CREDIT MANAGEMENT IN COMMERCIAL BANKS
A CASE STUDY OF UNITED BANK FOR AFRICA (UBA) PLC

BY

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DECLARATION

I hereby declare that this research work is wrtten by me.

All materials used for the purpose of this project have been duly acknowledged.

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CERTIFICATION

We certify that this research project entitled "Credit Management in Commercial Banks": A case study of United Bank for Africa Plc by Yusufu, Ibrahim Idris meets the regulations governing the award of Master of Business Administration Degree of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This research effort is dedicated to the memory of my father, Late Major Muhammadu Dodo Saulawa.

ACKNOWLEDGMENT

My first and foremost gratitude is to Allah [SWT] for all His mercies, guidance and sustenance which I have enjoyed in abundant measure.

I am indebted to a member of people who have helped me not just in the accomplishment of the study but also in going through the trials and tribulations of life.

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ABSTRACT

Lending Institutions occupy a central position in the nation's financial system and are essential in the development process of the economy. By intermediating between the surplus and deficit spending units, banks increase the quantum of national savings and investments and hence national output. By granting credits, banks create money thus influencing the level of money supply which is an essential item in the growth of national income as it determines the level of economic activities in the country.

For banks to be able to function effectively and contribute meaningfully to the development of a country, the Industry must be stable, safe and sound. Since early 1990s, the situation has been a far cry from the level of stability required. Consequently a number of commercial and merchant banks have failed owing to a number of reasons. One of these reasons is poor credit policies by the banks and in cases where good policies are in place such are never implemented faithfully.

The regulatory authorities and the banks have each tried to devise policies to avoid the causes of failure. This study focuses on commercial banking and takes United Bank for Africa [UBA] Plc as a case study to appraise the banks credit management system in meeting the challenges posed by the instability in the economy.

The study is divided into five chapters. Chapter One introduces the subject of the study stating the objectives and significance and problems observed. Chapter Two discusses review of Literature while Chapter Three reviews the UBA's credit management system. Chapter Four shows presentation and analysis of data while Chapter Five deals with Findings, Conclusions and Recommendations.

The major finding of this study is that for the period 1990 to 1999 die UBA Plc has improved in its financial intermediation function and has also reduced the incidence of loan losses in its operating results which by implication leads to an improvement in the quality of the loan portfolio.

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CHAPTER ONE

1.0 INTRODUCTION

1.1 General Background

Commercial banks offer a number of services in an economy. The most dominant, however, is that they serve as financial intermediaries channelling funds from the surplus economic units to deficit units thereby facilitating business transactions and economic development. The main source of investable funds are bank deposits while the main outlets are loans and investments. The spread, or difference between the rate at which funds are borrowed and the rate they are invested or loaned out is the main source of income and profitability for banks.

Credit therefore, has a central role in the primary functions of banks. And the lending pattern of banks is fundamental to any economy, as it has a direct impact on the pattern of economic development within that society.

Commercial banking in Nigeria began in 1892 with the establishment of African Banking Corporation. Since then several banks have been established in the country. As at 31st December , 1990 there were 58 commercial banks with 1,939 branches. By 31st December, 1993 the number had risen to 66 commercial banks with 2,358 branches (Central Bank of Nigeria Statistical Bulletin, June 1998).

The banking system consists of the Central Bank, Commercial and Mercha nt Banks, and non-bank financial Institutions. However, commercial banks dominate the system, accounting for 82.5 percent to 86 percent of the system's resources, (Okigbo, 1981:31)

Loans constitute a major asset of the total asset structure of commercial banks in the country. In a study by Soyibo et al (1985:131) loans and advances constitute well over 40 percent of the asset structure of commercial banks in Nigeria between 1978 and 1982. In addition, banks derive their, income principally from lending and investing and to a lesser extent, from fees and charges received from services rendered.
According to Crosse (1962:66) " income from loans constitutes more than 60 percent of the total"

An asset constituting such a significant proportion of total assets therefore deserves efficient management if the economic impact of commercial banks on the economy is to be optimally realized .

All Management of banking institutions take particular interest in the growth of loans and advances, as well as the spread or allocation to various sectors of the national economy. This could be discerned from the way they organize the banks' lending business as well as the way they define and manage their credit policies.

The Nigerian economy has gone through a lot of changes since the introduction of the Structural Adjustment Programme (SAP) in 1986. The exchange rate of Naira to the Dollar has fallen drastically. Whereas some commercial banks used the opportunity of getting foreign exchange at official rate and sell at unofficial rate thereby making huge profits, many companies that relied on importation of raw materials and spare parts had sharp increases in their costs of production. As time went by, many of such companies had to close thereby laying off many of their workers thus aggravating the unemployment problem. This in turn led to low demand thus creating a recession in the economy.

Commercial banks as a sub- system of the national economy were not totally immuned to this events and had their own share of the problem in the form of increasing loan defaults because of inability of borrowers to service and pay back their loans.

1.2 Statement of the Problem

One of the major problems that has confronted the banking industry from the late 1980s to the early 1990s has been the increasing incidence of loan defaults and consequent loan losses. Sequel to increasing incidence of huge bad debts in the Nigerian Banking industry, management's competence have been called to question. Bad debts occur due to the inability of the bank's management to recover loans granted to customers. The proportion of classified (non-performing) loans and advances in the nation's banks averaged 44.1 percent and 39 percent respectively (Umoh P.N. 1992 :7). In other

words, as much as 44 kobo and 39 kobo of every one Naira loan granted were not recoverable in 1990 and 1991 respectively.
(Umoh 1992:7) opined that " a review of the credit administrative processes of institutions could reveal poor credit administration and lax credit collection practices.

In similar vein, the NDIC 1989 Annual Report and Accounts observed the deteriorating health of the banking industry. The reasons adduced for this development in the report include amongst others:

i. huge uncollectable loans and advances
ii. the financing of long- term assets with short-term funds
iii. overtrading
iv. unsound management practices
v. reliance on volatile deposits
vi. non-standardization of accounting practices and financial reportage

These prompted the issuance of Central Bank of Nigeria (CBN) Prudential Guidelines in 1990 to standardize accounting practices and sanitize the banking system.

The 1992 NDIC Annual Report and Accounts further shows deteriorating quality of loans and advances in the banks asset portfolio. According to the report, " total loans and advance in 1992 was about N41.4 billion while total classified loans and advances stood at about N18.8 billion, giving a ratio of classified loans and advances to total loans and advances of 45.4 percent for the industry"

The report showed the analysis of the classified loans and advances in terms of ownership structure as in Table 1 below

Table 1: Loans and Advances and Classified Loans

Ownership	Loans and Advances ₦ million	Classified loans and Advance N million	Proportion %
State Governments' Controlled Commercial Banks	9,033	6,167	68.3
Non- State Governments Controlled Commercial banks	20,321	8,232	40.5
Merchant Banks	12,082	4,417	36.6

Source: **1992 NDIC Annual Report**

The report shows that State Government controlled banks are worst affected by uncollectable loans and advances. The report notes that one of the major causes of distress is poor management which results in excessive risk taking.

As observed earlier, loans and advances constitute the largest proportion of the banks' earning asset hence loan defaults which result in bad debts destroy this asset. Thomas (1962:25) described loans as being vital both to the banks and to the general public in that they are the source of earnings as well as essential items that determine the liquidity and ultimate solvency of the banks. Bank credits in the form of loans and advances are funds transferred to the deficit unit of the economy for investment purposes and any lowering of banks asset (loan and advances) due to bad debts will affect the amount available for future credits. Consequently this will affect production, employment, taxes due to the Government and funds available for social services.

In January 1991, the Central Bank of Nigeria took over control of National Bank of Nigeria Ltd., the oldest indigenous Bank in Nigeria which was established in 1933 by the defunct Western Region, now Ogun, Ondo Osun, Oyo and Ekiti States. Similarly in May 1993 another five indigenous Commercial Banks owned by some State Governments were taken over by the Central Bank. These were African Continental Bank, Co-operative and Commerce Bank, Mercantile Bank of Nigeria, New Nigeria Bank and Pan African Bank. These takeovers were attributable to their distressful situation, occasioned, amongst other things, by poor management resulting in huge uncollectable debts.

Again for same reasons, 26 banks were liquidated in 1998 by the Nigeria Deposit Insurance Corporation (NDIC) in efforts by the monetary authorities to sanitize the banking system .

It is within this context that concern has grown regarding increased potential of bank failures. As rightly put by Marshall (1980:113) "a commercial bank failure implies a loss of stockholders' investment in the bank. However, the general public may loose the insured portion of its deposits, as well as other bank debt owed to the public. Furthermore, a bank failure may seriously shake the public's confidence in other commercial banks".

A World Bank report noted that commercial banks, as an institution will remain dominant in the Nigerian Financial System for sometime and can be made more efficient by improving their management system. According to the report, better management requires new lending policies and better loan recovery procedures (UBA monthly Business and Economic Digest, June 1990).

Accordingly United Bank for Africa (UBA) Plc, came out in 1996 with a new credit management system that would ensure a sound lending policy. This is in addition to the provisions of the CBN Prudential Guidelines, which have been incorporated into the bank's credit policy.

The task before this study is to make an appraisal of UBA's credit policy and see to what extent it has enabled the bank to avoid or

reduce bad loans which had characterized the banking industry in the early 1990s. It will also try to see to what extent the credit policy has contributed towards profit growth.

1.3 Objectives of the Study

The basic objective of the study is to assess the performance of the bank in managing loans and advances as a major component of its asset structure. This is felt to be important not only to the overall success of the bank but also its ability to play its financial intermediation role effectively and efficiently in the national economy. In order to achieve this basic objective, the study inter alia:

i. Examines the banks' practices in granting loans and recovery procedures,
ii. Determines the extent of loan losses and the quality of loans and advances, and
iii. Identifies the problems that hinder the bank's effective and efficient management of loans and advances portfolio and then proffer solutions.

1.4 Significance of the study

The study is likely to be helpful to the bank's (UBA) Management, other commercial banks, shareholders and depositors as well as the economy as a whole.

To the bank's management and managers of other commercial banks, the study draws their attention to the importance of loans and

advances to the overall success and growth of their organizations. As the largest component of a bank's total assets, there is the need for its effective and efficient management. Besides, loans and advances are also the most profitable and risky assets hence the need for proper management for maximum profitability while minimizing the risk element.

The study is also likely to be useful to the shareholders, both existing and potential ones. This is based on the fact that the proper management of the resource will enhance reasonable returns on shareholders' investments.

As earlier observed, commercial banks' performance of financial intermediation involves accepting deposits from surplus units of the economy and channeling them to the deficit units. This role ensures proper allocation of scarce financial resources to the various sectors of the economy thereby enhancing the overall growth and development of the national economy.

The increasing competition in the financial system in which commercial banks operate also makes the study significant. Prior to the deregulation of the economy in 1986, there were only 29 commercial banks. This number had more than doubled in 1997 when there were 64 commercial banks. (CBN Statistical Bulletin, June 1998:24). Furthermore merchant banks have been given the option of conversion to commercial banks if they so desire. The implication of this development is stiff competition among the banks in sourcing of

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deposits which is the basis for loan-able funds in such a competitive environment. Effective and efficient resource management is imperative if a banks is to flourish.

One of the reasons adduced for bank failures is that of indiscriminate granting of loan that make collectibility difficult or virtually impossible . A study of this nature draws the attention of the bank's management to the need for proper management of loans and advances to prevent failure and its negative consequences on the economy. Bank failure erodes depositors' confidence in the financial system thus resulting in a dearth of loan-able funds in the economy. To enhance depositors' confidence in the financial system there must be proper management of the loan and advances portfolio.

The study is therefore relevant not only for the continued viability of the financial system but also for the overall growth and development of the economy.

1.5 Scope and Limitation

The study looks at credit management by Nigeria Commercial Banks using United Bank for Africa (UBA) Plc as a case study. UBA is one of the four big commercial banks in the country. Under the first phase of the privatization exercise, the Federal Government sold its 46 percent shareholding in the bank in 1993. Since then, the banks has undergone a lot of structural changes with a major shift in most of its policies including the credit policy.

