THE EFFECT OF FINANCIAL RATIO ANALYSIS ON CREDIT DECISION IN COMMERCIAL BANKS IN NIGERIA: A CASE STUDY OF LION BANK OF NIGERIA PLC)

BY

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CERTIFICATION

This thesis titled The Effect of Financial Ratio Analysis in Credit Decision in commercial banks in Nigeria A Case Study of Lion Bank Nigeria PLC by **Abel Ifah Ugoya**, meets the regulations governing the award of a degree of Master of Business Administration, Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DECLARATION

This thesis titled The Effect of Ratio Analysis in Credit Decision of Commercial Banks in Nigeria a case study of Lion Bank Nigeria Plc is my original work which cannot be found elsewhere, whether published and to the best of my knowledge, all references made are fully acknowledged.

I accept full responsibility for any mistake that may be found in this work.

Abel Ifah Ugoya.

Date 9/8/04

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ABSTRACT

The primary objective of this research is to examine the effect of financial ratio analysis on credit decision in commercial banks in Nigeria a case study of Lion Bank of Nigeria Plc. This may enable us to provide a framework for further research on financial ratio effect on credit decision; there are other factors that are taking into consideration. But there are cardinal believes that credits should be given to individuals and organization that will be able to pay them back.

This study is divided into five main chapters. Chapter one provides an insight to the problems to be studied, objectives of the study, the significance, the purpose, the scope and limitations of the study, and a brief history of Lion Bank.

Chapter two deals with related past studies concerning financial ratio analysis in credit decision and the evolutions of banks in the country. This chapter equally showed ratio as the basis for which financial analysis for credit decision can be possibly meaningful. In early days of banking operation financial ratio analyses calculated then are used mainly for credit decision of organization. No serious studies were done concerning its usage and acceptance in the commercial banks.

Chapter three showed the methodology employed to bring out our findings. The statistical tools used for the analysis; we adopted questionnaire and interview as methods of data collection for this study. The questionnaires were simple and designed to get the best from the practitioners.

Chapter four contains the presentation of data collected in tabular forms; the analysis and the interpretation of these data were done to see what it signifies.

Towards the end of this chapter is a summary of our research findings; chapter five which is our conclusion showed that the research problems were fairly comprehensive. No claim were made here that it is a complete and exhaustive research on financial ratio analysis usage. However, the investigator tried to bring out this aspect clearly that people are free to make further contribution since knowledge is in exhaustive.

CHAPTER ONE

1.1 GENERAL INTRODUCTION

Ratio analysis is a very powerful tool of the financial analysis. Many diverse groups of people

are interested in analysing the financial information of an organisation, to indicate its operating efficiency

and the various aspects of the organisation's financial position. Ratios can be used to determine.

a. The efficiency with which the business is utilising its various assets in generating sales revenues.
b. The ability of the business to meet its current obligations.
c. The extend to which the business has used its long term solvency by borrowing fund.
d. The overall operating efficiency and performance of the business.

Financial ratio which relates balance sheet and profit and loss account items to one another, permits the charting of a firm's history and the evaluation of its present position. However the use of the financial statements as fair and useful report of the financial activities of the company has received great criticism. This criticism flows from the lack of uniformity in such reporting, the effects of inflation on recurrence of cases where the financial accounts have not truthfull represented the firm's position. One must therefore take great care when using a financial ratio as predictor and indicator.

A ratio can act as useful means of communication of information which may be difficult to understand in another form. Figures by themselves have little meaning. Financial ratios are useful; in the sense that they construct simple explanation of a complicated statement by its expression in one figure. In particular, the aim of a financial ratio is to provide indicators of a company's performance and near present financial contidion, so as to give the decision maker a basis for predicting future performance of financial condition.

A survey as carried by Dr. M. Tamari in three countries, UK, US and Isreal, to see whether financial ratio analysis is viable for measuring risk despite the socio-economic differences. The studies show that financial ratios differentiate between representing the greater degree of risk, tend to have financial ratios which are substantially lower than bankruptcy but even three to five years prior to it. Furthermore, these ratios decline as the companies approach bankrutpcy.

A much more sophisticated tool, Z-scores, has bee developed by Professor Altman in the USA. The z-score is said to have a very high rate of success in predicting corporate bankruptcy. The z-score information is usually presented in a format which shows a company's financial strenght or weakness, reactive to other companies, the lower the rating the weaker the company. A z-score below 0 means the company is at risk, the higher the z-scores, the less the likelihood of insolvency. The results show that almost every quoted company that has failed has shown warning signs in the year's account.

Financial ratios, by their very nature, serve as indicators of the performances of a company, both past and present. They have been used, in conjunction with other indicators of risk to pass judgment on firms in terms of their success quo failure. However, most of the studies on the financial ratios in determining risk and predicting the probability of failures in a firm have been based on data emanating from Europe and America. These have, ipso facto, found little use and application in less developed economy. The major reason is that the ratios developed in these environments have been generated from large companies in contrast to those operating in developing economies and secondly, the availability of sophisticated computing facilities has ensured the generation of large data bases for developing predictive models.

1.1.1 Predicting the Failure of a Credit from Financial Ratios

The analysis of financial ratios is largely concerned with the efficiency and effectiveness of resources utilization by a company's management, and also with the financial stability of the company.

Investors will wish to know:

i. Whether additional funds could be lent to the company with reasonable safety, and

ii. Whether the company, without additional funds would fail.

Credit failure could mean:

a. Legal insolvency or bankruptcy - is going into liquidation.

b. Technical insolvency, where a company is unable to meet its maturing obligations e.g. redemption of a loan.

c. Legal insolvency, where the liabilities of the company exceed its assets (and if this is more than a temporary situation, the company will inevitably go into liquidation).

Various attempts have been made to use financial ratio analysis to predict credit failure.

One method of predicting failure is the case of liquidity ratios (i.e. the current ratic and the quick ratio). A compary with a current ratio of current assets to current liabilities well below 2:1 or a quick ratio well below 1:1 would be considered liquid and in danger of failure. Research seems to indicate, however, that the current ratio and quick ratio are trends in the variation of these ratios of a company, and are poor indicators of eventual failure.

In the 1950s J. E. Walter argued that the reason why the current ratio and quick ratio were poor indicators of solvency is that they measure a stock of working capital at one in time (the balance sheet date), whereas a better measure of potential insolvency must be cash flow i.e. the involvement of funds over time.

1.1.2 **Failure Prediction Models:**

The research which has been carried out to discover whether financial ratio analysis, and trends in the variations of ratio over time, can be used to predict failure can be divided into two categories:

a. Models which try to identify a single key ratio for failure predictions.

b. Models which use several financial ratios in combination for failure predictions.

W. H. Beaver (1966), investigating firms ratios over a five year period, wrote that failed firms not only have a lower cash flow than non-failed firms, but also have a smaller reservoir of liquid assets. Although the failed firms have less capacity to meet obligations, they tend to incur more debt than do non-failed firms. The trend line of the non-failed firms has a zero slope and the deviations from the trend line are small. Yet the deterioration in the (mean ratios) of the failed firms is very pronounced over the five year period. The evidence overwhelmingly suggests that there is a difference in the ratios of failed firms and non-failed firms credits.

