BANKS' SURVIVAL STRATEGIES IN A POTENTIALLY DISTRESSED FINANCIAL ENVIRONMENT: A CASE STUDY OF HABIB NIGERIA BANK LIMITED

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DECLARATION

I hereby declare that this thesis leading to the award of the degree of master of Business Administration has been written by me, and that it is a record and production of my own work. All quotations are indicated by quotation marks and the sources of information are duly acknowledged by means of references.

To the best of my knowledge this thesis has never until now been presented either partially or wholly for any other degree nor is it being concurrently submitted for any other degree.

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CERTIFICATION

The undersigned certify that they have read, and recommended to the Faculty Board of Administration for acceptance, a THESIS TITLED "Banks' Survival Strategies in A Potentially Distressed Financial Environment: A Case Study of Habib Nigeria Bank Limited", submitted by Muhammad Bello Tukur, in partial fulfilment of the requirements for the degree of Master of Business Administration (MBA) of Ahmadu Bello University Zaria, Nigeria.

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DEDICATION

In loving memory of my children - Faisal 1, Faisal II, Farhan and Rabi who have all passed on at very tender ages of 1, 10, 6 and at birth respectively.

May Allah grant them eternal rest and Al-Jannah Firdaws. Amin.

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To my wife Hadiza, and my children Farida, Faiza, Firdaws and Fahd I offer my profound gratitude for their love, support and understanding.

My mother, Hajia Rabi, has been unending source of inspiration and encouragement, with out whose love, support and prayers I will not have been who I am today and most certainly this work would not have been possible. For her, I have no words to adequately express my deep sense of gratitude and indebtedness.

Finally every page of this document reveal borrowings from scholars in many disciplines. I hope that this single overriding recognition of that fact will express my deep appreciation and admiration of their work.

A B S T R A C T

This study has revealed that a gap exists between the theoretical basis and the practical application of existing knowledge and experience in the field of banking and financial institutions management in the developing countries. As a consequence of this gap, the study further reveals that there could be an impact on the national economies, in particular the domestic currency operations, of such countries; with considerable loss of funds by shareholders, creditors and depositors. The measures necessary and steps needed to bridge the gap is the objective of this study.

The study gives a preview of the stormy and chequered history of banking in Nigeria. It also provides an overview of the current myriad of problems being experienced by the banking industry in Nigeria, which started in 1986 shortly following the introduction of the Structural Adjustment Programme (SAP), and culminated with the demise of some 40 banks in 1994 and the loss of an estimated over 41 billion Naira of depositors funds.

The central theme that emerge is that banking is in the midst of change. As government seek to improve economic efficiency and better allocate resources, policy makers are shifting economies towards openness, competition, and market discipline. Privatization is spreading, and state firms including banks that were once highly regulated, are being given greater autonomy. This, coupled with the near-global confrontation with financial distress - all demand substantial strengthening of banking institutions.

The study found a strong correlation between financial ratios and profit or strength of the bank in a sample statistics drawn from reports on the case study bank. The sample correlation is also demonstrated to be statistically significant through hypothesis testing using t test.

In summary, the study revealed that for banks in both in the developed and developing countries to survive and prosper in a market economy; they must be prudently run by competent, knowledgeable and experienced management and board of directors; meet regulatory standards and laws; developing the capacity to select from international experiences aspects of planning and management that are useful; and clearly defining feasible goals in relation to their technical and financial resources and in consonance with their cultural, economic and social environment.

TABLE OF CONTENTS

DECLARATION		i
CERTIFICATION		ii
DEDICATION		iii
ACKNOWLEDGMENT		iv
ABSTRACT		v
LIST OF FIGURES		x
LIST OF TABLES		xi

CHAPTER ONE (1):

INTRODUCTION

1.1	Statement of the Problem	9
1.2	The objective of the Study	11
1.3	Scope and Delimitations of the Study	12
1.4	Hypotheses	13
1.5	Definitions of Terms used	13

CHAPTER TWO(2):

LITERATURE REVIEW

2.1	Financial Failures	22
2.2	External Causes of Financial Failure	24
	2.2.1 Characteristics of the Economic System	25
	2.2.2 Age of Business Failures	27
	2.2.3 Geographic Distribution of Business Failures	28
	2.2.4 Size of Business Failures	28
	2.2.5 Disaster	29
2.3	Internal causes of Financial Failure	
	2.3.1 Inefficient Management	29
	2.3.2 Over-extension of Credit	33
	2.3.3 Insufficient Capital	34
	2.3.4 Dishonesty and Fraud	34

KASHIM IBRAHIM LIBRARY

2.4 Stages of Financial Failure

2.4.1 Period of Incubation **36**

2.4.2 Cash Shortage **37**

2.4.3 Financial Insolvency **38**

2.4.4 Total Insolvency **38**

2.5 Detection of Failure Tendencies

2.5.1 Trend Analysis **39**

2.5.2 Analysis of Accounting Measures **40**

2.5.3 Analysis of Management **43**

2.5.4 Importance of Forecasts **44**

2.5.5 Other Factors **44**

2.6 Failed Firm Resuscitation

2.6.1 Extension **46**

2.6.2 Composition **46**

2.6.3 Combination Settlement **46**

2.6.4 Appraisal of Voluntary Settlement **47**

2.6.5 Reorganisation **47**

2.7 Failed Firm Liquidation

2.7.1 Assignment **48**

2.7.2 Bankruptcy **49**

2.8 Previous Studies on the Case Study Bank **52**

CHAPTER THREE (3):

METHODOLOGY

3.1 Introduction **53**

3.2 Data Collection **53**

3.3 Population **54**

3.4 Sample and Sampling 54
3.5 Topic and Dimension 55

CHAPTER FOUR(4):
DATA ANALYSIS AND INTERPRETATION
4.1 Data Analysis 56
4.2 Financial Ratios Computation 57
4.3 Financial Ratios Analysis 60
4.4 Determination of Coefficient of Correction (r) 62
4.5 Hypothesis Testing 64

CHAPTER FIVE (5):
SUMMARY AND RECOMMENDATION
5.1 Summary 66
5.2 Recommendations 69
5.2.0 Timely Decision 70
5.2.1 Planning 71
5.2.2 Autonomy 71
5.2.3 Board of Directors 72
5.2.4 Policy Making 73
5.2.5 Credit Risk Management 74
5.2.6 Financial Management 74
5.2.7 Human Resource Management 74
5.2.8 Compliance and Control System 75
5.2.9 Information Technology. 75
5.3 Conclusions 76
BIBLIOGRAPHY

LIST OF FIGURES

Figure 1: Number of Commercial Banks in Nigeria (1970 - 1991)

Figure 2: Distribution of Commercial Bank Branches in Nigeria and Abroad

Figure 3: Number of Merchant Bank Branches in Nigeria (1977-1991)

Figure 4: Commercial Banks' Loans and Advances (1970 - 1991)

Figure 5: Merchant Banks' Loans and Advances (1970 - 1991)

Figure 6: Sample Distribution of r in which **P** = 0

KASHIM IBRA... ...RARY

LIST OF TABLES

Table 1: Commercial Banks' Loans and Advances categorized by purpose (per cent)

Table 2: Failure Trends Since 1940

Table 3: Causes of Failures (Dun and Bradstreet Study)

Table 4: Evidence of Management Incompetence

Table 5: Causes of Failures (Other Studies)

Table 6: Apparent Causes of Failure

Table 7: Altman (1971) Five Ratios Computed from the data of the case study Bank

Table 8: Distribution of Working Capital to Total Asset Ratios and Profit After Taxation of Habib Nigeria Bank Limited for 1993 - 1995.

CHAPTER ONE

1

INTRODUCTION

Banks play crucial roles in the process of economic development (Ekpenyong, 1994, p.15). By collecting savings of people who have more money than they immediately require and lending such money to people who require more money than they can immediately generate thus matching the savings requirements of depositors and investment requirements of borrowers (Afolabi, 1994, p.7) banks in the process increase the quantum of national savings and investment.

The banking industry in Nigeria is today under-going a turbulent period, one that is characterised by financial distress (Ademosu, 1994, p.4). In fact indigenous banking history in Nigeria has been rather stormy and chequered. It cannot be exphasised too strongly that the "free-for-all" nature of early banking activity in Nigeria led to innumerable bank failures and losses to depositors. Between 1929 and 1968, no fewer than twenty eight indigenous banks had been registered, of which twenty three either failed or never opened for business. Of the four banks established between May, 1945 and January, 1947 in the wake of post-war conditions of boom and high export prices only two, African Continental Bank and Agbonmagbe Bank managed to survive. Of the eighteen established within the short period of the ill-fated native banking boom of 1951-52, no fewer than seventeen had by the end of 1945 either been closed down or gone into voluntary liquidation. The only survivor, the Merchant's Bank had its license withdrawn in 1960 for misuse of government funds (Teriba, 1969, p. 79).

The spate of bank failures in Nigeria during the free banking era, the loss of depositors' funds and the consequent crisis of confidence generated widespread concern over the future of banking in the country. This concern, no doubt, led to the 1952 banking ordinance to regulate banking activities in Nigeria. However the real banking regulation commenced fully with the establishment of the Central Bank of Nigeria (CBN) in 1959 (Manu, 1993). p.111).

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Ever since the establishment of the CBN and up until the year 1986, banks had been most regulated institution in Nigeria. Banks during the era, were subjected to substantial restrictions on their products and activities. These included ceilings on credit expansion and interest rate; as well as restrictions on entry into the banking industry. A major form of regulation was the restriction placed on banks portfolio selection. Many of the banks were forced to perform developmental roles such as provision of subsidized credit to "so-called" priority sectors and public enterprises. There was also the compulsory participation in the rural banking programme (Manu, 1993, p. 112).

Table 1: Commercial Banks Loans and Advances categorized by Purpose (percent)

Year	Prescribed (Minimum)	Perfor-mance	Deviation from target	Prescribe (Maximum)	Perfor-mance	Deviation from target
1975	58.0	51.7	(6.3)	42.0	48.6	6.3
1980	75.0	70.8	(4.2)	25.0	29.2	4.2
1981	75.0	70.0	(5.0)	25.0	30.0	5.0
1982	75.0	69.3	(5.7)	25.0	30.7	5.7
1983	76.0	67.9	(8.1)	24.0	32.1	8.1
1984	75.0	68.2	(6.8)	25.0	31.8	6.8
1985	75.0	68.4	(6.6)	25.0	31.6	6.6
1986	59.0	53.4	(5.6)	41.0	46.6	5.6
1987	50.0	42.0	(8.0)	50.0	58.0	8.0

Source: CBN Annual Report and Statement of Accounts (various editions)

Table 1 above shows the limited impact of these regulations in the attainment of some of the roles ascribed to the banking sector. For example most banks defaulted on the ceilings imposed on their credit expansion and the guidelines on the sectoral credit allocation. Furthermore, the focus on direct controls resulted in declining competition in the banking industry as each bank's market share became strictly determined by credit ceilings and administratively fixed interest rates. Efficiency in the system was reduced as banks were allowed the same proportional expansion in credit. One feature of banking before 1986 was the low level of risk, as bank profits were more-or-less guaranteed by fixed interest rates. The negative effect of this is that banks had no incentive to be innovative. The ability of the economy to accumulate financial assets and the efficiency of investment and allocation of resources as a result, became severely hamstrung (Manu, 1993, p. 113).

These economic shocks of the eighties coupled with the consequent shrinking of international credit in response to the debt crisis convinced many developing countries to rely more on market forces to develop their economic and financial sectors. In an effort to promote financial deepning and domestic capital formation, developing countries including Nigeria moved to liberalize rates and capital controls, and phased out direct credit policies. A number of countries are also privatizing state-owned financial institutions (Manu, 1993, p. 116).

The de-regulation of the banking system, in the particular case of Nigeria, is part and parcel of the de-regulatory train brought by the Structural Adjustment Programme (SAP).

The element of SAP were basically aimed at strengthening the resistance of the economy to shocks, improving its resilience and increasing its sensitivity to market forces.

The banking policy reforms brought about by SAP were aimed at improving the reliance of banking industry on market forces and they included (Manu, 1993, p.116):

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(a) the abolition of import license in September, 1986

(b) the partial dismantling of exchange control in September, 1986

(c) the liberalization of the issuance of license to new banks

(d) the deregulation of interest-rate in August, 1987

(e) the removal of the rate of credit growth and the simplification of the format for sectoral credit allocation

(f) the lowering of the cash reserve ratio to 3% (later increased to 6%)

(g) the removal of restriction on commercial banks to engage in equipment leasing

(h) the relaxation of the restriction on equity participation in companies by banks and

(i) the licensing of other financial institutions, namely the community banks, finance companies, and the mortgage or savings and loans institutions.

These de-regulatory measures have had and would continue to have tremendous impact on the role of banks in Nigeria. Initially it led to the proliferation of banks and other financial institutions which subsequently turned out to be unhealthy.

The number of commercial and merchant banks increased from 15 in 1970 to a total of 119 with a total of 2,023 branches as at the end of 1991 (see figures 1,2 and 3). Their assets increased from ₦36.9 billion in 1985 to ₦232.2 billion as at the end of 1992. The volume of assets of the banks including the Central Bank of Nigeria (CBN) increased from ₦1.6 billion in 1971 to ₦282.2 billion in 1991. Total banks' deposits increased from ₦673 million in 1970 to ₦114.0 billion in 1991 and as revealed by figures 4 and 5 loans and advances granted in the same period expanded from ₦351.5 million to ₦40.9 billion (CBN Statistical Bulletin, Vol 2, NO. 2, 1991, Pp. 22 - 43).

By December, 1991 a total of 568 finance companies of all sizes, nature, structure and complexity had applied to the CBN for licensing. This phenomenal growth and expansion in the activities of banks was unfortunately not complemented by sufficient government policies to effectively control their operations from inception. As a result of this omission, technically insolvent banks which could not perform efficiently under the new dispensation were not in position to compete favourably with more efficient banks.

Just as such banks increased their branches and declared greater profits provision for bad and doubtful debts and actual bad debts were also increasing.

The negative signals which came from the banks following deregulation, led government to introduce a number of measures to sanitize the sub-sector. The measures introduced were aimed at strengthening and enhancing the performance of the regulatory framework and they include:

(a) the enactment of Decree No. 22 of 1988 establishing the Nigeria Deposit Insurance Corporation (NDIC) to insure the deposit liabilities of licensed banks in the country, provide financial and technical assistance to the banks and contribute to the quest for a stable and sound banking environment in Nigeria. By this decree a creditor to any of the licensed banks is entitled to be paid a maximum of ₦50,000 in the event of the liquidation of the bank even where such initial deposits are higher than ₦50,000.

(b) the granting of greater autonomy to the CBN in 1989.

(c) section 331 (2a) of the Companies and Allied Maters Decree (1990) now requires banks to disclose with reasonable accuracy, at anytime the financial position of their operation so as not to put in doubt as to their authenticity and reliability.

(d) the issuance of Prudential Guidelines (1990) and the Statement of Accounting Standard (SAS10). Prior to promulgation of these guidelines banks prepared their financial statements to suit their particular and peculiar interests. For example, while some banks charged interest income on non-performing loans into interest suspense account, others recognized it as income thereby overstating their profits. Some banks regarded it as income interest on non performing credit facilities after three months, some

after nine months or even more than one year without suspending interest on such facilities.

(e) in line with the international standards on capital adequacy recommended by the Basle committee, the Nigerian Government in 1991 increased the minimum equity capital of merchants banks from ₦12 million to ₦40 million and for commercial banks from ₦20 million to ₦50 million. Banks are also required to provide not less than 7.5 percent of their risk assets as capital and at least 50 percent of the banks capital for this purpose should include paid up capital and reserves.

Nonetheless the effectiveness of reforms to replace direct controls by indirect monetary policies also requires a concomitant strengthening of bank supervision. Liberalization of markets means increased competition, and a bank can only compete when it is financially sound. Weak banks lose clients and are forced to take greater risks, thus compounding their problems. Also, deregulation puts greater strain on bankers, who are required to make decisions that formerly were imposed on them by the authorities. Thus, financially and managerially weak banks will be less able to adjust to the new environment, increasing their financial problems and threatening the stability of the financial system (Manu., 1993, p. 121).

As a direct consequence of the measures taken by government to sanitize the banking sub-sector, the withdrawal of government and parastatals funds from the banking system, the abolition of offshore guarantees, and the introduction of the stabilization securities as an additional tool for monetary control, have resulted in many banks becoming insolvent or distressed.

It is not surprising that the distress signals have become a babel. For a good part of 1993 Ivory Merchant Bank, United Commercial Bank, North -South Bank and Republic Bank were not allowed to take part in foreign exchange bidding and clearing house activities. In another development, Abacus Merchant Bank, ICON Limited (Merchant Bankers) and the defunct Kapital Merchant Bank were dragged

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to court by Co-operative Development Bank (Nig) Plc asking the court to wind them up because they could not pay its deposits (Business, 1994 Banking Survey, p. 22).