The study period is 10 years, spanning from 1990 to 2000. This is a period within which a lot of changes occurred in commercial banking in the Nigerian Economy. The Federal Government sold off its shares in the three big commercial banks in the country. The CBN Prudential Guidelines came into effect during this period to control the phenomenon of 'paper profits' whereby interest was accrued by banks for non-performing loans. The Failed Banks Decree came into effect in 1995 to control and punish unauthorised lending and lending without adequate collateral. Still during the period merchant banks have been allowed to convert to commercial banks while restriction on the maximum shares an individual or institutional investor could hold in a bank has been removed.

These changes have had considerable impact on the functioning of the financial system. The period chosen therefore will likely be of much value in establishing trends in credit management over the period and will aid in predicting the likely trend in the future. A knowledge of the likely future trend would be of help to the bank management in bringing the future under control for effective and efficient management of loan and advances portfolio.

The study is limited by the non- availability of 1990, 1991 and 2000 Annual Reports and Account of the bank. This is however, not expected to have any significant impact on the outcome of the study which covers the period 1990 to 2000.

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The study relies heavily on the published accounts of the bank for the data analysis. Therefore those limitations inherent in published accounts also serve as limitations to the study. Fortunately an attempt to harmonize bank reporting on loans and advances has been addressed through the issuance of Central Bank of Nigeria Prudential Guidelines of 1990. This in effect has minimized the limitation.

The practice of many banks of not divulging information about their operations and about their customers also constituted a limiting factor to the study. The study therefore relied much on published information and some information from some officials of the bank.
It is hoped that these limitations will not significantly affect the outcome of the study.

1.6 Research Hypothesis

In order to appraise credit management in the bank, the following hypothesis are to be tested

i. That the bank has performed efficiently in its financial intermediation activity as reflected in the proportion of loans and advances to its deposits base.
ii. That the bank's profitability is a function of its loan and advances portfolio, and
iii. That classified loans and advances are decreasing over the period resulting in improvement of loan asset quality.

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1.7 Research Methodology

The data used for the study were obtained mainly from the annual report and accounts of the bank for the period, and in- house generated data obtained from the bank (UBA Plc). In addition, interview was held with some principal officers of the bank. Other information for the study were obtained from text books, journals, magazines, newspapers, government and monetary authorities publications and other materials from the library. Discussion were also held with the thesis supervisor to clear doubts and some difficult areas.

In the data analysis, ratio analysis were used in addition to Pearson product moment – correction coefficient to establish trends and relationship during the period. This has enabled easy interpretation of the results from which conclusions were drawn.

The study is divided into five chapters. Chapter one is introductory study to the research background, the problem before the research, its objectives, significance, scope and limitations, hypothesis and research methodology. In chapter two, a review of existing literature on the subject was made. Chapter three gives a brief history of the bank and states its credit policy and highlights the main features of the policy. Chapter four shows data presentation and analysis, while Chapter five is used to present the research findings, conclusions and recommendations.

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CHAPTER TWO

2.0 REVIEW OF RELATED LITERATURE

2.1 Introduction

In this chapter, a review of some of the existing literature on the subject is undertaken so as to enhance understanding of the subject matter. The position of loans in a commercial bank's asset structure and its nature is therefore examined, in addition to lending policy formulation, criteria for loan decisions, loan monitoring and classification. Finally a review is made of the regulatory and institutional environment of lending.

2.2 An Overview of Credit Management In Commercial Banks.

The fundamental objective of lending by Commercial banks is to make profitable loans with minimal risk.

According to Timothy W. Koch (1991:631) the credit management system of a commercial bank includes three functions:

i. Business development and credit analysis,
ii. Credit execution and administration, and
iii. Credit review.

Each of these functions reflects the bank's written **credit policy** as determined by the Board of Directors. A credit policy formalizes lending guidelines that employees follow to conduct bank business

and reduce risk. It identifies preferred loan qualities and establishes procedures for granting, documenting, and reviewing loans.

According to G.O. Nwankwo (1991:113), commercial banks' lending is more diverse and the criteria for such lending more complex. Their lending differs from many other financial intermediaries, most of whom specialize in particular loan or deposit markets and in particular economic sectors. For an effective credit management system to be achieved an effective credit policy is required. The policy should set out the bank's lending philosophy and objectives including the modalities for:

i. Implementation
ii. Monitoring, and
iii. Appraisal and review.

For clarity and ease of communication to all concerned, the policy should be in a written form so as to act as a signpost to guide management and lending officers.

H. Pierson Associates Ltd., in an in-house course on 'Credit and Marketing' for UBA staff (1995), stated that for an effective credit management system to be achieved in a commercial bank, it is essential to have a credit policy that establishes parameters that help minimize lending risks by installing a hopefully water tight lending organizational structure and criteria for lending.

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From the above, it is easy to deduce that a well conceived, comprehensive, documented and articulated credit policy is the cornerstone to an effective credit management system in a commercial bank. A credit management system could be seen from the three functions of business development and credit analysis, credit execution and administration, and credit review.

2.2.1 Business Development and Credit Analysis

Business development is the process of marketing bank services to existing and potential customers. As regards lending, it involves identifying new credit customers and soliciting their banking business, as well as maintaining relationships with current customers and cross-selling non credit services.

The normal starting point for any business development effort is market research. Management would establish targets for loan composition and identify areas of potential business. The research may formally analyze economic conditions, local demographic trends, and customer surveys. It could also evolve from normal customer contacts and any communications link with local businesses about forthcoming opportunities. The purpose is to forecast the demand for bank services. The second step is to train employees regarding what products are available, what customers are likely to need or want and how they should communicate with customers. Finally, the bank should make customers aware of its services. The most obvious means is through effective advertising and public relations. Many

banks also incorporate formal officer call programs, in which lending officers are required to make regular face-to-face contact with current and potential borrowers. Borrowers are often hesitant in revealing personal or business financial backgrounds. Before doing so, they like to know and trust the bank official with whom they are dealing.

Call programs require constant personal contact with potential borrowers, either through civic groups and trade associations or through direct appointments. Formal programs involve bank-determined numerical objectives and officer implementation of customer contact procedures. The numerical objectives often stipulate a minimum number of calls each month. Some are directed at current customers, while others target potential customers identified through research. The calling officer establishes the personal contact, makes the call, and files a report. After each call, the officer logs the date and time of the meeting, the issues discussed, and notes the opportunities for obtaining new business. As is usually the case, officers must call on new customers several times before an opportunity develops. The bank is essentially positioning itself for the times when customers become dissatisfied with their prior bank relationships or qualify as good credit.

Credit Analysis

Once a customer requests for a loan, bank officers analyze all available information to determine whether the loan meets the bank's risk/return objectives. Credit analysis is essentially default risk analysis in which a loan officer attempts to evaluate a borrower's

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ability and willingness to repay. The three distinct areas of commercial risk analysis are related to the following questions:

1 What risks are inherent in the operations of the business?
2. What have managers done or failed to do in mitigating those risks?
3. How can a lender structure and control its own risks in supplying funds?

The first question forces the credit analyst to generate a list of factors that indicate what could harm a borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower. Is management aware of the important risks and has it responded? The last question forces the analyst to specify how risks can be controlled so that the bank can structure an acceptable loan agreement.

Traditionally, key risk factors have been classified according to the five "Cs" of credit: Character, Capital, Capacity, Conditions, and Collateral.

Character refers to the borrower's honesty. An analyst must assess the borrower's integrity and intent to repay. If there are any serious doubts, the loan should be rejected.

Capital refers to the borrower's wealth position measured by financial soundness and market standing. Can the firm or individual withstand any deterioration in its financial position?

Capacity involves both the borrower's legal standing and management's expertise in maintaining operations so the firm or individual can repay its debt obligations. A business must have identifiable cash flow or alternative sources of cash to repay debt. An individual must be able to generate income.

Conditions refer to the economic environment or industry – specific supply, production, and distribution factors influencing a firm's operations. Repayment sources of cash often vary with the business cycle or consumer demand.

Finally, collateral is the lender's secondary source of repayment or security in the case of default. The formal credit analysis procedure includes a subjective evaluation of the borrower's request and a detailed review of all financial statements. The initial quantitative analysis may be performed by credit analysts for the loan officer. The process consists of:

1. Collecting information from the credit file.
2. Spreading financial statements, i.e. analyzing financial ratios.
3. Projecting the borrower's cash flow.
4. Evaluating collateral.
5. Writing a summary analysis and making a recommendation.

The credit file contains background information on the borrower, including summaries of information offered from officer calls, past and present financial statements, pertinent credit reports, and supporting schedules such as aging of debtors, a breakdown of current inventory and equipment, and a summary of insurance coverage. If the customer is a previous borrower, the file should also contain copies of the past loan agreement, cash flow projections, collateral agreements, and security documents, any narrative comments provided by prior loan officers, and copies of all correspondence with the customer. The credit analyst uses the credit file data to spread the financial statements, project cash flow, and evaluate collateral. The last step is to submit a written report summarizing the loan request, loan purpose, and the borrower's comparative financial performance with industry standards, and to make recommendation.

The loan officer evaluates the report and discusses any errors, omissions, and extensions with the analyst. If the loan does not satisfy the bank's risk criteria, the officer notifies the borrower that the original request has been denied. The officer may suggest procedures that would improve the borrower's condition and repayment prospects and solicit another proposal if circumstances improve. If the credit satisfies acceptable risk limits, the officer negotiates specific preliminary credit terms including the loan amount, maturity, collateral requirements, and repayment schedule. Thus the Business Development and Credit Analysis involves the following steps:

- Market Research
- Advertising Public Relations
- Officer Call Programmes
- Receiving of Formal Loan Request
- Obtaining Financial Statements, Borrowing Resolution, Credit Reports
- Financial Statement and Cash flow Analysis
- Evaluation of Collateral
- Recommendation on Accepting/Rejecting of loan by Loan Officer.

2.2.2 Credit Execution and Administration

The formal credit decision can be made by individual loan officers or by a committee, depending on the bank's organizational structure. This structure varies with a bank's size, number of employees, and the type of loans handled. A bank's Board of Directors normally has the final say over which loans are approved. In most cases, each lending officer has an authority limit regarding the maximum amount he can independently approve. Larger loans are often formally approved by a committee made up of the bank's senior officers. This committee reviews each step of the credit analysis as presented by the loan officer and supporting analysts and makes a collective decision. Loan committees meet regularly to monitor the credit approval process and asset quality problems when they arise. When required, the Board of Directors, or a director's loan committee reviews this decision and grants final approval.

Once a loan has been approved, the officer notifies the borrower and prepares a loan agreement. This agreement formalizes the purpose of the loan, the terms, repayment schedule, collateral required, and any loan covenants. It also states what conditions bring about a default by the borrower. These conditions may include late principal and interest payments, the sale of substantial assets, a declaration of bankruptcy, and breaking any loan covenant. The officer then checks that all loan documentation is present and in order. The borrower signs the agreement along with other guarantors, turns over the collateral if necessary, and receives the loan proceeds.

Documentation

A critical feature of executing any loan involves perfecting the bank's security interest in collateral. A security interest is the legal claim on property that secures payment on a debt or performance of an obligation, that is collateral. When the bank's claim is superior to that of other creditors and the borrower, its security interest is perfected.

Different types of borrowers and collateral call for different methods of perfecting a security interest. In most cases, the bank requires borrowers to sign a security agreement that assigns qualifying collateral to the bank. This agreement describes the collateral and relevant covenants or warranties. Whenever a security agreement is signed by all parties and the bank holds the collateral, the security interest is perfected. When the borrower holds the collateral, the bank must file a financing statement with the Authorities that describes the

collateral and the rights of the bank and borrower. It must be signed to establish the bank's superior interest.

