Securing our Financial System for Greater Efficiency:

An Analysis of Credit Recovery Policies and Operations of Commercial Banks in Nigeria

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Abstract
Banks occupy a central position in the financial system of any nation and are essential agents in the development of the economy. Bank lending policy and recovery strategies have impact on profitability. This study therefore, assesses credit recovery policies on the operations of commercial banks, using the United Bank for Africa (UBA) Plc as the case study. The study is a descriptive survey research. Ninety six (96) copies of questionnaire were administered to the junior and senior staff of UBA Plc in Ilorin through random sampling technique. Data were analyzed using frequency counts and percentage while the chi-square was used to test the hypotheses. The findings revealed that: i) there is a significant relationship between credit recovery policy and profitability, ii) there is a relationship between recovery policies and bank liquidity. Based on these findings, it was recommended that the CBN monetary policies, especially on credit policy of commercial banks should be more favorable to banks. Besides, there is the need for regular research and feasibility studies SSA to be conducted by government agents and organizations on bank lending policy and recovery strategies in order to improve profitability in the bank. There is also the need for the CBN to always organize training workshops and seminars on lending policy and recovery strategies in order to improve bank performance.
Keywords:* *.Credit .Recovery Policies .Operations .Commercial banks

INTRODUCTION

Unarguably, banks occupy a strategic position in the financial system of any nation and are essential agents in the development of the economy. Banks are particularly relied on for the promotion of financial integration of the various parts of a country; bring about improvements in the mobilization and utilization of funds for increased capital formation. The banking institution in a typical economy is saddled with the primary responsibilities of financial resource mobilization and intermediation. It engages in the redirection of funds from surplus spending units to deficit spending units. In other words, the banking institution provides funds used as capital input by producers in other sectors of the economy as well as by final consumers (Osinubi and Akinyele, 2006).

Banks play a part in this interest rate mechanism since a reduction in the money supply which consists mainly of deposit liabilities of banks is one of the principal factors pushing up interest rates. In this standard view of the monetary transmission mechanism, however, there is nothing unique about bank lending (Bernanke and Blinder, 1988).

In Nigeria today, we have two different types of banks, commercial and merchant banks, operate under the regulation of the Central Bank of Nigeria. The commercial banks engage in retail banking services through branch networks and operate with a broad deposit base consisting of demand and time deposits one provide short term lending. On the other hand, merchant banks are licensed to provide wholesale banking, assess deposit and arrange syndicated loan facilities for long terms by pooling, sometimes, a consortium of banks, including other financial institutions, to finance capital intensive projects. From the foregoing, it is realized that banks are generally debtors; they borrow money in order to lend them out to make profit. No bank can ever survive by just being a custodian of deposit, but they exist by lending from the deposit on fixed interest charged. Money lent on interest is always supposed to be secured on some guarantees or security.

Since banks depend largely on credit, the need to adhere to the basic principles of lending is quite inevitable. The principles, if strictly followed, will guarantee depositors and shareholders' funds, increase profitability and make a healthy turn over. Such advances in turn assist in the transformation of rural environment, promote rapid expansion of banking habit and improve and boost the nation's economy. Against this background, this study is to examine the impact of credit recovery policies on the operations of commercial banks, using the United Bank for Africa (UBA) Plc as the case study.

Statement of the Problem

Credit recovery policies have obvious impact on commercial bank operations, especially in profitability. However, in Nigeria, commercial bank credit recovery policies have not been fully addressed and the impact has not been fully felt. Banks in Nigeria are highly liquid but they not always comply with the credit recovery policies which have led to liquidity crunch in many commercial banks in the past.

Hence, this study is aimed at examining the impact of bank credit recovery policies on the operations of commercial banks using the UBA Plc as a case study. The need to solve the problem will generate the following fundamental questions that must be addressed.