Central Bank of Nigeria (CBN) in January, 1994 sent word round the banks warning them not to honour cheques in inter-bank deals from 10 banks unless the apex so instructs. The list included First African Trust Bank, Lobi Bank, United Commercial Bank and Mercantile Bank. Others were Republic Bank, New Nigeria Bank and North-South Bank. Their reserve with the CBN were said to have been depleted beyond acceptable level (Business, 1994 Banking Survey, p. 22).

Some 40 Banks were reportedly distressed in 1994 with over 41 billion of depositor's funds at the risk of going down the drain (Business, 1994 Banking Survey, p. 19).

Banking failures though undesirable, is not new in Nigeria nor is it peculiar to this country. The rate of bank failure is rather staggering among unit banks in the United States (US). Between 1928 and 1932, the US saw 9000 of its 27,000 banking institutions collapse and a third of aggregate deposit was lost. On March 5, 1933, President Roosevelt had to proclaim a four-day bank holiday to end the run on banks and restore confidence in the economy (Afolabi, 1994, p.11). There were also cases of distress among major banks in the U.S in the 1980's following the energy crisis and problems in third world debt and real estate sectors (Onwu, 1994, p.5).

Other countries where banks have experienced financial distress in recent times included Norway, France, Spain and Venezuela. In Norway where two of the largest banks Christiania Bank (CBK) and Dan Norske Bank (DNB) were distressed in 1993, as a result of heavy loans losses, the government provided lifelines in the form of equity funding to enable capital adequacy requirements to be met. This resulted in a situation where the government owned 80 percent of DNB and 93 percent of CBK which was subsequently disposed of through public issues (Onwu, 1994, p.5).

In the case of Spain where one of the largest banks experienced similar problems recently, the Central Bank took over Barnesto, provided liquidity support of 3.7 billion U.S dollars by way of equity and loans from the Deposit Guarantee Fund and arranged the sale of the bank to one of the large banks in the country. Spain's Deposit Guarantee Fund was said to have made a profit of 971 million US dollars from the sale (Onwu, 1994, p.5).

In Venezuela, the government had to provide assistance to about six private banks following the collapse in January, 1994 of Banco Latino the country's second largest bank. The bank was taken over by government and re-capitalised.

In France, the government in 1994 injected fresh capital of about 680 million U.S dollars into Credit Lyonnaise the country's biggest government bank to shore up its balance sheet. The problem of Credit Lyonnaise was said to have arisen from the country's sluggish economy and high interest rates which resulted in the failure of many small and medium sized companies and adverse developments in the property markets (Onwu, 1994, p.5).

In 1984 the bank of England had to take formal decision to arrest the collapse of Johnson Mathey Bank. In the same year, in Germany reform measures were needed and were arranged to rescue a leading banking institution (Afolabi, 1994, p.13).

Bank failure therefore appears to occur as a consequence of normal business, after all the frame works provided by regulatory authorities to prevent it had failed. The question then is can bank failure be prevented. If so, what survival strategies can banks adopt not only to ensure that they remain afloat, but to flourish.

This study will attempt to answer this question using for a case study, one of the banks in Nigeria (Habib Nigeria Bank Limited) that have so far survived the distress syndrome, in an atmosphere of growing competition, rising loss of confidence in the banking system and immeasurably increasing sophistication.

The main factors to be evaluated in this study are briefly discussed below in sections 1.1 through 1.3. They include a statement of the problem, the objective of the study and finally the scope of the study. The discussion of these factors is imperative as they provide a framework for presentation and evaluation of the case study. Hypotheses are postulated in section 1.4 and they will be tested at a later stage to enable the researcher draw informed conclusions about the study.

1.1 STATEMENT OF THE PROBLEM

The worsening problems of the financial distress in the Nigeria's banking industry and how to prevent it underlines the concern of this study.

The causes of distress are both internal and external to the banking industry. These include poor and deteriorating asset quality, liquidity mismatch between assets and liabilities, poor management and insider abuses. Others are rapid proliferation of financial market intermediaries, macroeconomic and policy instability, the prevailing economic recession, policy induced shocks and political instability (CIBN's Memorandum on Distressed Banks, 1995, p. 1).

Available statistics on bank's capitalization reveal that as at the end of 1992, the 120 operating banks in the country required in the aggregate additional capital to the tune of ₦5.6 million to meet the statutory minimum capital funds set by bank regulators for 1991 (Financial Guardian, April 11, 1994, p.6)

The banking industry's capital shortfall represented 56 per cent of Gross Domestic Product (GDP) as against 2.0 percent of GDP in 1991 (Ibid, p.6).

The capital adequacy of banks further deteriorated in 1993. The shortfall on capital requirements of banks increased from ₦5.6 million in 1992 to ₦9.1 million in 1994 (CIBN's Memo on Distressed Banks, 1995, Pp. 1-2).

Another common indicator to evaluate capital adequacy is the extent to which shareholder funds cover classified assets. The NDIC annual report for 1992 showed that the ratio of classified assets to shareholders fund worsened for all

categories of ownership in 1992. From 1,272 per cent in 1991 the ratio deteriorated to 2,310 per cent in 1992 for state government controlled banks. This is against an internationally accepted bench work of 100 per cent maximum ratio of classified loans and advances to shareholders funds. With a ratio of 299 per cent in 1992 it deteriorated to 381 per cent in 1993.

The incidence of distress is also readily manifested in deteriorating asset quality. Out of the total loans and advances of ₦80 billion in 1993, ₦38 billion or 41 per cent was classified as non-performing. For distressed banks the ratio of non-performing asset was about 60 per cent of loans and advances on the average, with this being as high as 90 per cent for some of the banks. These figures are much higher than the prudential maximum of 20 per cent. The ratio of the non-performing assets of distressed banks increased from 60 per cent in 1994 to 62 per cent in March 1994 (CIBN's Memo on Distressed Banks, 1995, p.2).

The number of banks that were unable to meet the 30 per cent minimum liquidity ratio requirement increased from 13 in 1992 to 24 in 1993. As at December 1993, distressed banks collectively overdrew their CBN accounts to the tune of ₦5.2 million (CIBN's Memo on Distressed Banks, 1995, p.2).

The foregoing reveal a fundamental and worrisome trend in the financial condition of Nigerian banks. This is the main problem not of the case study bank but of the Nigeria's Banking industry; the problem which if left unchecked will permeate the whole industry until every bank is affected one way or the other.

This study would evaluate the problems and attempt to establish their causes and remedies. The study would also attempt to establish strategies which if adopted by banks will guarantee their survival and growth.

The study could of course, be carried out in one of two ways, retrospectively by studying a failed bank and re-tracing its steps to find out what mistakes were made and what contributed to its failure; or prospectively by studying a bank that survived, identifying in the process all the right steps it has taken to ensure its

survival. I chose the later to satisfy and re-enforce my positive attitude.

The findings of the study, my conclusion and recommendations which would be documented must be practical and of immediate application, if the current trends of banks failures and their consequences are to be halted.

In the words of Simon, "The pleasure in handling difficult matters; it is a pleasure in using skillfully a well-stocked kit of well-designed tools to handle problems that are comprehensible in their deep structure but unfamiliar in their detail (Simon, 1977, p.98).

1.2 THE OBJECTIVE OF THE STUDY

Banks and indeed all businesses are set up with the intent mainly of becoming growing successful enterprises. Nevertheless, it is a fact that businesses do contract in size and do fail. To buttress this point the Business Times of Monday August 15, 1994 reported that the issue of distress in the financial system is one of the major problems facing Nigeria at this time (Business Times, August 15, 1994, p.1). A study of why these events occur might be expected to offer a useful insight into the strategies to be adopted if contraction, distress or failure are to be avoided.

The objective of this study, therefore, is to explore and establish, using Habib Nigeria Bank Limited as an example, the route leading to correctly and efficiently managed banks and financial institutions; and to identify and indicate for avoidance, the main pitfalls usually encountered in the management of such enterprises, which often lead to their distress or demise.

The study is being undertaken as a requirement in pursuit for a Master degree in Business Administration (MBA) at the post Graduate School of Ahmadu Bello University (ABU) Zaria, Nigeria. Therefore the study is intended for the Department of Business Administration ABU, which is the awarding body for the

degree. It is envisaged however that the following groups could benefit from the outcome of this study: government/regulatory authorities, bank executives, shareholders, depositors and borrowers.

Government and regulatory authorities need to know all the factors that impact upon the efficient management of banks and financial institutions. Their understanding of all the factors that directly or indirectly affect such institutions will enable them provide the leadership role needed for the development of fiscal policies which will result in the definition of current programmes to be abandoned, strengthened, and/or maintained; plus those that are deemed worthy of being developed along with the identification of necessary existing or required resources to meet the programmatic objectives.

Bank executive's knowledge of the common causes of financial trouble will enable them to identify a potential problem alert board to their suspicions and assist in taking corrective action before the situation becomes unredeemable.

The depositors stand to loose huge sums of money if a bank fails, since NDIC insures only up to a maximum of ₦50,000 of depositors funds in any licensed bank irrespective of the balances on the accounts. Depositors that can understand the early warnings signals of the possibility of their bank going under, stands a better chance of retrieving their deposits before the situation gets serious.

1.3 SCOPE AND DELIMITATIONS OF THE STUDY

The study is limited to financial failure only, as distinct from other forms of failures such as economic failure. There may be need in future for some other studies to consider the other failures individually or comprehensively.

In scope the study investigated a broad scale of many factors affecting the healthy growth and development of financial institutions. The bank under review offered good opportunities for the study and for comparison with other banks operating in the industry. So that valid interpretations of the case study could be obtained data were collected from the annual reports of the case study bank and from the

relevant literature on management of business and managerial finance.

Finally, during the course of the study the author held discussions with Chief Executive and other key personnel of the case study bank, some of them personally known to the author. This may introduce familiarity factor which serve as one of the delimiting factors of the study. However, to avoid the biases which are likely to be introduced in such a situation the author depended on documented evidences as presented in the bank's annual reports.

1.4 HYPOTHESES

In an attempt to answer the specific research question the following hypotheses will be tested:

1. A null hypothesis that the coefficient of correlation of the population from which our sample will be drawn equals zero, or that there is no significant relationship between financial ratios and profit after taxation

   $H_0 : P = 0$

2. Alternate hypothesis that correlation coefficient of the population from which our sample will be drawn differs from zero or that there is a significant relationship between financial ratios and profit after taxation

   $H_A : P \neq 0$

473328

1.5 DEFINITIONS OF TERMS USED

Assignment: A relatively inexpensive way of liquidating a failing firm that does not involve going through courts.

Bankruptcy: A legal procedure for formally liquidating a business, carried out under the jurisdiction of courts of law.

Bonds: A long-term debt instrument

Book Value The accounting value of an asset. The book value of a share of common stock is equal to the net worth (common stock plus retained earnings) of the corporation divided by the number of shares of stock outstanding.

Business Risk: The basic risk inherent in a firm's operations. Business risk plus financial risk resulting from the use of debt equals total corporate risk.

Capital Asset: An asset with a life of more than one year that is not bought and sold in the ordinary course of business.

Cash Budget: A schedule showing cash flows receipts, disbursements, and net cash) for a firm over a specified period.

Collateral: Assets that are used to secure loan.

Commitment Fees: The fee paid to a lender for a formal line of credit.

Composition: An informal method of reorganisation that voluntarily reduces creditors' claims on the debtor firm.

Debenture: A long-term debt instrument that is not secured by a mortgage on specific property.

Debt Ratio: Total debt divided by total assets.

Discounting Rate: The interest rate used in the discounting process; sometimes called capitalization rate.

Discounting: The process of finding the present value of a series of future cash flows. Discounting is the reverse of compounding

Dividend Yield: The ratio of the current dividend to the current price of a share of stock.

It is often used to distinguish between the "true value" of an asset (the intrinsic value) and the asset's current market price.

Lien: A lender's claim on assets that are pledged for a loan.

Liquidity: Refers to a firm's cash position and its ability to meet maturing obligations.

Merger: Any combination that forms one company from two or more previously existing companies.

Money Market: Financial markets in which funds are borrowed or lent for short periods. (The money market is distinguished from the capital market, which is the market for long-term funds).

Reorganization: When a financially troubled firm goes through reorganization, its assets are restated to reflect their current market value, and its financial structure is restated to reflect any changes on the asset side of the statement.

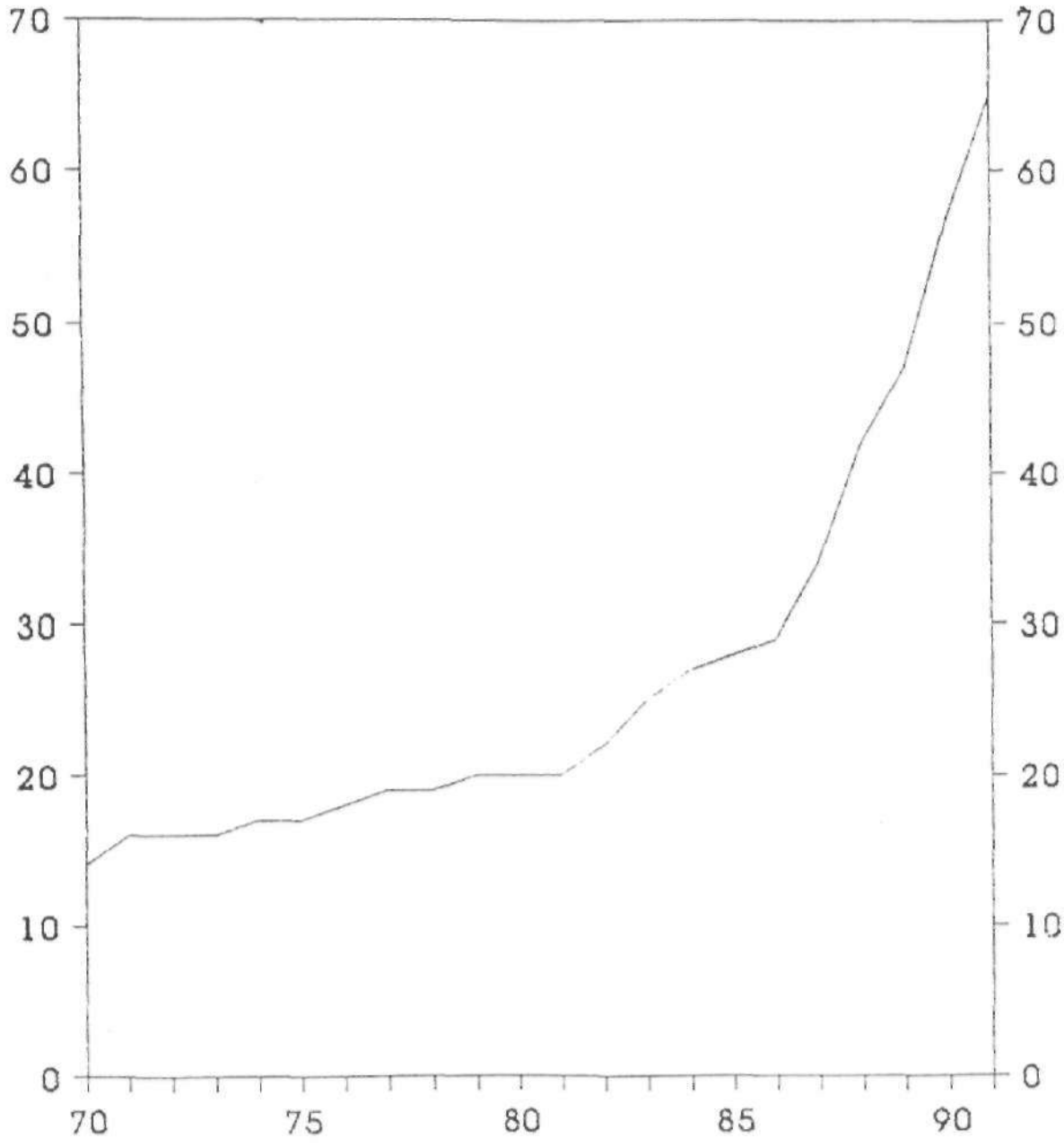
Retained Earnings: That portion of earnings not paid out in dividends. The figure that appears on the balance sheet is the sum of the retained earnings for each year.

Risk: The probability that actual future returns will be below expected returns. Measured by standard of deviation or coefficient of variation of expected returns.

Trustee: The representative of bondholders who acts in their interest and facilitates communication between them and the issuer.

