Credit Management Practices and Bank Performance: Evidence from First Bank

Abstract

The study examined the influence of credit management practices on financial performance of Nigerian banks with specific reference to First bank Plc. Data was collected using Purposive sampling technique from thirty (30) respondents *as a sample size used to collect data from the respondents. Both descriptive and inferential statistics were used to analyze data, such as frequency, percentage, weighted mean score, and multiple regression. The result revealed that credit management practices have a significant positive influence on the financial performance of First bank. The result concluded that client appraisal, credit risk control, and collection policy are major predictors of financial performance of First bank. Subsequently, the study recommended that management of other banks should learn from First bank by enhancing their client appraisal techniques, credit risk control and adopting a more stringent policy to improve their financial performance.*

Keywords: Client Appraisal, Credit Risk Control, Collection Policy, Credit Management, Nigeria

Introduction

A pivotal role of banking sector in economic growth and development in developed and developing economies has been acknowledged by scholars, economists, accountants, researchers, and professionals. Banking sector contributes to the real productivity of the economy and the overall standard of living, since banks can simultaneously satisfy the needs and preferences of both surplus and deficit units (Owojori, Akintoye & Adidu, 2011). Uwalomwa, Uwuigbe, and Oyewo (2015) also reiterate that banks are major players in the financial sector of every country's economy. The failure or success of these banks will to a large extent affect the financial sector and the economy at large. This implies that banks are the major determinant of financial inclusion because they allocate funds from savers to borrowers in an efficient manner.

Having recognized the vital contributions of the banking sector to economic growth and development in Nigeria, the federal government established regulatory authorities to monitor the activities of the sector, so that its contributions to Nigerian economy can be felt positively. Some years ago regulatory authorities compelled the banking industry in Nigeria to undergo serious reforms arising from the Central Bank of Nigeria's requirement for banks to increase their capital base (share) to a minimum level of ten billion naira (N10b) for regional banking, twenty-five billion naira (N25b) for national banking and fifty billion naira (N50b) for international banking, respectively. This policy has made the Central Bank of Nigeria (CBN) to license ten (10) banks with international authorization, nine (9) banks with national authorization and one (1) bank with regional authorization totaling twenty (20) Deposit Money Banks. Also, the introduction of tenure system for banks' chief executives and auditors represents a major shift in the Nigerian corporate governance system, in which managing directors of banks can now only serve for a 10-year period while auditors are compulsorily replaceable after a certain period.

In spite of these policies and programmes, Nigerian banks still witnessed several cases of collapses. This may be as a result of poor credit management. According to Osuka and Amako (2015), poor credit administration reduces bank profitability and leads to bank distress and failure. To support this revelation, Uwalomwa, et al. (2015) confirm that poor management of credit component of the banks' portfolio leads to the problem of bad debts in Nigerian banks which eventually made them perform below expectation. Consequently, this menace had eroded the confidence the depositors, shareholders and foreign investors have in Nigerian banking sector. Kagoyire and Shukla (2016) assert that credit management is one of the most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. Authors note that sound credit management is a prerequisite for a financial institution's stability and continuing profitability while deteriorating credit quality is the most frequent cause of poor financial performance and condition (Kagoyire & Shukla, 2016).

Myers and Brealey (2003) describe credit management as the method and strategy adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. The aim of credit risk management is to maximize a bank's risk-adjusted rate of return. This can be achieved by maintaining credit risk exposure within acceptable parameters (Taiwo, Ucheaga, Achugamonu, Adetiloye, Okoye, &Agwu, 2017). According to Kagoyire and Shukla (2016), a key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns.

Statement of the Problem

Incessant crisis in the banking sector has been attributed to poor credit management. Studies argue that provision for bad and doubtful debts that rise steadily in banks annual reports, indicate that credit component of the banks' portfolio is poorly managed. Many of them were writing off huge amounts of debt yearly and also reflected some going concern issues that related to their management of credit and finance (Uwalomwa, et al., 2015; ,Agu & Okoli, 2013). Equally, Taiwo et al (2017) reiterate that many banks have given out loans and advances which could not be recovered to a massive growth in Non-Performing Loans (NPLs) in their accounts. According to the statistics as at first half of 2017, 14 banks have recorded N177.3 billion bad loan. This unpalatable scenario is sending a bad omen to the investors within the economy.