Loan Covenants

Once a bank lends funds to a customer, the bank and borrower effectively become partners. The bank wants the customer to repay the debt service and purchase other bank services. The customer looks to the bank to provide useful accounting, financial and tax advice. Both the bank and borrower should recognize this partnership when negotiating credit terms. It is also important for each party to protect its interests. For this reason, the bank often includes covenants in the loan agreement. Covenants may either be negative, indicating financial limitations and prohibited events, or positive, indicating specific provisions to which the borrower must adhere. The intent is to protect against substantive changes in the borrower's operating environment that damage the bank's interests. Most covenants address target financial ratios, limitations on asset sales, and maintenance of management quality.

To summarize, the credit execution and administration involves the following steps:

- Loan Committee reviews proposal/recommendation.
- Accept/Reject decision made, terms negotiated.
- Loan agreement prepared with collateral documentation.
- Borrower signs agreement, turns over collateral, receives loan proceeds.

- Perfection of secur ty interest.
- Filing of all docum ents in credit file.
- Process loan paym nts, obtain periodic financial statements, call on borrower.

2.2.3 Credit Review

The loan review effor is used after loan approval and is directed at reducing credit risk as well as handling problem loans and liquidating assets of failed borrow rs.

The review process can be divided into two functions:

i. Monitoring the p rformance of existing loans, and
ii. Handling proble loans.

Many banks have a fo mal loan review committee, independent of calling officers, that re orts directly to the Chief Executive Officer and directors' loan com nittee. Loan review personnel audit current loans to verify that the borrower's financial condition is acceptable, loan documentation is i place and pricing meets return objectives. If the audit uncovers probl ms, the committee initiates corrective action. This may simply involv getting signatures on omitted forms or filing required documents witl the relevant authorities. If the borrower has violated any loan covena nts, the loan is in default. The bank can then force the borrower to co rect the violation or it can call the loan, even though this is normally u sed as a last resort.

The problem is much more serious when the borrower's financial condition deteriorates. These loans are classified as problem loans and require special treatment. In many cases, the bank has to modify the terms of the loan agreement to increase the probability of full repayment. Modifications include deferring interest and principal payments, lengthening maturities, and liquidating unnecessary assets. The bank may often request for additional collateral or guarantees and asks the borrower to contribute additional capital with the purpose of buying time until the borrower's condition improves.

Credit review therefore involves the following steps:

- Review loan documentation.
- Monitor compliance with loan agreement.
- Discuss nature of non-compliance with loan terms or other Problems with borrower.
- Institute corrective action which may include:
  - Modification of credit terms
  - Obtaining additional capital or guarantees
  - Call of loan.

2.3 Credit Policy

For an effective credit management system to be achieved, an articulated credit policy is required.

According to G. O. Nwankwo (1991:114), a well-articulated credit policy should, in general, have three sections which are as follows:

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i. the general objec ives and modalities

ii. machinery for loan administration and for routine administration,

iii. guidelines for cr dit analysis.

An outline of such a po licy is as follows:

A. **Preamble**

(a) Recognition of t e functions of lending in banking:

- highest earning sset, cultivation and maintenance of customer relati ns, a means of satisfying legal and other regulations, veh cle for satisfying legitimate credit needs of the community. Ye the most illiquid of bank assets.

(b) Recognition of need for a written policy:

- Compass for ma nagement and lending officers in terms of Philosophy, obj ctives and strategy;

- Mechanism for assessing performance.

(c) Factors to cons der in credit policy formulation:

- **Internal Cons raints**: Capital adequacy, earnings, liquidity, Size, structure and maturity of deposits and their volatility, competence of management.

- **External Constraints:** The macro-economic environment, Political and economic conditions, impact of monetary and fiscal policies, legitimate credit needs of the community;

- All the factors that influence deposit and loan inflows and Outflows;

- Regulatory and legislative constraints.

B. **The Credit Policy**

Part One: General objectives and Criteria:

- the lending philosophy and mission;
- objectives: keeping funds fully invested profitably at all times consistent with liquidity, profitability, safety and regulatory constraints;
- trade area to be served – whole country, state or zone;
- types of lending and activity sectors (proportions stated);
- quality of loans, collateral requirements, acceptable and unacceptable loans and collaterals, secured and unsecured lending;
- specification that final authority and responsibility resides with Board of Directors;
- Reporting, appraisal and review modalities.

Part Two: Machinery for loan administration:

- delegation of authority to loan committees and loan department;
- definition of limits of authority down to loan officers, reporting

relationships upwards – downwards;

- information and documentation requirements and methods of interpretation and application;
- machinery for routine administration:
  - pricing, interest rates, drawdown
  - perfection of collaterals, monitoring covenants;
- machinery for handling problem loans;
- machinery for appraisal and review;
- miscellaneous items – loans to directors, staff, etc;
- monitoring compliance with legislative and other regulatory requirements.

Part Three: Credit Investigation and Credit analysis:

- objective, ascertain credit worthiness of borrower, his capacity and willingness to repay loans as agreed, and maximize returns while minimizing risks;
- procedure(s), credit investigation, Five Cs of credit analysis, Character, Capital, Capacity, Collaterals, Conditions.
  - management capacity
  - financial statement and security analysis
  - environment appreciation
  - judgmental ability
  - loan packaging
  - the loan agreement
  - covenants, etc.

The lending policy would naturally differ from bank to bank depending on size, market area, philosophy and technical competence.

Crosse (1962:191-207) is of the view that in formulation of sound lending policies, the following factors should be given due consideration :

Community needs: According to him, the starting point of loan policy should be a knowledge of the legitimate needs of the community or credit markets which the bank serves or intends to serve. The import is that bank credit should further the stability and growth of the community or the economic wellbeing of its inhabitants. The issue of monetary and credit guidelines by the Central Bank of Nigeria annually is aimed at enforcing this important consideration so as to channel banks' credit towards the overall economic growth and development of the county.

Bank's willingness and ability to meet customer's needs: The bank's ability to grant loans, given adequate liquidity and capital protection, is limited only by the volume of its relatively stable deposits, that is time and savings deposits. As he pointed out (1962:194), "the ability and willingness to lend are the most important factors in creating and maintaining depositor relationships".

Determining the Character Loans: A bank's lending policies are, in effect, " screening devices" by which the directors and management seek to establish the kind and character of loans they feel their bank

should make. It means therefore, that the character of a loan should take precedence over its form. The bank should, as a matter of policy establish ceiling on the various forms of lending which in Nigeria are guided by the provisions of the monetary and credit guidelines. In determining the character of loans, Crosse proposed 3Ps of policy: **Payment, Purpose and Protection**

He opined that it should be a basic policy of commercial bank lending that the money loaned out should be paid back as the transaction being financed is consummated or liquidated. The terms of repayment should be related to the form and nature of the transaction being financed. Payment, he advocates, should be a basic premise of a bank's lending policy taking the means and timing of repayment into consideration. Loans and advances should only be made when a borrower agrees in advance to a repayment programme related to a realistic appraisal of his ability.

Purpose for which loan proceeds is to be put is considered to be important in credit policy because without knowledge of it, the banker cannot know whether the money he lends will produce income or profits to repay the loans and cannot relate the repayment programme to the nature of the transaction. Besides, the forms of monetary policy sometimes tends to restrict credits or to channel credits to a particular sector of the economy, and a knowledge of the purpose of loan application will assist the banker in the lending decision so as to comply with the guideline. Sound lending policy therefore requires that the purpose be disclosed.

Protection constitutes the third element in determining the character of loan. The importance of protection is derived from the responsibilities which a bank owes to its depositors and shareholders. bank management need to take every possible precaution to obtain adequate protection from the borrower so as to have something to hedge on and minimize losses in the event of default.

2.4 Regulatory and Institutional Environment of Lending

Banks do not exist in a vacuum but continually act, interact and react to their environment. It is important for the bank to understand the environment in which it operates. This environment can be divided into two major categories. One is the banking environment and the other is the economic environment.

On the banking environment the bank must first and foremost understand and appreciate the objectives of the bank. The objective of any commercial enterprise, of which commercial banking is one, is to maximize profits. Since the bank trades primarily with depositor's funds, it is of utmost importance to understand, appreciate and watch the sources and uses of funds. These constitute the bank's cost and revenue centres and are useful management control instruments. How and to what extent the funds are secured and employed of course depends on the bank's head office regulations and guidelines. Other aspects of the banking environment are the money and capital markets. The bank should understand the resource profile in the

economy of the various types of financial institutions and instruments and their various functions.

Effective lending will be difficult to achieve unless the banker is aware of who his competitors and collaborators are. For instance, he may find it necessary to form a consortium to execute a big project; he may be short of funds to complete a project or he may have surplus to invest, depending on the particular case. An understanding of the various components and instruments of the financial system will enable the bank to identify its sources and outlets. An important aspect of the financial system is the Central Bank in terms of its special position as a director, controller and regulator of the entire system. The credit guidelines and moral situations or directives from the Central Bank can only be ignored at the bank's peril.

On the whole, the significance of the understanding of the banking environment is that it equips the bank with objectives, possibilities and constraints. Against this background, the bank will then study the economic environment.

Key issues in the economic environment study include the resource profile in the economy, what is the government policy for developing or tapping the resources, the main economic sectors and economic indicators, the critical issues dominating economic thinking or policy at any particular time. And the short term economic or monetary techniques to deal with these issues. This means for the bank to be effective in its lending operation, it must study and understand the

natural resources in the economy, the country's economic policies as indicated in the National Development Plans, budget speeches, and Central Bank regulations and guidelines and the critical issues dominating the economy at each time, such as the current privatization drives of the Government.

2.4.1 Banks and Other Financial Institutions Decree No. 25, 1991

This decree completely repealed the Banking Act of 1969 with all its subsequent amendments thereto and currently regulates the operation of banking business in Nigeria.

The Decree was designed to make banking business much more prudent and effective instrument in the national economy.

In relation to lending the following provisions are contained:

a. No bank shall grant any advance, loan, credit facility, financial guarantee or any liability which exceeds 20 percent of the shareholders' funds in the case of commercial banks- section 20 (1) (a).

b. No bank shall grant loans, advances, credit facilities outstanding as unsecured of an aggregate amount exceeding N50,000 to the following.

i. its directors or any of them jointly or severally

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ii. any firm or company in which anyone or more of its directors is interested as director, partner, manager or agent or any individual firm or company of which its director i a guarantor

iii. any publi or private company which anyone or more of its direct rs jointly or severally maintains shareholding up to 5 pe cent.

iv. Its offic r and employees for grant of unsecured advances, loans or credit facilities which is in excess, for any one o ficer or employee in an amount, exceeding one year salar of such officer or employee - section 20.

c. No Manager o any officer of a bank shall have personal interest directly or indirectly in any advance, loan or credit facility unless h has declared the nature of his interest to the bank - section 1

d. Every director o a bank who has any personal interest directly or indirectly i an advance, loan or credit facilities as aforementioned rom the bank shall as soon as practicable, disclose the natu e of his interest to the board of the bank and the secretary of the bank shall cause such disclosure to be circulated to all d rectors – section 18 (3)

However, directors of bank are exempted from the requirement in section 18(3) if their pe sonal interests arise from their being members of the company or whe the Central Bank has considered or regarded such interests as not ma erial- section 18(4) (a) (b).

2.4.2 **Central Bank of Nige ia Prudential Guideline**

This guideline is ai ned at ensuring prudent management and administration of bank ' funds so that reports of financial institutions may be current and ref ective of their risk portfolio. Though over the years, some licensed ba ks have evolved stringent lending policies to regulate their activitie , the central Bank of Nigeria's Prudential Guidelines of Novemb r 7th, 1990 could be seen as an effort by the Monetary Authorities t bring sanity in the Banking system. The Guideline provides as fc lows.

Credit Portfolio Classi cation System

Licensed banks are r quested to review their credit portfolio continuously (at least o ce in a quarter) with a view to recognizing any deterioration in c dit quality. Prior to this time, it is not uncommon to find situat ons where credit portfolios are not reviewed with the result that by t e time a review is undertaken, the loan may have gone bad. Some bank credits are made available without assessing risk of defa lt which should among others, include repayment performance borrowers repayment capacity and net realizable value of coll teral. Credits are to be classified into two broad categories.

a. **Performing Credi** :

For a credit to be performing, payment of both principal and interest should b up-to-date in accordance with agreed repayment terms

b. **Non- Performi g Credit**

This occurs whe e interest or principal is due and unpaid for 90 days or more o interest payments equal to 90 days or more have been capit alized, rescheduled or rolled- over into a new loan .