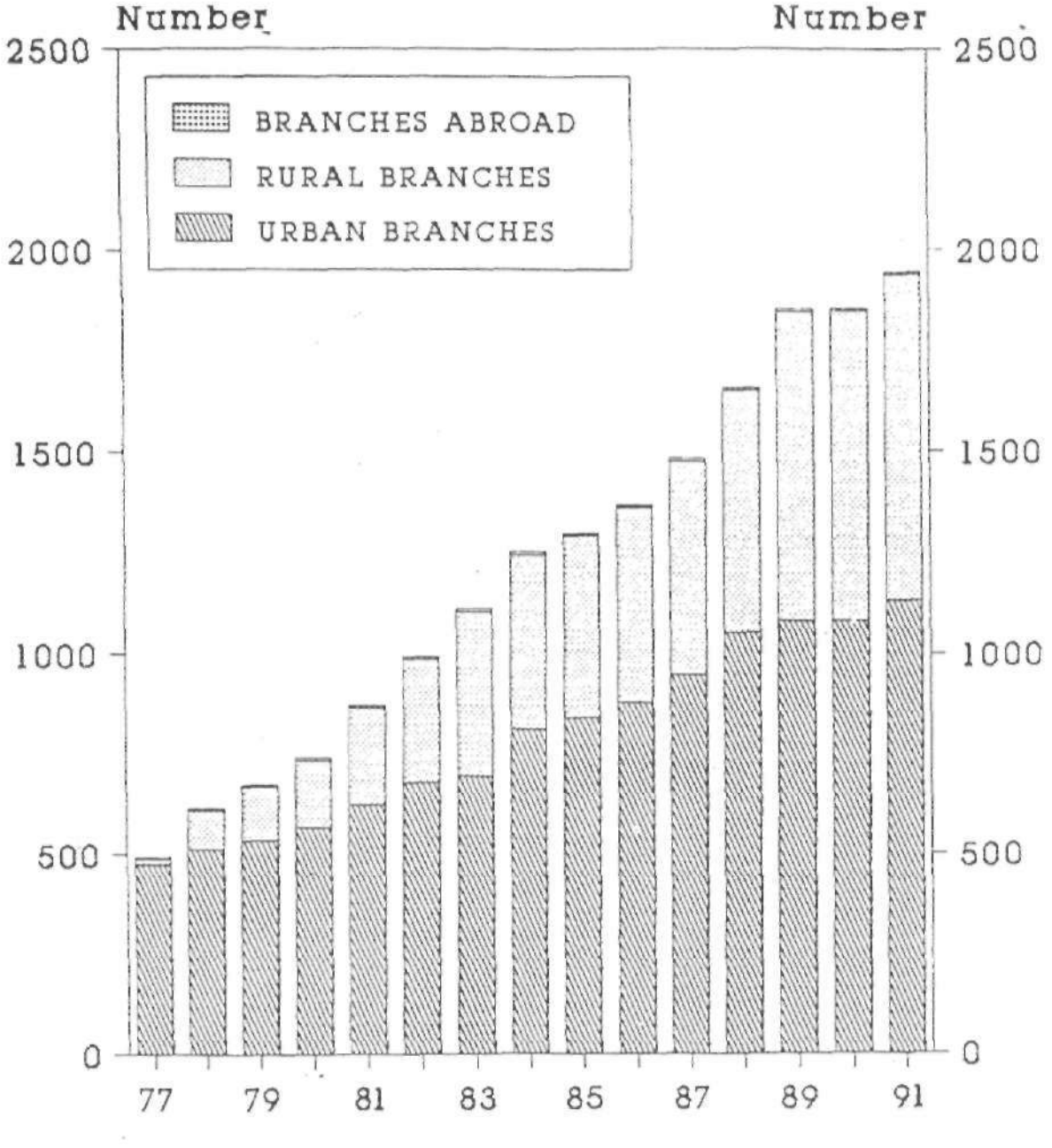
Working Capital: Refers to a firm investment in short-term assets - cash, short-term securities, accounts receivable, and inventories. Gross working capital is defined as a firms total current asset. Net working capital is current assets minus current liabilities. If the term "working capital" is used without qualification, it generally refers to gross working capital.

FIGURE 1: Number of Commercial Banks in Nigeria (1970 - 1991)



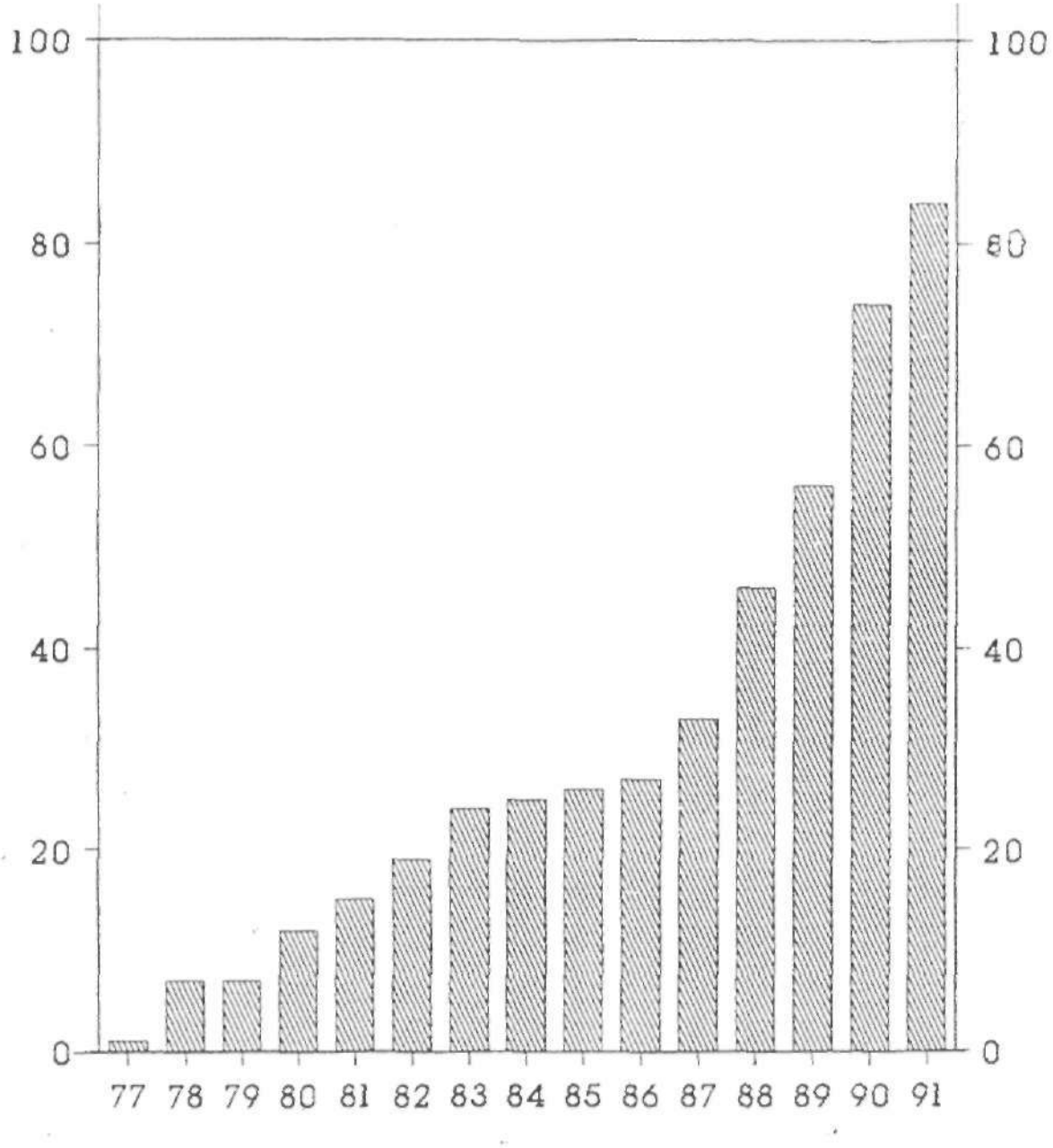
Source: CBN Statistical Bulletin, Vol. 2, No. 2, December, 1991, p. 29

FIGURE 2: Distribution of Commercial Bank Branches in Nigeria and Abroad



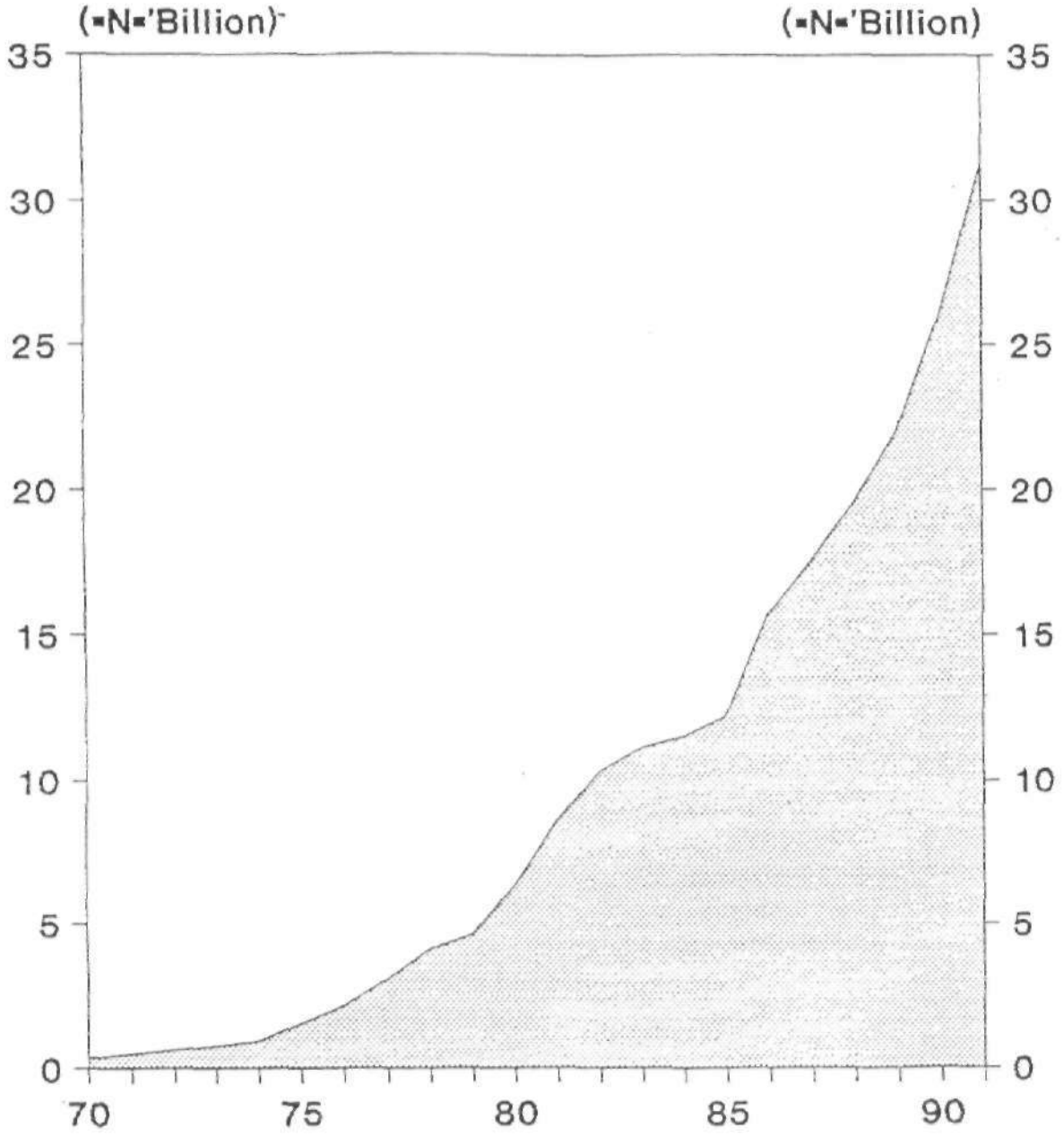
Source: CBN Statistical Bulletin, Vol. 2, No. 2, December, 1991, p. 31

FIGURE 3: Number of Merchant Bank Branches in Nigeria (1977 - 1991)



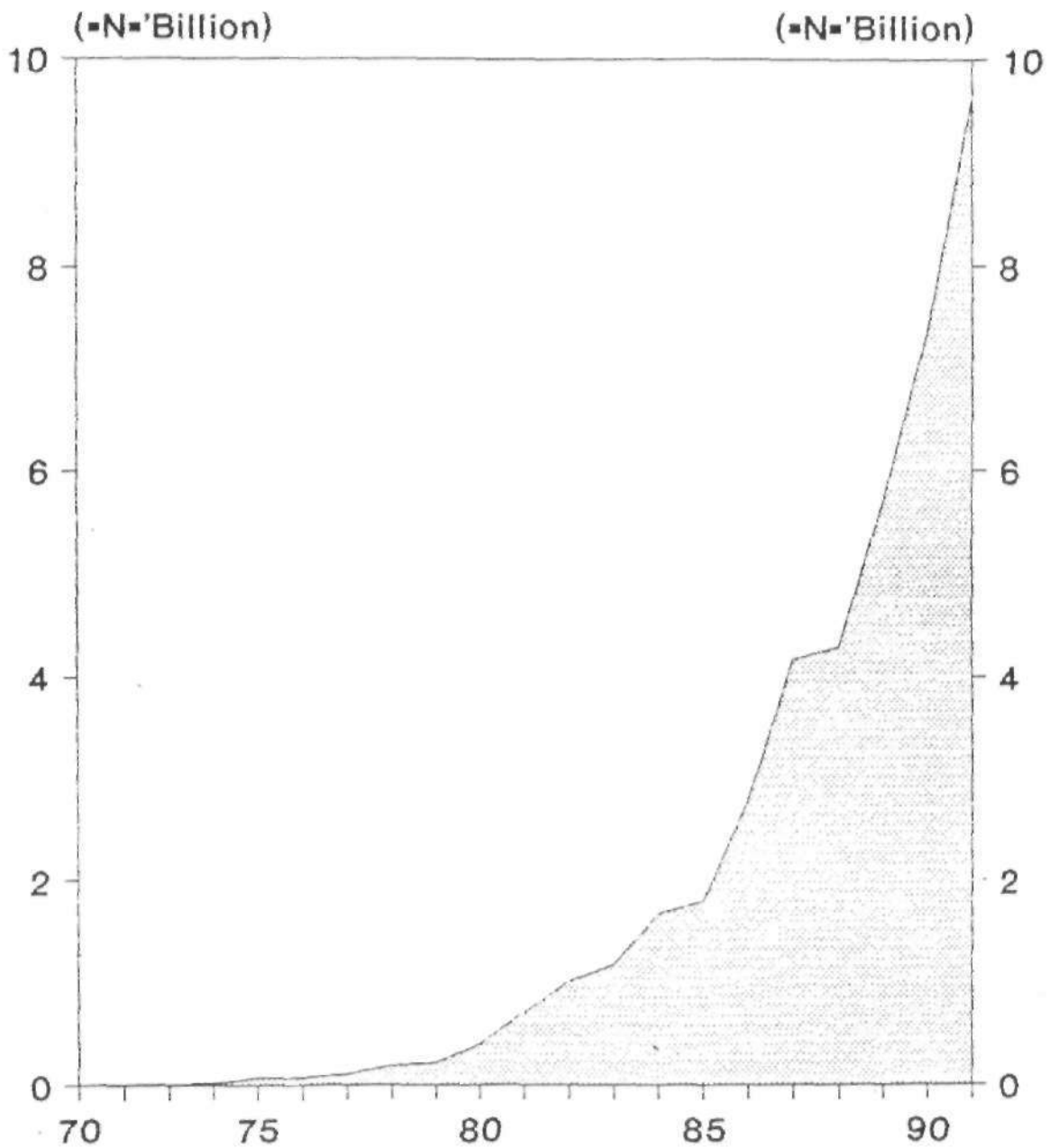
Source: CBN Statistical Bulletin, Vol. 2, No. 2, December, 1991, p. 40

FIGURE 4: Commercial Banks' Loans and Advances (1970 - 1991)



Source: CBN Statistical Bulletin, Vol. 2, No. 2, December, 1991, p. 23

FIGURE 5: Merchant Banks' Loans and Advances (1970 - 1991)



Source: CBN Statistical Bulletin, Vol. 2, No. 2, December, 1991, p. 36

CHAPTER TWO

2

LITERATURE REVIEW

This chapter summarizes some of the findings made through reviews of literature, reports, memos, and studies on causes and consequences of financial failure. All factors discussed in this chapter are important considerations in understanding comprehensively the subject under review.

2.1 FINANCIAL FAILURES

Failure is defined by Webster as "the state or fact of being lacking or insufficient, failing short". While all businesses plan to be successful, not all of them accomplish their objective. The fact that many firms fail to achieve success is evidenced to some extent by the increasing number of businesses that discontinue operations each year (see table 2). All of the discontinued businesses could not be defined as failures. No doubt several were discontinued because they were successful in that they had accomplished their objective.

