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DOES CREDIT RISK MANAGEMENT AFFECET FINANCIAL PERFORMANCE OF BANK IN NIGERIA?

AJAGBE, SURAJDEEN TUNDE, PhD.
Department of Banking and Finance,
Faculty of Management Sciences,
Al-Hikmah University, Ilorin,
Kwara State, Nigeria;
E-mail: tundesuraj@gmail.com or stajagbe@alhikmah.edu.ng

EWANSIHA, EMMANUEL OSARETIN
Department of Banking and Finance,
The Federal Polytechnic, Bida,
Niger State, Nigeria
E-mail: ewansihaemmanuel@yahoo.com

And

SAIDU, SULAIMAN
Department of Banking and Finance,
The Federal Polytechnic, Bida,
Niger State, Nigeria

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Abstract

The study examined the effect of credit risk management on the financial performance of Eco Bank Nigeria Plc for the period of 2011-2020. Secondary data were sourced from annual reports and financial statement of Eco Bank Nigeria Plc. The study employed ordinary least square regression technique in analyzing the data extracted; the analysis was done with the aid of E-View Econometric tool. The study revealed that loans and advances and loan loss provision have positive and insignificant effect on profitability, while non-performing loan has a negative and insignificant effect on profitability. The R-squared which measures the overall goodness of fit of the regression shows the value of 84.5%. While the Durbin Waston statistic with value of 2.808450 shows that there is relative auto correlation among the considered variables and the overall regression is statistically significant. Thus, the study concluded that sound credit management heightens financial performance and holds the financial strength of the bank. It was recommended that the bank should put in place sound credit management policies and Practice. Issue recoverable loan and advances and provide for loan losses for desired credit risk exposure and increased profitability.

Introduction

Credit risk continues to create problem in the Nigeria banking system, if credit risk is not managed and monitored very well (Makriand, 2013). A poor performing economy leaves people heavily caught up in debt and defaulting leading to bank failure, since credit is an immense component of the financial soundness of banks. Therefore, effective oversight of non-performing loans is imperative to boost bank performance and offer guidance on economic efficiency (Haneef, Riaz, Ramzan and Rana, 2012). Credit management is crucial, as failure to have quality loans and credit-worthy customers' leads to an increase of default risk, which will strongly affect financial performance, growth and survival of banks (Mirach, 2010).

One of the notable financial crises is credit risk, which has to be cautiously monitored and supervised so as to reduce default rate (Noomenand, 2018). General lack of a monitoring process on credit records, which includes not following up after banks give credit, and instability of governance are contributors of increased credit risk in banks. It is essential for any bank as a lender to continuously monitor the borrower's ability to repay the debt (Addae-korankye, 2014). The level to which a bank extends credit to the public for productive activities accelerates the pace of a nation's economic growth and its long-term sustainability and hence its profitability (Kolapo, Ayeni and Oke, 2012).

However, credit risk management alleviates the effect of non-performing loans to circumvent collapse of banks, which lead to lower economic growth and higher unemployment, which was approximately at 29% in Africa (Sujeewa, 2015). A well-structured banking system leads to a sound financial system which then results in an improved economy for the country.

Despite the stringent regulations put in place by the Central Bank of Nigeria and other regulatory bodies, the banking industry is still overwhelmed with high credit risk in the form of non-performing loans. The rate of non-performing loans had its peak of 37.3% in 2009 and had a low rate of 3.0% in 2014 and it has continue to increase to the rate of 11.4% in 2018 (Central Bank of Nigeria, 2019). Credit management has often been a challenge to many Deposit Moneys Banks in Nigeria, because, despite best practices measures in credit risk management put in place by the management of these banks, customers still have strong tendencies to delay or completely stop repayment of their loan, which often lead to problem of non-performing loans. Most researches considered by this study (e,g. Gadzo, Oduro, and Asiedu,2019 ; Nwanna and Oguezue, 2017; Li and Zou 2014; Ndubuisi and Amedu ,2018; Ojiong, Okpa, and Egbe, 2014 they all emphasis that credit risk management have significant positive relationship with profitability of deposit money banks.