1. What is the nature of credit recovery policies in UBA Plc?
2. What are the effects of credit recovery policies on bank operations?
3. How can the operations of commercial banks be enhanced through credit recovery policies?

Objectives of the Study

The main aim of this study is to assess credit recovery policies on the operations of commercial banks, using the United Bank for Africa (UBA) Plc as the point of reference.

This will be achieved through the following objectives:

(a) To examine the nature of credit recovery policies.
(b) To investigate the impact of credit recovery policies on bank operations.
(c) To make recommendations for improving banking operations through credit recovery policies in Nigeria.

Hypotheses

For the proper analysis of this research work, the following null hypotheses have been formulated to assist in giving focus and direction to the research work.

Ho_1: There is no significant relationship between credit recovery policies and profitability.

Ho_2: There is no significant relationship between credit recovery policies and liquidity.

Literature Review

Overview of Principles of Bank Lending

The view that bank lending plays a special role in monetary policy has been part of policy debates for over 40 years. The existence of a lending or credit channel implies that ongoing structural changes in the banking industry may alter the monetary transmission mechanism and make it harder to implement monetary policy. There is general agreement among economists and policymakers that monetary policy works mainly through interest rates. When policy is tightened through a decrease in reserve provision, for example, interest rates rise. A rise in interest rates leads to a reduction in spending by interestsensitive sectors of the economy, such as housing and consumer purchases of durable goods.

Banks play a part in this interest rate mechanism since a reduction in the money supply—which consists mainly of deposit liabilities of banks—is one of the principal factors pushing up interest rates. In this standard view of the monetary transmission mechanism, however, there is nothing unique about bank lending. Indeed, the interest rate mechanism does not depend on what assets banks hold; the same response would occur regardless of the proportions of a bank's assets that are held as loans or securities (Bernanke and Blinder, 1988).

In contrast to this description of the transmission mechanism, some economists and policy makers have argued that an additional policy channel works through bank credit. In this view, monetary policy directly constrains the ability of banks to make new loans, making credit less available to borrowers who are dependent on bank financing. Thus, in the credit channel, restrictive monetary policy works not only by raising interest rates, but also by directly restricting bank credit.

The view that bank lending plays a special role in the transmission mechanism is not a new idea. Indeed, it has been part of monetary policy debates for over 40 years. During the 1950s, for example, proponents of the "availability doctrine" argued that a bank credit channel provided the Federal Reserve with additional leverage in conducting monetary policy. According to this view, the existence of a direct channel from monetary policy to bank lending made it possible to carry out monetary policy without large changes in interest rates. Restrictive monetary policy would cause banks to directly reduce the supply of loans, forcing businesses to cut back their spending.

The recent distress in the financial system, witnessed more importantly in the banking sector, did wreak havoc on the economy. Depositors lost billions of Naira for no fault of theirs to greedy, selfish and corrupt banking officials. For some time, the public wondered what could have caused the dismal performance of the banks in the Nigerian economy. This resulted greatly in the lack of confidence by Nigerians in financial institutions. The major cause of distress, as witnessed in the banking sector, is the lack of proper coordination, mismanagement and deliberate greed on the part of the management, connivance of banking officials with fraudsters, among others (Osinubi and Akinyele, 2006).

Since banks depend largely on lending, the need to adhere to the basic principles of lending is quite inevitable. The principles, if strictly followed, will guarantee depositors and shareholders' funds, increase profitability and make a healthy turn over. Such advances in turn assist in the transformation of rural environment, promote rapid expansion of banking habit and improve and boost the nation's economy.

The basic considerations in bank lending are the character of the client seeking loan from the bank. The client must be an honest, upright customer whose record of transaction with the financial institution or in the society is remarkable. The information on the character of the borrower could be obtained through a completed form of his guarantor or his statement of account.