Provision for n n-performing facilities

Prior to 1990, banks provided for non-performing facilities based on subje tive considerations. Thus while some over-provided, other under-provided. To harmonize provisioning, the Guideline cl ssified provisions into two types;
Specific and gen eral provisions.

Specific provisi ns are those made on the basis of perceived risk of default o n specific credit facilities. General provisions on the other han d, pertain to those made in recognition of the fact that even pe rforming facilities still have some risk of loss no matter how sm all it may be.

Specific Provisi ns

The guideline provides that specific provisions for non-performing credi s should be made as follows:

i. For substa ndard, Doubtful or lost
Interest o verdue by more than 90 days should be suspended and recognized on cash basis only. Principal

repayment that are overdue by more than 90 days should be fully provided for and recognized on cash basis only.

ii. For principal repayment not yet due on non-performing credits, provision are to be made as follows:

a. Substandard Credit facilities, that is facilities in which interest or principal is due and unpaid for 90 days or more, but less than 180 days, 10 percent of the outstanding balance;

b. Doubtful Credit facilities, that is, facilities in which interest or principal is due and unpaid for 180 days or more but less than 360 days; 50 percent of the outstanding balance

c. Loss credit facilities, that is, facilities in which interest or principal is due and unpaid for 360 days or more; 100 percent of the outstanding balance.

General Provisions

Each licensed bank is required to make provision of at least 1 percent of risk assets not specifically provided for.

Credit Portfolio Disclosure

Banks are also required to provide in their audited accounts an analysis of their credits into performing and non-performing facilities. The amount of losses are to be segregated between principal and interest. The maturity profile of credit facilities along with the maturity profile of deposit liabilities are to be disclosed in the financial statement. This provision is aimed at ensuring that there is

no mismatch betwee deposit liabilities and credit. It must be noted that financing long- erm assets with short- term funds, could create liquidity problems c lminating in a ruin. This is what this provision seeks to prevent.

Interest Accrual

The guideline provid s the following criteria for banks treatment of interest on non- perfc ming credit facilities.

a. Interest on all c asses of non- performing credit facilities should automatically b placed on non-accrual statues, that is, not to be recognized as ir come.

b. A suspense acc unt titled " Interest in Suspense Account" into which all intere t previously accrued and uncollected but taken into revenue s ould be reversed unless paid in cash by borrower. Futu e interest charges should also be credited into some account ur til such facilities begin to perform

c. Once the facil ties begin to perform interest previously suspended and provision previously made against principal debts should be recognized on cash basis only.

Before a non- erforming facility can be reclassified as performing, unp id interest outstanding should not exceed 90 days. The provis on is to ensure that interest on all classes of non-performing credit facilities are not recognized until realized.

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Implications of the P udential Guidelines

The guidelines basi ally touched on the management of credit facilities. Bad, doubtf l and lost loans and advances erode the capital of many banks, whic is aggravated by poor management quality. A good number of ban s have poor credit policies and where good polices exist, they are not strictly adhered to. In addition, failure to provide adequately fc classified assets has led to a declaration of huge profits thereby g ving a false sense of comfort to the bank. The Guideline was design d to address these problems in the interest of shareholders, deposito s and the entire financial system.

2.4.3 Monetary and Credit Guideline

Lending decisions are lso influenced by the Central Bank of Nigeria Monetary and Credit C uidelines issued annually to regulate aggregate credits to the economy. The first Monetary Policy Circular was issued by the Central Bank f Nigeria in 1964 and has since then become and annual event ex ept between 1966 and 1968 when it was suspended due to the p olitical crisis and imminent resultant civil war (Nwankwo 1984:343-5 .

The Guidelines usually cover the following

i. Aggregate credit eiling
ii. Sectoral allocatio n of credit
iii. Loans to rural bo rowers
iv. Loans to small- s ale enterprises
v. Grace period on l ans agricultural purposes
vi. Interest rate polic

vii. Liquidity ratio equirement for banks

2.4.4 **National Deposit Ins rance Corporation(NDIC)**

This was establishe by Decree No. 22 of 1988 with the main objective of insuring eposit against bank failure and ensuring a sound banking system. Its fi nctions are:

a. to give assist nce in the interest of depositors in case of imminent or a tual financial difficulties of banks particularly where suspen ion of payments is threatened and avoiding damages to the public confidence in the banking system, and

b. to assist mo netary Authorities in the formulation and implementatio of monetary policy.

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CHAPTER THREE

3.0 UNITED BANK FOR AFRICA (UBA) PLC: BRIEF HISTORY AND CREDIT MANAGEMENT SYSTEM

3.1 Introduction

This chapter gives a brief history of United Bank for Africa (UBA) Plc and explains the bank's credit management system. It explains the bank's objective, credit policy and credit structure. It will be seen that the credit system lays great emphasis on RISK. Lending officers are expected to first think in terms of **RISKS** before thinking in terms of **RETURNS**.

3.2 Brief History of the Bank

The United bank for Africa (UBA) Plc started its operations in Nigeria with the name British and French Bank Limited in 1961. UBA was incorporated to take over the assets and liabilities of the British and French Bank. Its shareholders then in addition to the British and French Bank included a consortium of foreign banks from Italy, Holland, United Kingdom and United States of America.

The indigenisation decree of 1978 changed the shareholding structure to 60% Nigerian and 40% foreign equities respectively. The recent past privatization exercise saw the sale off of the 46% Federal Government interest in the Bank to private investors. The Bank has undergone a lot of structural changes with a major shift in most of its policies including the credit policy. The bank has grown from its 10 branches in 1961 to over 200 at present.

3.3 Objective of the Bank

The overall objective of the bank is to provide prompt, courteous and efficient services to its numerous clients and to be clearly the leading bank in the country.

3.4 Credit Policy of the Bank

It is within the above broad objective that the bank's credit policy is designed to provide investment funds to meet the needs of the bank's customers as well as maximize profits, keeping within the laws of the land.

The credit policy of any banking institution is based on certain internationally accepted standards, which relate to safety, liquidity and profitability of the advances. Other considerations relate to extent of risk, interest margins, credit spread and credit dispersal. UBA gives regard to these considerations. In its credit policy formulation, the bank is guided by:

i. Central Bank of Nigeria monetary guidelines.
ii. The Bank treasury position.
iii. Statutory lending limits.
iv. Micro and Macro economic factors, and
v. Environmental consideration.

The current credit policy of the Bank was introduced in 1996, in the wake of changes in the banking and economic environment at the time.

3.5 **Emphasis of the UBA Credit Management System**

The UBA credit system lays great emphasis on RISK. Lending officers are expected to first think in terms of **Risks** before thinking in terms of **Returns**.

This is the risk that is always inherent in lending activities which would not go away but it would have to be first identified, then quantified in some straightforward manner and then managed and protected against. This type of risk is referred to as CREDIT RISK and in simple terms represents the likelihood that the borrower will not repay the loan or meet important loan obligations as and when due.

The bank has introduced **Risk Rating Guidelines** which are an important part of the Risk Management Process for the bank's lending activities. The guidelines are crucial to arriving at a safe and sound lending decision.

3.6 **The Main Features of the UBA Credit Management System**

1. **Utilization of the Risk Rating Guidelines**

   These guidelines are used in the following cases:

   (i) All loans to legally registered commercial entities (Partnerships, Registered Companies, Limited Liability Companies, Joint Ventures and similar status borrowers).

   (ii) All non individual loans of N250,000 (Two hundred and fifty thousand Naira) and above OR when UBA exposure will reach N250,000 with the current loan request.

Credit requests and b rrowers whose descriptions fall outside (i) and (ii) above, are availe credits under credit programs designed by individual business un s.

2. **Objectives of tl e Risk Rating Guidelines**

There are 3 (T ree) main objectives which use of the Risk Rating Guidelin s seeks to achieve:

A. To MEASU E Credit Risks on a common scale;
B. To COMPA RE Credit Risks within portfolios and across business uni s;
C. To provide a rationale for PRICING Credit Exposures.

3. **Risk Rating Ap proach**

The Risk Rating Approach is to assign two Risk Ratings to each existing or pros ective borrowing customer of the bank based on the Credit Ri k assessment of:

A. The custom r's business and cashflows, and
B. The facility tructure and security.

The risk rating btained in A above will be referred to as the **Customer Qua ty Rating (CQR)** while the rating obtained in B above will be eferred to as the **Facility Risk Rating (FRR).** Each borrowin customer of UBA will have both ratings rendered in the f equency indicated below:

4. **Frequency of Rating**

For existing borrowing customers of the bank, the frequency of ratings will be determined by their current FRR, while for new borrowers or existing borrowers requesting new facilities or renewals, ratings will be done at the time the requests are being appraised.

For existing borrowers, the following minimum frequency will apply for formal rating reviews for both CQR and FRR.

EXISTING RATING	FEQUENCY OF RATING
1	Every 12 months
2	Every 6 months
3	Every 3 months
4 (Work-out Credits)	Continuos review by the Responsible officer or Loan Workout/Debt recovery unit subject to a quarterly review by a senior committee.

Each borrowing customer of UBA will therefore be rated (CQR and FRR) at least once every 12 (twelve) months, within three months of the customer's financial year end. This is merely a minimum requirement for maintenance reviews as described above.

In practice howeve , lending officers and their supervisors will be expected to review and risk rate each borrowing customer at the following events:

A. During the a praisal of any credit request, either renewals, increases, redu :tions, restructures, new lines or material change in the terms of an existing facility.

B. Once informa on is received or suspected about a material change in the b siness condition, internal arrangements or other circumstances or industry in which borrowing customer operates.

C. When there is material change in the credit facility or the circumstances a fecting the credit facility, such as a change in the structure of he credit, change in the security, change in the circumstances o a bank that is part of the syndication, etc.

D. Any material c ange in regulations affecting the customer or the customer's i dustry.

E. In accordance w h the minimum frequency described above.

5. **Non-Performin Credits**

The procedure f r the identification of non-performing credits and the regulari y of their review are clearly set out in the

Prudential Gui elines published by the Central Bank of Nigeria. This procedur is being used by all the UBA's lending units.

6. **Rating Respo sibility**

It is the resp sibility of the lending officer who has been designated the **Responsible Officer** for the credit file to risk rate the custo ner and the facility in accordance with the guidelines. Ra ngs should be confirmed within the sector by at least the seni r credit officer (SCO)4, i.e. AGM before submission to c mmercial and credit policy (CCP) sector.

In confirming ne rating done by the responsible officer, the senior credit o ficer within the sector is also expressing his **independent udgment** based on his experience and consequently a sumes full responsibility for the suitability of the rating given

Confirmation f risk ratings is not intended to be an administrative c clerical exercise.

7. **Confirmation c `Rating**

All risk ratings will have to be submitted to commercial and credit policy se or for review and confirmation at least once a year or earlier if atings are done earlier.

8. **Credit Appro al Authorities**

The appropria credit approval authority for approving and managing eacl credit exposure in the bank will be determined by the Facility Risk Rating (FRR) of the credit.

In considering credit, the Credit Approval Authority relies on the worse or ost constraining rating presented on the credit proposal.

The bank mai tains a grid for Credit Approval limits to be reviewed by t e CCP from time to time and submitted to the Board for ap roval through Executive Council Committee (EXCO) and t e Board Credit Committee (BCC).

There are two evels of Credit Officers (COs) and four levels of Senior Credit fficers (SCOs) that consider and give approvals for various cr dit requests. These are made up, in ascending order, as follo s:

Senior Credit Of cer (SCO) 4 – Assistant General Manager (AGM)
Senior Credit Of cer (SCO) 3 – Deputy General Manager (DGM)
Senior Credit Of cer (SCO) 2 – Executive Director (ED)
Senior Credit Of cer (SCO) 1 – Managing Director (MD)
Executive Coun Committee – EXCO
Board Credit Co mittee - BCC.