Many previous researchers have focused on all the Deposit Money Banks in Nigeria. This work focuses on just one bank to fill the existence gap and since most previous research works on credit risks management and financial performance of banks covered up to 2018, therefore, this study covered 2011-2020 which also falls within the period of global economic recession, covid-19 pandemic and unpleasant credit risk management consequences for banks.

Therefore, this study intends to uncover the effect of loan and advance, non-performing loan and loan loss provision on the return on asset (ROA) of Eco-Bank Plc.

The general objective of this study is to establish the effect of credit risk management on the profitability of Eco bank Nigeria plc, while the specific objectives are;

i. To evaluate the effect of loan and advances on the financial performance of Eco bank Nigeria plc.
ii. To determine non-performing loan effects on the financial performance of Eco bank Nigeria plc.
iii. To examine Loan Loss Provision on the financial performance of Eco bank Nigeria plc.

Literature Review

Conceptual Review

Credit Risk Management

Credit risk management in financial institutions has become crucial for the survival and growth of these institutions. It is a structured approach of uncertainty management through risk assessment, development of strategies to manage it and mitigation of risk using managerial resources (Afriyie and Akotey, 2011). Credit management policies includes the establishment of formal, legitimate and legal procedures that maintains that the proper authorities are responsible for the award of credit and to maintain that the credit awarded goes to the right person and that the granted amount is used for the intended purposes with the aim of investing in productive ventures or for business which are economically or technically viable. Also, the policies include ensuring that the right amount of credit is granted, the credit granted is recoverable and ensuring that there is an adequate flow of information within and across the organization to credibly monitor the credit awarded (Dei Ofosu-Hene and Amoh, 2016).

The primary purpose of credit risk management is to maximize the risk-adjusted return rate of a bank by keeping an exposure of credit risk within acceptable parameters that leads to improvements in economic performance (Olabamiji and Michael, 2018). Banks, therefore, need to manage the credit risk inherent in the entire portfolio as well as the uncertainty in individual credits or transactions. Financial institutions should also consider the relationships between credit risk and other risks as well as their impact on financial performance. Effective credit risk management is a key aspect of an integrated risk management strategy, which is crucial to a banking organization's long-term achievement as well as its economic results (Taiwo, and Achugamonu, 2017).

Saeed and Zahid (2016) postulated that Banks like other financial institutions face a number of risks and hazards including credit risks, liquidity risks, operational risks, exchange rate risks, interest rate risks, political risks, and all other internal and external risks. However, credit risk is considered as the most common and dangerous risk especially for the banks that can put them into deep trouble and even, they may face bankruptcy. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions.

Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. The term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Financial performance is crucial for a commercial bank to attain its going concern issue, banks being at the center of financial sector can disrupt the entire economy if their inherent challenge, credit management is not handled properly (Dimitrios, Helen, and Mike, 2016).

Financial performance refers to the measure of how well a bank can use assets from its primary mode of business and generate revenues (Karugu and Ntoiti, 2015). It is necessary to assess the economic health of a bank over some time to compare or compare comparable companies in the same sector or sector in aggregation. In risk management, the financial performance of a firm is assessed by evaluating its profitability, liquidity, and capital adequacy (Kodithuwakku, 2015).

Turyahebwa (2013) defines performance in financial sector as the ability to operate efficiently, profitably, survive, grow and react to the environmental opportunities and threats. In agreement with this, Pandey (2005) assert that, banks performance is measured by how efficient the enterprise is in use of resources in achieving its objectives.

Theoretical Review

The Credit Risk Theory

The premise at which study laid is the credit risk theory which emphasis that risk is primarily that of the lender and includes lost principal and interest, disrupt loss may be complete or partial and can arise in a number of circumstances, such as an insolvent bank unable to return funds to a depositor. To reduce the lenders risk, the lender may perform a credit check on the prospective borrower, may require the borrower to take appropriate insurance, such as mortgage insurance or seek security or guarantees of third parties. In general, the higher the risk, the higher will be the interest rate that the debtors will be asked to pay on the debt.