The capital base of the borrower and the amount of money injected into the project must be considered before granting any credit facilities. A customer who expects a bank to fund an entire project should not be considered, unless he provides clear evidence of his injection of initial capital into the project before consulting the bank. Ability and capability to repay the money sought should also be considered. The method of repayment period and collateral put forward to the bank, in addition to a strong recommendation from a highly respected guarantor from the society, are basis for major lending to avoid default and abscondment after approval. Not all projects may be profitable to the customer seeking loan. In that case, the bank should examine and study the purpose of such loans. Some projects may be against cardinal government policies like money-laundering, drug trafficking, smuggling, among others, while others may just be a kind of charitable project, which may not yield any profitable result. This is why the lending should be known and the amount required for it should be vividly stated for the bank to judge its merit. After all, banks are not established as charitable organizations.

For effective credit administration, the bank must assign functioning lending officers, properly trained on lending, to be responsible for evaluation of reports and collection and reporting findings to relevant senior schedule officers, for further consideration and final approval or rejection. Monitoring and supervision of the projects after the loan has been granted should be religiously pursued by the relevant departments in the bank like legal, security, supervision and any other such relevant units of the banks. Experience has shown that once a customer realizes that he is not being monitored, he easily diverts the fund for other unworthy projects.

An internal credits/lending policy should be formulated, implemented and pursued vigorously by the bank to minimize the risk of default from borrowers. The successful banks operating within the financial system are those that consider and coordinate basic principles of lending and monitor the activities of borrowers regularly (Osinubi and Akinyele, 2006).

Theories of Bank Lending

In recent years, debate over the existence of a bank credit channel has focused on two distinct but related lines of research. One theory examined whether banks ration credit to borrowers (Jaffee; Keeton; Stiglitz and Weiss, 1999). To the extent that "credit rationing" exists, it may provide a direct channel for monetary policy. More recently, a second line of research termed the "credit view," or "lending view," has explored how credit market imperfections may not only create a credit channel for monetary policy, but also may make disruptions in credit availability a source of fluctuations in economic activity (Bernanke and Blinder, 1988). As in the availability doctrine, this approach emphasizes that changes in monetary policy may work partly by directly affecting the supply of bank loans.

These theories provide a rationale for observed differences in large-firm and small-firm financing. Generally speaking, larger firms have a greater array of financing options, including equity, long-term debt, and short-term debt, in addition to bank loans and internal cash flow. In contrast, smaller firms appear to have much less access to capital markets and depend more on bank loans, trade credit, and internal funds for financing. The greater dependence of smaller firms on bank financing, in turn, suggests they may be more vulnerable than larger firms to disruptions in credit availability.

A number of studies have provided evidence that these credit market imperfections may explain differences in behaviour of small and large firms during periods of tight credit. For example, small firms appear to account for a larger share of the decline in manufacturing activity and reduced inventory demand that follow a monetary tightening (Gertler and Gilchrist, 1994). Similarly, small firms appear to have less access to bank and nonblank external finance in periods of monetary tightening (Oliner and Rudebusch, 2000). This behaviour is consistent with the view that restrictions in the availability of bank credit could have macroeconomic consequences by affecting the investment and spending decisions of bank -dependent borrowers.

Impact of Credit Recovery Policies on Bank Operations

The impact of bank lending policy and recovery strategies on profitability in Nigerian banking industry cannot be under-estimated. This is in view of the significant impact which bank lending policy and recovery strategies have on banks profitability.

Lending remains one of the major functions of banks in all economies. In fact, interest charged on loans and advances today constitute a sizeable part of banks' earnings. However, the possibility of failure of loans creates nightmares for not only the borrower and lender, but also poses a serious setback to the economy (Aremu, Suberu and Oke, 2010).

Empirical studies of banking crises all over the world have shown that poor assets quality (predominantly loan) has been the most frequent factor in bank failures and low profits. Stuart (2005) emphasized that the spate of non-performing loans, is as high as 35% in Nigerian Commercial Banks between 1999 and 2009. Umoh (1994) traced the rising non-performing loans' ratio in banks' books to poor loan processing, undue interference in the loan granting process, inadequate or absence of loan collaterals, among other things, which are all linked with poor and ineffective credit administration.