Terms indicative of financial difficulties are therefore, used indiscriminately and often fail to convey the legal or even the generally accepted meaning of the word. Dun and Bradstreet has adopted the term failure to refer to those businesses that ceased operations following assignment or bankruptcy, ceased doing business with a loss to creditors, or were involved in court action such as reorganisation or arrangement.

Failure in an economic sense or **economic failure** as its so called, usually signifies that a firm's revenues do not cover costs, its rate of earnings on the historical cost of investment is less than the firms cost of capital or its actual returns have fallen below expected returns (Weston and Brigham, 1977, p. 543).

Financial Failure on the other hand is a less ambiguous term than the concept of economic failure, even though two aspects of it are generally accepted. The first aspect is what is termed **technical insolvency,** where a firm is considered a failure because it is insolvent in the sense that it cannot meet its current obligations as they fall due, even though its total assets may exceed its total liability. The second aspect is where a firm is termed **bankrupt** because its total liabilities exceeds a fair valuation of its total assets or that the real net worth of the firm is negative.

When the term failure, financial failure or distress is used in this study hereafter, is meant to refer to bankruptcy only.

Table 2: Failure Trends Since 1940 (Selected years)

Year	Number of Failures	Total Failure Liabilities ($'000	Failure Rate per 10,000 Listed Coys.	Average Liability per Failure
1940	13,619	$166,684	63	$12,239
1945	809	30,225	4	37,361
1950	9,162	248,283	34	27,099
1955	10,969	449,380	42	40,968
1960	15,445	933,630	57	60,772
1965	13,514	1,321,666	53	97,800
1966	13,061	1,385,659	52	106,091
1967	12,364	1,265,227	49	102,332
1968	9,639	940,996	39	97,654
1969	9,154	1,142,113	37	124,767
1970	10,748	1,887,754	44	175,638
1971	10,326	1,916,929	42	185,641
1972	9,566	2,000,244	38	209,099
1073	9345	2,298,606	36	245,972
1974	9,915	3,053,137	38	307,931
1975	11,432	4,380,170	43	383,150
1976	9,628	3,011,271	35	312,762
1877	7,919	3,095,317	28	390,872
1978	6,619	2,656,006	24	401,270
1979	3,564	2,667,362	28	352,639

Source: The Business Failure Record, 1979 (New York: Dun & Bradstreet Inc. 1980, p.2)

2.2 EXTERNAL CAUSES OF FINANCIAL FAILURE

The exact cause or causes of financial failure are not easily discernable. Often it is the result of several factors leading up to one event that immediately brings failure. Different studies assign the causes of failure to different factors. The Dun and Bradstreet compilations assign these causes as shown in table 3 (Weston and *Brigham, 1977, p. 544*):

Table 3: Causes of Failure (Dun and Bradstreet Study)

Causes of Failure	Percentage of Total
Neglect	2.0
Fraud	1.5
Disaster	9
Management Incompetence	93.1
Unknown	2.5
Total	100

The evidence of incompetence was further broken down as follows (John Freear, 1985, p. 349):

Table 4: Evidence of Management Incompetence

Evidence of Management Incompetence	Percentage of Total
Inadequate sales	44
Competitive weakness	24
Heavy operating expenditure	9
Inadequate control of debtors	8
Excessive fixed assets	4
Inadequate inventory control	4
Total	93

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A number of other studies of failure may be generalized into the following groups (Weston and Brigham, 1997, p. 544).

Table 5: Causes of Failure (Other Studies)

Causes of Failure	Percentage of Total
Unfavourable Industry trend	20
Management incompetence	60
Catastrophes	10
Miscellaneous	10
Total	100

Lying behind these causes is failure to plan (or bad planning) and failure to control the consequences of the plans. Environmental factors may be significant but only to the extent that they are beyond the abilities of competent managers to predict and control (Freear John, 1985, p. 349).

In general the causes of financial failure could broadly be discussed under factors that are both external and internal to the banking industry. The remaining part of this section will be dedicated to discussions on external causes of failure only while the internal causes will be discussed in the next section.

2.2.1 Characteristics of the Economic System

Microeconomic shocks has been identified by Harry Snoek (1977) as one of the major factors incidental to financial distress. In many countries these exogenous shocks have been exacerbated by inappropriate domestic economic policies particularly large budget deficits and excessive growth of money and credit. The resulting economic dislocation has had serious adverse effects on the profits of many domestic firms thereby impairing their ability to service their bank debt (Manu, 1993, p. 120).

As would be expected, the number of failure does increase as a result of a contraction of economic activity. The number of failures as reported by Dun and Bradstreet decreased for the years 1971, 1972, and 1973 when the rate of inflation was the highest since the inflationary period following World War II. It should be noted, however, that the number of bankruptcy petitions filed in the fiscal year ending June 30, 1972 increased by 18 per cent over those filed in fiscal 1971. We also experienced, in the 1974-1976 period following the years of high inflation, the largest increase in business bankruptcies since the depression. During 1979 when the inflation rate was 13 per cent the number of petitions filed increased by 12 per cent. No doubt inflation does have an unfavourable effect on the operations of some firms, but it tends to assist others.

One characteristic of a free-market economic system such as the one operational in Nigeria, is freedom of enterprise, meaning the absolute right of all individuals to engage in any business regardless of their personal qualification. This permits the entry of people who lack experience and training in their chosen business and who are thus more susceptible to failure. Galbraith suggests that there are two parts to the economy. One is the small and traditional proprietors and the other consists of the world of the few hundred technically dynamic, massively capitalized and highly organized corporations (Galbraith, 1967, Pp. 8-9). The smaller firms are the ones most susceptible to failure. The large firms can tolerate market uncertainty much better than the small firms. Galbraith further states, "vertical integration", the control of prices and consumer demand, and reciprocal absorption of market uncertainty by contracts between firms all favour the large enterprises (Galbraith, 1967, p.32).

Frequently given as a cause of failure is intensity of competition, however, an efficient management is a tough foe for any competitor. Some new businesses do fail because of a lack of adequate ability, resources and opportunity to meet successfully the existing competition. Also established concerns may be unable to match the progressive activities of new and better qualified competition (Broom and Longenecker, 1971, Pp. 86-87).

Analogous to intense competition is the challenge offered by business changes and improvements and shifts in public demand. Companies that fail in the transition to modern methods of production and distribution, or are unable to adapt to new consumer wants, must ultimately go out of business (Donaldson, Pfahl, and Mullins, 1975, Pp. 612-614).

Business fluctuations are another characteristic of a free economic system. Adverse periods marked by maladjustment between production and consumption, significant unemployment, decline in sales, falling prices, and other disturbing factors will have some effect on the number of business failures. However a temporary lull in business activities is not usually found to be a fundamental cause, although it does at least accelerate movement towards what is probably an inevitable failure.

The freedom of action characteristic of our society may result in actions by third persons that prove detrimental to a business firm. The demands of labour unions and organised actions by community and other special interest groups have in recent years contributed to the failure of some businesses. Government actions - for example, the enactment of new tax legislation, lowering or elimination of tariffs, wage and hour laws, court decisions, price regulations and the like - occasionally result in failure of some companies.

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2.2.2 Age of Business Failures

One of the most consistent bankruptcy court statistics is the age at which companies fail. For the past twenty years the percentage of failures of companies which have been in business for five years or less has ranged only from 53.1 to 59.9 per cent. The percentage of failures of those in business between six and ten years has a range of less than 7 per cent since 1957. The retail industry has consistently had a larger percentage of failures in the first five years of operation than the other businesses.

2.2.3 Geographic Distribution of Business Failures

An organization's environment can range from stable to dynamic, simple to complex; integrated to diversified; and munificent to hostile. It stands to reason that in a stable environment, an organization can predict its future conditions and so, all things being equal, can easily insulate its operations. When an organization faces extreme hostility - the sudden loss of its key client or source of supply, severe attack by the government, or whatever its very survival is threatened (Mintzberg, 1979, Pp. 268-282).

During 1979, five per cent of the failures in the United States reported by Dun & Bradstreet occurred in New York city. This large percentage, which has been higher in prior years, is due in part to the large number of firms that have corporate offices in New York. The nationwide total of failures has been decreasing since the early 1960's, except for 1971 and 1975. During the early 1970's there was a considerable increase in the number of failures in 25 cities compared with the rest of the United Sates. In recent years the percentage of failures in large cities has declined some what.

2.2.4 Size of Business Failures

Organisation size can be measured by the number of employees, the amount of sales, the size of the budget, the size of the capital involvement and other factors (Mintzberg, 1979, p. 230). In this section size will generally mean the average liability per failure.

Although the number of business failures in the United States has declined in recent years, the total liabilities associated with each failure have increased tremendously. Part of this increase is due to the rise in prices, which is reflected in larger asset and liability balances, but most of this change has been caused by a greater number of large companies having financial difficulties. The number of failures with liabilities in excess of 1 million U.S dollars increased from 155 in 1969 to 469 in 1975. The number has dropped since 1975. Dun & Bradstreet reported that there were particularly large liabilities among failures of general building contractors, business

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service enterprises, and textiles and apparel manufacturers. Since 1973 the number of failures with liabilities over 1 million US dollars has been greater than the number with liabilities under 5 thousand US dollars as reported by Dun & Bradstreet. It is anticipated that the trend of large company failures will continue.

2.2.5 Disaster

Every organisation exists in a mileu - a set of "domains", formally called to which it must respond. One of the factors associated with this milieu, is characteristics of its general environment (Mintzberg, 1979, p. 267). The causes of trouble occasionally may be entirely beyond the control of the business. Some of these causes are known as "act of God" and are found in all societies regardless of their particular economic system. Included are such things as fires, earthquakes, explosions, floods, tornadoes, and hurricanes, all of which may certainly cause the downfall of some businesses. Thus the limits within which a business must function prove to be an important determinant of its success. The challenge to management is to meet and adapt to changing conditions in such a manner that they do not prove to be adverse. A company cannot change the environment; it must be able to use it to its benefit.

2.3 INTERNAL CAUSES OF FINANCIAL FAILURE

Internal causes of failure are those that could have been prevented by some action within the business, and often result from an incorrect past decision or failure of management to take action when it was needed. Management must assume the responsibility for any business difficulty resulting from internal factors. Some of the factors associated with internal causes of failure are as follows:

2.3.1 Inefficient Management

Inefficient management has been found to be the cause of the majority of business failure. Dun & Bradstreet's analysis show that 93 percent of business failures are due to management's incompetence and lack of experience. The incompetence and inexperience were evidenced to a large extent by management's inability to avoid conditions that resulted in inadequate sales and competitive weakness.

Table 6 lists the apparent causes of failure that is in fact, evidence of the incompetence and inexperience.

Table 6: **Apparent Causes of Failure - 1979**

Evidence of Inexperience or Incompetence	Manufactures %	Wholesalers %	Retailers %	Construction %	Commercial Services %	All Concerns %
Inadequate Sale	49.9	50.4	56.7	49.6	46.8	52.3
Heavy Operating Expenses	37.8	31.6	23.0	31.6	31.7	28.9
Receivables difficulties	16.6	18.5	3.7	13.5	8.3	9.8
Inventory difficulties	7.4	13.6	14.4	1.3	1.6	2.8
Excessive fixed asset	4.4	1.5	3.0	2.0	4.7	3.1
Poor Location	0.4	0.8	4.4	0.4	1.2	2.2
Competitive Weakness	24.5	21.9	24.9	34.0	25.2	26.2
Other	2.0	2.0	1.6	1.7	1.6	1.7

Source; The Business Failure Record, 1979 (New York: Dun & Bradstreet, Inc, 1980, p. 13).

Businesses often fail because of manager's lack of training, experience, ability, adaptation, or initiative. Indications of probable failure of an enterprise include managements' inability in any of the major functions of business, lack of educational training, and lack of experience in the particular line of business that is being pursued (Sadd and Williams, 1932, Pp. 5-8, 16-32).

Inefficient management include neglect on the part of managers to coordinate and effectively communicate with specialists. With the great complexity and vast specialization of business, complete harmony and cooperation become crucial. All management services must be integrated for maximum profitability. Often it has been found that a business failure could have been avoided by the proper

application of effective managerial control tools (Beyer, 1964 , Pp. 33-35).

The Bureau of Business Research of the University of Pittsburgh made a detailed study of ten unsuccessful manufacturing plants in Western Pennsylvania between 1954 and 1956 (Woodruff, 1957, Pp. 85-86). The firms that failed were contrasted with ten conspicuously successful firms to determine points of contrast that might explain the reasons for failure. The differences identified were as follows:

(a) the unsuccessful firms had very poor records and records keeping procedures. One firm shipped 10,000 U.S dollars of oil burners to a customer who was bankrupt. The shipments continued over nine months, during which no payments were received.

(b) the successful firms spent time and money on product development while several unsuccessful firms ignored this end.

(c) several unsuccessful firms allowed themselves to go beyong the technical depth of their management.

(d) executives of unsuccessful firms neglected market analysis and selling.

(e) unsuccessful plants displayed a lack of organisation and of efficient administrative practices.

The results of the analysis were summarised in the following statement:

> None of the failures studied occurred because the firm was small. They all occurred because of a very obvious, easily identified management error. The management error might have occurred because one man was saddled with too much and didn't have time to devote to his various responsibilities, a situation indirectly associated with smallness but in the last analysis, the failure was occasioned by a management error which could have been avoided (Woodruff, 1957, p. 11).

A common situation involves managers who are expects in their particular fields, such as engineering, but lack the simple tools necessary to control their finances or administer a going concern. In this instance, it is often found that they fail to restrain salaries or benefits and are unable to maintain a close raport with their accounting staff (Donnelly, 1971, p. 14).

Inefficient management is often evidenced by its inability to control conditions that have resulted in the following :

(i) **Inadequate sales:** This may be a result of poor location, incompetent organization, poor supervision or an inferior product or service. This means the firm will be unable to make a sufficient profit to sustain the business

(ii) **Improper Pricing:** In relation to its costs the firm is charging too low accepting either a loss on the item or very little profit.

(iii) **Inadequate Handling of Receivables and Payables:** The failure to take large discounts and the failure to pay crucial creditors on time can create problems that could be avoided with careful planning as to the timing of payment and selection of creditors to be paid.

(iv) **Excessive Overhead Expenses and Operating Costs, and Excessive Charges on Long-Term Debt:** All these act as fixed charges which do not vary with the volume of goods produced. High fixed charges pushes up the firm's break-even point, which means the firm must sale a relatively large volume before it begins earning a profit.

(v) **Over Investment in Fixed Assets and Inventories:** Both types of commitments tie up cash or other funds so that they are no longer available to the firm for meeting other obligations. In addition carrying a large amount of inventories results in excessive storage costs, such as warehouse rent and insurance coverage, and the risk of spoilage or obsolescence.

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(vi) **Insufficient Working Capital Including a Weak Cash Position:** This is often the result of excessive current debt due to acquisition of fixed assets through the use of short-term credit; over expansion of business without providing for adequate working capital; or deficient banking facilities, resulting in high cost of borrowing current funds.

(vii) **Unbalanced Capital Structure** that is, an Unfavourable Ratio of Debt to Capital: If the amount of capital secured through bonds or similar long-term liabilities is relatively high, fixed charges against income will be large. This is advantageous when the firm is earning a healthy profit and the residual after-interest charges accrue to the owners. But where the business is experiencing financial difficulties, this interest burden acts to drag down earnings.

(viii) **Inadequate Insurance Coverage:** If a business is not compensated for such losses as fire and theft, it might very well be forced to close its doors.

(ix) **Inadequate Accounting Methods and Records:** Management will not have the information it needs to identify problem areas and take preventive action.

The existence of any one of these factors may be an indication of potential trouble due to management's inability or inefficiency. The accountant is in an excellent position to discover any of these conditions and alert management to their existence and possible consequences.

2.3.2 Over extension of Credit

Another inside cause of failure is the tendency for businesses to overextend credit and subsequently become unable to collect from their debtors in time to pay their own liabilities. Manufacturers overextend credit to distributors so that they may increase their sales. Distributors, to be able to make payments to their manufacturers, must then overextend credit to their customers. These buyers must

in turn continuously keep bidding lower and lower to be able to keep their equipment busy and meet their commitments. In this manner a chain of credit is developed and if one link defaults there is trouble all the way down the line. The failure to establish adequate credit margins thus may result in business crises.

The obvious answer is to expand credit investigations and possibly restrict sales made on account. However, many businesses feel that their volume sales will fall as a result, perhaps more than offsetting the credit losses they are now experiencing. But one unusual default could cause serious financial trouble to the firm and might have been avoided by a more careful credit policy. A manager's decision to grant credit indiscriminately means a risk of the company's own financial stability. Unusual credit losses may so greatly weaken the firm's financial structure that it is no longer able to continue operation.