Empirical Review

Hence, this study reviews the following prior studies: Adjei, Niibton and Ntim (2020) their study explored the effect of credit risk management and its relationship to financial performance in the Ghanaian banking sector. This study adopted the explanatory research design to census four (4) selected banks. These banks were Access Bank, Agricultural Development Bank, Ghana Commercial Bank, and Republic Bank. Data was obtained from published audited annual report of the banks and the Ghana Banking Survey. The study adopted the regression analysis. The results indicated that credit risk has a negative relationship with performance in the banking sector.

Nwanna and Oguezue (2017) examined a study titled investigated a study titled Effect of Credit Management on Profitability of Deposit Money Banks in Nigeria. The study employed multiple regression analysis in Eviews 9. The findings of the study reveal that loans and advances and loan loss provision have positive and significant effect on profitability, while non-performing loan has a negative and insignificant effect on profitability.

Taofeek and Adeniyi (2020) study was aimed at establishing the relationship between the credit management and financial performance in financial institutions in Nigeria. Correlation and Regression analyses were used to estimate the causal relationships between credit management and financial performance and other related variables. The results of the analyses revealed that when a company implements effective credit management systems, the firm's efficiency is enhanced.

Adegbie and Otitolaiye (2020) investigated credit risk and financial performance: An empirical study of deposit money banks in Nigeria. The study covered

169 firm-year observations for the period of 2006-2018 in Money Deposit Banks in Nigeria. The result of their analysis revealed that credit management had a positive significant effect on financial performance of the Deposit Money Banks in Nigeria.

Patrick (2020) examined Credit management, credit policy and financial performance of commercial banks In Uganda. The study used universal sampling techniques, where all banks licensed and operational in Uganda were selected, multiple regressions was used. The findings indicated a significant relationship (r=0.639) between credit management credit policy and financial performance of commercial banks in Uganda.

Hudu, Abdu, Murtala and Sulaiman (2019) Study analyzed the effect credit risk management on the financial performance of quoted deposit money banks in Nigeria for a 9-year period (2010-2018). The findings revealed that Loan to deposit ratio, credit risk and capital adequacy risk have insignificant effect on return on assets while solvency risk and firm size have positive significant effect on return on assets.

Ajao and Oseyemon (2019) investigated the relationship between credit risk management and the performance of Deposit Money Banks (DMBs) in Nigeria over the period 2006-2016 using the dynamic Generalized Method of Moments (GMM) and Granger causality techniques. The study revealed a direct and statistically significant relationship between DMBs credit risk management variables measured by capital adequacy ratio, non-performing loan ratio and loan loss provision ratio and performance measured by return on asset.

Oduro, Asiedu and Gadzo (2019) identified the factors that determine the level of bank credit risk and further estimate the effects of bank credit risk on corporate financial performance using financial data from banks on the Ghana Stock Exchange over a 15-year period from 2003 to 2017. Using the method of 2SLS, it was observed variables such as capital adequacy, operating efficiency, profitability, and net interest margin are inversely related to credit risk.

Gadzo, Kportorgbi and Gatsi (2019) assessed the effect of credit and operational risk on the financial performance of universal banks in the context of the structural equation model (SEM). Data were collected from all the 24 universal banks in Ghana without missing variables and using the PLSSEM, the results showed that credit risk influences financial performance negatively contrary to the empirical study but in line with the information asymmetry tenant of the lemon theory.

Ndubuisi and Amedu (2018) studied the Relationship between Credit Risk Management and Bank Performance in Nigeria using Fidelity Bank Nigeria PLC as a case study. The statistical analysis for the study was done using Pearson Correlation Coefficient. The findings of the study reveal that there is weak significant relationship between credit risk management and bank performance in Nigeria. The study concludes that there is no significant relationship between credit risk management and bank performance in Nigeria.