The devastating effect of credit loss which is the aftermath of non-performing loans and advances makes sound lending policy and recovery strategies of credit paramount in the banks. The Credit Officers of banks need to properly evaluate and articulate the projects, the customers and the prevailing economic situations. Mather (1962) described three basic principles for evaluating credit as safety, suitability and profitability. In the first instance, safety of any advance or loan is of utmost importance. Banks must emphasize among other things, the character (honesty, integrity and reliability) of borrowers. The probability that the amount granted would be repaid from the cash flows generated from the operations of the company must as a matter of requirement be high. The borrower must be able to provide acceptable security, which will serve as something to fall back on if the expected source of repayment fails.

Secondly, the bank should be satisfied with the suitability of a loan/advance. The purpose of the loan must be legal and non-conflicting with the economic and monetary policies of the government, Central Bank of Nigeria (CBN) guidelines and Banks and Other Financial Institutions Decree (BOFID). Certain ventures such as gambling, pool betting and speculative investment should be avoided while giving credit facilities to customers.

Also, profitability is a guiding force to any operation of the bank, including credit extension. As profit oriented institutions, banks necessarily expect their facilities to yield certain level of profits with which they can declare dividends to make shareholders happy. The interest charged on loans and advances constitutes a major source of income to the banks among others.

However, the enumerated principles of lending identified by Mather were discovered to be inadequate. There are some other factors which must be considered when granting loans and advances. The factors are usually described as 'the canons of lending' and according to Adekanye (1983) are presented in question forms as follows: How much does the customer want to borrow? Why does the customer want bank finance or what does he want it for? How long does he want it? How does he intend to repay? Is the customer's business financially strong enough to keep going if there is a setback? What security can he offer? What is your assessment of the customer?

Adekanye emphasized that the Manager must obtain satisfactory answers to those questions before agreeing to a loan request. This proposition also has its flaws as comprehensive credit ratings and credit management and recovery procedures which are the essential requirements of modern lending were not emphasized.

The CBN in 2005 maintained that the credit framework of banks should be designed to serve as a tool for monitoring and controlling risk inherent in individual credits. The concept has been referred to as 'credit scoring' in some quarters. Credit scoring is a statistical method used to predict the probability that a loan or an existing borrower will default or become delinquent (Loretta 1997). This model assigns scores for potential borrower by estimating the probability of default of their loans based on borrower and loan characteristic data (Myra 2000). Information on borrowers to be used are applicant's monthly income, outstanding debt, financial assets, duration on the job, lending history of the customer, collateral owned, type of banks accounts, among others. The afore stated are potential factors that may relate to loan performance and they may be used in the scorecard. The non-establishment of a credit bureau has been a source of concern when it comes to good credit rating in Nigeria.

Every bank has to develop and implement comprehensive procedures and Information systems to follow up the condition of individual credits. An effective loan monitoring system according to Odufuye (2007) will include measures to: Monitor compliance with established covenants, Assess, where applicable, collateral coverage, relative to creditor's current condition, Identify contractual payment delinquencies and classify potential credits on a timely basis, and, Direct actions at solving problems promptly for remedial management. Loan monitoring which is the work of the relationship manager in most cases is not a choice, but an imperative for effective and efficient credit administration in the banking sector. Problem loans can easily be spotted out. The banker's experience, knowledge of the customer's business and above all, faith in the customer can be a guide in taking a decision as to how far the customer can be supported before declaring the loan as bad.

In some occasions, the customer may be in need of more support. Any or a combination of the following recovery strategies can then be employed:

(a) Alteration or waiver of some of the terms and conditions of loan covenant in a way not to tamper with the bank's interest. However, this must be communicated to the credit department.
(b) Issue of additional collateral security, if available.
(c) Granting of additional funds, if borrower's circumstances and analysis require the need.
(d) Extension of loan repayment period supported by fresh cash flow statement.