Beaver then went on to consider whether any single financial ratio was a reliable prediction of business failure, and found that:

a. The best indicator of failure was a ratio with profit cash flow above the line and assets or liabilities below the line, i.e.

   i. $\frac{\text{Cash flow}}{\text{Total asset}}$ was the best predictor, and

   ii. $\frac{\text{Profit}}{\text{Capital employed}}$ was the best

b. As indicated earlier,

   $\frac{\text{Current assets}}{\text{Current liabilities}}$ is a poor predictor of failure

Dr. Osaze (1985) developed a less complicated model for a developing economy, like ours, based on what local financial institutions and decision makers consider most important in determining risk in a company. He finds that a subjective index of risk, rather than the complicated statistical models, is more useful in selecting entrepreneurs for financial assistance based on the tests aimed at assessing the individual's ability to rationalise operation entailing risks.

1.2 STATEMENT OF THE PROBLEMS

The use of financial tools in assessing the bank customers for credit worthiness has actually be for a long standing issues since century ago. At one time financial ratios, were hired as a basis in taking their audit decisions. At a point this tool was challenged because of its inherent problems of predicting company failure. The alternative employed was the determinant and analysis was employed for taking audit decisions: Many companies in the world now rely on these tools in predicting the company and now use it as basis in credit management in their organisation. But there are some companies that use synthesis of both financial ratio and DCA in taking credit decision.

Despite the use of these financial tools there is alarming increase in the bank failures. In the developed world this Altman's model was built, the banks were not free of bankruptcy. For those companies that actually use these ratios in predicting the company failures are actually doubting

whether this model is applicable to the country as the model actually shows wrong signal whether company is healthy or not. Like financial ratios, the applicability of this discriminant analysis in determining bank failures therefore is questionable. There may be other factors that are much more important or fundamental to the bank in taking credit decisions that the financial ratios or discriminant analysis in taking credit decision. These other factors must be investigated and recommendation on them passed forward if company failures must be stopped.

1.3 OBJECTIVES OF THE STUDY

1. To examine the extent to which statistical tools are used in credit decision by the commercial banks example Lion Bank in particular.
2. To study the impact and the reliability in predicting credit failure from applications.
3. To determine whether the present level of financial report improves any credit decision.
4. To contribute to the decision model employed by commercial banks in the country example Lion Bank.
5. To determine whether data improves decision making taking cost of information into consideration.

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The research is aware that other factors and bases of decision making are available but this is to evaluate the extent to which financial statements have been given recognition among these factors.

1.4 SIGNIFICANCE OF THE STUDY

That despite the various financial tools employed in the test and empirical literature, the increasing trend of the company failure in Nigeria shows that these companies are not well acquainted with this financial tools in taking credit decisions. Bring the knowledge of this financial tools to the banks in management of credit is necessary if this failure has to be discontinued in Nigeria.

That the failure of these banks in Nigeria may not only be that they are not aware of these financial tools in taking credit decision. But they may not be able to use these financial tools in the evaluation of their credit application as such some credit applicants are considered worthy why they are not credit worthy. The thesis intends to educate banks on the uses and analyses of financial tools.

1.5 PURPOSE OF THE STUDY

This study intends to assess the effect of financial ratio and analysis in credit decision in commercial banks in Nigeria and Lion Bank in particular. The assessment is meant to find out whether financial ratios forms the basis of credit decisions. It further wishes to determine what provisions ought to have been made in the circumstances of poor credit management of the firm.

1.6 THE SCOPE OF THE DELIMITATION OF THE RESEARCH

The scope of this research covers the commercial banks in Nigeria and Lion Bank of Nigeria PLC in particular.

The effort here is to see what influence credit analysis exert on decision and to what extent considerations were given to financial ratio as a means of determining ability to repay credit and other variables used in evaluating credit applicants.

W. H. Beaver was the first to use statistical techniques to predict credit failure. A broad definition of failure was employed, namely, the inability to meet financial obligations of any type. Beaver collected a large sample of firms that failed. Another firm was compared to each of these companies - a firm that did not fail, that was in the same industry, and that was of approximately the same size as the one that failed. The data collected for the non-failed credit were for the same years as those for the failed credits. These samples were used to test the predictive ability of four ratios. The mean value of the ratios for the two samples were compared over 5 years period prior to failure.

We are not concerned with sufficiency or insufficiency of present statistical tools used in communicating credit analysis statements to shareholders and other users of decision making. Therefore, presentation required by Companies and Allied Matters Decree of 1990 would be deemed sufficient for the purpose of the research. This delimitation is necessary to avoid arguments and confusions associated with different levels of discriminant analysis. For instance, Ijiri, Jaedicke and Knight and Sorter hypothesize that merely changing from the financial statements can

affect user's decisions. In psychological studies, Cartello and Zalkeid found that arrangement of data in a report affects both the quality of the decision and the time required to reach it.

In our questionnaire, the respondents were asked to state whether the present financial ratio analysis is adequate and predict credit default or riskiness of a credit, and whether further information is required. The aim of including that question is to enable the researcher suggest further research on the field to determine proper financial ratio analysis of credit that will satisfy the various users' needs. Though, this has been proved to be very difficult days, but we believe more effort towards the angle may yield positive result one day.

In this research, the factors measuring the willingness to pay, personal qualities, credit decisions as to aim and purpose of the credit are considered not to be influenced by financial statements and therefore not taken into consideration in setting this research design. Furthermore, the credit decision is made for each individual borrower and is not subject to the argument surrounding perfect capital markets as in the decision of investing in securities. Accordingly, the effect of the particular financial information supplied to credit officer (users) will not be marked by market trends and movements. It is assumed that subsequent information supply will affect the decision of the credit officer since such information does not change the financial statement being analysed.

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1.7 LIMITATION OF THE STUDY

1. Know standard industrial ratio
2. Limitation of financial ratios, example they do not consider the conditions of the economy, industrial relations, the quality of the present and potential work force and activities of the competitors.
3. The use of lease equipment out to knowledge of the research.
4. The time required for the completion of the project.
5. Financial constraints
6. Banks inability to provide relevant information that are vital to the study.
7. The danger of relying on other people's work.

1.8 SHORT HISTORY OF LION BANK NIGERIA PLC

Corporate Profile

Lion Bank of Nigeria PLC was commissioned in 1987 with its headquarters in Jos and International Merchant Bank PLC (IMB) as technical partners. The bank was nurtured by then Plateau State Government and initially incorporated in 1987 as Plateau Cooperative Bank. The limited scope envisaged in cooperative business led to the decision to change to commercial banking and subsequently in 1982. The name was changed to Lion Bank of Nigeria Limited.

A wholly owned Nigeria commercial bank. Lion Bank was put into operational gear with the mandate given to IMB for a five year technical working agreement for implementation and management of the Bank. This five year working arrangement has since lapsed and within a decade of remarkable growth adjudged by the size and the market rating of their shares on the Nigerian Stock Exchange.

