Retained Profits | 173 | 301 | 50 | 29 | - |

APPENDIX TWO

BANK OF CREDIT AND COMMERCE INTERNATIONAL

BALANCE SHEET, PROFIT AND LOSS ACCOUNT AS AT 31ST DECEMBER

| ASSETS | 1982 N(000) | 1981 N(000) | 1980 N(000) |
|---|---|---|---|
| Cash & Short term funds | 362,174 | 202,848 | 89,098 |
| Loans & Advances | 219,999 | 88,600 | 38,861 |
| Investments | 23,842 | 4,938 | 4,172 |
| Fixed Assets | 9,944 | 5,670 | 2,438 |
| Other Assets | 86,190 | 72,048 | 34,880 |
| | 702,150 | 373,834 | 169,350 |
| CAPITAL FUNDS AND LIABILITIES | | | |
| Share Capital | 9,000 | 4,000 | 4,000 |
| Bonus Issue | 8,000 | 5,000 | - |
| Statutory Reserve | 6,100 | 2,500 | 450 |
| Retained Earning | 881 | 463 | 121 |
| Total Capital Funds | 23,981 | 11,963 | 4,571 |
| Deposits | 482,184 | 297,721 | 154,435 |
| Provision for Taxes | 16,393 | 8,802 | - |
| Other Liabilities | 179,592 | 55,348 | 10,345 |
| | 702,150 | 373,834 | 169,350 |
| Gross Income | 65,844 | 35,106 | 9,050 |
| Interest Paid | 17,253 | 9,345 | 2,839 |
| | 48,591 | 25,761 | 6,211 |
| Overhead Expenses | 17,395 | 8,580 | 2,743 |
| Taxation | 16,927 | 9,339 | 1,748 |
| Net Profit | 14,268 | 7,843 | 1,720 |
| Statatory Reserve | 3,600 | 2,050 | 450 |
| Bonus Issue | 8,000 | 5,000 | 1,000 |
| Devidends | 2,250 | 450 | 150 |
| Retained Earnings | 419 | 342 | 120 |

## MERCANTILE BANK OF NIGERIA LIMITED

### FIVE YEAR FINANCIAL SUMMARY FOR THE YEAR ENDED 31ST DECEMBER, 1982

| YEAR ENDED 31ST DECEMBER | 1982 | 1981 | 1980 | 1979 | 1978 |
|---|---|---|---|---|---|
| | ₦000 | ₦000 | ₦000 | ₦000 | ₦000 |
| **BALANCE SHEET** | | | | | |
| **USE OF FUNDS** | | | | | |
| Cash, Short Term Funds and Bills | 68,103 | 66,061 | 50,680 | 36,436 | 33,429 |
| Certificate of Deposit | 2,000 | 2,000 | 2,500 | – | 2,500 |
| Loans & Advances | 116,335 | 91,042 | 66,076 | 56,854 | 44,612 |
| Investments | 6,889 | 8,890 | 7,877 | 450 | 450 |
| Other Assets | 13,701 | 13,521 | 9,530 | 8,651 | 5,405 |
| Fixed Assets | 11,853 | 10,978 | 8,638 | 6,628 | 2,088 |
| TOTAL ASSETS | 218,881 | 192,492 | 145,301 | 109,019 | 88,484 |
| **SOURCES OF FUNDS** | | | | | |
| Share Capital – | | | | | |
| Ordinary Share | 4,000 | 4,000 | 4,000 | 4,000 | 4,000 |
| 8% Cum. Pre-Shares | 2,100 | 2,100 | 2,100 | 2,100 | – |
| Statutory Reserve | 963 | 929 | 581 | 581 | 545 |
| Retained Profit | 1,708 | 1,604 | 562 | 825 | 716 |
| | 8,771 | 8,633 | 7,243 | 7,506 | 5,261 |
| Long Term Loan | 16,667 | 18,000 | 19,333 | 20,000 | – |
| Current, Deposit and Other Accounts | 142,625 | 136,867 | 99,474 | 71,112 | 76,219 |
| Other Liabilities | 50,818 | 28,992 | 19,251 | 10,401 | 7,004 |
| | 218,881 | 192,492 | 145,301 | 109,019 | 88,484 |
| **PROFIT & LOSS ACCOUNT** | | | | | |
| Gross Earnings | 23,573 | 16,047 | 11,394 | 8,317 | 7,191 |
| Profit before Taxation | 252 | 2,399 | – | – | 557 |
| Profit after Taxation | 138 | 1,399 | – | – | 316 |
| Transfers to Reserves | 35 | 815 | – | 36 | 60 |
| Dividends to Shareholders | – | – | – | – | 400 |
| Earnings Per Share | 3k | 31k | – | – | 8k |
| Dividends Per Share | – | – | – | – | 10k |
| Net Assets Per Share | ₦1.67 | ₦1.63 | ₦1.28 | ₦1.35 | ₦1.31 |



MERCANTILE BANK OF NIGERIA LIMITED

**Mercantile Bank of Nigeria Limited**