Regardless of genuine efforts of parties to a loan, default can still occur. The recovery of loans should be a prerogative of the Recovery Unit to ensure that appropriate recovery strategies are implemented. However, assistance may also be sought from Corporate Banking / Relationship Management.

The Recovery Unit must perform the following functions:

- Determination of account action plan.
- Pursuance of all alternatives to maximize recovery, including placing customers into receivership or liquidation as may be appropriate.
- Ensuring that adequate and timely loan loss provisions are made based on actual and expected losses, and,
- Regular review of deteriorating loans.

It should be emphasized that after a loan has been classified as substandard, it should be assigned to a specific Account Manager in the Recovery Unit. The Account Manager serves as the primary customer contact during the recovery process. A number of methods exist for recovering debts owed by banks. Some of these, according to Ademu (1998) are:

i. Appeals to debtors
ii. Threats and blackmail
iii. Legal action
iv. Use of debt-factoring companies
v. Invoice discounting
vi. Seizure and sale of collaterals
vii. Use of Nigerian Deposit Insurance Corporation's services.

The importance of bank profitability can be appraised at the micro and macro levels of the economy. At the micro level, profit is the essential prerequisite of a competitive banking institution and the cheapest source of funds. It is not merely a result, but also a necessity for successful banking in a period of growing competition on financial markets.

Hence, the basic aim of a bank's management is to achieve a profit, as the essential requirement for conducting any business (Bobáková, 2003: 21).

Methodology

Research Design

This study is a descriptive survey research. The researcher, therefore, sampled the opinion of a cross-section of the population and used this as a basis for generalization. The researcher preferred this design because of the capability to produce reliable and objective result expected of this type of research. Ipaye (2006) noted that descriptive survey type of research design is useful when no manipulation of variables is considered necessary and phenomena are being described as they are. This method also enabled the researcher to obtain the opinions of the representative sample of the target population. The aforementioned were what the researcher considered before considering survey design the most appropriate for the study.

Study Population

The entire staff and customers of United Bank for Africa (UBA) Plc Ilorin will constitute the population of this study. There are presently six branches of UBA in Ilorin. These include Unity, Challenge, Taiwo, Oja-Oba, Muritala and University of IIorin branches. The total population of the staff in these branches is about ninety six (96). The population will include both the junior and senior staff of the bank. The branches of UBA Plc in Ilorin have been specifically chosen in this study.

The first step in data collection for this research study involved drawing up the samples. The researcher used stratified sampling technique to draw the samples for the study. The two categories of worker, the junior and senior staff of the banks were stratified so as to ensure representation of all shades of opinion. Stratified sampling ensures the representation of different element of the population and also ensures that the researcher obtains relatively homogeneous class in terms of characteristic under investigation.

The questionnaire method was adopted as the major instrument for this study. According to Gonthin (2002) the questionnaire is an instrument for collecting descriptive and attitude data. It contains necessary question to elicit information from the respondents and it is divided into two parts. The first parts normally a classification section, which requires the detail of respondents' personal data. The second part contains questions that are related to the credit recovery policies.

In an attempt to gather relevant data to establish the relevance of the topic, that is, credit recovery policies and bank operations, questionnaire forms were administered to ninety six (96) workers and customers of the UBA Plc Ilorin branch.

Personal Data of Respondents

The following tables present the personal characteristics of the respondents in term of sex, age, educational qualification, marital status and work status.

Testing of Hypotheses

This section aims at testing the hypotheses in chapter three. The significance of this test is to possibly validate the hypotheses that are found to be true and therefore accept them. On the other hand, those hypotheses that are untrue shall be rejected and hence are unacceptable.