The Facility R sk is rated from 1 to 4, with a rating of 4 having more risk tha 1. A credit approval within the approval

authority of an AGM (SCO 4) shall be conclusively approved once it is appr ved by the AGM in the originating sector (like commercial ba king sector, or international banking sector or credit manage ent sector) and confirmed by the appropriate AGM in Credit Risk management or in his absence the DGM or ED.

For control pur oses Authorization of Credit Slip (ACS) issued by the credit risk management are the only medium for communicating credit approvals to Branch Operations Managers and c her disbursement officers.

9. **Facility Pricin**

It is expected t at UBA's pricing of its credit facilities and the Target Return n Asset (TRA) will reflect the credit risks involved in thes facilities as shown in the Facility Risk Rating (FRR).

10. **Documentation**

Credit Risk Rat ngs (CQR) and FRR) should be done by the responsible offic r on combined risk rating sheets which will be pre-printed for t is purpose.

A copy of the ombined Risk Rating sheet as confirmed by CCP should be laced in a specific section in the customer's credit file. CCP will maintain a file of all confirmed ratings on electronic storag .

11. **Risk Rating Methodology**

The first step is to rate the customer before rating the facility. The Customer Quality Rating (CQR) is the basis for deriving the Facility Risk Rating (FRR).

12.a **Obtaining the Customer Quality Rating (CQR)**

i. <u>Approach</u>: The customer is measured on the basis of a list of financial and non-financial factors which are given **equal weighting.** The average of the two factors provides the CQR. Rating officers will be required to cross check the resulting CQR against the matching profile in the Rating Grid to confirm whether in their considered opinion the customer merits the description in the matching profile. In most cases, an optimistic evaluation of non-financial factors which are largely judgmental would cause a rosy CQR.

ii. <u>Measuring non-Financial Factors</u>: Customers will be measured against the following six (6) non-financial factors

- INDUSTRY RISK
- MARKET POSITION
- MANAGEMENT ADEQUACY
- SHAREHOLDEER SUPPORT
- POLITICAL/LEGAL RISKS
- EARNINGS STABILITY

Each n n-financial factor will be measured on a scale of 1 – 5 as guided by the **Non-Financial Profile**. See Appen ix I.

The su n of the ratings for the non-financial factors will be divi ed by 6 to obtain the non-financial rating for the custom r.

In ex rcising judgment about the non-financial conditi ns of the customer's operations, credit officers and th ir supervisors should bear in mind that the objecti e is to measure and test whether the customer can reason bly be expected to repay the loan as contracted, if grantec The objective is not necessarily to measure the opport nities in the customer's business.

To sati fy this objective, the rating officer should focus on wh her and how these non-financial factors could cause l an default.

iii. **Measu ing Financial Factors**

Custon rs will be measured against the following six (6) financi l factors:

- SIZ AND CAPITAL ACCESS
- LE ERAGE
- INT REST COVERAGE
- PR FITABILITY

- WO KING CAPITAL
- INV NTORY TURNOVER

Each fi ancial factor will be measured on a scale of 1 – 5 as guid d by the Financial Profile. See Appendix II. The su n of the ratings for the financial factors will be divide by 6 to obtain the financial rating of the custom r.

Howev r, where other important performance ratios which are not among the above financial factors are worse han the industry average for the customer, the Respo sible Officer should consider using them as a basis f r downgrading the customer's CQR. They would not ho vever be the basis for an upgrade. Such ratios includ Receivable Days on hand, payable days on hand which hould be compared to industry averages and trade terms. Another consideration would be whether working capita is positive or negative over the preceding three years.

12.b **Obtai ing the Facility Risk Rating (FRR)**

Facili / Risk Ratings will flow from the Customer Quali / Ratings. The rationale is that the basic or intrin c risk quality of the customer including debt repay ient capacity is measured by the CQR. The way

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the exp(sure is to be undertaken or structured including the qual y and realisability of the securities as measured by the F RR can only marginally affect the basic risk of the cred . In most cases, they will add to the basic risk not imp ove it. The FRR in addition to being derived from the CQR, will in most cases be higher than it except in a few ases.

Approac h: Obtain the Customer Quality Rating (CQR) as earlie on explained. Then derive the Facility Risk Rating (RR) following the guidance notes shown in Appendi III

13. **Credit Proced re**

UBA Plc alwa s ensures that a customer who applies for a facility is legal and financially eligible to do so. If it is an individual it en ures that he is not a minor, an undischarged bankrupt or ar insane person. If it is a limited liability company, the pu pose of borrowing and amount are covered by the memorandu and articles of association of the company.

14. **Formal Reques**

A customer see ing a credit facility from UBA is required to put in a signe written request stating the purpose of the facility, amount, proposed repayment programme and proposed security.

15. **Information l equirement**

Certain inform ation is required to enable the bank to adequately assess the cus omer's request. While some information will be supplied by he customer, some will be investigated and gathered by t e bank independently. Some of the information usually suppli d by customers includes:

- Historical nformation concerning the customer's back-Ground.
- Performan e
- Nature of Operation
- Financial tatements
- Managem nt Accounts.

All informat on supplied by the customer is usually checked thoroughly a id confirmed independently by the bank. The bank usually obtains this information from its own records, trade associa on, major suppliers of the borrower, etc.

16. **Post Appro al Credit Management**

After the cr dit facility is approved, it is expected to be well managed by the Responsible Credit Officers, up to when full reimburseme it is made. The objective is to secure the collection o the facility as originally structured and where default occ s, to maximize recoveries and minimize credit losses.

Credit manag nent is the responsibility of the Responsible Credit Officer who presented the credit for approval from the Branch to Re ional offices and up to the Head office. It involves a seri s of tasks performed at the right time and with initiative to en ure timely detection of threats and the initiative of prompt an effective containment, and taking remedial actions.

The credit off ers have the following responsibilities within UBA's credit p ocess:

i. Develop the marketing plan and budget for individual custome accounts.
ii. Business Development.
iii. Compan Credit Analysis
iv. Credit Sp nsorship
v. Negotiati n with Customer
vi. Docume ation, Closing and Disbursement Management
vii. Account Maintenance and Review
viii. Problem Loan Management and Collection
ix. Credit C llection.

17. **Communicatic n of Credit Terms**

The bank write to the client advising of the grant or refusal of the facility and he terms of the facility if granted.

(a) **Offer L tters**

Where a facility is granted, the communication will be in writing i n the form of an offer letter signed by authorized signator s of the bank one of whom should be the responsi le officer.

The cor munication of credit terms is an important contractu l act and normally satisfies the following requirem nts:

- Is don on the bank's approval format for offer letters for loa ns of the type granted.
- Comp es with existing policies on external comm nications.
- * Comm nicates only what was approved by the credit approv r except where the approver had expressly directe the credit originator to use his discretion in makin or negotiating specified charges to the terms previo sly proposed.
- Is done as soon as possible after receipt of official Interna confirmation of credit approval.
- * Should e formally acknowledged by the customer usually by stamping and signing an acknowledgement copy a l despatch register or by letter.

(b) **Rejecti n Letters**

These a e letters sent informing the customer of the bank's d ecision not to grant the credit request. They are normall polite and straight to the point, without being insensit ve. The reason for declining the credit request is normall stated in a summary form unless the circums ances of a particular case demand a detailed stateme t. Where the conditions not to lend can be remove or rectified by the customer and the bank intends his to happen, the rejection letter explains these conditi ns in some detail and affords the customer the opportu ity to improve his chances.

Rejecti n letters are signed by authorized signatories of the ban and counter-signed by the Responsible Credit officer.

18. **Enforcement of Credit Terms**

Credit terms nd conditions are normally specified in the offer letter and are xpected to be adhered to by the borrowers. They are important ecause they contain the basis for protecting the interest of the bank and securing a fair economic compensation for the credit sk the bank undertakes.

Enforcement of credit terms is the joint responsibility of the Responsible Officer and his supervisors. Credit terms and

conditions dep nd on the type of credit offered and include the following tern s:

* Identificati n of the borrower who is responsible for the re-imburseme t of the loan.
- Purpose of he facility.
- Repaymen terms.
- Tenor/Exp y.
- Interest Ra e.
- Security.

19. **Usual Condit ons and Covenants**

The borrowe is expected to observe the following usual conditions an covenants:

- Legal Acc ptance of Offer
- Going Con ern Status.
- Representa ions and Warranties.
- Security P rfection.
- Financial C ovenants.
- Events of D efault.

20. **Security Com pliance**

To ensure s curity compliance, the loan is normally not disbursed unt security is perfected. And before accepting an asset as secur y, the bank ensures:

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a. The secu ity is of sufficient forced sale value to fully repay pr ıcipal and accumulated interest in the event of default. As a policy, the bank in most cases insists on a minimun coverage of principal plus 2 years compound interest, plus estimated bank charges and anticipated recovery expenses.

b. The bor ower has a perfectible legal title in the asset being pl lged as security.

c. The secu ity can be perfected within a reasonable period of time a d at reasonable cost.

d. The phy cal location and condition as well as distress sale valu of the asset can be independently monitored by the bank t reasonable expenses and difficulty.

After accepting he asset as security the bank:

a. obtains p rfection.

b. Obtains nd annually renews comprehensive insurance from a ri k worthy insurance company.

c. Ensures ıe borrower maintains the economic value of the asse for example by regular refurbishment and

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repainti g, and by careful use as well as physical inspecti n to ascertain value.

In doing these the responsible officer consults closely with the Legal and Secu ity Divisions and other professionals.

Where pledge assets are assessed to have lost value, the Responsible C ficer takes immediate steps to notify the customer and n gotiates additional security with him.

21. **File Maintenan ce**

The objective of file maintenance is to provide essential documentation n each relationship in such a way as to allow for diligent han over in the event that another officer is to take over the relation hip.

Usual contents o relationship files include:

a. Customer Relationship particulars
   - Custon er name and address;
   - Busine s activities;
   - Relate Accounts;
   - Facilit s Granted;
   - Collate al/Guarantees or Agreements.

b. Copies of pproved credit commitments

c. Credit Ris Rating sheet

d. Loan docu nentation:

- Aut orization of credit slip
- Acc pted offer letter
- Perf cted security documents
- Oth· legal documents evidencing the facility

e. Operati nal memos:
   - Man ates
   - Rec(ıciliation's

f. Corresp ndences

g. Financi information and analysis.

22. **Compliance w th Bank Policies**

The bank dem nds **credit discipline** or the willing compliance by credit proc s participants with all credit policies in force in the bank from me to time.

The breach of redit policies by staff attract sanctions and the followings are lustrations of such offences:

a. Authoriz ıg loan disbursements in the absence of valid powers o beyond valid powers or against procedures and policies f r such loans.

b. Disburse ıents on loans before the perfection of security documen s.

c. Disburse ents on accounts with expired approvals.

d. Not acti g with sufficient responsibility when breach of credit rocedures and policies is brought to their attentio .

e. Delays n the recognition of distressed or non-performing loans.

f. Poor m nagement of distressed or non-performing loans.

g. Breach n loan documentation.

h. Unsatis actory credit management.

23. **Types of UB . Lending and Evaluation of Lending Proposal**

The bank eng ges in different types of lending to its customers that request or credit and who deserve same. This customer may be any individual, partnership, corporate body, public, institutions a d associations who maintain banking relationship with the ba k and on whom the bank holds adequate and satisfactory r ference.

Some of the najor types of lending undertaken by the bank are as follows:

i. Overd aft
ii. Loans
iii. Advan es.
iv. Direct Credit

v. Bills Di counted

vi. Stock R placement Credit.

vii. Packing Credit.

viii. Docume itary Credit Line

ix. Trust Re ceipt

x. Conting nt Liabilities (Bonds and Guarantees).

The bank also undertakes specialized lending like Equipment Leasing and Lo in syndication.

Evaluation

From the vario s information gathered about the application of a facility it is p imarily determined if it falls within the bank's credit policy. ny application not in line with the policy will be rejected at th s stage.