In October last year, Lion Bank of Nigeria PLC went to the market to shop for additional ₦504 million to enable the bank to meet the ₦500 million CBN mandatory capital adequacy requirement. The bank placed on the market 839,291,000 ordinary shares of 50 kobo each at 60 kobo per share.

Results of the allotment as approved by the Securities Exchange Commission (SEC) shows that the offer has been subscribed by 107% and over subscription level of 7%. This fact is undoubtedly a measure of the confidence and trust investors have in the Bank.

With the new equity in place, the bank is now ready to expand its infrastructure to new strategic markets like Port Harcourt, Warri, Kaduna and Aba.

CHAPTER TWO

LITERATURE REVIEW

2.1 CONCEPT OF FINANCIAL RATIOS

Financial analysis is the process of identifying the financial strength and weaknesses of a firm is accomplished by properly establishing relationship between the items on the balance sheet and the profit and loss account. The analysis of the financial statement is devoted to the calculation of ratios. Financial ratio aims at revealing the performance and soundness of a particular investment. Financial ratios wrongly establish numerical relationship between variables contained in financial information about the state, condition and performance of a firm, bond rating, risk determination and a lot more.

Ratios when computed can be expressed in the following ways:

a. Percentages

b. Fractions

c. Relations between one variable and the other not looted in this country, can be applicable to firms in the country i.e. either organisations or financial institutions.

2.2 STANDARDS OF COMPARISON

Ratio analysis involves comparison for a useful interpretation of the financial statements, since a single ratio in itself does not indicate either a favourable condition. Such standards of comparison may consist of:

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a. Ratios developed using the projected or proforma financial statements of the same firm.

b. Ratio calculated from the past financial statements of the same company.

c. Ratios of the industry to which the firm belongs.

d. Ratios of some selected firms, especially, the most progressive and successful at the same point in time and lastly;

e. Ratios of the industry to which the firm belongs.

According to I. M. Pandey, "the easiest way to evaluate the performance of a firm is to compare its present ratio with the past ratio." This is so, because, the comparison of financial ratio over a period of time gives an indication of the direction of the change and reflects whether the firm's financial position and performance has improved, deteriorated or remained constant over time.

2.3 TYPES OF COMPARISON

The basic ways in which financial ratios are used are:

a. The cross-sectional approach

b. The time-series analysis.

This approach involves the comparison of different firms financial ratio at the same point in time. This comparison could be done with firms of the same industry. Such a comparison is done so as to know how well

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a firm has performed in relation to its competitors. It is usually advisable to compare the firm's performance with that of the industry leader so as to direct and cover major operating differences which if compared, will increase the firm's efficiency.

Another type of cross-sections/comparison is to compare the firm's ratio to industry averages:

Time-Series Analysis:

This is when the financial analyst measures a firm's performance over time. This is made possible by comparing the current performance with the past performance by the use of ratios.

The comparison enables the analyst determine whether the firm is progressing as planned. The theory behind the time-series analysis is that a firm must be evaluated in relation to its past performance and any developing trend must be taken to direct the firm towards its immediate and long term goals. The time-series analysis is helpful in checking the reasonableness of the firm's projected financial statement. The comparison of current and past ratios to those resulting from an analysis of proforma statement may reveal discrepancies or over optimism in the proforma statement.

Since a single ratio does not generally provide sufficient information to judge the overall performance of the firm. The analyst must be very

of the firm's past performance. The analysis also has to take note of the seasonal and current development, since they may result to erroneous conclusions and decision.

Finally, it is very important to make sure that data in the financial statements being compared have been developed in the same way, since any variation, in the method may result in erroneous conclusions and decisions.

2.4 RECENT CONTRIBUTION TO FINANCIAL RATIO ANALYSIS

The detection of company financial position and operating efficiency has been for a long time associated to financial ratio analysis, but because investment has become an important daily activity, a lot of contribution has to be made.

More accurate tools of assessing corporate performance, has been invented in the areas of financial ratio analysis, the most prominent of them are the multivariate and univariate analysis.

Univariate Analysis:

This approach is called the Bets analysis. It examines the association between the relative risk measures of a security (B) and the single accounting variable, given that B is a covariability measure; A natural accounting variable to use is the expected covariability of a firm earnings with the earnings of all other firms which is termed as an accounting B. The univariate analysis also requires comparing earnings with the earnings of other firms.

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The univariate analysis was first published by Ball and Brown in 1969[14], when they examined 269 firms quoted on the New York Stock Exchange over the period between 1946 and 1966.

In 1970, Beaver[15] extended the analysis to cover the total portfolio analysis Bequer and Manegold later made an extensive research in 1975, where they sampled 254 computed firms over the period between 1951 and 1968.

Multivariate Analysis:

This is an extension of ratio analysis, which deals with the prediction of corporate bankruptcy. There are many contributions but the most prominent is that of Edward I. Altman i.e.

The multi discriminant analysis (MDA). Altmann used various ratios as the variables in a discriminant function to categorise firms into two groups i.e. those who did go bankrupt and those who did not go bankrupt.

The basis of the Altmann model is pivoted on the argument that traditional analysis is no longer an important analytical technique in an academic environment because of the relative unsophisticated manner in which it has been presented. Altmann's point is that, ratios when analysed within a multi-variant framework will take on a greater statistical significance than the standard technique of ratio comparison.

Altman worked with a sample of corporations that filed for bankruptcy. Like Beaver, he collected a paired sample of non-bankrupt

firms on a stratified random basis, starting with 22 financial ratios, only 5 did the best combined job of predicting bankruptcy.

These ratios were used to discriminate between bankrupt and non bankrupt firms using data from 1 to 5 years prior to bankruptcy.

The z-score model itself was as follows:[16]

$$z = 1.2x_1 + 1.4x_2 + 3.3x_3 + 0.6x_4 + 1.0x_5$$

2.5 COMMERCIAL BANKS

2.5.1 Historical Development of Commercial Banks:

It is pertinent to distinguish commercial banks from other banks in the country. To a layman a bank is a bank and such conception will be a mis-information by professionals.

Understanding commercial banks in Nigeria, it will be necessary to have cursory view of the evolution of banks in the country. There is no precise data from research and literature when banking started in Nigeria. For instance, rudimentary banking activities started in Nigeria in about 1861, when a shipping company, the Elder Damstariness, started banking services in Lagos with the objective of making easier transaction with the company's customers in Nigeria.

However, the first commercial bank in Nigeria was the African Bank (ABC), which opened its first branch in Lagos in 1892. This bank was initiated by South African investors to tap the untapped idle funds in the economy. The assets and liabilities of the (ABC) were taken over by the

Bank of British West African (BBWA) in 1894. Prior to the establishment of (BBWA), the (ABC) and Anglo-African Bank (AAB) controlled banking activities in the Anglo-phone West African countries. Eighteen years after the take-over of the ABC by the BBWA, the latter enhanced its position in West Africa by also taking over the AAB. The primary objective of BBWA in entrenching its position in West Africa was to provide external banking facilities to British businessmen. It later had the singular honour of becoming the currency agent of West African Currency Board, thus becoming the banker to the colonial government in Nigeria, Ghana, Sierra Leone and Gambia.