2.3.3 Insufficient Capital

As previously mentioned, insufficient capital may be thought to be an inside cause of business failures. When business conditions are adverse and there is insufficient capital, the firm may be unable to pay operating costs and credit obligations as they mature. However the real cause of difficulty is often not insufficient capital, but a lack of ability to manage effectively the capital that is available for use to convert merchandise and receivables into cash with which to pay firm's debts.

2.3.4 Dishonesty and Fraud

Fraud comprised of two fundamental elements. The one is **premeditated deceit.** The other is **peculation,** a collective term for any combination of embezzlement, defalcation, or misappropriation. The Nigeria Deposit Insurance Corporation (NDIC) in its 1990 annual report mentioned that "as high as 75 percent of the commercial and merchant banks surveyed contravened guidelines relating to required liquidity, foreign exchange dealings and bank credit allocations" (Fuja, April 19, 1993, p. 5)

The NDIC report indicated that 417 bank's staff were involved in frauds in 1990 as compared to 313 staff in 1989. The total amount involved increased from ₦105

million in 1989 to ₦804 million in 1990 representing a seven-fold increase. A breakdown of the report shows that the total sum of ₦786.8 million was classed under frauds and forgeries in commercial banks out of which ₦22.4 million was regarded as actual or expected loss. Similarly, the merchant banks recorded a total of ₦15.4 million within the period under review. An insignificant amount of ₦0.03 million was considered to be actual or expected loss in this category (Financial Guardian, October 7, 1991 p. 1).

In 1991 a total of ₦360 .2 million was involved in frauds with actual loss amounting to ₦25.2 million compared with the ₦788.8 million recorded in 1990 there was a decrease by 54.3 per cent. But then in 1993 the banking industry lost about ₦1 billion to fraudsters, indicating an upswing and a continuing up trend in banking frauds in Nigeria (Fuja, April 19, 1993, p. 1)

The 1990 NDIC annual report have identified the following as ways through which the fraudulent practices were perpetrated (Financial Guardian, October 7, 1991, p.2):

(a) manipulation of loans accounts which involved the reduction of their balance in order to avoid instalment payment;

(b) withdrawal from customer's accounts through forged vourchers;

(c) falsification of passbooks, partial posting of deposits with a view to defrauding, basic travel allowances (BTA) application with forged documents and stealing of travels cheques and other illegal foreign exchange dealings; and

(d) using bank letterheads with forged signatures to authorize payment for supplies, use of computer operations passwords and fraudulent operation of frozen accounts.

Other forms of fraudulent practices include planned bankruptcies or sham. Premeditated bankruptcy fraud has been found to be the cause of small number of bankruptcy proceedings. The reasons for fraudulent bankruptcies include the desire of many credit grantors to maintain their sale volume at any cost, the neglect of creditors to investigate bankruptcy causes and the ability of dishonest persons to utilize profitably the benefits of bankruptcy courts without fear of prosecution.

2.4 STAGES OF FINANCIAL FAILURE

The general activity in firms that are failing includes lower and slower growth in sales, poorer cash flow and net income positions, and incurrence of debt. These factors combine to cause marked deterioration in the firms solvency position. Unsuccessful firms also experience higher operating costs, especially excessive overhead costs, than the average similar successful firms. As the firm suffers losses and deteriorates, its asset size is reduced. Assets are not replaced as often as in more prosperous times, and this with the cumulative losses further dim the prospects for profitable operations (Altman, 1968, p. 5).

The stages of financial failure may be analyzed in four distinct phases: **period of incubation, cash shortage, financial insolvency and total insolvency**. The time period associated with each state will differ depending on many factors.

2. 4.1 Period of Incubation

A business does not suddenly or unexpectedly become insolvent. Any business concern having financial difficulty will pass through several transitional stages before it reaches the point where it is necessary to file a bankruptcy petition (Ramanauskas, 1966, p. 3). Such transitional period is what is often termed period of incubation.

During the period of incubation one or even a number of unfavourable conditions can be quietly developing without being recognizable immediately by outsiders or even by management. Some of the types of developments that may be occurring in the incubation period are listed below.

- Change in product demand
- Continuing increase in overhead costs
- Obsolete production methods
- Increase in competition
- Incompetent managers in key positions
- Acquisition of unprofitable subsidiaries
- Overexpansion without adequate working capital
- Incompetent credit and collection department
- Lack of adequate banking facilities.

It is often in the incubation stage that an economic loss occurs, in that the return realised on assets falls below the firm's normal rate of return. It is at this stage of failure that management should give careful consideration to the causes. If the cause cannot be corrected, management must look for alternatives. It is best for the company if the problem is detected at this stage, for the following reasons (Walker, 1965, p. 202):

(a) replanning is much more effective if initiated at this time
(b) the actions required to correct the causes of failure are not nearly so drastic as those required at later stage and
(c) the public confidence is less likely to be impaired if corrective action is taken at this stage.

It is possible that, under certain conditions, the economic loss may not occur until the enterprise is in the second stage, experiencing a shortage of cash.

2.4.2 Cash Shortage

The business for the first time is unable to meet its current obligations and is in need of cash, although it might have a comfortable excess of physical assets over liabilities and a satisfactory earning record. The problem is that the assets are not sufficiently liquid and the necessary cash is tied up in receivables and inventories.

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2.4.3 Financial Insolvency

Financial or commercial insolvency is the third stage of financial failure in which the business is unable to procure through customary channels the funds required to meet its maturing and over due obligations. Management will have to resort to new financing techniques. However, there still exists a good possibility for survival and for future growth and prosperity if substantial infusions of new money and financing can be obtained.

2.4.4 Total insolvency

At this point the business can no longer avoid the public confrontation of failure and, the management's attempt to secure additional funds by financing generally prove unsuccessful. Total liabilities exceed the value of the total assets. The total insolvency becomes confirmed when legal steps, involuntary or voluntary, are taken by filing a petition for bankruptcy.

2.5 DETECTION OF FAILURE TENDENCIES

There are several tools that may be used to diagnose business failures but they will not necessarily reveal the cause of failure. It is the cause, and not merely the symptom, that must be determined and corrected. A constantly inadequate cash position, for example, is an indication that financial problems are developing, but the problem is not solved by management's borrowing additional funds without determining the real cause for the shortage. However, if the cause of the shortage is ascertained and corrected management can then raise the necessary cash and be reasonably certain that the future cash inflow will not be interrupted in such a manner as to create a similar problem (Walker, 1965, p. 202). External and internal methods may be used to detect failure tendencies. The most common sources of external data are trade reports and statistics and economic indicators published by government and by private organisations.

Internal methods used are simply an extension of the work done by accountants. During the preparation of their reports, their audit investigation, and the

performances of other services accountants are often able to identify when the enterprise is headed for trouble and alert management. Effective management will then seek to take avoiding action, unless they believe failure to be in the best interests of the equity holders. The following are some of the internal methods often used to detect failure tendencies.

2.5.1 Trend Analysis

One of the most frequently used methods of examining data from within the firm is an analysis of the financial statements over a period of years so that trends may be noted. Using a certain year as base, a trend analysis of the important accounts is developed on a monthly or quarterly basis (Starkweather, 1949, p. 432).

The important consideration here is the identification of trends in motion over a time dimension that are in the process of either rapidly eroding a relatively good present position of a firm, or that its relatively weak position is being improved. The balance sheet trends will generally reveal the following failure tendencies:

- Weakening cash position
- Insufficient working capital
- Overinvestment in receivables or inventories
- Overexpansion in fixed assets
- Increasing bank loans and other current liabilities
- Excessive funded debt and fixed liabilities
- Overcapitalisation
- Subordination of loans to banks and creditors.

The income account changes may disclose additional failure tendencies as follows:

- Declining sales
- Increasing operating costs and overhead
- Excessive interest and other fixed expenses
- Excessive dividends and withdrawals compared to earning records

- Declining net profits and lower return on invested capital
- Increased sales with reduced mark-ups

2.5.2 Analysis of Accounting Measures

In conjuction with the trend analysis, certain ratios or accounting measures are of benefit in indicating financial strength. Interest in the prediction of failure was simulated in the USA by the rate of business failures during the Depression of the 1930s. Between 1930 and 1942, five studies were undertaken, by Fitzpatrick (1932), Smith (1930), Smith and Winakor (1935), Ramser and Foster (1931), and Merwin (1942). The studies gave a good indication of the data which appeared to be relevant to the prediction of failure.

The idea was that, for example, if current assets more than covered current liabilities, this was a sign of strength. The lower the cover, the greater the weakness. The extremes could easily be identified, and a cut-off point or range could be stabilised from predictive experience. Most of the data was in the form of ratios and those which appeared to be useful predictors were:

(1) Current ratio = $\frac{\text{current assets}}{\text{current liabilities}}$

(2) "Acid test" ratio = $\frac{\text{(current assets minus inventories)}}{\text{current liabilities}}$

(3) Net worth to fixed asset = $\frac{\text{(total assets minus total liabilities)}}{\text{fixed assets}}$

(4) Working capital to total assets = $\frac{\text{(current assets minus current liabilities)}}{\text{total assets}}$

(5) Net profit to net worth = $\frac{\text{net profits}}{\text{(total assets minus total liabilities)}}$

(6) Net worth to total liabilities = $\frac{\text{(total assets minus total liabilities)}}{\text{total liabilities}}$

The first two concentrated on the short-term position, measuring the company's ability to meet short-term liabilities. The other measures concentrated on the overall, long-and short-term position of the company, with the fifth ratio incorporating an income measure.

The next major study was by Tamari (1964), who found that six ratios in particular were good predictors of failure, in some cases up to five years ahead and in all cases in the year prior to failure.

(1) Current ratio, as above

(6) Net worth total liabilities, as above

(7) Sales to inventory = $\frac{\text{(sales plus change inventory)}}{\text{Inventory}}$

(8) Sales to Working capital = $\frac{\text{sales}}{\text{(current assets minus current liabilities)}}$

(9) Profit trend (fitting a trend line to profit figures over the recent past)

(10) Sales to debts

Tamari observed that a large proportion of the successful (non-failed) companies in his sample had at least one weak ratio; some had two and even three. He concluded that the analyst cannot rely on one ratio alone in measuring the degree of risk associated with a company.

An analysis of accounting measures or predictions of failure by Beaver indicates that the non liquid asset measures predict future better than the liquid asset measures. The evidence also indicates that failed firms usually have lower, rather than higher, inventory balances as is often expected (Beaver, 1966, p. 121). The

longer-term ratios found by Beaver to be the best predictor of failure were:

(11) Cash flow to total debt = $\frac{\text{cash flow}}{\text{total debt}}$

(12) Net profit total assets = $\frac{\text{net profit}}{\text{total assets}}$

(13) Total liabilities to total assets = $\frac{\text{total liabilities}}{\text{total assets}}$

In a model designed by Altman, five basic ratios were used in predicting corporate bankruptcy (Altman, 1970, p. 18). The five ratios selected from an original list of twenty two are as follows:

(4) Working capital/total assets
(14) Retained earning / total assets
(15) Earnings before interest and taxes / total assets
(16) Market value equity / Book value of total debt
(17) Sales/ total assets.

Based on the results of his research, Altman suggested that the bankruptcy prediction model is an accurate forecaster of failure up to two years prior to bankruptcy and that the accuracy diminishes substantially as the lead time increases.

However, the fact that there is no unanimity amongst the studies as to which ratios offer the best predictive ability presents problems to managers who might wish to make practical use of their findings. Johnson (1970) started that:

> "For ratios to predict failure, they should be deduced from a model of the underlying economic and decision processes. While ratios do provide information about the current status of the firm, they do not contain information about the alternative strategies and the intervening economic conditions confronting management and investors, such as mergers and deferral of payments. Unfortunately, ratios seem suited to analysis after the fact."

He explained this in terms of measurement errors, standard of comparison in the data and the fact that ratios are not dynamic, being, at best 'comparative statistic'. Published data on which ratios are based, he suggested, reflect only ex-post effects. Ex-ante, the inability of ratios to identify intervening economic processes prevents the analyst from differentiating between companies which will fail and companies which almost fail. Johnson however did concead that the studies do appear to demonstrate some ability to distinguish between companies which will fail over the next one, two, and to a lesser extent, more years ahead, and those which will not.

Altman (1970) replied to Johnson's criticisms. He accepted the criticism that the studies were, at best, comparative statistic rather than dynamic, and argued that the science was still being developed, and that dynamism would come. He criticised Johnson, though, for failing to recognise in his 'ex-post' criticism, that ratios cannot trace the causes of failure, but can only "attempt to measure the extent to which a firm's policies and problems have resulted in poor performance. While most informative ratios indeed reflect operating and financial problems after the fact, they by no means measure bankruptcy after the fact" (Freear John, 1985, p. 349).

47

2.5.3 Analysis of Management

Traits of inefficient and ineffective management also serve as warning signals to potential trouble. Such evidence which portray that management lacks training or experience in basic business methods, as interpreting financial data, managing funds, scheduling production and shipping, coordinating departmental activities, and any other managerial functions, should alert those concerned with the firm's viability.

Indications that management is ineffective and that trouble may result include presence of any of the following: Inefficient and inaccurate information systems, disregard for relevant operating and financial data, lack of interest in maintaining an adequate sales volume, large charges resulting form excessive overhead and operating expenses or debt in the capital structure, or illogical pricing schemes.

Other corollaries pointing to inefficient management certainly are possible, and all such should alert those concerned to the possible existence of later trouble.

2.5.4 Importance of Forecasts

A firm's accountant can assist in the detection of financial failure tendencies by preparing or in some cases reviewing, for management, forecasts and projections and cash flow for the next accounting period. These forecasts often highlight problems at a very early point in time which permits corrective action to be taken. Forecasts, if prepared periodically, should answer these questions for management.

- Can the profit objective be achieved?
- Are financial resources adequate?
- What areas of costs and expenses will create a drag on profitability and should be watched?

It is also important that interim financial statements be prepared in a meaningful manner, and that the company have year-end certified audit.

2.5.5 Other Factors

The following events may also indicate to the accountant that financial difficulties are imminent.

- Factoring or financing receivables, if they are normally handled on account basis.

- Compromise of the amount of accounts receivable for the purpose of making advance collections.

- Substitution of notes for open accounts payable

- Allowing certain key creditors to obtain security interests in the assets of the firm.

- Inability of the firm to make timely deposits of trust funds such as withholding taxes.

2.6 FAILED FIRM RESUSCITATION

If failure of a firm has occurred, a number of remedies are open to the interested parties. The first question to be answered is whether the firm is better off "dead or alive". Assuming the decision is made that the firm should survive, it must be put through what is called a reorganization. Legal procedures are always costly, especially in the cases of a business failure. Therefore, if it is at all possible, both the debtor and the creditors are better off if matters can be handled on an informal basis rather than through the courts. The informal procedures used in reorganisation are (1) extension, which postpones the date of settlement, and (2) composition, which reduces the amount owed.

Both extension and composition have the purpose of keeping the debtor in business and avoiding court costs. Although creditors absorb a temporary loss, the recovery is often greater than if one of formal procedures had been followed, and the hope is that a stable customer will emerge.

In either case the procedure is initiated by a meeting of the debtor and his creditors, at which the creditors appoint a committee consisting of our four or five of the largest creditors and one or two of the small ones. These meetings are typically arranged and conducted by adjustment bureaus associated with local credit manager's associations or by trade associations.

After a meeting is held at the adjustment bureau and it is judged that the case can be worked out, the bureau assigns investigators to make an exhaustive report. The bureau and the creditors committee use the facts of the report to formulate a plan for adjustment of claims. Another meeting between the debtor and his creditors is then held on an attempt to work out an extension or a composition, or a combination of the two. Subsequent meetings may be required to reach final agreements.

2.6.1 Extension

An extension is preferred by creditors because it provides for payment in full. The debtor buys current purchases on a cash basis and pays off his past balance over an extended time. In some cases, creditors may agree not only to extend time of payment but also to subordinate existing claims to new debts incurred in favour of vendor extending credit during the period of the extension. The creditors must have faith that the debtor will solve his problems. Because of the uncertainties involved, however, creditors will want to exercise controls over the debtor while waiting for their claims to be paid.

As examples of controls, the committee may insist that an assignment (turnover of assets to the creditors' committee) be executed to be held in escrow in case of default. Or, if the debtor is a corporation, the committee may require that stockholders transfer their stock certificates into an escrow until repayment as called for under the extension has been completed. The committee may also designate a representative to countersign all cheques. Furthermore, the committee may obtain security in the form of notes, mortgages, or assignment of accounts receivable (Weston and Brigham, 1977, p. 548).