Other applicatic is which are relevant will undergo an extensive evaluation. Th evaluation procedure aims to find favourable answers to the f llowing questions:

a. What is tl e amount required?

b. For what urpose is it required?

c. Is it a n w project? If yes, then is feasibility report required?

d. How is tl e facility to be repaid and for how long will it be repaid'

e. What are ne sources of repayment?

f. Does t e customer bank elsewhere? If yes,

i. wha is the level of commitment and utilization?

ii. l ow are the facilities secured?

iii. wh t repayment arrangement has been made?

g. Based n the economic trend what are the business prospec s?

h. What e: pansion plans has the customer and the source of finance'

i. What is he make up of the company's management and for how ong have they been with the company?

j. What is the level of risk inherent in the project? Is it within tl : Risk Acceptance criteria?

Generally, len ng officers are expected to first think in terms of risks before inking in terms of returns.

Answers to the above questions will reveal the actual amount required for t e project, adequacy of security, necessary infrastructure r quired and right calibre of personnel needed. A proper account ; created right from here.

The appraisal f the customer's financial statements is also undertaken to : certain his financial standing. The financial statements bein looked into include Balance Sheet, Trading, Profit and Loss ccount, Cash Flow etc.

Some of the relevant information that can be deduced from the financial statements include level of efficiency, market trend, capital adequacy, and debt cover.

Financial ratios are also used to analyze the company historical trends and also in relation to industry standards. Significant deviations are investigated satisfactorily before a decision is made. In case of a new project or company a feasibility report is thoroughly analyzed and the forecasts confirmed.

Other factors also considered in proposal evaluation include government regulation/fiscal policy which is administered through credit ceiling, section/distribution of credit and liquidity ratio. Then there is also the environmental factor which include political consideration, banking policy, technological considerations and infrastructural factors.

Where a decision has been taken to lend, approval is normally sent in the form of Authorization of Credit Slip (ACS) sent by the Central Risk Management at the Head office to the unit processing the request.

The task of sound account management starts immediately from the disbursement of the facility.

REFERENCES

UBA Lendin ; Manual 1990

UBA Credit 'resentation Format January, 1996

UBA Credit Risk Rating System January, 1996

UBA Credit Management Guide April, 1996

UBA Cre lit Limits and Credit Authorities, June 1997

CHAPTER FOUR

4.0 DATA PRESENT ATION AND ANALYSIS

4.1 Introduction

This chapter is dev ted to the presentation and analysis of the data obtained in the stud of credit management in United Bank for Africa (UBA) Plc. Howeve some of the methods of data analysis are briefly discussed out of v nich the ones used are stated. Thereafter the hypothesis of the stu y is tested.

4.2 Methods of Data A alysis

A number of statisti l methods can be used in a study of this nature that seeks to det rmine relationships between variables and establishment of ends. Such statistical techniques include correlation, regressio analysis, time series and ratios.

4.2.1 Correlation

Correlation simply d ls with the extent to which two variables are related. To establish is, an index of relationship called correlation and coefficient, must e determined. In order to do this, the Pearson Product Moment corr lation coefficient or Spearman Rho correlation coefficient can be use

a. **The Pearson P oduct- Moment Correlation Coefficient**

The correlation coefficient (r) can be determined using the formula

$$r = \frac{z \times zy}{N}$$

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It involves the co version of the scores for variables x and y into standard scores or : scores and computing the product of each pair. The products are then summed and divided by the number of items(N). In other words, r is the sum of the cross products of two variables, in standa d score forms, divided by N (Jurs et al 1982 : 108). An alternativ formula which uses only the observed x and y scores is.

$$r = \frac{N\Sigma xy - \Sigma x \, \Sigma y}{\sqrt{[N\Sigma x^2 - (\Sigma x)^2][N\Sigma Y^2 - (\Sigma Y)^2]}}$$

This correlation co fficient gives an indication of the nature of relationship betwee two variables, x and y. The sign of r may be positive or negative : nd the absolute values range from 0 to 1. While the sign indicates the direction of the relationship, the absolute value shows the strengths o the relationship. The greater the absolute value, the stronger the relati nship. If r = + 1 there is a perfect positive linear relationship between x and y and all the points lie exactly on a strength line with a p sitive gradient. Where r = - 1, there is also a perfect linear relatio ship between x and y but with a negative gradient. A zero corr ation coefficient indicates a random scattering of point with no linea relationship at all.

According to Jurs : al (1982: 109 –110) what constitutes a meaningful relations ip is somewhat arbitrary and depends specifically on the var ables being correlated. They gave the following rules of thumb of inter reting the coefficient of correlation.

.90 to 1 (-.90 to –1 very high positive (Negative) Correlation

.70 to 90 (-.70 to-) high positive (negative) correlation

.50 to .70 (-.50 to - 70) moderate positive (negative) correlation

.30 to .50 (-.30 to - 50) low positive (negative) correlation

.00 to 30 (-.00 to -. 0) little if any correlation

However correlati n coefficient will not indicate which variable depends on which Also the absolute magnitude depends both on the units or measurem nt used and on the size of the sample.

(b) **Spearman l ho Correlation Coefficient**

This is used where the level of measurement of either or both variable bei g correlated is ordinal or nominal and the formula is

$$Ps = 1 - \frac{6\,\Sigma d2}{N(N-1)}$$

Where d = fference between the paired ranks

N = umber of pairs of ranks

4.2.2 Linear Regress A alysis

This is used in pre iction, it involves determining the regression line, which is a mathe natical equation, that can be used in the actual prediction of score .

The mathematical quation of linear function is of the form

$$y = bx + a$$

y = pr dicted score

b = sl e of the line

a = y i tercept

The equation ex esses a functional relationship between two variables, say x an y

The regression lin is a line that describes a trend in the data such that a change in x will e reflected in an 'average' change in y which is ' fitted' to the data b / least squares method. The method fits the line in such a way that th sum of the squared distances from the data points to the line is a min num. (Jurs et al 1982: 127 – 128)

The formulae for t e slope (b) and the y intercept (a) of the regression are:

$$b = \frac{N\Sigma xy - \Sigma x\Sigma y}{N\Sigma x^2 - (\Sigma x)^2}$$

$$a = y - bx$$

The slope b is th regression coefficient while the intercept (a) is called the regressi n constant.

An alternative f rmula which shows the relationship between correlation and re ession coefficient (b) is

$$b = \frac{rsy}{sx}$$

Where

r = correlation betw en variables x and y

sy = Standard devia ion of the y scores

sx = Standard devia ion of the x scores

Once the regressio line has been determined predicting y scores simply involves sub stituting the x value into the equation and solving for the correspondi g y value.

4.2.3 Time series

This is another sta stical technique that can be used to analyze the data for the period f study. A time series has been defined as " data classified chronolo ically" (Thirkettle, 1981:212). It is a set of observations taken t specified times at equal intervals. According to Spiegel (1972: 284) it is mathematically defined by the values of y1, y2..... of a variable y at t1, t2.....Thus y is a function of t, that is y = f (t).

This can be graphed o establish trend. The series is therefore useful in forecasting. The esti nation of trend can be achieved by the method of least square earlier d scussed, freehand method or the moving average method.

4.2.4 Ratios

This shows the rel tion between two variables determined by the number of times one contains the other. The calculation of such ratios

over a period can be graphed to establish trends and useful in forecasting.

4.3 Choice of Method of Data Analysis

In this study, ratios and Pearson Product Moment correlation are used because of their simplicity and ease of understanding.

Their use can be understood easily by both the operators of the banking system and the public at large.

In the data analysis, ratios are used in establishing relationships and trends of the following

a. Loans to total deposits
b. Savings plus time deposits to total deposits and
c. Classified loans to total loans.

The Pearson Product Moment correlation coefficient is used in determining the nature of relationship between interest earned on loans and total loans. This will show the degree of association between the two variables, even though it will not indicate the cause.

The data analysis is based on data extracted from the bank's annual accounts as shown in Appendix IV.

4.3.1 Loans to Total Deposits

It has earlier on been observed in Chapter One that an important function of Commercial Banks is that of financial intermediation and the avenue for discharging this function is through loans and advances. It therefore implies that the amount of loans and advances

outstanding and its atio to total deposits can be used to evaluate the intermediation func on. According to Agu (1988:67)

" the loans and adv nces ratio gives an impression of the extent to which commercial l nks used resources available to them".

It is thus a meas re of performance of a bank's intermediation activity. The follo ing table shows the relationship between total loans and total depc its.

Table 4.1: Loans nd Advances to Total Deposits

Year	Total Loans And Advan es	Growth Rate	Total Deposits	Percentage of Loans and Advances to Total Deposits
	₦ million	%	₦ million	%
1990	2,505	-	9,694	26
1991	2,435	(2.79)	11,894	20
1992	3,650	49.90	17,356	21
1993	5,429	48.74	18,628	29
1994	4,318	20.46	18,354	24
1995	6,220	44.05	33,161	19
1996	8,987	44.49	37,019	24
1997	10,761	19.74	39,521	27
1998	16,796	56.08	48,858	34
1999	24,614	46.55	73,207	34

Source: Annual Re ort and Accounts

From Table 4.1, tot l loans grew from ₦ 2,505 million in 1990 to ₦ 24,614 in 1999 tl t is almost 10 times growth.

On the other hand t tal deposits grew from ₦ 9,694 million in 1990 to ₦ 73,207 million in 1999, that is about 7.5 times growth.

The percentage of lo ıns and Advances to total deposits has fluctuated from 1990 to 1995, l etween 19 percent and 29 percent. However from 1996 to 1999, there a steady increase from 24 percent in 1996 to 34 percent in 1999.

This shows an incre se in the bank's ability to offer loans since the loans have grown gr ater than total deposits (10 times growth and 7.5 times growth respec vely). It also shows more deposits are utilized to give out loans from 6 percent in 1990 to 36 percent in 1999.

4.3.2 Savings Plus Time eposits to Total Deposits

It was pointed out i chapter one that loans are made from deposits available to a lendi g Banker. Generally savings plus time deposits constitute a fairly st ble fund from which these loans and advances can be made. This m ıst be viewed against, the background of the fact that every banker al ays strives to hold enough cash or near cash to meet customers' de osit withdrawals. Thus, current account with its high turn over, is not a stable fund for meeting loan demands.

The implication of tl s is that the higher the proportion of savings plus time deposits in a ba k's total deposits portfolio, the better placed it is to meet customers' loan demands. The following table shows the relationship between saving, plus time deposits and total deposits.

Table 4.2 Savings Pl s Time Deposits To Total Deposits

Year	Savings Plus Time Deposits	Gr wth Rate of Sa ings Plus Ti e Deposits	Total Deposits	Percentage of Saving Plus Time Deposits to Total Deposits
	₦ million	%	₦ million	%
1990	N.A	-	9,694	N.A
1991	N.A	-	11,894	N.A
1992	8,411	-	17,356	48
1993	6,705	20.28)	18,628	36
1994	7,675	14.47	18,354	42
1995	14,941	94.67	33,161	45
1996	15,960	6.82	37,019	43
1997	18,795	17.76	39,521	48
1998	25,338	34.81	48,858	52
1999	34,338	35.52	73,207	47

Source: Annual Repo and Accounts

From Table 4.2, both savings plus time deposits, and total deposits have grown by about 4 times between 1992 and 1999. The ratio of savings plus time dep sit to total deposits fell marginally from 48 percent in 1992 to 47 percent in 1999. The average ratio of savings plus time deposit to otal deposits for the 8 years period for which figures are available i 45 percent.

4.3.3 **Interest on Loans a d Advances**

Interest income deriv d from loans and advances constitute significant proportion of a bank s income. An improved loan rate policy brings about an efficient per ormance. The following table shows the bank's interest earnings on lo ns and advances granted for the period 1992 to 1999 for which figure are available.