Dominion, colonial and overseas Barclays Bank now known as Union Bank opened its first office in Lagos in 1917 soon after, nine (9) other branches were opened. The British and French Bank, now called United Bank for Africa (UBA) PLC, was established in 1949 making the third expatriate bank to dominate early Nigeria commercial banking. These three banks controlled close to 90 of total bank deposits. The Nigerian foreign banking scene was dominated by these three foreign banks.

In 1929, the industrial and commercial banks was set up by a handful of patriotic Nigerians making the first indigenous bank in Nigeria.

It is necessary now to see why and when commercial banks are different from other banks.

2.5.2 **The Difference Between Commercial Banks and Other Banks**

Commercial banks are established to provide short-term loans opposed to long term, mobilisation of savings and other deposits, providing facilities for the transfer of funds. Management of customers investment and advising on insurance matters. Create money, providing facilities for financing of international trade, safe-keeping of valuables for travellers; providing night safe facilities and business advisory services.

Other banks such as the merchant and development banks are concerned with facilities such as leasing, long term loans, guarantee bonds, etc. The main difference between commercial banks, merchant banks, development banks (NIDB, NECI and NACB) can succinctly be stated as follows:

i. All merchant banks provide corporated financial advice on new shares and bonds issues, capital structure and re-construction, mergers and acquisition.

ii. The merchant Banks are wholesale bankers accepting deposits only in large blocks with a minimum of fifty thousand naira (₦50,000.00).

iii. Merchant banks operate with only a few branches.

iv. Merchant banks provide mainly medium and long term finance.

v. The merchant banks depends on public and private corporations for deposits.

2.6 CREDIT DECISION OF COMMERCIAL BANKS

The Banks do not operate in isolation. They operate within environment and preview of the law. There are many factors which influence the credit decision of a bank.

A. Government control through Central Bank of Nigeria.

B. Principles of banking

C. Environmental conditions

A. Government Controls Through Central Bank

The government controls the financial sector through monetary policy and legal regulations. Falegan (1978) describes monetary policy as discretionary control of money supply by the monetary authorities in order to achieve stated or desired economic goals.

The devices used to influence supply, allocation and loss of credit to the economy are

1. Open market operations;
2. Reserve requirements;
3. Discount rate;
4. Moral suasion;
5. Liquidity Reserve ratio;
6. Special deposit
7. Credit guidelines or selected credit control.

i. **Open Market Operations:** The buying and selling of government securities to and from commercial banks by Central Bank after the capacity for multiple credit creation of the commercial banks.

ii. **Reserve Requirement:** The reserve requirement are usually expressed as a relation or percentage above which each bank may not raise its advances or loan relative to its liquid assets. Increase or decrease of these requirements affect multiple credit creation.

iii. **Discount Rate:** This instrument is used by the Central Bank to discourage borrowing. It is the rate at which the Central Bank loan to commercial banks. Increase or decrease in this rate affect the commercial banks interest rate on their loan to their customers.

iv. **Moral Suasion:** The instrument has no legal backing but an agreement and commitment on the part of commercial banks.

v. **Liquidity Reserve Ratio:** This specifies the required rate of certain selected assets and securities to the deposit liabilities of commercial banks. The higher the ratio the more problems commercial banks face with their reserves.

vi. **Special Deposits:** The Central Bank has right to call for special deposit from the commercial banks. When this

deposit is demanded, it reduces the ability or availability of fund for credit facilities.

2.7 CREDIT GUIDELINE OR SELECTIVE CONTROL

This is the most important and effective maligsia. In fact, it is the instrument of monetary policy used specifically to direct credit to the so-called favoured and preferred sector like agriculture, mining, manufacturing and real estates. Specific minimum percentage of the available loan fund that must be granted those sectors are always given at every budget period by the monetary authorities.

Another useful aspect of this guideline is related to the fixing of interest rate on loans, interest rate on deposit and savings accounts of the commercial banks and the fixing of exchange rates.

The fixing of interest rates has some administrative problem as some transactions are entered into before the budget speech every year. Will the speech terminate such contracts or nullifies conditions of such agreements that were not matured before the speech.

B. CREDIT PRINCIPLES

The principles of lending and the mechanics of safe lending which is aiso known as the common or safe borrowing, suitability and profitability. Of most importance to this research is safety of the loan credit. A crucial question as credit officers may ask is how the loan would be repaid back? To determine this, the bank lay emphasis on the famous "four C's" of

credit: character, collateral, capital and capacity and of course the fifth C's which is not accepted yet: connection to the manager's credit officers.

They must be reasonably certain that the amount granted can be repaid from profit and cash flow generated from the operation of the applicant to enable them predict the future ability to repay the loan.

According to the Credit Officer of Lion Bank Nigeria PLC, he said the following is their own requirement outside the Central Bank requirement:

i. You must maintain a current account in active operation for a minimum period of six months.

ii. The credit applicant applying must state the purpose for seeking the loan, since the Bank does not give credit for illegal business.

iii. The mode of payment and how long payment will last must be clearly stated.

iv. The applicant must provide collateral security in case of default.

v. The bank credit officer then appraise the application based on the viability of the project.

These they do through the following.

i. The applicant supplies the Bank with his cash flow information for the proposed project.

ii. When the project is not a new one, the Bank demands for the annual financial reports for at least a period of three years.

iii. The Bank then subjects the application to credit analysis by using financial ratios index of composite ratios or univariate or multivariate discriminant analysis (MDA), or regression analysis or aggregated accounting data.

C. **ENVIRONMENTAL CONDITIONS**

Banks should understand their political, economic and social environment before granting a facility to customers. It is not enough to say that a good financial profile securities may not be sufficient to make a credit decision.

Other aspects of the banking environment are the money and capital markets. The bankers should understand the resource profile in the economy of the various types of financial institutions and instruments and their various functions. Effective credit will be difficult to achieve unless the banker is aware of who his competitors and collaborators are. An understanding of the various components and instruments of the financial system will enable him himself identify his sources and outlets.

2.8 CREDIT SOURCES OF INFORMATION

The firm extending credit may have to be satisfied with a limited amount of information on which to base a decision. In addition to cost, the firm must consider the time it takes to investigate a credit applicant. A

shipment to a prospective customer cannot be delayed unnecessarily, pending an elaborate credit investigation. Thus the amount of information collected needs to be considered in relations, the credit officer may use one or more of the following sources of information.