2.6.2 Composition

In a composition, a pro rata cash settlement is made, creditors receive in cash from debtor a uniform percentage of the obligations. The cash received is taken as full settlement of the debt. The ratio may be as low as 10 percent. Bargaining will take place between the debtor and the creditors over the savings that result from avoiding certain costs associated with the bankruptcy; costs, of administration, legal fees, investigators and so on. In addition to avoiding such costs, the debtor gains in that he avoids the stigma of bankruptcy, and thus he may be induced to part with most of the savings that result from avoiding bankruptcy.

2.6.3 Combination Settlement

Often the bargaining process will result in a compromise involving both an extension and a composition. For example, the settlement may provide for a cash payment

of 25 percent of the debt and six future installment of 10 percent each. Total payment would thereby aggregate 85 percent. Installment payments are usually evidenced by notes. Creditors will also seek protective controls.

2.6.4 Appraisal of Voluntary Settlements

The advantages of voluntary settlements are informality and simplicity. The procedure is the most economical, all procedural costs are held to minimum, and results in the largest return to creditors.

One possible disadvantage is that the debtor is left in control of the business. The situation may involve legal complications or erosion of assets still operated by the debtor. However numerous controls are available to give the creditors protection.

A second disadvantage is that small creditors may take a nuisance role in that they may insist on payment in full. As consequence, settlements typically provide for payment in full for claims under certain fixed amount, say ₦100 plus the agreed on percentage of the balance of their claims.

2.6.5 Reorganization

If voluntary settlement through extension and composition is not possible, the matter is thrown into the courts,. If the court decides on reorganization rather than liquidation, it will appoint a trustee (1) to control the firm going through reorganization and (2) to prepare a formal plan of reorganization. The plan which must be reviewed by the Securities Exchange Commission (SEC), must meet the standard of fairness and feasibility.

A reorganization is in essence, a composition, a scaling down of claims. In any composition, two conditions must be met: (1) the scaling down must be fair to all parties and (2) in return for the sacrifices the likelihood of successful rehabilitation and profitable future operation of the firm must be feasible. These are the standards of fairness and feasibility.

2.7 FAILED FIRM LIQUIDATION

Liquidation of a business occurs when the estimated value of the firm is greater "dead than alive". Assignment is a liquidation procedure that does not go through the courts, although it can be used to achieve full entitlement of claims on the debtor. Bankruptcy is a legal procedure carried out under the jurisdiction of special courts in which a business firm is formally liquidated and claims of creditors are completely discharged (Weston and Brigham, 1977, p. 555).

2.7.1 Assignment

Assignment (as well as bankruptcy) takes place when the debtor is insolvent and the possibilities of restoring profitability are so remote that the enterprise is better off dissolved. Assignment is a technique for liquidating a debt and yielding a larger amount to the creditors than is likely to be achieved in formal bankruptcy.

Technically, there are three classes of assignments:

(a) Common law assignment
(b) Statutory assignment and
(c) Assignment plus settlement

(a) **Common Law Assignment:** The common law provides for an assignment whereby a debtor transfers his title to assets to a third person, known as an assignee or a trustee. The trustee is instructed to liquidate the assets and to distribute the proceeds among the creditors on a pro rata basis. The assignee may liquidate the assets through what is known as a bulk sale which is a public sale through an auctioneer, or by a piecemeal auction sale conducted on the premises of the assignor by a competent licensed auctioneer. The common law assignment does not discharge the debtor from his obligations. If a corporation goes out of business and does not satisfy all its claims, there will still be claims against it but in effect the corporation has ceased to exist.

(b) **Statutory Assignment:** Statutory assignment is similar in concept to

common law assignment. Legally, it is carried out under state statutes, by a court appointed assignee who supervises the proceedings, including the sale of the assets and distribution of the proceeds. As in the common law assignment, the debtor is not automatically discharged from the balance of his obligations but may be so discharged by printing the requisite statement on the settlement cheques.

(c) **Assignment Plus Settlement**: Both the common law assignment and the statutory assignment may take place with recognition and agreement before hand by the creditors that the assignment will represent a complete discharge of obligation. This is what is referred to as assignment plus settlement.

2.7.2 Bankruptcy

Bankruptcy represents two main achievements:

(a) It provides safeguards against fraud by the debtor during liquidation and simultaneously, it provides for an equitable distribution of the debtors assets among his creditors.

(b) Insolvent debtors may discharge all their obligations and start new businesses unhampered by a burden of prior debt. A voluntary petition of bankruptcy may be filed by the debtor, but if an involuntary petition is to be filed by his creditors three conditions must be met.

(i) The total debts of the insolvent debtor must be ₦2000 or more

(ii) If the debtor has fewer than twelve creditors, any one of the creditors may file the petition if the amount owed him is ₦500 or more. If there are twelve or more creditors, the petition must be signed by three or more creditors, each having provable total claims of ₦500 or more.

(iii) Withing the four preceeding months, the debtor must have committed one or more of the following six acts of bankruptcy:

(a) **Concealment or Fraudulent Conveyance:** Concealment constitutes hiding of assets with intent to defraud creditors. Fraudulent conveyance is transfer of property to a third party without adequate consideration and with intent to defraud creditors.

(b) **Preferential Transfer:** Is the transfer of money or assets by an insolvent debtor to a creditor, giving the creditor a greater portion of his claim that other creditors would receive on liquidation.

(c) **Legal Lien or Distraint:** If an insolvent debtor permits any creditor to obtain a lien on his property and fails to discharge the lien within thirty days, or if the debtor permits a landlord to distrain (to seize property that has been pledged as security for a loan) for non payment of rent, he has committed an act of bankruptcy. In such a case any creditors, by obtaining a lien, may force an insolvent but obdurate debtor into bankruptcy.

(d) **Assignment:** If an debtor makes a general assignment for the benefit of his creditors, an act of bankruptcy likewise exists. This enables creditors who have become distrustful of the debtor in the process of assignment to transfer the proceedings to a bankruptcy court.

(e) **Appointment of Receiver or Trustee:** If an insolvent debtor permits the appointment of a receiver or a trustee to take care of his property, he has committed an act of bankruptcy. In this event, the creditors may transfer a receivership or an adjustment proceeding to bankruptcy court.

(f) **Admission in Writing:** If the debtor admits in writing his inability to pay his debts and his willingness to be judged bankrupt, he has committed an act of bankruptcy.

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Procedurally on the filing of the petition of involuntary bankruptcy a subpoena is served on the debtor. There is usually no contest by the debtor and the court adjudges him bankrupt. On adjudication, the case in transferred by the court to a referee in bankruptcy. A referee in bankruptcy is generally a lawyer appointed for a specified term by the judge of the bankruptcy court to act in his place after adjudication.

In addition, on petition of the creditors, the referee in voluntary proceedings or the judge in involuntary proceedings may appoint a receiver, who serves as the custodian of the property of the debtor and has full control until the appointment of a trustee.

A meeting of the creditors is then convened to elect a trustee. The trustee and the creditors committee act to convert all assets into cash. The trustee sends a letter to people owing the debtor money, warning that all past-due accounts will result in instant suit if immediate payment is not made, and that, if necessary, he will institute such suit. Appraisers are appointed by the courts to set a value on the property. With the advice of the creditor's committee and by authorization of referee, the merchandise is sold by approved methods.

Property may not be sold without consent of the court at less than 75 per cent of the appraised value that has been set by the appraisers appointed by the court. Cash received from the disposition of the property is used first to pay all expenses associated with proceedings of the bankruptcy and then to pay any remaining funds to the claimants.

When the trustee has completed his liquidation and has sent out all the claimants' cheques, he makes an accounting, which is reviewed by the creditors and the referee. The bankruptcy is then discharged and the debtor is released from all debts. If the hearings before the referee indicate the probability of fraud, the police is required to undertake an investigation. If the fraud was not committed and the bankruptcy is discharged the debtor is again free to engage in business (Weston and Brigham, 1977, Pp. 558-559)

2.8 PREVIOUS STUDIES ON THE CASE STUDY BANK

Although other studies on Habib Nigeria Bank Limited were carried out on different topics; no study specifically on financial failure to my knowledge was previously carried out nor is it concurrently being carried out for presentation and award of a degree of any kind by any institution of learning.

CHAPTER THREE

3

METHODOLOGY

3.1 INTRODUCTION

This case study broadly investigates the worsening problems of financial distress in the Nigeria's banking industry and narrowly but more particularly the survival strategies adopted by Habib Nigeria Bank Limited to avoid it. The study focuses on how the elimination mainly of management incompetence, neglect, fraud and inexperience, could lead to the healthy growth and development of financial institutions; thereby avoiding financial distress or the demise of the institutions.

There is always a mutual interplay of problem and method. Kerlinger noted that problems dictate methods to a considerable extent, but methods-their availability, feasibility, and relevance also influence problems (Kerlinger, 1973, p. 478).

Analysis of problem can be done by several different methods. The methodology usually encompasses the technique of data collection, the source of the data collected, an evaluation of consistency and interpretation of the data.

3.2 DATA COLLECTION

To implement general plans for research, methods of data collection must be used. Data collection methods can be categorised by the degree of their directness. If we wish to know something about someone, we can ask him about it directly. On the other hand, we may choose not to ask him a direct question. We may give him some ambiguous stimulus, like a blurred picture, or a vague question; and then ask him for his impressions of the stimulus on the assumption that he will give the needed information without knowing he is giving it. This method would be highly indirect. Most of the data collection methods used in psychological and sociological research are relatively direct or moderately indirect (Kerlinger, 1973, p. 479).
The data used in this study was collected from secondary sources mainly textbooks, journals, Newspapers, memos, annual reports, and annual reports and accounts of

the case study bank. A review of the literature relevant to the field of study was made. As a result theoretical models on various aspects of financial failure were established and documented.

3.3 POPULATION

An important factor in all kinds of research is the selection of the research group, in this case the failed banks, from where specific data of the problem being investigated are collected. It is important because researchers plan and carry out studies in the hope that they can draw general conclusions based on results obtained from a relatively small number of observations. Methods of statistical inference allow the investigator to make an "educated guess" about some characteristics of a population from data derived from only relatively small proportion or sample of that population - being the entire finite or infinite aggregate of individuals or items from which samples are drawn.

3.4 SAMPLE AND SAMPLING

There are a number of methods used in selecting a sample, but all fall under two broad categories known as **probability** and **non probability** sampling. Probability sampling includes a variety of forms. The most general of these are **stratified sampling** and **cluster sampling.** In stratified sampling, the population is divided into strata, such as men and women, from which random samples are drawn. Cluster sampling, the most used method in surveys, is the successive random sampling of units, or sets and subsets.

On the other hand, **quota sampling** is one form of non probability sampling in which knowledge of state of the population - sex, age, and so on is used to select sample members that are representative, "typical", and suitable for certain research purpose. Another form of non probability sampling is characterized by the use of judgement and a deliberate effort to obtain representative sample by including presumable typical criteria or groups in the sample.

Purposive sampling is probably the most frequent form of sampling. It is also often thought as the weakest form of sampling and yet used with reasonable knowledge

and care it is probably not as bad it has been said to be.

For the purpose of this study Habib Nigeria Bank Limited was selected as representative sample of all the non failed commercial banks in Nigeria.

According to Ball and Gall (1971) 20% of any population that is between 1- 1000 is sufficient to represent the entire population. Habib Bank Nigeria Limited was selected a sample out of the 4 well known commercial banks that were solidly out of the trouble waters as at the time of this study and thereby make up more than 20% of the four banks and as such sufficient enough to represent the non failed commercial banks population.

3.5 TOPIC AND DIMENSION

The researcher in any research work is not engaging in completely unplanned activity (Gordon, 1969). For this reason, the topic he or she is exploring or the dimension they are measuring should be clearly defined; and they should endeavour to avoid possible influence of preconceived notions, and rely mainly on objective finding of the investigations (Kerlinger, 1973, p. 481).

In concurrence I have done the atmost in ensuring that both the topic and the dimensions of this case study were clearly defined in the preceding chapters and I have made no attempt to control or manipulate any of the variables in this study in order to arrive at a desired results. Finally I have used classification tables and figures in order to emphasize trends and relationships.

CHAPTER FOUR

4

DATA ANALYSIS AND PRESENTATION

4.1 DATA ANALYSIS

Analysis of data is achieved through categorizing, ordering, manipulating, and summarizing data, with the purpose of reducing the data to intelligible and interpretable form so that the relations of research problems can be studied and tested (Kerlinger, 1973, p. 134).

Interpretation, makes inference pertinent to the research relations studied from the results of analysis and draws conclusions about these relations. This is done in two ways: one, the broad meaning of the research data is sought by comparing the results and the inferences drawn within the data to theory and other research results. Two, the relations within the research study and its data are interpreted. This is the narrower and more frequent use of the term interpretation, in which interpretation and analysis are actually closely interwined. One almost simultaneously interprets as one analyses. Thus, when one calculates, say, a coefficient of correlation one almost immediately infers the existence of a relationship and draws out its significance for the research problem as one analyses the data (Kerlinger, 1973, p. 134).

The data on the case study bank reduced into interpretable form on balance sheets, profit and loss accounts, operating results, and financial summaries will be used to measure the extent to which the case study bank's policies and management style have resulted in its good performance which subsequently has kept the bank out of the distressed waters. This will be done using the Altman (1971) "five ratio" model, and will be presented in the succeeding part of this chapter under the caption financial ratios analysis.

The hypothesized relationship between the problem (financial distress) being studied and its indicators (financial ratios) will also be tested, using **t** test to

determine if a true relationship do exist between them; and that the measured parameters are truly in congruence with reality they purport to describe.

4.2 FINANCIAL RATIOS COMPUTATION

From the actual data of the case study bank presented in appendices 1 - 8 the Altman (1971) financial ratios are computed for the three years under consideration to determine the strength or otherwise of the case study bank as follows:

(1) Working capital to total assets

$$= \frac{\text{working capital}}{\text{total assets}}$$

$$= \frac{\text{current assets minus current liabilities}}{\text{total assets}}$$

for 1995 $= \frac{5,200,624,000 - 1,510,749,000}{5,618,050,000}$

$= \underline{\mathbf{0.6568}}$ or $\underline{\mathbf{65.68\%}}$

for 1994 $= \frac{3,789,157,000 - 753,936,000}{3,525,063,000}$

$= \underline{\mathbf{0.7413}}$ or $\underline{\mathbf{74.13\%}}$

for 1993 $= \frac{3,222,308,000 - 1,010,364,000}{3,525,063,000}$

$= \underline{\mathbf{0.6275}}$ or $\underline{\mathbf{62.75\%}}$

(2) Retained earning to total assets

$$= \frac{\text{retained earnings}}{\text{total assets}}$$

for 1995 $= \frac{27,943,000}{5,618,050,000}$

$= \underline{\mathbf{0.00497}}$ or $\underline{\mathbf{0.497\%}}$

for 1994 $= \frac{1,514,000}{4,094,2000,000}$

= **0.00037** or **0.037%**

for 1993 = 87,697,000
3,525,063,000

= **0.02487** or **2.487%**

(3) Earning before interest and taxes (EBIT) to total assets

= EBIT
total assets

for 1995 = 237,573,000
5,618,050,000

= **0.4585** or **45.85%**

for 1994 = 103,075,000
4,094,200,000

= **0.0251** or **2.51%**

for 1993 = 364,478,000
3,525,063,000

= **0.1033** or **10.33%**

(4) Market value of equity to book value of long-term debt

= market value of equity
book value of long-term debt

= net worth
loans and advances

= total assets minus total liabilities
loans and advances

for 1995 = 5,618,050,000 - 5,170,208,000
2,118,990,000

= **0.2113** or **21.13%**

for 1994 = 4,094,200,000 - 3, 762, 139,000
1,138,580,000

= **0.2916** or **29.16%**

for 1993 = 3,525,063,000 - 3,213,525,000
544,097,000

= **0.5726** or **57.26%**

(5) Sales to total assets

= sales
total assets

= gross earnings
total assets

for 1995 = 926,273,000
5,618,050,000

= **0.1648** or **16.48%**

for 1994 = 600,812,000
4,094,200,000

= **0.1467** or **14.67%**

for 1993 = 846,548,000 / 3,525,063,000

= **0.2401** or **24.01%**

4.3 FINANCIAL RATIOS ANALYSIS

Table 7 given below provides a graphic view of the five ratios computed for the three years under consideration (1993 - 1995).