Table 4.3: Interest E rned on Loans to Gross Earnings

Year	Interest E rned On loans ₦ million	Gross Earnings ₦ million	Percentage of Interest on Loans to Gross Earnings %
1990	N.A	N. A	-
1991	N.A	N.A	-
1992	847	2,078	40.79
1993	1,336	2,908	45.94
1994	1,184	3,629	32.63
1995	1,210	4,640	26.08
1996	1,924	6,973	27.59
1997	1,995	7,276	27.42
1998	2,974	7,850	37.89
1999	4,639	10,650	43.56

Source: Annual Report nd Accounts

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From Table 4.3, wh reas Interest earnings on loans have increased by 5.5 times, gross ear ings increased by 5 times between 1992 to 1999 for which figures ar available.

The ratio of interes on loans to gross earnings also, improved from 40.76 percent in 19 2 percent in 1999. The average ratio for the 8-year period is 35 23 percent.
This indicates an im provement of interest earnings as a ratio of gross earnings, over the p riod under review.

4.3.4 Classified loans to Total loans

Classified loans rel tes to loan assets that may not be recoverable. In other words, classi ed loans and advances constitute a potential loss of asset value or liminution in the value of the loan asset. The following table sho s the banks classified loans to total loans.

Table 4.4 Classifie Loans To Total Loans

Year	Classi ed Loans ₦ mill on	Total Loans ₦ million	Percentage of Classified Loans to Total Loans %
1990	N.A	2,505	-
1991	N.A	2,435	-
1992	455	3,650	12.47
1993	741	5,429	13.65
1994	456	4,318	10.56
1995	396	6,220	6.37
1996	(43)	8,987	(0.48)
1997	(75)	10,761	(0.70)
1998	220	16,796	1.31
1999	503	24,614	2.04

Source: Annual Re ort and Accounts

From Table 4.4. it could be seen that whereas total loans increased by almost 7 times between 1992 and 1999, the classified loans increased by just 1.1 time within the same period. The ratio of classified loans to total loans has been on a steady decline from 1992 to 1999 except in 1993 when there was a marginal increase from 12. 47 percent to 13.65 percent . In 1996 and 1997 the bank made more recoveries than it classified its loans.

The overall result shows an improvement in the bank's loan portfolio.

4.4 Correlation Coefficient of loan interest and Total Loans

The following table shows the Interest earned on Loans and Total Loans granted by the bank during the period under study.

Table 4.5: Loan Interest and Total Loans

Year	Interest Earned on Loans	Total Loans
	₦ million	₦ million
1990	N.A	2,505
1991	N.A	2,435
1992	847	3,650
1993	,336	5,429
1994	,184	4,318
1995	,210	6,220
1996	,924	8,987
1997	,995	10,761
1998	,974	16,791
1999	,639	24,614

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4.5 Correlation Coefficient of Loans Interest and Total Loans

The following table shows the interest earned on loans and total loans granted by the bank during the study.

Table 4.6: Loan Interest and Total Loans

Year	Interest Earned On Loans x ₦ millio	Total Loans Y ₦ millions	x2	Y2	xy
1990	N.A	2,505	-	-	
1991	N.A	2,435	-	-	
1992	847	3,650	717,409	13,322,500	3,091,550
1993	1,336	5,429	1,784,896	29,474,041	7,253,144
1994	1,184	4,318	1,401,856	18,645,124	5,112 ,512
1995	1,210	6,220	1,464,100	38,688,400	7,526,200
1996	1,924	8,987	3,701,776	80,766,169	.17,290,988
1997	1,995	10,761	3,980,025	115,799,121	21,468,195
1998	2,974	16,796	8,844,676	282,105,616	49,951,304
1999	4,639	24,614	21,520,321	605,848,996	114,184,346

N= 8 $\Sigma x = 16,109$ $\Sigma y = 80,7\ 5$ $\Sigma x^2 = 43,415,059$ $\Sigma y^2 = 1,184,649,967$ $\Sigma xy = 225,878,239$

$$r = \frac{N\Sigma XY - \ :X\Sigma Y}{\sqrt{[N\Sigma X - (\Sigma\ :)^2]\,[N\Sigma Y - (\Sigma Y)^2]}}$$

$$= \frac{8 \times 225,87\ ,239 - 16,109 \times 80,775}{\sqrt{[8 \times 43,4\ 5,059 - 16,109^2]]\,[8 \times 1,184,649,967 - 80,775^2]]}}$$

$$= \frac{1,807,025,\ 12 - 1,301,204,475}{}$$

$\sqrt{[347,320\,472 - 259\ 499{,}881][9{,}477{,}199{,}736 - 6{,}524{,}600{,}625]}$

$$= \frac{505{,}821{,}437}{\sqrt{87{,}820{,}591 \times 2{,}952{,}599{,}111}}$$

$$= \frac{505{,}821{,}437}{\sqrt{9{,}371.26 \times 5\ {,}337.82}}$$

$$= \frac{505{,}821{,}437}{\sqrt{509{,}213{,}839}}$$

$$= 0.99$$

4.6 Test of Hypothesis

For the purpose of t e data analysis three hypothesis are to be tested

Hypothesis 1

This states that th bank has performed efficiently in its financial intermediation activ ty as reflected in the high proportion of loans and advances to total de posits. From table 4.1 the proportion of loans and advances to total de posits have been generally on the increase from 26 percent in 1990 to 3 4 percent in 1999.

Furthermore while otal deposits increased by 7.5 times from 1990 to 1999, total loans in reased by almost 10 times during the same period.

The ratio of total lo ns to total deposits has also increased from 26 percent in 1990 to 34 percent in 1999.

This therefore prove the hypothesis that the bank has performed well in its financial intern ediation function during the period.

Hypothesis 2: that th bank's profitability is a function of its loan and advances portfolio. This hypothesis is tested by determining the correlation coefficie t between total loans and interest earned on loans (see table 4.4) This found to be 0.99, an indication of a very strong positive relationship This therefore proves the hypothesis.

Hypothesis 3: that assified loans and advances are decreasing over the period resulting n improvement in the loan- asset quality.

From Table 4.4 a d wnward trend in the proportion of classified loans to total loans is sho n. This therefore proves the hypothesis.

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CHAPTER FIVE

5.0 FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

This Chapter discusses the research findings as they relate to the objectives of the study stated in Chapter One. Conclusions are then drawn from the findings. At the end, recommendations are offered which could lead to an improvement in the bank's credit management system.

5.2 Findings

The study has earlier on identified the problem that afflicted the banking system which led to the closure and liquidation of a number of commercial and merchant banks by the monetary authorities in the period under study. Both the monetary authorities and the banks have evolved means to guard against these factors that contributed to the failure of banks. One of the means evolved by UBA Plc during the period is a review of its credit management system which the study has tried to appraise. The following are the findings and conclusions drawn from the study.

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5.2.1 Objective 1 – Examines the bank's practices in granting loans and recovery procedures

Growth in volume of Loans

The study shows a remarkable improvement in the volume of loans granted by the bank particularly between 1998 and 1999 when ₦ 16,796 million and ₦24,614 million were granted. These represent 34 percent of the total deposits for each of the two years. In 1991 only ₦ 2,435 million was granted representing 20 percent of total deposits.

In spite of this however, one is inclined to believe that there is still room for improvement. It appears most of the managers of the commercial banks are
risk averse and do not make adequate effort in reaching out to clients to market their credit facilities.

Much liquidity is maintained by the commercial banks, which could have been used to create credit. The NDIC quarterly reviews, for 1994 and 1995 reveal holding of excess liquidity by commercial banks above the prescribed limits. This can be seen as follows:

Commercial Banl s liquidity Ratio

Year	Quarter	Prescribed Ratio %	Average Actual Ratio for the Period %	Excess %
1994	June	30	42.04	12.04
1994	September	30	44.5	14.50
1995	June	30	42.82	12.82
1995	September	30	41.47	11.47

Source: NDIC Qua terly Report ,1994 ,1995

The growth in the volume of loans granted by the bank from 1998 to 1999 could be attr buted to the picking up of the economy following the funds releas l by the Government of general Abdulsalami Abubakar. This co trasts with the tight monetary policy of the Abacha regime. Since G vernment is the largest spender in Nigeria, its spending pattern a ffects economic activities in the real and financial sectors.

Loans Maturity l rofile

The study also shows that the bank places more emphasis on overdraft and sho t- term lending than long-term which spans over one year. This can easily be seen from the loan maturity profile of the loans granted for t ie period of study.

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	Amount	%
	₦ million	
Overdraft	53,091	47
1-3 months	29,821	26
3-6 months	4,063	4
6-12 months	8,341	7
over 12 montl	18,377	16
	13,693	

See Appendix VI

The real sector (agricultur and manufacturing) do not get first preference in the bank's lending pract e as they require over one years activity. This could however be associat d to the down turn in the nation's economy.

Security Pattern of Loan

The bank's security patter of loans granted for the period is as follows;

	N million	%
Secured on Real Estate	32,305	28
Otherwise Secured	63,715	56
Unsecured	17,672	16
	113,692	

See Appendix VII

This practice is sa isfactory as it does not deviate form the industry standard.

5.2.2 Objective 2 – Det rmine the extent of Loan losses and the quality of the loan asset

From a review of able 4.4, it is seen that classified loans as a ratio of total loans grantec have been on the decline from 1992 to 1999 (12.4 percent and 2.04 ercent respectively) . In 1996 and 1997 more recoveries were 1 ade than loans were classified. Recoveries were ₦ 43 million and ₦ 75 million in 1996 and 1997 respectively.

This therefore shc vs a decline in loan loss and increase in quality of the loan asset.

5.2.3 Objective 3 – Ide tify the problem that hinder the bank's effective and efficient ma agement of loans and advances portfolio and proffer solutions

Problems

The following pr blems have been observed in the course of the study, as they rela e to the bank's credit management

a. Delays in isbursement of approved facilities as a result of centralizati n of issuance of Authorization of Credit slips (ACS) fron the head office, Credit Risk Management Division.

From the cre t management system of the bank reviewed in Chapter 3, it vould be seen that no disbursements should be made at the b nch level to any customer unit an ACS is issued from the Hea office. As these are not issued out timely from the head offic after due approval is given, this brings out a lot of delay in th customers business transactions.

b. Excessive us of power by the staff of credit risk management division in striking out any recommendation by Deputy General Ma agers (DGMS) and Assistant General Manger (AGMs) at I egional Office without much inquiry as to the status of cust mers with whom the latter

This should l viewed against the background that lending is a highly subje ive phenomenon. In the final analysis it depends on the judg nent of the lender and not the principles and techniques f effective lending, which are only a guide. Some of the figure contained in the Audited Account may not even be authentic

c. Not much c cession are granted to already existing customers who wish to renew or upgrade their facilities with the bank as they have to go through the whole screening process like new customers.

d. High staff t nover. The bank's structuring efforts have taken a toll on the aff many of whom have been laid off. In 1997

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3,193 members of staff were l d off, following the bank's investment in technology. A substantial number were also l d off in 1999. This has made some of the bank's customers to shift to other banks part ·ularly the new generation banks.

5.3 Recommendations

These recommendations coul bring an improvement in the bank's credit management system:

(a) Decentralisation of the c dit risk management function to at least each unit of the bank's branches. The Branc Managers do not have the power to lend even a kobo presently. Even the power to give temporary overdrafts by them (giving credit before customers' cheques are cleare) have been stopped by the Head office.

The bulk of the bank's deposi rs, just like the other three old generation banks are the local people engaged in small l usinesses. These people cannot understand how a Branch Manager cannot assist them to get small credits. The severe curtailment of the powers of the Branch Managers has also educed their self esteem greatly.

It is believed a review of this p licy will be mutually beneficial to the bank as well as its teeming customers who are n w frustrated.

(b) The bank could increase he powers of the Relationship managers in the consumer, commercial and corporate len ing units. For example in the consumer lending sector, any amount above N500,000.( ) has to be sent to the Head office for consideration and approval which takes up to a r inimum of three weeks before it is replied. And in some cases by then the need for the redit may have been overtaken by events.

Because of the low value of he Naira, N500,000.00 is not really much now. If the amount is reviewed upwards will go along way in satisfying the bank's customers' credit needs.