1. Financial statements frequently, there is a correlation between a company's refusal to provide a statement and its weak financial position. An audited statement are preferable, when possible, it is helpful to obtain interim statement.
2. Credit relatings and report: This system is not popular in Nigeria. Dum and Bradstreets Inc, is perhaps the best known and most comprehensive of these Agencies. It provides credit ratings to subscribers for a vast number of business firms throughout the nation. 476615
3. Bank checking: Many banks have large credit departments that undertake credit check as a service for their customers. By calling or writing a bank in which the credit applicant had an account.
4. Trade checking - credit information frequently is exchanged among banks selling to the same customers. Through various credit organisations, credit people in a particular area became a closely knitted group.

5. Bank own experience - A study of the promptness of past payments, including any seasonal patterns, is very useful. Frequently, the credit department make written assessment of the quality of management of a company to whom credit has been extended to.

2.8.1 **Credit Analysis and Decisions**.

Having collected all credit information, the bank must make a credit analysis of the applicant and determined if the company falls above or below the minimum quality standard. If the financial statements are provided, the credit officer should undertake a ratio analysis, a source and use of funds analysis.

2.8.2 Financial ratio analysis is a statistical tools that can help us decide which prospective accounts to accept or reject on the basis of certain relevant variables. These types of analysis are similar to regression analysis but assumes that the observations comes from two or more different universe.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 RESEARCH DESIGN

This research is essentially survey-oriented. It is an empirical survey of the financial ratio analysis in credit decisions on the quality of lending decisions in commercial banks in Nigeria.

3.2 FACTORS CONSIDERED IN DESIGNING THIS RESEARCH

In this research, the factors measuring the willingness to pay were assumed to have been investigated to the satisfaction of the lending officers, thus, allowing them to concentrate their attention on the ability to pay.

Furthermore, the lending decision is made for each individual borrower and is not subject to arguments surrounding perfect capital markets as is the decision of investing in securities.

Accordingly, the effect of the particular financial information supplied to lending officers (users) will not be marred by market trends and movements except in-so-far as the availability of fund is concerned.

3.3 SAMPLING TECHNIQUES

The decision to incorporate sampling in the methodology of the research is in order to reap the merits associated with it.

These include:

- attaining greater spread in the conduct of the research.
- the research will be conducted at a reasonable cost.

3.4 SOURCES OF METHODS OF DATA COLLECTION

3.4.1 **Sources of Data:** Data were collected from Lion Bank head office.

3.4.2 **Questionnaires:** In the questionnaire, the loan officers were asked to specify three pieces of information:

- their experience
- their risk attitude, and
- time consumed in assimilating the data provided to them in evaluating the credit worthiness of the customer.

3.4.3 **Personal Interview:** Personal interview was conducted to compliment the questionnaire. By inclusion of personal interview in the methodology, we believe enough information would be gathered to compliment, data on questionnaire for meaningful conclusion.

3.5 RESEARCH HYPOTHESIS

With this background of information, the research was designed to achieve the objectives stated earlier. Therefore, the hypotheses would allow for generalisation to be made. They are stated thus:

i. Financial statements are practically in use in commercial banks in Nigeria for lending decision.

ii. Financial ratios calculated from banks records are reliable.

iii. Financial ratios are especially useful in credit decision making in commercial banks in Nigeria and Lion Bank in particular.

The alternate hypotheses tested are:-

i. That financial statements are not practically in use in commercial banks in Nigeria for lending decision.

ii. That decision made by those who detailed information are not better than those who used banks' data.

iii. Financial ratios are not especially useful in credit decision making in commercial banks.

3.6 ANALYTICAL TECHNIQUES

The analysis of data in this research combines, a good number of techniques. They include tables and statements. The statements are necessary especially because of the incorporation of interview as data gathering procedure.

It is noteworthy that tables have no meaning without precise subsequent statements as to what they are for.

Tables, made it possible for data presented to be seen at a glance. To relate these data, percentage and other points estimated were employed to enable comparison of variables. This orderly and systematic presentation of numerical data facilitates the interpretation of the assembled data.

CHAPTER FOUR

4.1 PRESENTATION OF DATA AND ANALYSIS OF DATA

Data here is presented and analysed in a manner that is commensurate with the research methodology used. Table below shows the total number of the questionnaire issued out and the total responses received. Total number of forty-eight (48) questionnaires - were issued out to various credit officers and out of these forty eight (48) questionnaires distributed, thirty nine were received which contributed to about 81.25% of the total questionnaires issued. See table one below the percentage of respondents is high and encouraging.

Table One **Responses to the Questionnaires Issued**

1	Returned questionnaires	39	81
2	Unreturned questionnaires	9	19
		48	100

In view of the negligible percentage of the unretumed questionnaires cannot affect the research result.

The information contained in the questionnaires will depend on the opinion and practical experiences of the respondents. All percentages are analysed to the nearest whole number.

Factors considered in drawing up these questionnaires is the year of the banking experience. The position of the respondent and the educational qualifications of the respondent, complimented by the length of services of these respondents.

Table Two **Tells the years of experiences of the respondent**

S/NO	LENGTH OF SERVICES	NUMBER	PERCENT
1	One to three years	4	10
2	Three to five years	15	39
3	Five years and above	20	51
		39	**100**

Another factor considered by the research in drawing up his questionnaire is the academic qualification of those expected to receive and respond to the questionnaires.

Table Three **Shows the data of educational qualification of respondents**

1	Post graduate/professional	4	10
2	Post graduate certificate only	6	15
3	Graduate/professional	7	18
4	Graduate only	11	28
5	Diploma/professional	9	23
6	Professional only	1	3
7	Diploma only	1	3
8	Others only	0	0
	Total	**39**	**100**

For the table three above, at least ninety-four (94%) of the respondents are graduates and professional bankers. Since the questionnaire was designed in such a way that the recipient will hardly be

reluctant to respond. The danger of possible distortion has been minimised before questionnaires were given out, permission was sought thereby providing information required in the questionnaires. It was not mandatory for the recipient to indicate his name or sign on the questionnaire.

The least group that respondent to the questionnaires are diploma holders and in my opinion those groups are not in position to give the required information sought in the questionnaire since the bankers from this group are not heads of department or units.

Table Four **Shows the levels of decision maker in the bank.**

Out of the thirty-nine (39) respondents, three (3) of them are final decision makers. Final decision makers are those who have approval to a loan application.

TABLE FOUR

S/N	LEVEL OF DECISION MAKER	NUMBER	PERCENTAGE
1	Final decision maker	3	8
2	Management member	4	10
3	Supervisor/investment executive	10	26
4	Analyst	20	51
5	Advisers/Credit consultant	2	5
	TOTAL	**39**	**100**

51% shows that those who answer this questionnaire are those with the subject matter of the research. They analysed the possibility or

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otherwise of a good loan. From these breakdown, it is my opinion that the respondent represent good quality, relevant experiences - therefore all information provided are honest and can be relied upon.

Table Five **Shows how many loan applicants on the respondents must have evaluated for the past five (5) years.**

We want to confirm that despite the years of services, that staff giving these information have been doing this job practically.