The incessant bank distressed in the economy over the years had eroded the confidence of depositors, investors and even government in the sector. The reason for the failure of these banks despite the mechanisms put in place by the regulatory authorities to checkmate unprofessional ethics prompts this current study to conduct further study on the impact of credit management on the performance of Nigerian banks with specific reference to First Bank Plc.

Research Questions

The following questions are the focus of this study:

i. What is the effect of client appraisal on financial performance in First bank Plc?

ii. What is the effect of credit risk control on financial performance in First bank Plc?

iii. What is the effect of collection policy on financial performance in First bank Plc?

Objectives of the study

The general objective for this study was to establish the effect of credit management on the financial performance of Nigerian banks with specific reference to First bank Plc. The Specific Objectives are:

i. To determine the effect of client appraisal on financial performance in First bank Plc.

ii. To determine the effect of credit risk control on financial performance in First bank Plc.

iii. To determine the effect of collection policy on financial performance in First bank Plc.

Research Hypothesis

The following hypothesis was formulated for this study

H_0: Credit management practices have no significant effect on financial performance of First bank Plc.

H_I: Credit management practices have significant effect on financial performance of First bank Plc.

Literature Review

Concept of Credit Management

According to Tetteh (2012), sound credit-giving is one of the most essential principles which strengthen financial institutions in their financial standing. This researcher stressed that, sound credit giving establishes credit limits as well as develop credit granting process for approving new credits. Credit plays a very vital part in the economic growth and development of a country. These roles credit plays can be categorized into two: it enables the transfer of funds to where it will be most effectively and efficiently used and secondly, credit economizes the use of currency or coin money as granting of credit has a multiplier effect on the volume of currency or coin in circulation (Nwanna & Oguezue, 2017). According to Pasha and Mintesinot (2017),credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. Shekhar (1985) notes that, in banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans.

Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Nelson (2002) views credit management as simply the means by which an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk. Nzotta (2004) opined that credit management greatly influences the success or failure of commercial banks and other financial institutions. This is because the failure of deposit banks is influenced to a large extent by the quality of credit decisions and thus the quality of the risky assets. He further notes that, credit management provides a leading indicator of the quality of deposit banks credit portfolio.

A key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns (Kagoyire & Shukla, 2016).

Theoretical review

Information Asymmetry Theory

This study anchors on information asymmetry theory, because the theory is very relevant to this study. Information asymmetry theory elucidates on basic information to be known by both lenders and business owners in terms of potential risks and returns associated with investment projects for which the funds are earmarked. Binksand Ennew (1992) note that perceived information asymmetry poses two problems for the banks; moral hazard (monitoring entrepreneurial behavior) and adverse selection (making errors in lending decisions). This implies that before credit can be granted, the “5cs” (character, capacity, capital, collateral and conditions) must be adequately evaluated. This is because data needed to screen credit applications and to monitor borrowers are not freely available to banks. Bankers face a situation of information asymmetry when assessing lending applications. Edwards and Turnbull (1994) argue that information asymmetry arises when a borrower who takes a loan usually has better information about the potential risks and returns associated with investment projects for which the funds are earmarked. The banker on the other hand does not have sufficient information concerning the entrepreneurs. In the same vein, Watts and Zimmerman (2005) also note that information asymmetry is the extents to which banks’ managers know more about the firm than investors as a group.