Table 7: Altman (1971) Five Ratios computed from the data of the case study bank of the period of 1993 - 1995

S/N	RATIO	YEARS		
		1993	1994	1995
1	Working Capital to total assets	62.75%	74.13%	65.68%
2	Retained earnings to total assets	2.487%	0.037%	0.497%
3	Earnings before interest and taxes (EBIT) to total assets	10.33%	2.51%	45.85%
4	Market value of equity to book value of long-term debt	57.26%	29.16%	21.13%
5	Sales to total assets	24.01%	14.67%	16.48%

On the basis of his empirical studies, Altman assigned weights to each of his five ratios, as set out below (Freear John, 1985, p. 346):

	RATIOS	WEIGHTS
1	Working capital to total asset	0.012
2	Retained earning to total assets	0.014
3	Earnings before interest and taxes (EBIT) to total assets	0.033
4	Market value of equity to book value of long term debt	0.006
5	Sales to total assets	0.999

These ratios are normally drawn together with the weights assigned to each of them to give an overall score, often called the Z factor:

$$Z = (1)w1 + (2)w2 + (3)w3 + (4)w4 + (5)\,w5$$

the year 1995 our case study bank had the following ratio values: (1) = 65.68 per cent; (2) = 0.497 per cent (3) = 45.85 per cent (4) = 21. 13 per cent; (5) = 16.48 per cent. The weights would be applied thus:

$$Z = (0.012)\,(65.68) + (0.014)\,(0.497) + (0.033)\,(45.85) + (0.006)\,(21.13) + (0.999)\,(0.1648) = 2.6$$

For the year 1994 the same bank had the following ratio values: (1) = 74.13 percent; (2) = 0.037 per cent; (3) = 2.51 per cent; (4) = 29.16 per cent; (5) = 14.67 per cent. In this case the weights would be applied as follows

$$Z = (0.012)\,(74.13) + (0.014)\,(0.037) + (0.033)\,(2.51) + (0.006)\,(29.16) + (0.999)\,(0.1467) = 1.3$$

For the year 1993 the case study bank had the following ratio values: (1) = 62.74 per cent; (2) = 2.487 per cent; (3) = 10.33 per cent; (4) = 57.26 per cent; (5) = 24.01 per cent. The weights in this case are applied thus:

$$Z = (0.012)\,(62.74) = (0.014)\,(2.487) + (0.033)\,(10.33) = (0.006\,(57.26) + (0.999)\,(0.2401) = 1.7$$

Notice that in all three cases absolute percentages are used for the first four terms and that the fifth is shown as a decimal: this caused some confusion following Altman's 1968 article, when several finance managers applied the formula and found their companies apparently heading towards failure. The very heavy weight given to the fifth variable is apparently due to the way the equation has been specified, and has relatively little significance in terms of discriminating between failed and non-failed groups (Altman, 1971, p. 64).

Of course, a Z score of 2.6, 1.3 or 1.7 as calculated above has no meaning in itself .It must be related to a scale which establishes a cut-off point between failing and non failing companies. Accordingly to Altman a minimum score of 1.8 is necessary to avoid failure, but with only a score of 3.0 or more is the company fairly safe (Freear John, 1985, p. 347) . In this regard our case study bank seemed to have done quite well in 1995 and marginally well in 1993 with Z scores of 2.6 at 1.7 respectively. The score for 1994 which is 1.3 however appear to indicate from the stand point of Altman ratios that the bank had drifted towards failure.

4.3 DETERMINATION OF COEFFICIENT OF CORRELATION (r)

To find out if the financial ratios are a good measure of strength or weakness of a business enterprise we will now attempt to determine the coefficient of correlation between them.

Table 8: Distribution of working capital to total asset ratios and profit after taxation of the Habib Nigeria Bank Ltd for 1993 - 1995

YEAR	Working capital to total asset ratios (R)	Profit after Taxation (P)
1993	62.74%	₦250,281,000
1994	74.13%	₦64,271,000
1995	65.68%	₦148,989.00

$\sum R$	=	202.55	$\sum P$	=	463,541,000
$(\sum R)^2$	=	41022.454	$(\sum P)^2$	=	21.49×10^{16}
$\sum R^2$	=	13744.11	$\sum P^2$	=	8.89×10^{16}
$\sum RP$	=	3.03×10^{10}	n	=	3

Note: $\sum$ = Summation sign

Table 8 above shows a bivariate distribution of working capital to total asset ratios and profit after taxation of the case study bank. Profit after taxation is used here as

measures of corporate strength. To determine if the financial ratios and profit are related, using empirical evidence, the correlation coefficient between the two variables would be calculated by substituting our data in the formula below (Schefler, 1984, p. 253):

$$r = \frac{\sum RP - \frac{\sum R \sum P}{n}}{\sqrt{\left[\sum R^2 - \frac{(\sum R)^2}{n}\right]\left[\sum P^2 - \frac{(\sum P)^2}{n}\right]}}$$

$$r = \frac{3.03 \times 10^{10} - \frac{(202.54)\,463,541,000)}{3}}{\sqrt{(13744.11 - \frac{41022.45}{3})(8.89 \times 10^{16} - \frac{21.49 \times 10^{16}}{3}}}$$

$$= \frac{3.03 \times 10^{10} - 3 \times 10^{10}}{\sqrt{(69.96)(1.73 \times 10^{16})}}$$

$$= \frac{-0.1 \times 10^{10}}{0.11 \times 10^{10}}$$

$$= \underline{\mathbf{-0.90}}$$

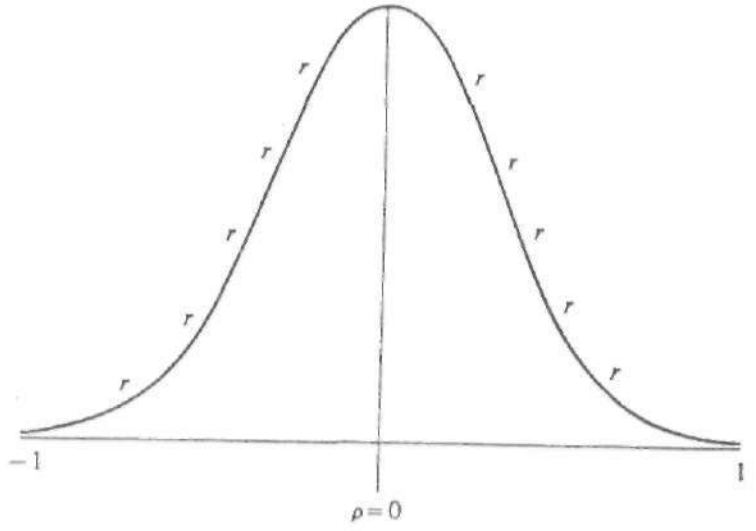
The denominator of the formula above contains the sum of **R** and **P**, which stands for financial ratios and profit after taxation respectively. The numerator contains an expression called the covariance, and is a measure of how variables **R** and **P** covary" or vary "together". The more they covary, the greater their correlation coefficient.

The correlation coefficient obtained from the bivariate distribution in table 8 is r = -0.90. Since the correlation coefficient runs between zero and either plus 1 or minus 1, (see figure 6) and **r** of -0.90 would be considered a very high correlation and would imply a strong association between financial ratios and profit or strength of the bank.

4.5 HYPOTHESIS TESTING

The **t** - test will be used for testing the hypotheses. We have determined in the above section that a correlation exists between **R** and **P**. But what we have done is merely brought evidence to bear that a correlation exists between **R** and **P** in our sample. How then do we know if our sample **r** represents a true correlation between **R** and **P** variates of the Population?

FIGURE 6: Sampling Distribution of r in which p = 0



Source: William C. Schefler: Op. Cit, p.255

Figure 6 shows a theoretical sampling distribution based on **r** computed from many samples drawn from a population in which the parameter **p** is zero. Looking at this figure one will note that if **p** is really zero, the sample coefficient (**r**) could by chance alone range anywhere from -1 to +1 but the majority would be clustered around zero. Thus it is possible to draw a sample with perfect correlation, from a population in which no correlation between the variates exists. It is also evident from figure 6 that it is highly improbable to obtain a sample correlation of zero which is why it will not be surprising if a given sample **r** is other than zero.

It therefore follows we must also statistically demonstrate that **p**, the true correlation in the population of interest, is something other than zero and that our sample

correlation is not just a chance deviation from zero. To do this a null hypothesis that the population coefficient equals zero must be tested.

The null hypothesis can be written as follows

H_o: P=0

Also, since we are interested in whether or not the population coefficient differs from zero in a minus direction we will assume the alternate hypothesis to be:

H_A: P<O

Next we calculate the sample statistic (r = - 0.90) using the formula given below (Schefler, 1984, p. 256):

$$t = \frac{(r-0)}{\sqrt{\frac{(1-r^2)}{(n-2)}}}$$

$$= \frac{(0.90-0)}{\sqrt{\frac{(1-0.90^2)}{(3-2)}}}$$

$$= \underline{-2.065}$$

Finally we look up the critical values for the one-tailed test at two degrees of freedom (n - 1) from the table in appendix 9. It will be seen that t value of - 2.093 is statistically significant below the 0.95 level. Therefore we have evidence that a correlation exists between R and P in the population. In other words we have found the sample r to be statistically significant.

CHAPTER FIVE

5

SUMMARY AND RECOMMENDATIONS

5.1 SUMMARY

The study provides a comprehensive approach to effective and efficient management of banks and financial institutions. It also provides an integrated basis for decision making by managers who may discover that their institutions are not in sound financial position or they are heading for distress.

First of all the study demonstrate how national policies can affect financial institutions and investments in such institutions. We have seen ab initio that the problem of distress in the Nigerian Financial Institutions begun with the introduction of Structural Adjustment Programme (SAP) in 1986, the subsequent rise of the so called "wonder banks" to cater for high nominal interest rate expectations and the increase in the number of financial institutions (finance houses, mortgage banks, specialized banks and licensed banks).

In the absence of proper regulation and supervision the failure of the wonder banks and most of the finance houses and mortgage banks was fait accompli. The problem for the major merchant banks with large exposure to industry can be attributed mainly to the changing economic environment and regulatory measures which accompanied the SAP. These measures had major adverse impact on many industrial borrowers and projects which subsequently resulted in substantial increase in banks' bad debt portfolio. This problem was clearly manifested in 1989 when public funds were withdrawn from commercial and merchant banks and many of the banks had to seek financial support from CBN/NDIC. This development resulted from the fact that the major merchant banks did not have adequate capitalization or access to stable retail deposits to support the deteriorating long-term assets on their books.

They therefore depended on government deposits and short-term borrowings from the interbank market sources which dried up or become very expensive following the withdrawal of parastatals funds.

The introduction of stabilisation securities in 1992 had the same impact on banks which were yet to fully recover from the problem of 1989. Hence the current manifestation of distress in these financial institutions.

The problem of this category of banks can be said to include mismatch of assets and liabilities, illiquidity, poor capitalisation, and declining profitability as a result of high level of non-performing assets and high cost of funds.

On the other hand the problem of state owned and private owned commercial banks is to a large extent similar. The problems are those of weak management controls, lending to projects owned by shareholders, sudden penchant for foreign exchange trading at the expense of their traditional services, direct interference in their activities by the CBN, political instability, diversion of funds and frauds.

This clearly calls for urgent establishment of a more stable and more predictable policy framework. The formulation of good national policies, through pertinent laws and regulations, and effective supervision by the regulatory agencies should provide a sound basis for the development and healthy growth of financial institutions.

The study further reveals that 93 per cent of all business failures are due to management incompetence and lack of experience. Management is often referred to as an art, elusive and personalized in its practice. Bank analysts often mistake distinguished credentials and personalities of senior managers for excellent management. Such things are important, but are not reliable indications of leadership and vision, quality of management, ability to control risk, staff excellence nor of prospects for financial performance.

Management systems, particularly their formality and decentralization, depend on many factors, including the size and structure of the business, the style of senior management, as well as competition, and economic regulation. As organisations expand and diversify, they need to rely more on impersonal systems of management.

Although a precise definition of good management is difficult to formulate, observable aspects exist and proficiency in their execution can be evaluated. Success in any business requires leadership and competency in strategic analysis, planning, policy making and in the management functions intrinsic to the business. Banks are no exception.

The study suggests that it is entirely possible that the establishment and the management of financial institutions could call for better orientation and more guidance and supervision. The entire process of re-orienting the financial system and within it the network of facilities should be greatly enhanced if decision making and programming are decentralized and the population and financial experts are involved. However decentralization and participation should be achieved only within the framework of national policy and overall design of financial system.

At present the financial system in Nigeria as revealed by the study, shows over centralisation of decision making, and weakness in management, characterized by untimely decisions, and poor planning and supervision.

Concerning the case study bank the study has shown that it has done fairly well in 1993 with a Z score of 1.7 only slightly lower than the minimum score of 1.8. The bank's Z scores for 1994 and 1995 were 1.3 and 2.6 respectively. This appear to indicate from the stand point of Altman ratios, that the bank had drifted towards failure in 1994 which the management seemed to have overcome in 1995.

5.2 RECOMMENDATIONS

The transition to market economies in Eastern Europe and the former USSR; financial liberalization in Africa, Asia, and Latin America; the near global confrontation with financial distress - all demand substantial strengthening of banking institutions.

Traditionally bank in developing economies have been under managed in comparison with industrial firms. A World Bank report on Latin American Banks for example, showed that until recently banks generally existed as conduits for financing bank owners' projects, rather than as independent profit centres.

The first point of importance that has emerged from this study seems to me to be desirability for general planning activities for financial services in the developing countries to be based and progressively so, on detailed study and analysis. Only then should the countries be able to produce a financial system which is reasonably well suited to the functions is intended to serve. Such countries, in the planning stage must also not loose sight of the fact that internationalization of financial services has been spurred by the geographic spread of major banks, cross-boarder lending technology and investment in capital market instruments,.

It has also been expedited by the adoption by major financial centres of certain common banking regulations through the Basle Agreement on the International Convergence of Capital Measurement and Capital Standard, the international Accounting Standard 30 on Bank Accounting and Disclosure Standards and "The Audit of Commercial Banks" issued by the International Auditing Practices Committee in February, 1990. The global transfer of banking techniques and technology touches banks in Latin America, Asia, Africa, Eastern Europe and the former USSR. Increasingly, these banks need to strive not only for viability but also for excellence and competitiveness if they are to survive and prosper. A panel of

independent observers have listed the following 10 points as critical characteristics of banking excellence.

(i) An open culture and extensive vertical and horizontal communication.
(ii) Strong share value
(iii) Profit performance as a value
(iv) A customer drive business orientation
(v) A willingness to invest in new products
(vi) Strong and consistent leadership and a strong sense of direction
(vii) Commitment to recruit the best people
(viii) Investment in training and career development
(ix) A client or product information system permitting assessment of product and client profitability
(x) Strong credit risk management

I now bring forth here in one place a description of the basic policies, procedures and functions essential to sound, efficient, and competitive banking, and necessary for the attainment of such excellence:

5.2.0 Timely Decisions

The financial system in Nigeria as revealed by this study, shows over centralisation of decision making, and weaknesses in management; characterised by untimely decisions and poor planning. Speaking of untimely decisions, the importance of time in national development is often missed in the developing countries.

Indeed the survival of our way of living calls for a more realistic sense of timing than hitherto. The rapid obsolescence of infrastructures, the obligation to provide our growing population with modern facilities, and the necessity of keeping abreast of the advancement of technology; the computerization of the financial system, on-line transactions in cash, stocks and commodities and many others all point to the fact

that time is of essence. Therefore our present orientation regarding time which often leads to stalling or sitting on important decisions should be immediately re-addressed.

5.2.1 Planning

The planner's motto is "if you don't know where you are going, you will end up somewhere else." Competition stimulates the need for internal and external analysis, the establishment of performance objectives and the strategies and plans to carry them out. Good planning encompasses budgeting, reviews, and incentives. In budgeting, plans are quantified according to anticipated revenues and expenses; a pro forma balance sheet and income statement for the next year will reflect a financial structure and earnings performance commensurate with institutional objectives. Management incentives may be linked to budget achievement.

Recently insolvent banks in Nigeria were restructured, which involved the removal of bad assets, recapitalisation and a change of management. Many restructured banks were engaged in financing the unbankable-loss-making public sector enterprises, self-lending, speculation, political loans and social programs. In well-serviced competitive markets, such banks will find it tough to find a new role that leads to an acceptable share of the market, adequate earnings and a sound financial structure. Often they do not have the management or service quality to attract credit worthy borrowers or voluntary depositors. Some may need to be closed or merged, as indeed many such banks have been closed in Nigeria. For others, a critical, realistic and comprehensive strategic and financial plan is needed. This in no uncertain term underscore the importance of planning.

5.2.2 Autonomy

In a competitive market, banks need autonomy to define an operating role and strategy and to carry out lending and management independently and professionally. While theoretically amenable to governance by law, contract or

formal agreement, in practice, autonomy is largely determined by ownership.

Autonomy is, essentially, the freedom to hire and compensate staff based on market conditions, to undertake expenditures based on objectives for financial performance and more important, to make loans based on an evaluation of risk and efficiency

.

The autonomy of a bank can be compromised whether it is state owned (which often makes it an instrument of social and political goal) or privately owned (when it may be used to mobilize financing for related entities). While the abuses of private owners are being brought under control, regulators find it difficult to discipline state - owned banks. Prudential regulation can hold privately-owned banks to arms-length dealings with customers, but such rigour is difficult, if not impossible, with state-owned banks. Many state banks are becoming hybrids, which seek to be competitive and viable while continuing to finance government programs and loss-making public-sector companies. Increasingly, it is these hybrids that need to be managed with transparency.