The decision is to accept the null hypothesis (Ho) if the chi-square (X^0 0.05) value as in the statistic table is less than the calculated value (X^2), this will indicate that there is no relationship between the variables. On the other hand, null hypothesis (Ho), would be rejected if the calculate value (X^2) is more than the table value (X^2 0.05), hence in this case the alternative hypothesis (Hi) would be accepted.

Hypothesis One

H_O: There is no relationship between credit recovery policy and profitability

Table 1.1: Cross Tabulation between Credit Recovery Policy and Profitability

Credit Recovery	Profitability of the Bank		
	High	Low	Total
Yes	49	21	70
No	12	3	15
Total	61	24	85

Source: Research Survey, 2013

$X^2C = 12.56 > X^2\ (0.05) = 4.99$, df = 1, n =85

Decision Rule

Set the level of significance at 95% with the degree of freedom (2-1) (2-1) = 1, the critical (table) value or chi-square (X^2 0.05) 12.56 was found to be greater than the table value of 4.99. Therefore, the alternative hypothesis is accepted while the null hypothesis is rejected. Hence there is a significant relationship between credit recovery policy and profitability.

Hypothesis Two

H_O: There is no relationship between recovery policy and liquidity

Table 1.2: Cross Tabulation of Credit Recovery Policy and Liquidity

Recovery Policies	Level of Liquidity		
	High	Low	Total
Litigation	3	6	9
Lien	44	8	52
Neutral	20	4	24
Total	67	18	85

Source: Research Survey, 2013

$X^2C = 13.02 < X^2\ (0.05) =5.99$, df = 2, n =85

Decision Rule

Set the level of significance at 95% with the degree of freedom (3-1) (2-1) =2. The critical (table) value of chi-square ($X^2$0.05) 13.02 is greater than the calculated table value of 5.99. Therefore the null hypothesis is rejected and the alternative hypothesis is accepted. Hence there is a relationship between recovery policies and bank liquidity. This means that recovery strategies increase the operations of the bank.

Summary

This study was carried out to assess credit recovery policies on the operations of commercial banks with a reference to the United Bank for Africa (UBA) Plc. Questionnaires were administrated to collect the views of the respondents on the questions relating to the subject.

The results from the data were analysed through the frequency table and percentage while the chi-square was used to test the hypotheses. The following are the major findings of the study. First, there is a significant relationship between recovery policies and profitability. Secondly, there is a significant relationship between credit recovery policies and liquidity.

Conclusion

This study has brought to the fore the impact of credit recovery policies on the operations of commercial banks with a reference to the United Bank for Africa (UBA) Plc. From this study, it was found that there are various credit recovery policies that affect operations of the bank. These, in turn have contributed to the profitability of the bank. Ongoing reforms in the banking industry have brought renewed attention to the role banks play in the monetary transmission mechanism. To the extent certain borrowers are dependent on bank credit and bank lending is constrained by monetary policy, restrictive policy may affect the economy through a bank credit channel. Structural changes in the role banks play in the financial system may then affect lending policy by altering this credit channel. The analysis presented in this study finds little many that bank lending and recovery strategies contribute to profitability.

Recommendations

Based on the above findings and observations in this study, the researcher would like to make some recommendations, which will be very useful to credit recovery policies and the operations of the bank.

The CBN monetary policies, especially on credit policy of commercial banks should be more favorable to banks. This in turn, will assist commercial banks to reduce interest rates on loans to industries, which will eventually lead to industrialization.

There is the need for regular research and feasibility studies to be conducted by government agents and organizations on bank lending policy and recovery strategies in order to improve profitability in the bank.

We recommend that bank consolidation in the financial market must be market driven to allow for efficient process. Researchers should begin to develop a new framework for financial market stability as opposed to banking consolidation policy.

There is also the need for the CBN to always organize training workshops and seminars on lending policy and recovery strategies in order to improve bank performance.

Finally, there is the need for research to develop workable initiatives on lending policy and recovery strategies in the banking institutions in Nigeria.

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