(c) There should be adequat consultations by the Head office with branches before any recommendation for lendi g by the branch is turned down. This is also related to the problem of over centralisation of powers in giving approvals at the Head office. A recommendation for lending to a ustomer for example engaged in grains or livestock business sent by a branch lending officer to the Head office may just be struck out without adequate consultations with th branch staff who are familiar with the customers peculiarities.

If more consultations are mad by the Head office with the branch it would address some of the dissatisfaction of the ba k's numerous customers. The dissatisfaction has reached the point that the bank had to sue out a circular recently debunking insinuations that it has stopped lending.

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APPENDIX I

NON FINANCIAL PROFILE CPRC - 022

SCORE	INDUSTRY RISK	MARKET POSITION	MANAGEMENT ADEQUACY	SHAREHOLDER SUPPORT	POLITICAL LEGAL RISK	EARININGS STABILITY
1 - (Minimal risk)	Highly organised essential maturing or growing industry unaffected by business cycle. Prohibitive entry barriers - unaffected or adequatly mitigated against sourcing of capital i. e. Material Personnel. etc	Leader in Industry dominant or very large market share Highly diversified. Differentiated Products with few substitutes, high quality reputation.	Extensive Industry experience good continuity and Excellent reputation at both Board and management levels. Management has good technical competence. Strong rapport between Management. Board and ownership. Very strong and effective management and internal control systems	Excellent support from Parent Coy. and major Shareholders. S/holders are of excellent reputat - tion and ability. No barriers to providing support.	Minimal exposure to Political and Legal risks.	Stable 3yr Operating PBT and CFLWS Excellent Realistic forecasts Historically accurate forecasts.
2 - (Modest Risk)	Limited competition major maturing or growing Industry. Strong entry barrier insulated or adequa - tely protected from business cycle.	Well diversified very good products reason - ably differentiated. Well known product or brand names. Well entrenched.	Broad Industry experience. Good continuity and depth at Board & Management Level Strong rapport between management, Board and ownership. Effective management control systems.	Strong support from Coy. and major S/hs. Major Shareholders are of strong reputation and ability. Whatever barriers to providing support can be overcome.	Modest exposure to Political and Legal risks.	Stable 3yr Operating PBT and CFLWS. Strong Realistic forecasts. Previous success.
3 - (Average risk)	Growing Industry not so strong entry barri - er. Relatively well protected from cycle. stable Industry with promising future.	Very good product Reasonably differenti - ated with a fairly large or potentially large market share. Competing at par with key Industry names.	Broad Industry experience. Good continuity and depth in most positions. Good rapport between manage - ment, Board and ownership. Satisfactory management internal control systems.	Acceptable level of support from Parent Coy. and major S/holders but concerns about their resources and ability exist. Barriers to provid - ing funds or arranging securities e.g off-shore guarantees exist and will be a constraint to quality of UBA exposure.	Exposure to Political and Legal risks where they exist can be managed. Exposures can be indire - ct through prominent shareholders or compan - ies or industries import - ant to the business of the customer.	Stable 3yr Operating PBT and CFLWS. Even if previous fore - casts record has not always been accur - ate.

APPENDIX I

SCORE	INDUSTRY RISK	MARKET POSITION	MANAGEMENT ADEQUACY	SHAREHOLDER SUPPORT	POLITICAL LEGAL RISK	EARINGS STABILITY
4 - (Marginal Risk Management attention required) Watch List	Limited number of firms, but strong competition and non-important industry. Vulnerable to business cycle and devaluation of the Naira. Could be a fledgling industry. Uncertain future.	Rapidly growing market share good quality product but constrained by key industry risks.	Broad Industry experience but some management weakness. Limited continuty due to ownership structure. Some risk of distabilising interference from Board or ownership. Possible disharmonies.	support of Parent Coy. or major Shareholders can not be relied upon. Either lack of willingness or lack of ability to support.	Highly regulated Industry or Company and regulatory decisions are unstable. Legal or Political enviroment highly unstable or speculative.	Indifferents 3yr operating PBT - Earnings boosted by non-operating income. Forecast cannot be relied upon. Substantial doubts about sustainability of performance.
5 - (Sub-standard Risk outside risk acceptance Limits)	Non essential Industry with great competition No entry barrier, Industry mature or declining. Vulnerable to business cycle, Devaluation of the Naira or dependence on foreign exchange volatile.	Undistinguished firms with small or declining market share mediocre quality. No cost or key advantage.	Limited Industry experience little or no depth with weaknesses in key spots. Management uncooperative with the bank.	No entity Playing role of Parent Coy. or Major shareholder or where such exists, substantial support cannot be expected. Or S/hs are taking resources from the coy. possible through transfer pricing.	Business of the coy. or key aspects of it are subject to negative Legal or Political regime.	Earnings are unstable or below Indstry standards significant doubts about continuity of key aspects of operations or entire operations Speculative

KASHIM IBRAHIM LIBRARY

APPENDIX II

FINANCIAL PROFILE CPRC-023

SCORE	SIZE & CAPITAL ACCESS	LEVERAGE	INTEREST COVERAGE	P/TABILITY	W/CAPITAL RATIOS		INVENTORY T/OVER
					CR	QR	
1	Sales p.a >N10bn & Superior performance confers unrestricted access to capital mkts. e.g main exchange and debt issues.	<1.5	>1	>15%	>2	>1.5	<60 days
2	Sales p.a >N5bn & Access to capital mkts. e.g main exchange	1.5<2	>5	>10%	>1.5	>1.25	<90 days

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APPENDIX II

3_Sales p.a >N1bn & Some Access to Capital Sources primarily bank loans, second tier exchange and strong s/hs.	2<3	>2	5	>7.5%	>1.25	>1 <120 days
4 Sales p.a >N250m & Limited access to capital sources primarily bank loans and s/holders. Private coy.	3<5	>1	5	>5%	>1	>.5 <150 days

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5 Sales p.a <N250m but within Target Market. Capital sources are bank loans and profits. S/holders not a significant source.	5& abov	<1.5	<5%	<1	<.5	>150 days

(ii) GUIDANCE NOTES TO DERIVING FACILITY RISK RATINGS (FRR)

KEY FEATURE OF FACILITY	FACILITY RISK RATING(FRR)
A. COLLATERAL	
CASH COLLATERAL.	FRR 1 irrespective of CQR
FIRST CLASS DEVELOPED PROPERTY IN GOOD LOCATION IN COMMERCIAL CITY (SEE LIST).	FRR equal to CQR
ACCEPTABLE QUALITY DEVELOPED PROPERTY IN GOOD LOCATION IN COMMERCIAL CITY AS PER SAME LIST.	FRR equal to CQR + 1
OTHER ACCEPTABLE SECURITIES AND NON BANK GUARANTEES.	FRR equal to CQR + 1
ACCEPTABLE BANK GUARANTEE AND STAND-BY LETTER OF CREDIT.	FRR equal to issuing bank's CQR
TREASURY BILLS.	FRR 1
EXPORT RED CLAUSE L/C	FRR equal to issuing bank's CQR.
UNSECURED - CQR 1	FRR equal to CQR
UNSECURED - CQR 2	FRR equal to CQR + 1

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APPENDIX III

TENOR

WITHIN 12 MONTHS	FRR equal to CQR
12 - 48 MONTHS	FRR equal to CQR + 1
OVER 48 MONTHS	FRR equal to CQR + 2

OTHER

(I) BANK PLACEMENT LINES

UNSECURED	FRR equal to CQR + 1
SECURED WITH T/BILLS, CASH	FRR equal to 1

(ii) LEASES

STRAIGHT LEASE - NEW ASSET	FRR equal to CQR
SALE AND LEASE BACK - USED ASSET	FRR equal to CQR + 1 due to valuation problems.

NOTES TO GUIDANCE NOTES

There should be no double counting. In the event that a facility exhibits more than one key feature as identified above, the most constraining (worst) FRR should be adopted.

APPENDIX IV

UNITEI BANK FOR AFRICA PLC

BALANCE SHEET EXTI ACT FOR THE YEAR ENDED 31ST MARCH

	1999	19	98	1997	1996	1995	1994	1993	1992
	₦	₦		₦	₦	₦	₦	₦	₦
	million	mi	ion	million	million	million	million	million	million
Use of funds									
Cash and shortterm funds	42,221	32	81	26,686	27,729	25,870	10,118	9,128	9,009
Bills Discounted	13,347	9,8	2	9,435	5,991	3,636	1,947	999	1,353
Investments	515	53		3,664	3,058	3,034	868	1,429	45
Loans and Advances	24,614	16	96	10,761	8,987	6,220	4,318	5,429	3,650
Others Assets	10,350	10	72	4,894	4,240	4,595	5,449	4,848	3,645
Fixed Assets	3,431	3,(	3	2,342	2,011	1,755	1,545	1,117	909
	99,978	73	51	57,782	52,016	45,110	24,245	22,950	18,611
Liabilities									
Deposit and Current Account	73,207	48	58	39,521	37,019	33,161	18,354	18,628	17,356
Other Liabilities	20,915	19	06	12,543	10,227	8,129	4,156	3,492	732
Taxation	845		51	428	483	224	171	107	18
	94,967	68	15	52,492	47,729	41,514	22,681	22,227	18,106
Capital and Reserves									
Share Capital	500		00	300	300	300	100	100	100
Reserves for bonus issue	-		-	200	-	-		-	-
Other Reserves	4,511	4	36	4,790	3,987	3,296	1,464	623	405
Shareholders funds	5,011	5	36	5,290	4287	3,596	1,564	723	505
	99,978	73	51	57,782	52,016	45,110	24,245	22,950	18,611

APPENDIX V

UNITE) BANK FOR AFRICA PLC

PROFIT AND I OSS EXTRACT AS AT 31ST MARCH

	1999	1 98	1997	1996	1995	1994	1993	1992
	₦	₦	₦	₦	₦	₦	₦	₦
	million	m lion	million	million	million	million	million	million
Gross Earnings	10,650	850	7,276	6,973	4,640	3,629	2,908	2,078
Profit before taxation	1,766	225	903	1,246	488	213	350	15
Taxation	(657)	91)	(66)	(302)	(135)	(80)	(96)	(5)
Profit after taxation	1,109	34	837	944	353	133	254	10
Transfer to/(from)								
Reserves	529	66	(775)	(744)	(253)	(82)	(213)	(2)
Ordinary dividends	(530)	00)	(60)	(200)	(100)	(50)	(40)	(8)
Retained Profit for the year	0		2	0	0	1	1	0
Profit brought forward	5		3	3	3	2	1	1
Retained Profit Carried forward	5		5	3	3	3	2	1

APPENDIX VI
LOAN MATURITY PROFILE

	Total		1999		1998		1997		1996		1995		1994		1993		1992	
	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%
	₦ m		₦ m		₦ m		₦ m		₦ m		₦ m		₦ m		₦ m		₦ m	
Overdrafts	53,091	47	16,927	60	11,615	60	6,156	36	4,555	31	3,958	35	3,105	36	3,932	47	2,843	48
1 –3 months	29,821	26	6,452	23	121	0.6	7,144	41	6,364	43	3,159	28	2,989	35	2,021	24	1,571	27
3 –6 months	4,063	4	957	3	931	5	496	3	693	5	290	3	281	3	248	3	167	3
6 – 12months	8, 341	7	1,957	7	2,156	11	714	4	658	4	941	8	522	6	982	12	411	7
over 12months	18.377	16	1.790	7	4.391	23.4	2.774	16	2.563	17	3.042	26	1.702	20	1.220	14	806	15
	113,693		28,083		19,214		17,284		14,833		11,390		8,599		8,403		5,887	

APPENDIX VII

LOAN SECURITY PATTERN

	Total	%	1999		1998		1997		1996		1995		1994		1993		1992	
	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%	Amt ₦ m	%
Secured Against Real Estate	32,305	28	7,995	28	5,824	30	3,673	21	3,840	26	3,680	32	3,236	38	2,310	27	1747	30
Otherwise																	3,622	62
Un-secured	17,672	16	1,330	5	3,603	19	4,726	28	2,746	18	2,631	23	1,295	15	824	10	517	8
	113,692		28,083		19,213		17,284		14,833		11,391		8,598		8,404		5,886	