

Title Page

Credit Risk Management Perception in Nigeria commercial
Banks: A Case Study of First Bank of Nigeria Plc and Union
Bank of Nigeria Plc

By:

Eze Nkechi R.
PG/MBA/08/53107

In Partial Fulfillment Of The Requirements For The Awards Of
Master Of Business Administration (MBA) In The Department
Of Banking And Finance, Faculty Of Business, Administration,
University Of Nigeria Enugu Campus

Supervisor: Dr. (Mrs.) E.O. Ogamba

NOVERMBER 2011

CERTIFICATION

I certify that this research work was conducted and carried out by Eze Nkechi R. in the Department of banking and Finance, Faculty of business administration, University of Nigeria, Enugu Campus and was carried out under my guidance and supervision.

.....

Date:.....

Dr. (Mrs.) E.O. Ogamba
(Project Supervisor)

.....

Date:.....

Dr. J. U. J. Onwumere
(Head of Department)

DEDICATION

This project is dedicated to God Almighty whose love and strength saw me throughout this work; and to my beloved family who stood by me throughout the period of this tedious exercise.

ACKNOWLEDGEMENTS

This research work was conducted and put to print with the co-operation and support of many people.

First in the list is my project supervisor Dr. (Mrs.) E. Ogamba, and Dr. J. U. J Onwumere whose constructive criticism of this work made it more meaningful.

I express my profound gratitude to the management and staff of the department of banking and finance, faculty of business administration, university of Nigeria, Enugu Campus.

Also, my immense gratitude goes to my parents, family members and my beloved husband Nicholas, for their encouragement both financial and other wise during the course of this work.

Lastly I am grateful to all my friends and colleagues who have contributed in one way or the other in making this research work a dream-come through.

Eze Nkechi R.

PG/MBA/08/53107

ABSTRACT

The research was undertaken to evaluate credit risk management Perception in Nigeria commercial banks using First bank of Nigeria Plc and Union bank of Nigeria Plc as a case study. The work was intended to achieve the following objectives; to examine the causes of credit risks in Nigeria commercial banks. To review the strength of the Commercial banks in combating this menace. To also ascertain the level of contribution of the central bank of Nigeria in helping the commercial banks mitigate credit risk. Relevant data were collected from both primary and secondary data sources. Questionnaire was the main primary data collection instrument employed while data from various relevant publications and annual reports constituted the secondary data. Based on the study, the following conclusions were drawn: There are several causes of credit risk to commercial banks in Nigeria Credit risks do really affect or reduce the operational efficiency of these banks. Employment of strategies in reducing this credit risk is more sophisticated in first bank of Nigeria plc than in union bank of Nigeria plc. Central bank of Nigeria has over the years been assisting the commercial banks in fighting these credit risks. On the basis of the above findings the following recommendations were made: Commercial banks should employ more strategic means in monitoring credit losses in their banking system. Commercial banks should assess the workability of each strategy before implementation. Since strategies are costly and may involve heavy capital investment. More research should be conducted in assessing the lending behaviour of Nigeria commercial banks.

TABLE OF CONTENTS

Cover pager

Title page

Certification

Dedication

Acknowledgements

Abstract

Table of contents

Chapter One: Introduction

- 1.1 Background of the study
- 1.2 Statement of problem
- 1.3 Objectives of the study
- 1.4 Research questions
- 1.5 Hypotheses of the study
- 1.6 Significance of the study
- 1.7 Profile of the selected commercial banks
- 1.8 Scope and limitations of the study
- 1.9 Acronyms/Definition of terms
- References

Chapter Two: Review of Related Literature

- 2.0 Introduction
- 2.1 The changing bank environment
- 2.2 Bank exposure to risk
- 2.3 Corporate Governance of commercial banks in Nigeria
- 2.4 Risk based analysis of banks
- 2.5 Analytical tools provided
- 2.6 Justification for banks regulation
- 2.7 Political Economy of the based accord
- 2.8 The based accord of 1988
- 2.9 The based accord base II
- References

Chapter Three: Research Methodology

- 3.1 Research design
- 3.2 Nature and sources of data
- 3.3 Method of data collection
- 3.4 Population and sample determination
- 3.5 Method of data analysis and presentation
- 3.6 Primary data analysis techniques

Chapter Four: Data Presentation and Analysis

- 4.1 Introduction
- 4.2 Data presentation and analysis
- 4.3 Testing of Hypothesis

Chapter Five: Summary of findings, Recommendations and Conclusions.