Relationship between Credit Management and Financial Performance

There are of plethora studies on the relationship between credit management and financial performance of banks in developed and developing economies; however, their results are conflicting and inconclusive. For instance, Nwanna and Oguezue (2017) examine the nexus between credit management and profitability of Deposit Money Banks (DMBs) in Nigeria context for the period of 2006 to 2015. Secondary data were sourced from the Central Bank of Nigeria Statistical Bulletins and the Annual Reports of all the existing DMBs studied. The study employed multiple regression technique in analyzing the data that was gathered, the analysis was done using ordinary least square method. The study found 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. Kagoyire and Shukla (2016) determine the effect of credit management on the financial performance of commercial banks in Rwanda. The target population of the study consisted of entire population was used as the sample giving a sample size of size of 57 employees. A Purposive sampling technique was used from Equity Bank in the credit department. Structured questionnaires were used to collect data, while descriptive and inferential statistics were used to analyze data. Results revealed that client appraisal, credit risk control and collection policy had effect on financial performance of Equity bank.

Uwuigbe, Uwuigbe and Oyewo (2015) assess the effects of credit management on banks' performance in Nigeria. Secondary data sourced from annual financial statement of selected ten (10) listed banks covering the period 2007-2011.Both descriptive statistics and econometric analysis were used to analyze the data. Results revealed that ratio of non-performing loans and bad debt do have a significant negative effect on the performance of banks in Nigeria, on the other hand, the relationship between secured and unsecured loan ratio and bank's performance was not significant. Kwaku (2015) assess the credit risk management practices in the Banking Industry of Ghana. The result indicated that the bank has documented policy guidelines on credit risk management with a senior managers having oversight responsibility for implementation. Result also revealed that that there was some implementation challenges of the credit risk policies which have resulted to low quality of loan portfolio of the bank. In another study, Lalon (2015) examines the impact of credit risk management on financial performance of commercial banks of Bangladesh. Results showed that the relationship between credit risk management and banks profitability is positive. This implies that effective credit risk management contributes significantly to banks financial performance.

Osuka and Amako, (2015) using time series data from 2001 – 2011, appraise the impact of the credit risk management in bank's financial performance in Nepal. The results of the study indicate that credit risk management is an important predictor of banks' profitability and financial performance. Chen and Shuping (2012) also examine the credit management of commercial banks of Lianyungang City for the small scale and medium enterprises (SMEs). Result showed that the risk management plan and operation method that really suit for credit demand for the SMEs is still not mature and it caused that the bad debts and dead loan were overstocked in lianyungang commercial bank. Result also revealed that credit management has negative impact on the performance of the commercial banks.In a similar study, Hagos (2010) examines the effect of credit management on Wogagen Banks. Results indicated that issues impeding loan growth and rising loan clients complaint on the bank regarding the valuing of properties offered for collateral, lengthy of loan processing, amount of loan processed and approved, loan period, and discretionary limits affecting the performance of credit management negatively.

Funso (2012) investigates the quantitative effect of credit risk on the performance of commercial banks in Nigeria for the period 2000-2010. Findings from his study showed that the effect of credit risk on bank performance measured by the return on assets of banks is cross sectional invariant. Also, Kargi (2011) examines the impact of credit risk on the profitability of Nigerian banks. Findings from the study revealed that credit risk management has a significant impact on the profitability of Nigerian banks. In the same vein, Afriyie and Akotey, (2011) investigate the effect of credit risk management techniques on the banks' performance of unsecured loans. They concluded that financial risk in a banking organization might result in imposition of constraints on bank's ability to meet its business objectives.

In another study, Kithinji (2010) examines the effects of credit risk management on commercial banks profitability in Kenya. The findings revealed that the bulk of the profits of commercial banks are not influenced by the amount of credit and non-performing loans suggesting that other variables other than credit and non-performing loans impact on profits.Harvey and Merkowsky (2008) examine the relationship between credit risk and banks' profitability. They found a linear relationship between credit risk and bank profitability. Also, Felix and Claudine (2008) examine the association between the performance of banks and credit risk management. Results show that credit risk management has inverse impact on the performance of studied banks.