Nwude and Okeke (2018) investigated the impact of credit risk management on the performance of deposit money banks in Nigeria using five banks that had highest asset base. Ex-post facto research design was adopted using dataset for the period 2000–2014 collated from the annual reports and financial statement of the selected deposit money banks. Three hypotheses were proposed and tested using ordinary least square regression model. The findings reveal that credit risk management had a positive and significant impact on total loans and advances, the return on asset and return on equity of the deposit money banks.

Taiwo, Achugamonu, Adetiloye, Okoye and Agwu, (2017) researched on the effect of credit risk management on the performance of Nigeria's Deposit Money Banks (DMBs) and Bank lending growth over the period of 17 years (1998- 2014). Secondary data for empirical analysis was obtained from CBN Statistical bulletin 2014 and World Bank 2015. The study employed multiple linear regression model to analyze the time series data. The result showed that sound credit management strategies can boost investors and savers confidence in banks and lead to a growth in funds for loans and advances which leads to increased bank performance.

Methodology

The research used secondary data obtained from the annual reports and audited financial accounts of Eco Nigeria Plc from (2011-2020). Ordinary least square regression analysis was carried out on data collected. Also, descriptive statistics and correlation test were equally conducted to establish the effect of credit risk management on the financial performance of the bank under review.

Model Specification and Variable Definition

The independent variable is credit risk management proxy with loans and advances, non-performing loans and loan loss provision. While the dependent variable was financial performance proxy with return on assets.

Variable	Measurement
Loans and Advances	Obtain from statement of financial position
Non-Performing loans	90 days + late loans and still accruing to non-accrual loans, and then dividing the total by the total amount of loans in the portfolio.
Loan Loss Provision	Profit before tax+loan loss provision/net charge-offs
Return on Assets	Profit after Tax/Total assets X by 100

Source: Researcher Computation, (2022).

Model Specification

ROA= α0+αLA+NPL+LLP+ε

Where:

ROA: Return on Assets
α0: Constant
LA: Loan and Advances
NPL: Non-Performing Loan
LLP: Loan loss provision
ε: Error Term.

Result and Discussion

Descriptive Statistics

Table 1

	ROA	**LA**	**NPL**	**LLP**
Mean	1.123	8192.19	494.408	513.9625
Median	2	7974.7	180.525	277.95
Maximum	4.29	13222.7	2922.8	1977.5
Minimum	-9.28	2524.3	123.56	160.9
Std. Dev.	3.849087	3065.887	860.616	557.3036
Skewness	-2.191428	-0.2133	2.584745	2.082258
Kurtosis	6.683963	2.697704	7.845285	5.956769
Jarque-Bera	13.65875	0.113901	20.91684	10.86903
Probability	0.001082	0.944641	0.000029	0.004363
Sum	11.23	81921.9	4944.08	5139.625
Sum Sq. Dev.	133.3392	84596993	6665939	2795286
Observations	**10**	**10**	**10**	**10**

Source: E-view Output (2022)

Table 1 above presents the various descriptive statistics and distribution of the independent and dependent variables used in the study. It shows that financial performance which was represented by return on assets had mean of 1.123 with a standard deviation of 3.849087. The mean values and standard deviation of the independent variables shows the extent of distribution and relationship among relation to return on assets and themselves.