- 5.1 Summary of Findings
- 5.2 Recommendations
- 5.3 Conclusion

Appendix

Bibliography

CHAPTER ONE

1.1 Background of the Study

The changing environment in which banks finds themselves present major opportunities for banks, but also entails complex, variable risk that challenge traditional approaches to bank management.

Recently, there was increase in non-performing credit portfolios in banks and other financial institutions and these significantly contributed to the financial distress in the banking sector.

Consequently, banks must quickly gain financial risk management capabilities in order to survive in a market oriented environment, withstand competition by foreign banks, and support private sector-led economic growth. An external evaluation of the capacity of a bank to operate safely and productively in its business through effective credit risk management is normally performed once each year. All animal assessment is similar in nature, but has slightly different focuses depending on the purpose of the assessment.

Risks faced by banks are numerous but this study is essentially concerned with credit risk management in Nigeria commercial banks with First Bank Nigeria Plc and Union Bank Nigeria Plc. as case studies.

The credit risk management in commercial banks should be adequately attended to by banks that want to succeed in its over-all business operation.

For most banks, loans are the largest and most obvious source of credit risk, loans and advances constitute almost sixty to seventy percent of the assets side of the balance sheet of any bank. As long as the borrower pays the interest and the

principal through proper amortization of loan on the due dates, a loan will be a performing asset.

The problem however arises once the payment are delayed or defaulted and such situations are very common occurrences in any bank. Delay or defaults in payment of bank loan affects the cash forecast made by banks and further result in a changed risk profile, as the bank will now have to face an enhanced interest rate risk, liquidity risk and credit risk.

Bank are increasingly facing credit risk in various financial instruments other than loans, which includes inter bank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees; and the settlement of transactions.

The late 1980s and early 1990s witnessed a great rising non performing credit portfolio in commercial banks especially in First Bank Nigeria Plc. and Union Bank Nigeria Plc. The use of status enquiries on bilateral basis between banks was characterized by some weaknesses. Status enquiries is

regarded as business courtesies to which some banks either did not respond to or gave vague replies.

In spite of the systematic weakness, many banks continued to extend fresh facilities to customers who already had hard core and un-serviced debt with other banks and financial institutions. Although, it is difficult to evaluate credit risk, an argument can be made that the loan default disclosures proxy for credit risk may also provide an indication of operational risk related to management decision making.

However, it has been noted that managerial weakness for failed banks includes inadequate supervision of loan portfolio and over-all aggressive strategies for growth in loans and deposits.

Between 1994 and 2003, thirty-seven (37) banks were closed in Nigeria as against twenty-one (21) banks closed between 1930 through 1966. An assessment of the banking distress era of 1993 through 1997 reveals that lending defaults were essentially responsible for over seventy-five (75)

percent of the casualties suffered by the Nigerian banking sector through this period.

So the effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization. Banks should also consider the relationship between credit risk and other risk.

1.2 Statement of Problem

Various commercial banks in Nigeria are faced with the problem of credit risk management. The First Bank of Nigeria Plc. and Union Bank Nigeria Plc. are faced with the problem of credit risk management just like other commercial banks in Nigeria.

During the recent re-capitalization of the banking industry, many banks even the ones people hold to high esteem closed operation as they could not meet up with the statutory capitalization requirement.

According to Rose and Hudgins (2008) and Kock and Macdonald (2003) bank capital provides a cushion against the

risk of failure by absorbing financial and operating losses until management can address the problem.

This problem of credit risk management has crippled most of the commercial banks in Nigeria including First Bank Nigeria Plc. and Union Bank Nigeria Plc.

1.3 **Objective of the Study**

Regards to the problem or point enumerated above in the statement of the problem; the following objectives are to be pursued:

-  To examine the causes of credit risk in Nigeria commercial banks
-  To review the strength of the commercial bank in combating risk credit.
-  To also ascertain the contribution of the central bank of Nigeria in combating the credit risk management antagonistic factors.