Brief History of First Bank

First Bank of Nigeria Limited ("FirstBank"), established in 1894, is the premier Bank in West Africa, Nigeria's number one bank brand and the leading financial services solutions provider in

Nigeria. The Bank was founded by Sir Alfred Jones, a shipping magnate from Liverpool, England. With its head office originally in Liverpool, the Bank commenced business on a modest scale in Lagos, Nigeria under the name, Bank of British West Africa (BBWA). In 1912, the Bank acquired its first competitor, the Bank of Nigeria (previously called Anglo-African Bank) which was established in 1899 by the Royal Niger Company. In 1957, the Bank changed its name from Bank of British West Africa (BBWA) to Bank of West Africa (BWA). In 1966, following its merger with Standard Bank, UK, the Bank adopted the name Standard Bank of West Africa Limited and in 1969 it was incorporated locally as the Standard Bank of Nigeria Limited in line with the Companies Decree of 1968.

Changes in the name of the Bank also occurred in 1979 and 1991 to First Bank of Nigeria Limited and First Bank of Nigeria Plc, respectively. In 2012, the Bank changed its name again to First Bank of Nigeria Limited as part of a restructuring resulting in FBN Holdings Plc (FBN Holdings), having detached its commercial business from other businesses in the First Bank Group, in compliance with new regulation by the Central Bank of Nigeria (CBN). First Bank had 1.3 million shareholders globally, was quoted on The Nigerian Stock Exchange (NSE), where it was one of the most capitalised companies and also had an unlisted Global Depository Receipt (GDR) programme, all of which were transferred to its Holding Company, FBN Holdings, in December 2012 (*www.firstbanknigeria.com , 2018)*.

Building on of its solid foundation, the Bank has consistently broken new ground in the domestic financial sector for over a century and two decades. First Bank is present in the United Kingdom and France through its subsidiary, FBN Bank (UK) Limited with branches in London and Paris; and in Beijing with its Representative Offices there. In October 2011, the Bank acquired a new subsidiary, Banque International de Credit (BIC), one of the leading banks in the Democratic Republic of Congo. In November 2013, First Bank acquired ICB in The Gambia, Sierra-Leone, Ghana and Guinea, and in 2014, the Bank acquired ICB in Senegal. These were major landmarks in its plan for growing its sub-Saharan African footprint and all the African subsidiaries now bear the FBN Bank brand (*www.firstbanknigeria.com , 2018)*.

Methodology

Research design: The study made use of descriptive research design, because it would enable the researcher to generalize the findings to a larger population (Creswell, 2008). This study therefore was able to generalize the findings to all the deposit money banks in Nigeria.

Sampling technique and Sample size: Purposive sampling technique was used to select accountant, operation manager and branch manager from regional headquarters, Dugbe, University of Ibadan branch, Bodija branch, Mokola branch, Apata branch, The polytechnic Ibadan branch, New Gbagi branch, Challenge branch, Iwo road branch and Ojoo branch in Ibadan respectively totaling thirty (30) respondents as a sample size for the study.

Data Collection Instruments: Structured questionnaires developed and validated by Gatuhu (2013) and Kagoyire and Shukla (2016) was used to obtain and gather information to analyze and compare different practices of credit risk management in the bank.

Data collection procedure: The questionnaires were administered to the accountants, operation managers and branch managers of the selected branches of the First bank through drop and pick method. It was believed that this method was the best since the respondents could answer the questions during their free time.

Data Analysis: Both descriptive and inferential statistics were used to analyze data,such as frequency, percentage, weighted mean score, and multiple regression with the aid of SPSS version 25.

Model Specification

To examine the influence of credit management on financial performance of First bank, credit management is measured by client appraisal, credit control and collection policy. Financial performance is measured by ability to meet target profit level.

Mathematically, the model is expressed as follows;

Financial Performance = f (X_1, X_2, X_3) .... (1)

Financial Performance = $\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_2 + \mu i$ ....(2)

where;

a priori expectation is $\beta_1 .. \beta_3 > 0$

X_1 =client appraisal; X_2 = credit control; X_3 = collection policy.

μi = Disturbance Term

β = Intercept

β_1- β_3 = Coefficient of the independent variables.