TABLE FIVE

S/NO	**Approximately, how many loan applications have you evaluated during the past five years**	NUMBER	PERCENTAGE
1	Less than 50	6	15
2	51 - 100	8	21
3	101 - 200	8	21
4	201 - 300	8	21
5	301 - 400	3	8
6	401 - 500	2	5
7	501 and above	4	10
	TOTAL	**39**	**100**

21% of the total respondents have evaluated application between 51 -100, 101 - 200 and that the respondent have sufficient knowledge and experience to tackle our questionnaires. These result shows officers sample have done enough practical work.

TABLE SIX

Question: How much can you approve without referring?

S/NO	To Your Superior Officer	NUMBER	PERCENTAGE
1	Not more than 50,000	3	8
2	Not more than 100,000	1	3
3	Not more than 150,000	0	0
4	Not more than 200,000	0	0
5	Not more than 250,000	0	0
6	Not more than 300,000	0	0
7	Not more than 350,000	0	0
8	Not more than 400,000	0	0
9	Not more than 450,000	0	0
10	Not more than 500,000	0	0
11	Others (specify)	35	89
	TOTAL	**39**	**100**

The question is asked to test the authorities of the respondents. The question, in other words, is complementary to question five which states "in what ways are you involved in handling credit decision in the bank?"

Table Seven shows the results.

Question: In your opinion, which of the following would you consider to bear acceptable annual average range of naira losses to total loan granted base on financial ratio analysis done?

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TABLE SEVEN

S/NO		NUMBER	PERCENTAGE
1	Not more than 0.5%	3	8
2	Not more than 1%	4	10
3	Not more than 1.5%	3	8
4	Not more than 2%	2	5
5	Not more than 2.5%	5	13
6	Not more than 3%	2	5
7	Not more than 3.5%	1	3
8	Not more than 4%	2	5
9	Not more than 4.5%	5	13
10	Not more than 5%	12	30
	TOTAL	**39**	**100**

In the course of their examination of the financial statement of the loan seekers, the analyst would recommend granting of the loan based on his risk perspection. Risk averts would consider a low rate of the percentage, which risk above would still recommend granting of loan where this is high.

Out of 39 respondents 30 reacted very high and these percentage represent the risk attitude ofthe respondents. From the analysis of this question, it is clear that there is no hard and fast rule about the amount of naira that can be granted. The result of this question depicted that high number of the respondents accepted higher percentage of naira losses on the total loan based of financial ratio analysis. This responses could be

based on the financial principle that the higher the risk, the higher the return and vice versa.

Question: Which of the following factors do you rely on most in your credit decision?

TABLE EIGHT

1	Collateral security	12	30
2	Financial ratio analysis	15	38
3	Personality	6	15
4	Political factors	5	14
5	Other factors	1	3
	TOTAL	**39**	**100**

In the analysis of this question, it is observed that financial ratio is one of the best yardstick used in taking loan decision. 12 persons rely on collateral security. 15% rely on personality while 14% rely on political consideration for credit facilities.

Question: To the best of your knowledge what are the chances that loan granted based on applicant's financial ratio analysis would be liquidated at the expiry data.

TABLE NINE

1	1 - 20%	4	18
2	21 - 40%	4	10
3	41 - 60%	17	44
4	61 - 80%	9	23
5	81 - 100%	5	13
	TOTAL	**39**	**100**

From table nine (9), it shows that the respondents who agreed that loans are repaid when the financial ratio analysis used are about thirty (30) persons which constitute about 77% of the total respondents.

Question: In your opinion how reliable are ratio analysis computed from financial statements?

TABLE TEN

1	10%	3	8
2	30%	7	18
3	50%	20	51
4	80%	9	23
5	100%	0	0
	TOTAL	**39**	**100**

In table 10 above, out of thirty nine (39) respondents, 51% agreed that ratio analysis are reliable.

Question: Which of the these ratios do you rely on most in your credit decision?

TABLE ELEVEN

S/NO		NUMBER	PERCENTAGE
1	Liquidity ratio	13	33
2	Profitability Ratio	13	33
3	Debt Ratio	5	14
4	Activity Ratio	4	10
5	Solvency Ratio	4	10
	TOTAL	**39**	**100**

This question presupposes that financial statements are in use and ratios are highly reliable.

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Table 11 provided the responses to this question. Usefulness of each of the follow up ratios in credit decision making.

		LOW		MODERATE		HIGH		NO. OPIN	
		NO.	%	NO.	%	NO.	%	NO.	%
1	CR	1	3	16	50	8	25	4	12
2	ATR	2	6	7	22	19	59	5	16
3	ITR	3	9	16	56	7	22	5	16
4	RTR	2	6	17	53	7	22	6	19
5	GPR	2	6	10	31	13	41	6	19
6	SAL	2	6	16	50	8	25	6	19
7	OR	2	6	11	34	14	44	7	22
8	PER	6	19	7	22	6	22	1	24
9	NAR	3	9	19	59	3	9	7	22
10	EPS	6	15	15	47	6	19	8	25
11	PER	6	11	11	34	8	25	6	19
12	DER	2	15	15	47	8	25	6	19
13	DS	2	16	16	50	10	31	5	16
14	ICR	2	15	15	47	7	22	8	25
15	CFR	1	14	14	44	8	25	7	22
16	0	0	1	1	3	2	6	13	41

How would you rank the usefulness of each of the following ratios in credit decision making?

We break the ratio down to see the degrees of their usage. The degrees were low, moderate, high and no opinion. In this respect, accounting ratios are relationship which bring together the results of

activity, which experience shows, identity - the key areas or success of the business. The choice of ratio will be determined by the needs of the user of the information.

Do loans and advances performances form the basis of your credit decisions in Lion Bank?

Four years Lion Bank loan and advances.

TABLE TWELVE

DATE	PERFORMING	NONE PERFORMING	TOTAL
1996	₦303,865.00	₦132,375.00	₦436,240.00
1995	₦77,298.00	₦61,105 .00	₦238,403.00
1994	₦150,740.00	₦61,242.00	₦211,982.00
1993	₦83,425.00	₦38,556.00	₦121,981.00

Percentage of performing and none performing credit for a period of four years.

TABLE THIRTEEN

DATE	% OF PERFORMING	% OF NONE PERFORMING	TOTAL
1996	70%	30%	100%
1995	74%	26%	100%
1994	71%	29%	100%
1993	68%	32%	100%

The credit of the bank has been increasing in performance until 1996. The reduction in the credit performance was as a result of the

economic situation of 1995. The credit performance forms the basis of decisions.

TABLE FOURTEEN

Total credit by the commercial banks to various sectors of the economy for a period of four (4) years.

	1992		1993		1994		1995	
	T	A	T	A	T	A	T	A
CDE	13.2	73.0	17.5	75.9	9.4	27.9	11.3	36.2
CPS	17.7	34.7	20.0	16.6	32.0	28.3	21.9	69.6
CG	7.7	109.9	14.6	120.7	0.0	27.7	5.6	18.4
TOTAL	**38.6**	**217.3**	**52.1**	**213.2**	**41.4**	**83.9**	**38.8**	**124.2**

CDE = Credit to Domestic Economy

CPS = Credit to Private Sector

CG = Credit to Government

T = Target

A = Achievement

Growth of Licensed commercial banks during the period under review.