Regression results of the equation:

$$ROA=\alpha0+\alpha LA+NPL+LLP+\varepsilon$$

Table 2

Dependent Variable: ROA

Method: Least Squares

Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.312652	1.783331	-0.175319	0.8666
LA	0.000495	0.000213	2.319712	0.0595
NPL	-0.014518	0.002706	-5.365131	0.0017
LLP	0.009800	0.001731	5.662811	0.0013

R-squared	0.845179	Mean dependent var	1.123000

Adjusted R-squared	0.767769	S.D. dependent var	3.849087
S.E. of regression	1.854888	Akaike info criterion	4.362700
Sum squared resid	20.64366	Schwarz criterion	4.483734
Log likelihood	-17.81350	Hannan-Quinn criter.	4.229926
F-statistic	10.91818	Durbin-Watson stat	2.808450
Prob(F-statistic)	0.007631		

Source: E-view Output (2022)

Table 2 above, R-squared show that 84.5% of the variations in financial performance as proxy by (ROA) can be attributed to explanatory variables (LA, NPL and LLP), While the remaining 15.5% variations in the respective dependent variable were caused by other factors not included in the model. Durbin-Watson statistics stands at 2.808450 which signify that there is though evidence of autocorrelation detected in the sample data for the study.

Also, from the result of the analysis presented in Table 2, Loan and Advances (LA) has a positive effect on financial performance (ROA). This is shown by a regression coefficient of0.000495 statistically significant at 5%. This shows that the management of Loan and advance helps to increase the financial performance of Eco Bank. Performing Loan (NPL) has a negative effect on financial performance (ROA) as indicated by a coefficient of -0.014518 statistically significant at 1% level. This implies that increase in Non-Performing Loan is detrimental to Eco Bank financial performance (ROA).

Loan Loss Provisions (LLP) has a positive effect on financial performance (ROA). This is indicated by a regression coefficient of 0.009800. The effect is statistically significant at 1%. This means that the increase in Loan Loss Provisions brings about increased financial performance. Thus, there is enough provision made against loan losses.

Test of Hypotheses

Table3. Summary of regression result

Variables	Coefficients	P-value	DecisionRule	Conclusion
Loan and Advance	0.000495	0.0595	P-value≤0.05	Significant
Non-Performing Loan	-0.014518	0.0017	P-value<0.05	Significant
Loan Loss Provision	0.009800	0.0013	P-value<0.05	Significant

Loan and Advances hasa positive coefficient of 0.000495 showing a positive effect on financial performance (ROA).The result showed consistency with the earlier findings of Nwanna and Oguezue (2017).Non-performing Loan has a negative coefficient of -0.014518 indicating a negative relationship with financial performance of the bank under review. The finding concurs with prior findings of Taiwo et al (2017) Loan Loss Provisions has a positive coefficient of 0.009800 showing a positive effect on financial performance. The finding is in disagreement with result of (Alrop and Kokh, 2020). However, the result aligns with the findings of Adegbie and Otitolaiye (2020) who finds that loan loss provision has positive and significant relationship with Nigeria banks financial performance.

Research Findings

Based on analysis and interpretation carried out, this study note the following finding:

i. Loan and Advances (LA) has a positive effect on Return on Asset (ROA).
ii. Non-Performing Loan (NPL) has a negative effect on Return on Asset (ROA.
iii. Loan Loss Provisions (LLP) has a positive effect onReturn on Asset (ROA).

Conclusions and Recommendations

This study examines the effect of credit risk management on the Profitability of Eco Bank Nigeria Plc and as a result the following conclusions were reached based on the findings of the study:

i. Loan and Advances (LA) has a positive effect on Return on Asset (ROA) as well as, showing significant effect of Loan and Advances on financial performance.
ii. Non-Performing Loan (NPL) has a negative effect on Return on Asset (ROA), with significant effect to Non-Performing Loan on financial performance.
iii. Loan Loss Provisions (LLP) has a positive effect on Return on Asset (ROA) with significant effect of Loan Loss Provisions on financial performance

In view of the findings and conclusions, it was therefore recommended that: Management should ensure that credit officers adhering to prudential guidelines when given out credit facilities, ensure recoverable loan and advances and provide for loan losses for desired credit risk exposure and increased profitability. Eco Bank Nigeria Plc must put in place sound credit-granting process, strictly hold fast to know your customer (KYC) system, applying effective measures in measuring and monitoring of credit and ensure effective controls over credit risk.

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