Data Analysis, Interpretation of Results and Discussion

Table 1: Distribution of Respondents by Client Appraisal in First Bank

Statement	Weighted Mean Score (WMS)	Rank
Client appraisal is a viable strategy for credit management	3.90	1st
First bank has competent personnel for carrying out client appraisal	3.85	2nd
Client appraisal considers the character of the customers seeking credit facilities.	3.83	3rd
Aspects of collateral are considered while appraising clients.	3.74	5th
Failure to assess customers capacity to repay results in loan defaults	3.80	4th

Source: Author's Field Survey, 2018

Table 1 reveals that client appraisal is a viable strategy for credit management was ranked highest (WMS = 3.90). Others in the rank orders include; First bank has competent personnel for carrying out client appraisal (WMS = 3.85), Client appraisal considers the character of the customers seeking credit facilities (WMS = 3.83), Failure to assess customers capacity to repay results in loan defaults (WMS = 3.80) and Aspects of collateral are considered while appraising clients (WMS = 3.74) respectively.

Table 2. Level of Client Appraisal in First bank

Level of Credit Appraisal in First bank	**Frequency**	**Percentage**	**Mean**	**Standard Deviation**
Out standing	19	63		
Manageable	8	26	41.12	5.98
Below Expectation	3	1		

Source: Author's Field Survey, 2018

It is observed from the Table 2, nineteen (63%) respondents agreed that the level of client appraisal is outstanding in their branches. Eight (26%) respondents agreed that the level of client appraisal is manageable while only three (1%) respondents agreed that the level of clientappraisal is below expectation. The mean clientappraisal score of the respondents was 41.12 and standard deviation was 5.98. From this, it is clear that First bank had outstanding level of client appraisal. This implies that client appraisal is a veritable tool for bank performance. This study is consistent with Kagoyire and Shukla (2016) that client appraisal is an alternative paradigm to financial performance of banks.

Table 3: Distribution of Respondents by Credit Risk Control in First bank

Statement	Weighted Mean Score (WMS)	Rank
The use of credit checks on regular basis enhances credit management	3.87	4^{th}
Flexible repayment periods improve loan repayment.	3.52	7^{th}
The use of customer credit application forms improves monitoring and credit management as well.	3.98	3^{rd}
Interest rates charged affect performance of loans in the bank.	4.02	1^{st}
Imposing loan size limits is a viable strategy in credit management.	4.00	2^{nd}
Penalty for late payment enhances customers commitment to loan repayment.	3.85	5^{th}
Credit committee’s involvement in making decisions regarding loans are essential in reducing default/credit risk.	3.76	6^{th}

Table 3 presents the distribution of respondents by credit risk control. It was revealed that interest rates charged affect performance of loans in the bank was ranked highest among the respondents (WMS = 4.02). Other opinions about credit risk control in the rank order include; imposing loan size limits is a viable strategy in credit management (WMS = 4.00), the use of customer credit application forms improves monitoring and credit management as well (WMS = 3.98), the use of credit checks on regular basis enhances credit management (WMS = 3.87), penalty for late payment enhances customers commitment to loan repayment (WMS = 3.85), credit committee’s involvement in making decisions regarding loans are essential in reducing default/credit risk (WMS = 3.76), and flexible repayment periods improve loan repayment (WMS = 3.52). This implies that financial performance of First bank does not come about in isolation, as it is dependent on credit risk control.

Table 4. Level of Credit Risk control in First bank

Level of Credit Appraisal in First bank	Frequency	Percentage	Mean	Standard Deviation
Out standing	17	56		
Manageable	9	30	26.98	3.72
Below Expectation	4	14		

Source: Author's Field Survey, 2018

Table 4 reveals that the majority of respondents with 56% agreed that the level of credit risk control in First bank is outstanding. Nine (30%) respondents agreed that the level of credit risk control is manageable while only four (14%) respondents agreed that the level of credit risk control is below expectation. The mean credit risk control score of the respondents was 26.98 and standard deviation was 3.72. This implies that First bank had outstanding level of credit risk control.