TABLE FIFTEEN

COMMERCIAL BANKS

END YEAR	NUMBER	BRANCHES
1992	66	2269
1993	66	2353
1994	65	2397
1995	64	2351

The ratios analysed above are classified into five main ratios for easy analysis. These basic classifications are: liquidity ratios, profitability ratios, use of assets - efficiency ratios, capital structure (gearing) ratios and finally, investment ratios. The liquidity ratios are further classified into current - ratio and acid test ratio.

In table 12, current ratio is moderately used. Among the respondents 3% agreed that its usefulness is low, 50% agreed that its usefulness is moderate and 25% agreed that its usefulness is high. About 12% have no opinion concerning its usefulness.

Liquidity Ratios

Liquidity ratios measures the ability of a firm to meet its short-term obligations before and when they fall due. The conventional ratio in use here include the current ratio, the quick ratio, the cash flow, the inventory turnover and receivables turnover. Research has indicated that these ratios often present substantial difference among bankrupt and non-bankrupt firms. Empirical studies in the UK, USA and Israel have shown

that the current ratio is a significant indicator of financial problems. Altmann, (1968), Beaver (1968), Edminister (1972), Tamarind Porash (1979).

Activity Ratio

Activity ratios are used to give a general idea of the length of the segments of a company's operating cycle so that the liquidity of selected current assets may be evaluated. A company's operating cycle is the length of time it takes to invest in inventory, make credit sales and convert the receivables into cash. The ratio also indicates the efficiency with which the company uses its short-term economic resources.

Debt Ratio

The gearing level often serves as a trip wire to high liquidity ratio. For instance, a firm may be relatively liquid yet be highly risky to investors if its reliance on debt is very high. Usually, the higher the gearing level, the higher the chances of the firm's inability to withstand sudden changes in profitability or market conditions, and so the higher the probability of failure except the profits are retained (January, 1978) U.K data used by Tamari and U.S data employed by Beaver all showed higher debt in failed companies. In other words, the reliance on debt tends to increase as the firm draws near to failure.

Profitability

It has been determined that, theoretically and in fact, a firm can

operate successfully with very poor liquidity and high gearing, so long as its level of profit is high enough to compensate investors and lenders for assuming greater risks (Tamari, 1978). Hence, the trend in profitability over an appreciable period, i.e. 5 years is a very important complement to unfavourable liquidity and gearing ratios and should tell a failing firm from a successful one. Thus the emphasis really should not be on profitability ratios but on the trend in profitability. However, one profitability ratio that has given good indications of the potential of a given firm is the ebit to total assets ratio. This is the best indicator of the productivity of the assets of a company and measures the efficiency of a firm - putting its assets to use.

4.2 INTERPRETATION OF DATA

The data collection for the purpose of this research presented on table 1 to 15 above. Based on this presentation, analysis followed in this writing. Based on the analysis, one could infer the message that is communicated to us.

Table one to five relates personal data of the respondents. This was to enable us know whether the respondents are in position to give us the right information for the purpose of the research and whether they are qualified enough to provide the information. From table 2 relating to the experience of the respondents, 56% have served above five years in the bank. In table 3 which relates to number of application processed since

the past five years, table 4 shows the educational qualification and table 5 shows the level of decision makers. From table 1 to 5 it can be said that all information sold to us are correct. Table 7 presented the risk attitude. Table 8 presents the respondent acceptance level of naira losses on total loan.

Table 9 shows the factor relied on most for credit decision. Table 10 shows the chance of loss recovery if decision is based on financial ratio.

Table 11 shows the reliability of ratio analysis. Tables 11 is solely on ratios. Tables 12 and 13 show the credit performance of the bank for the past four years while tables 14 and 15 show the credit disbursement to the various sectors of the economy and the reduction of the licensed banks.

Hypotheses are stated that, "financial ratio analysis are practically in use in commercial banks in Nigeria for credit decision." This is true that was why the respondents who claim that it is reliable was 50%. Hypothesis two is equally proved by tables 9 and 10. The hypothesis states that "financial ratios calculated from financial statement data are reliable and can adequately reflect the economic conditions of an organisation."

4.3.1 **Hypothesis One**

The hypothesis states that financial analysis are practically in use in Lion Bank of Nigeria PLC for credit decision. To test hypothesis, we picked questions 9 and 10. These questions were assigned V7 and V8 respectively. Figure one (1) to five (5) show the test performed on this hypothesis. This hypothesis is accepted at significance level of < .05 or <5%.

One sample t Test

Hypothesised mean = 0

Mean	DF	t Value	P Value
2.179	38	12.405	< 0001

Figure one above, one sample t test was carried out. With the hypothesised mean = 0 the one simple 4 test proved significant at .0001. This point is less than 0.05, therefore, we accept that financial ratio data are practically in use in Lion Bank for credit decision in Nigeria. It is practically clear from this one sample t test that the mean of data is significantly different from the mean of the sample data. P value shows probability of the outcome.

Chi square test

Hypothesised variance = 1

Variance	DF	t Value	P Value
1.204	38	45.744	.3631

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Figure 2 credit decision factors (V7).

The chi square test was run for hypothesis one (see figure (2) above), but do not prove significant of < .05 level. Somewhat, there is a contradiction here but this does mean we are rejecting the hypothesis. Chi-square test was carried out of hypothesised variance = 1. The chi-square test tries to show variance in the mean data and sample data. The P value for chi-square test in this calculation is 0.3631 which is greater than the hypothesised value of < 0.05. Though, despite that the lost is not significant, it does not mean that financial ratio data are not in use. It shows that financial ratio are not practically in use more than other factors stated in questions 9 of the questionnaire.

The proportion of the usage of the financial statement compared to other factors like collateral security, personality, political factors and other factors are significant. From the frequency table of this question, it proves that financial ratio data are actually in use in banks decision on credit facilities like other factors.

4.3.2 Hypothesis Two

Hypothesis two states that financial ratios calculated from financial statement data are reliable. To this hypothesis, we consider responses on question 10 that is variable 9 as relevant to test the hypothesis.

One sample t test

Hypothesised mean = 0

Liquidate loan

Mean	DF	t Value	P Value
53.603	38	15.833	< 0001

Chi-square test.

Hypothesised variance = 1

LIQUIDATE LOAN

Variance	DF	Chi-square	P Value
447.016	38	16986.590	< 0001

T-test and chi-square test were used to test these variables. The result of these tests are shown in figure 3 and 4 above. The hypothesis will be accepted at significant level of <.05. From the T-test conducted, the hypothesis proved significant. The T-test value is 0.0001 and when compared with our significant level of < 0.05, invariably the hypothesis is accepted that financial ratios calculated from financial statement data are reliable.

It is equally proved that the result in the hypothesis one was correct. We went further to test question 10 which we called variables. This question states to the best of your knowledge, what are the chances that a loan granted based on significance of financial statements would be liquidated at the expiry date." One sample test. Chi-square test and one

sample significant test were conducted on this question. The one sample T-test proved significant at 0.0001. This means that every loan granted on the financial statement of an applicant will be repaid at the date of maturity of the loan.