Autonomy can be evaluated through assessing a bank's policies on lending, financial management, and personnel and its compliance with these policies. The objectives for institutional performance and the way they are established and evaluated; and the extent of government-directed credit programs and their effect on the bank. The composition, role and objectives of the board of directors also provide good indicators of autonomy. And lastly, and perhaps most importantly, it is critical to evaluate the way in which presidential appointments are made.

47332

5.2.3 Board of Directors

Proper conduct, control, and professional management should mean that banks are prudently run and meet regulatory standards and laws. External auditors and bank supervisors may verify that a bank comes up to regulatory scratch but owners and directors are responsible for running it.

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Bank directors should normally:

- Hire and fire executive managers
- Approve corporate plans and budgets
- Monitor quarterly performance and advise management
- Approve large loans or exceptions to bank lending policy
- Approve major investments, assets sales, and compensation programs
- Avoid self-serving practices and preferential transactions with insiders
- Establish an Audit Committee to review financial statements and maintain internal controls
- Set corporate policy on finance, credit, and personnel

A political board, an aggressive or abusive board even no board at all, are frequent deficiencies in financial institutions. The composition, role, responsibility and accountability of the board influence bank behaviour . A study has shown that of all bank failures in the United States, 60 percent had weaknesses in their boards, including lack of banking knowledge as well as uninformed (or passive) board supervision (U.S. Office of the Comptroller of the Currency Report, 1988).

5.2.4 Policy Making

Bank policy is often formulated by monetary authorities in developing markets. In some banks that were once colonial subsidiaries of western institutions, inherited bank policies are often obsolete bearing little relevance to the business activities actually being conducted. In some smaller banks, run by personalized management, there are no formal policies. And in socialist economies, bank policy is usually synonymous with government policy.

The need for policies grows with expansion, decentralization and autonomy. Bank policies usually cover major functions of credit and lending, investments in securities and subsidiaries, major capital expenditures, personnel, internal controls and financial management. Policies are drafted by senior managers and staff from the

areas to which the policies apply. Policy development is often based on industry practice, local custom and input from executives and the board of directors that eventually approves new policies. A bank may also seek help from outside sources, but to be credible and relevant such imports must be tailored to the bank's needs.

5.2.5 Credit Risk Management

In response to their greater responsibility for managing credit risk, some banks have begun to develop credit risk management by devising credit policies, procedures and analytical capabilities. These efforts need to be expanded into full credit risk management - including origination, approval, monitoring and problem loan management - tailored to the needs of each bank. Attention should be devoted to explicit and effective internal controls, assessing and dealing with credit risk, and classifying, monitoring and following up on late payments and arrears.

5.2.6 Financial Management

As interest rates are liberalised, financial markets broadened with new instruments, and banks permitted to lend, deposit or trade foreign exchange, assets and liabilities of banks become more diversified and interest-sensitive, both in maturity structure and rate volatility. It is therefore essential to build systems and skills in liquidity management, asset and liability management and foreign exchange management. This aspect of institutional development should begin as soon as possible because of its critical nature for the continued growth and development of the institution.

5.2.7 Human Resources Management

Banking is a highly competitive industry, and depends heavily on well- qualified, highly motivated people. Personnel procedure are vital to the development and continuity of high-quality staff. Professional managers may ensure that traditional personnel procedures are implemented for example, job description, appraisals - but, in developing markets, fostering an effective and successful banking culture goes well beyond that. In commercial banking managing people must be a

fundamental line management responsibility if high-quality staff are to be developed and maintained. Moreover, attitudes and behaviours often need to change to increase efficiency and institutional capacity .

The organizational structure of a bank is closely linked to its business strategy and its degree of decentralized decision making. The structure should be designed to define lines of authority, accountability and responsibility and limit duplication of effort.

5.2.8 Compliance and Control Systems

To ensure that a bank operates in a sound and safe manner, the directors in consultation with management and specilised staff, should implement control systems to ensure that employees perform their duties in accordance with bank policy and procedures, as well as the law.

Control Systems may include auditing, internal controls, asset quality reviews, establishment and review of financial risk management and compliance management

5.2.9 Information Technology

Money has been called" information in motion" and information technology has indeed become an integral part of service delivery. It also provides important support for bank management. Banks must carefully consider hardware and software selection, phasing of programs, and its ability to absorb the technology. A misconception prevalent in developing markets is that automation will modernize bank management. In fact, only banks with sound management will be able to define the technology needed . Technology is a tool, though a critical one. It is a lagging factor in institutional development.

5.3 CONCLUSIONS

The case study bank has provided a good example of how a competent and responsive management can detect early signs of failure and take corrective action to forestall it. This study has conclusively proved that failure can be prevented.It need not be emphasized also that this study aims to offer some tools and concepts that will lead banks in developing financial markets towards the attainment of banking excellence. It draws on best banking practices in many financial systems. While many references are drawn from the U.S, the internationalization of financial services has led to the dissemination of these practices throughout both developed and developing markets worldwide. No special interest informed the decision to use references from the U.S., except for the fact it provides readily available and accessible data that allowed an in depth discussion and analysis of the subject, which is necessary in the pursuit of such academic exploits.

APPENDIX 1

Balance Sheet for Habib Nigeria Bank Ltd as at 31 at December, 1993

ASSETS EMPLOYED	
	₦ '0000
Cash and short Term Fund	1,579,376
Balance with other Banks	642,992
Bill Discounts	-
Investments	10,650
Loans and Advances	544,097
Other Assets	455,843
Fixed Assets	292,105
	3,525,062
FINANCED BY:	
Deposits	2,203,159
Tax Payable	113,924
Dividend Payable	87,500
Other Liabilities	808,940
	3,213,523
Share Capital	87,500
Statutory Reserve	136,266
Reserve for Bonus Issue of Shares	87,500
Profit and Loss Account	274
Shareholder's Funds	311,540
	3,525,063

Source: Annual Report and Accounts 1993: Habib Nigeria Bank Limited, 18 Waff Road, Kaduna, Nigeria, p. 22

APPENDIX 2

Balance Sheet for Habib Nigeria Bank Ltd as at 31st December, 1994

ASSETS EMPLOYED	₦ '000
Cash and Short Term Funds	1,330,686
Balance with other Banks	1,048,579
Investment	10,664
Loans and Advances	1,138,580
Other Assets	271312
Fixed Assets	294,379
	4,094,200
FINANCED BY:	
Deposits	3,008,203
Tax Payable	39,137
Dividend Payable	43,750
Other Liabilities	671,049
	3,762,139
Share Capital	175,000
Statutory Reserve	155,547
Reserve for Bonus Issue of Share	0
Profit and Loss Account	1,514
Shareholders' Funds	332,061
	4,094,200

Source: Annual Report and Accounts 1994: Habib Nigeria Bank Limited, 18 Waff Road, Kaduna, Nigeria, p. 22

APPENDIX 3

Balance Sheet for Habib Bank Ltd as at 31st December, 1995

ASSETS EMPLOYED	₦ '000
Cash and Short Term Funds	1,302,686
Balance with other Bank	1,210,076
Investment	16,664
Loans and Advance	2,118,990
Other Assets	569,088
Fixed Assets	400,762
	5,618,050
FINANCED BY:	
Deposits	3,659,459
Tax Payable	91,774
Dividend Payable	76,349
Other Liabilities	1,342,626
	5,170,208
Share Capital	218,141
Statutory Reserve	200,244
Reserve for Bonus Issue of Share	27,268
Profit and Loss Account	2,189
Shareholders' Funds	447,842
	5,618,050

Source: Annual Report and Accounts 1995: Habib Nigeria Bank Limited, 18 Waff Road, Kaduna, Nigeria, p. 22

APPENDIX 4

Profit and Loss Account of Habib Nigeria Bank Ltd for the year ended 31st December, 1993

INCOME	₦ '000
Interest Received	465,144
Commission Charges	86,297
Foreign Exchange Earnings	19,454
Income from Investments	245,142
Other Income	30,511
	846,548
EXPENSES	
Interest Paid	202,300
Provision for other Assets and Loans Loss	37,148
General and Administrative Expenses	221,806
Depreciation	20,816
	482,070
Profit Before Taxation	364,478
Taxation	114,197
Profit after Taxation	250,281
APPROPRIATION	
Statutory Reserve	75,084
Dividend: Interim	43,750
-Final	43,750
RETAINED PROFIT FOR THE YEAR	87,697
RETAINED PROFIT BROUGHT FORWARD	77
	87,774
RESERVE FOR BONUS ISSUE OF SHARE	87,500
RETAINED PROFIT CARRIED FORWARD	274

Source: Annual Report and Accounts 1993: Habiba Nigeria Bank Limited, 18 Waff Road, Kaduna, p. 23

APPENDIX 5

Profit and Loss Account of Habib Nigeria Bank Ltd for the year ended 31st December, 1994

INCOME	₦ '000
Interest Received	302,319
Commission Charges	115,936
Foreign Exchange Earnings	3,860
Income from investments	127,204
Other Income	51,493
	600,812
EXPENSES	
Interest Paid	174,788
Provision for other Assets and Loans Loss	27,590
General and Administrative Expenses	260,244
Depreciation	35,115
	497,737
Profit Before Taxation	103,075
Taxation	38,804
Profit after Taxation	64,271
APPROPRIATION	
Statutory Reserve	19,281
Dividend: Interim	0
-Final	43,750
RETAINED PROFIT FOR THE YEAR	1,514
RETAINED PROFIT BROUGHT FORWARD	274
	1,514
RESERVE FOR BONUS ISSUE OF SHARE	0
RETAINED PROFIT CARRIED FORWARD	1,514

Source: Annual Report and Accounts 1994: Habiba Nigeria Bank Limited, 18 Waff Road, Kaduna, p. 22

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APPENDIX 6

Profit and Loss Account of Habiba Nigeria Bank Ltd for the year ended 31st December, 1995

INCOME	₦ '000
Interest Received	454,302
Commission Charges	190,582
Foreign Exchange Earnings	23,480
Income from investments	170,251
Other Income	87,658
	926,273
EXPENSES	
Interest Paid	194,106
Provision for other Assets and Loans Loss	34,184
General and Administrative Expenses	422,930
Depreciation	37,584
	688,700
Profit Before Taxation	237,573
Taxation	88,584
Profit after Taxation	148,989
APPROPRIATION	
Statutory Reserve	44,697
Dividend: Interim	76,349
RETAINED PROFIT FOR THE YEAR	27,943
RETAINED PROFIT BROUGHT FORWARD	1,514
	29,457
RESERVE FOR BONUS ISSUE OF SHARE	(27,457)
RETAINED PROFIT CARRIED FORWARD	2,189

Source: Annual Report and Accounts 1995: Habib Bank Limited, 18 Waff Road, Kaduna, p. 23.

APPENDIX 7

Three - Year Operating Results At A Glance of Habib Nigeria Bank Limited

YEARS ENDED 31ST DECEMBER	1993	1994	1995
INCOME AND EXPENDITURE ITEMS	**₦ '000**	**₦ '000**	**₦ '000**
Gross Earnings	846,548	600,812	926,273
Interest Paid	202,300	174,788	94,106
Provision for other Assets and Loans Loss	37,148	103,075	34,184
Overhead Expenses	242,622	295,359	460,410
Profit Before Taxation	364,478	103,075	237,573
MAJOR BALANCE SHEET ITEMS			
Deposits	2,203,159	3,008,203	3,659,459
Loans and Advances	544,097	1,138,580	2,118,990
Total Assets	3,525,063	4,094,200	5,618,050
Total Liquid Assets	2,222,368	2,379,200	2,512,546
Shareholder's Funds	311,540	332,081	447,842

Source: Annual Report and Accounts 1994 and 1995, Habib Nigeria Bank Limited 18 Waff Road, Kaduna, Nigeria Pp. 13 and 12

APPENDIX 8

Three - Year Financial Summary of Habib Nigeria Bank Limited

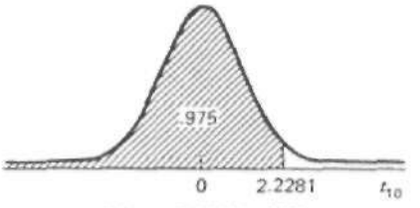
YEAR ENDED 31ST DECEMBER	1993	1994	1995
CAPITAL EMPLOYED	₦ '000	₦ '000	₦ '000
Share Capital	87,500	175,000	218,141
Statutory Reserve	136,266	155,547	200,244
Profit and Loss A/C Balance	87,774	1,514	2,189
Reserve for Bonus Issue	-	-	27,268
Shareholders' Funds	311,540	332,061	447,842
Deposits	2,203,159	3,008,203	3,659,459
NET ASSETS	2,514,699	3,340,264	4,107,301
REPRESENTED BY:			
Fixed Assets	292,105	294,379	400,762
Investment	10,650	10664	6,664
	302,755	305,043	417,426
Current Assets	3,222,308	3,789,157	5,200,624
Current Liabilities	(1,010,364)	(753,936)	(1,510,749)
NET ASSETS	2,514,6993	340,264	4,107,301
TURNOVER, PROFIT, TAXATION, AND DIVIDENDS			
Turnover	846,548	600,812	926,273
Profit/(Loss) Before Taxation	364,478	103,075	237,573
Dividend	87,500	43,271	148,989
Earnings per share	1.15	0.29	0.68
Dividend per share	0.40	0.20	0.35
Working capital Ratio	3.19	5.03	0.44
Number of Employees	896	931	927

Source: Annual Report and Accounts 1995: Habib Nigeria Bank Ltd. 18 Waff Ro Kaduna, Nigeria p. 30

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APPENDIX 9

Percentiles of the t Distribution



$P(t_{10} < 2.2281) = .975$

d. f.	$t_{.90}$	$t_{.95}$	$t_{.975}$	$t_{.99}$	$t_{.995}$
1	3.078	6.3138	12.706	31.821	63.657
2	1.886	2.9200	4.3027	6.965	9.9248
3	1.638	2.3534	3.1825	4.541	5.8409
4	1.533	2.1318	2.7764	3.747	4.6041
5	1.476	2.0150	2.5706	3.365	4.0321
6	1.440	1.9432	2.4469	3.143	3.7074
7	1.415	1.8946	2.3646	2.998	3.4995
8	1.397	1.8595	2.3060	2.896	3.3554
9	1.383	1.8331	2.2622	2.821	3.2498
10	1.372	1.8125	2.2281	2.764	3.1693
11	1.363	1.7959	2.2010	2.718	3.1058
12	1.356	1.7823	2.1788	2.681	3.0545
13	1.350	1.7709	2.1604	2.650	3.0123
14	1.345	1.7613	2.1448	2.624	2.9768
15	1.341	1.7530	2.1315	2.602	2.9467
16	1.337	1.7459	2.1199	2.583	2.9208
17	1.333	1.7396	2.1098	2.567	2.8982
18	1.330	1.7341	2.1009	2.552	2.8784
19	1.328	1.7291	2.0930	2.539	2.8609
20	1.325	1.7247	2.0860	2.528	2.8453
21	1.323	1.7207	2.0796	2.518	2.8314
22	1.321	1.7171	2.0739	2.508	2.8188
23	1.319	1.7139	2.0687	2.500	2.8073
24	1.318	1.7109	2.0639	2.492	2.7969
25	1.316	1.7081	2.0595	2.485	2.7874
26	1.315	1.7056	2.0555	2.479	2.7787
27	1.314	1.7033	2.0518	2.473	2.7707
28	1.313	1.7011	2.0484	2.467	2.7633
29	1.311	1.6991	2.0452	2.462	2.7564
30	1.310	1.6973	2.0423	2.457	2.7500
35	1.3062	1.6896	2.0301	2.438	2.7239
40	1.3031	1.6839	2.0211	2.423	2.7045
45	1.3007	1.6794	2.0141	2.412	2.6896
50	1.2987	1.6759	2.0086	2.403	2.6778
60	1.2959	1.6707	2.0003	2.390	2.6603
70	1.2938	1.6669	1.9945	2.381	2.6480
80	1.2922	1.6641	1.9901	2.374	2.6388
90	1.2910	1.6620	1.9867	2.368	2.6316
100	1.2901	1.6602	1.9840	2.364	2.6260
120	1.2887	1.6577	1.9799	2.358	2.6175
140	1.2876	1.6558	1.9771	2.353	2.6114
160	1.2869	1.6545	1.9749	2.350	2.6070
180	1.2863	1.6534	1.9733	2.347	2.6035
200	1.2858	1.6525	1.9719	2.345	2.6006
∞	1.282	1.645	1.96	2.326	2.576

Source: Wayne, W. Daniel: Op. Cit., p. 494

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