Table 5: Distribution of Respondents by Collection Policy of First Bank

Statement	Weighted Mean Score (WMS)	Rank
Formulation of collection policies have been a challenge in credit management	3.63	6th
Enforcement of guarantee policies provides chances for loan recovery in case of loan defaults.	3.69	5th
Regular reviews have been done on collection policies to improve state of credit management.	3.82	1st
A stringent policy is more effective in debt recovery than a lenient policy	3.76	2nd
Available collection policies have assisted towards effective credit management	3.71	4th
Staff incentives are effective in improving recovery of delinquent loans	3.75	3rd

Table 5 reveals that the majority of respondents agreed that regular reviews have been done on collection policies to improve state of credit management, which was ranked highest (WMS = 3.82). Other perceptions of Collection Policy in the rank order include; a stringent policy is more effective in debt recovery than a lenient policy (WMS = 3.76), staff incentives are effective in improving recovery of delinquent loans (WMS = 3.75),available collection policies have assisted towards effective credit management(WMS = 3.71), enforcement of guarantee policies provides chances for loan recovery in case of loan defaults (WMS = 3.69), and formulation of collection policies have been a challenge in credit management (WMS = 4.08).

Table 6. Level of Collection Policy in First bank

Level of Credit Appraisal in First bank	Frequency	Percentage	Mean	Standard Deviation
Out standing	20	66		
Manageable	6	20	17.29	5.95
Below Expectation	4	14		

Source: Author's Field Survey, 2018

From Table 6 above, the majority of respondents with 66% agreed that the level of collection policy in First bank is outstanding. Six (20%) respondents agreed that the level of collection policy is manageable while only four (14%) respondents agreed that the level of collection policy is below expectation. The mean collection policy score of the respondents was 17.29 and standard deviation was 5.95. This implies that First bank had outstanding level of collection policy.

Testing of Hypothesis

H_0: Credit management practices have no significant influence on financial performance of First bank.

H_I: Credit management practices have significant influence on financial performance of First bank.

Table 7: Influence of Credit management practices on financial performance

Variable	Coefficient	Std. error	T	Sig.
-con	-0.190	0.146	-1-299	0.199
Credit appraisal	0.145	0.038	5.052	0.000
Credit risk control	0.399	0.081	4.914	0.000
Collection Policy	0.215	0.069	3.114	0.003
R2	0.643			
Adj. R2	0.638			
Probability	0.000			
F – Statistics	211.440			

The results in Table 7 show that the predictors variables (credit appraisal, credit risk control and collection policy) were significant joint predictors of financial performance (F = 211.440; R^2 =

0.643; P<.01). The predictor variables jointly explained 64.3% variance of financial performance. Furthermore, credit appraisal (β = 0.145; t = 5.052; P <.01), credit risk control (β = 0.399; t = 4.914; P <.01) and collection policy (β = 0.215; t = 3.114; P <.01) were significant independent predictors of financial performance. This implies that credit management practices are major determinants of financial performance of Deposit Money Banks. This result conforms to Kagoyire and Shukla (2016) who asserted that client appraisal; credit risk control and collection policy had effect on financial performance of Equity bank. Also, Gatuhu (2013) agreed that client appraisal; credit risk control and collection policy are major predictors of financial performance.

Therefore, the null hypothesis which states that credit management practices have no significant influence on financial performance was rejected, while alternative hypothesis is accepted. The implication of this finding is that if credit management techniques are implemented and monitored, the issue of writing off huge amounts of debt yearly by Nigerian banks will be thing of the past.

Conclusion

The study examined the influence of credit management practices on financial performance of Nigerian banks with specific reference to First bank Plc. The result revealed that credit management practices have a significant positive influence on financial performance of First bank. The result also established that client appraisal, credit risk control and collection policy were independent predictors of financial performance of First bank. This indicates that effective implementation and monitoring of credit management had helped First bank not to be included among 14 banks that recorded ₦177.3 billion bad loans in the first half of 2017.

Recommendation

The study therefore recommended that management of other banks should learn from First bank by enhancing their client appraisal techniques, credit risk control and adapting a more stringent policy so as to improve their financial performance.

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