One sample t test

Hypothesised mean = 0

Reliability

Mean	DF	t Value	P Value
50.256	38	15.442	< 0001

Chi-square test

Hypothesised Variance = 1

Reliability

Variance	DF	t Value	P Value
413.090	38	15697.436	< 0001

Figure 6

Chi-square test equally proved significant at 0.0001. Compare this value to our hypothesis significant level. We will accept that loan granted based on the financial statements of a client will be paid. The one sample test equally prove significant. The same explanation goes for it. These results are shown in figures 5 and 6 respectively.

One may ask, why the default are rampant? Hypothesis one proved that financial ratio analysis data are practically in use in credit decision. If financial ratio are practically in use and loan granted based on financial ratio analysis are repaid at maturity, then why defaults on loan are rampant?

Because of the subjective nature of financial ratio tools, many decide to consider collateral security more than financial ratio tools. This shows that from the onset, ability to repay the loan were not properly investigated before granting the loan.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY

The main motivation to carry out this research was as a result of the default in banks and the degree of failure in the financial sectors of today. The curiosity came as a failure to repay loans at maturity despite the expertise in the financial sector and demand for collateral before granting of loans.

We therefore decided to venture into this research to find out what effect financial ratio exerts on credit decisions in the commercial banks in Nigeria and Lion Bank in particular. It is well known that in granting loans, it is not only one factor that is considered. We decided to hold other factors constant to observe the effect of financial ratio in decision making process. It was considered that financial statements would give us insight to the applicant's ability to pay.

It is therefore the objective of the study to examine the effect of the financial statement on the lending decisions in Lion Bank in Nigeria, giving the cloudy situation in financial sector.

Chapter one deals with the general introduction, the significance of the study, purpose of the study, the scope of the study, limitation and the brief history of Lion Bank.

Chapter two talks about - literature review, concepts of financial ratios, standard of comparison, types of comparison, related research on financial ratio analysis, commercial banks, credit decision of commercial banks and credit sources of information.

Chapter three attempts to look at the research methodology, research design, factors considered in research design, sampling techniques, sources and method of data collection, and analytical techniques in table forms.

Chapter four looked into presentation and analysis of data, interpretation of data and hypothesis.

Chapter five deals with the summary, conclusion and recommendation.

5.2 CONCLUSION

Based upon the hypothesis tested and the responses received, we are of the opinion that the following conclusion could be drawn from the research.

i. That financial ratio analysis are useful and reliable for lending decision in commercial banks in Nigeria.

ii. That financial ratios are tools used in analysing data for lending decision in commercial banks in Nigeria.

iii. That regression data could be used to confirm that financial ratio tool figure were actually compiled from three records.

iv. That banks which do not rely on financial ratio may likely have higher bad debt and rate of defaults than those that use financial analysis for granting loan.

iv. That the reliance on financial ratio analysis data in loan decision is better when it confirmed that the data were actually computed from accounting record of an organisation.

5.3 RECOMMENDATIONS

That there should be massive education of the user of financial ratio of their right to sue the auditors that normally certify the accounts of an organisation to be true and fair when in real term they are not true and fair. If the users exercise this right, auditors will present a true financial statement for an ensured financial ratio analysis. The banks should study properly the financial statement submitted to back the loan application that loans should not be given just on collateral security.

The banks should establish beyond reasonable doubt that collateral securities mortgage are not already mortgages elsewhere for loan. If this is done, those who used a single property for several loans will be checked.

The banks should confirm the financial ratio from the external guarantor and make them to know the purpose of which it is being submitted to the bank with the intention of making them liable if any information in the accounts tends to be false one. There should be no

inspection of the assets presented in the accounts by the officers. This will go a long way to avoid false claim.

The commercial bank should make ability of the loan seeker ~~to~~ repayment a priority.

Much weight should be given to financial ratio analysis when it comes to loan decision making rather than collateral security, personality and other political factors. By so doing, default would not be possible.

There should be a general information bureau within the banking system to avoid debtors transferring from bank where they are indebted to another bank. This will help the bank to watch over the loan through the accounts of borrower.

We believe that if these our recommendations are put into consideration, situation of false financial data presented to banks will be avoided and many credit analysis will also enhance the performance of firms as they will know their true financial position.

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QUESTIONNAIRE

1. Name of the Respondent .....

2. Name and location of the respondent bank .....

3. Length of services

   a. 1 - 3 years

   b. 2 - 5 years

   c. 5 years and above

4. Educational qualification:

   a. Post graduate/professionals

   b. Post graduate only

   c. Graduate/professional

   d. Graduate only

   e. Diploma/professional

   f. Diploma only

5. In what ways are you involved in handling credit decision in your bank (tick)

   a. Financial decision makers

   b. Member of management

   c. Superior/investment executive

   d. Analyst involved directly with the computation

   e. Adviser/credit consultants

6. How much can you approve without referring to your supervisors?

   a. Not more than ₦50,000.00

   b. Not more than ₦100,000.00

   c. Not more than ₦150,000.00

   d. Not more than ₦200,000.00

   e. Not more than ₦250,000.00

   f. Not more than ₦300,000.00

   g. Not more than ₦350,000.00

   h. Not more than ₦400,000.00

   i. Not more than ₦450,000.00

   j. Not more than ₦500,000.00

   k. Others (specify) .....

7. Approximately, how many commercial loan application have you evaluated during the first five years?

   a. Less than 50

   b. Less than 51 - 100

   c. Less than 101 - 200

   d. Less than 201 - 300

   e. Less than 301 - 400

   f. Less than 401 - 500

   g. 501 and above.

8. In your opinion, which of the following would you consider to be an acceptable annual range of naira losses to total loan granted base on financial ratio analysis.

   a. Not more than 0.5%

   b. Not more than 1%

   c. Not more than 1.5%

   d. Not more than 2%

   e. Not more than 2.5%

   f. Not more than 3%

   g. Not more than 3.5%

   h. Not more than 4%

   i. Not more than 4.5%

   j. Not more than 5%

9. Which of the following factors do you rely on most your credit decisions?

   a. Collateral security

   b. Financial ratio analysis

   c. Personality

   d. Political factors

   e. Regression analysis

10. To the best of your knowledge, what are chances that a loan granted based on applicant's financial ratio analysis would be liquidated at maturity?

a. 1 - 20%

b. 21 - 40%

c. 41 - 60%

d. 61 - 80%

e. 81 - 100%

11. In your opinion how reliable are ratio analyses?

a. 10%

b. 30%

c. 50%

d. 80%

e. 100%

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12. Which of these ratios do you rely on most in your credit decision?

a. Liquidity ratios

b. Profitability ratio

c. Activity ratios

d. Test ratios

e. Solvency ratios

13. How would you want the usefulness of each of the following ratios in credit decision making?

14. Do loans and advances performances form the basis of your credit decisions in Lion Bank?