1.4 **Research Questions**

The above objectives of this study are operationalized into the following investigative research questions to give the study a direction and magnitude.

- ✚ To what extent are credit risks affecting the operational efficiency of commercial banks?
- ✚ What constitute the strength of the commercial banks in mitigating credit risk?
- ✚ Does central bank of Nigeria assist commercial banks in mitigating credit risk?

1.5 **Hypotheses of the study**

In order to give focus to this study, the following hypotheses were formulated to enhance the efficient study:

1. Ho: Credit risk management does not affect the operational efficiency of commercial banks.
2. Ho₂: Central bank of Nigeria does not assist the commercial banks in mitigating credit risk.
3. H₀₃: Commercial banks do not have the required techniques of mitigating credit risks.

1.6 **Scope and Limitations of the Study**

This study will cover just credit risk management of First Bank of Nigeria Plc and Union Bank Nigeria Plc, Enugu branch between (2007- 2009).

Since the researcher will find it difficult, if not impossible to appraise the credit risk management in all the commercial banks in Nigeria, the above named two banks were chosen.

This decision is justified by the fact that commercial banks in Nigeria are homogenous in all respect.

The hypotheses test control measures put in place to combat credit risk in Nigeria Commercial banks.

1.6.1 Limitations of the Study

There are constraints which hinders the progress of this work. Such constraints include:

- Time constraints, financial and other resources
- Disappointment on the part of our interviewee
- Poor Communication and withholding of vital information that would have aided or facilitate more efficiency of this work by some of the commercial banks staffs.

1.7 Significance of the Study

For any commercial bank like First Bank of Nigeria Plc and Union Bank of Nigeria Plc with wide range of responsibilities of service delivery to her customers through prudent and efficient credit management undermining credit risk management is doing so to the detriment of its over all effective and efficient and operation in banking business.

In view of the on-going problems in credit risk management of banks; this study through its findings and recommendations will be significant in the following ways.

- It will provide commercial banks managers with the procedures for ascertaining and curbing banks credit risk.
- It will help the stakeholders (depositors, investors, banks staff, legislator etc) with information about the liquidity position of the banks under review.
- It serves as a useful reference material for lectures, financial analyst and other researchers in this field of study.

- It will also bring to bank stakeholders the practical evaluation statistics model to assessing banks credit risk management in Nigeria commercial banks.
- It will be of immense importance to bank regulatory and supervisory agencies such as Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC) in fulfilling their collective mission of maintaining stability and public confidence in Nigeria banking sectors.
- Lastly but not the least, it will assist bank management to appropriately focus attention on those areas perpetrating bank's credit risk in order to boost operational efficiency.

1.8 Profile of the Selected Banks

Among the existing 24-re-capitalized banks in Nigeria commercial banks setting, two are selected for review in this study. The sample selection is judgmental and the selected banks include: the Union Bank of Nigeria Plc. and the First Bank of Nigeria Plc.

1.8.1 Union Bank of Nigeria Plc

Union bank of Nigeria Plc was established in 1917 as a colonial bank with its first branch in Lagos. In 1925, Barclays Bank Dominion colonial and overseas was formed to take over the activities of the bank. In 1965, the bank was legally incorporated in Nigeria as a wholly owned subsidiary of Barclays Bank International Limited and renamed Barclays Bank of Nigeria Limited.

The ownership structure of the bank remained unchanged until 1971 when 8.33% of the Bank's shares were offered to Nigeria. In the same year, the Bank was listed on the Nigeria stock exchange market. As a result of the Nigeria Enterprise promotion Decree of 1972, the Federal Government of Nigeria acquired 51.67% of the Bank's shares, which left Barclays Bank Plc, London as a minority with 48.33%.

A landmark event in the bank's history occurred in 1979 when Barclays Bank sold 50% of its shareholding in the Bank to Nigerians. This resulted in the change of the banks name from Barclays Bank of Nigeria to Union Bank of Nigeria Limited to reflect its new image and ownership structure.

The remaining share holding of Barclays Bank was disposed off in 1989. Today, Union Bank is the First Publicly quoted banking institution that is 100% owned and wholly managed by Nigerians (see [WWW.union banking.com](http://WWW.unionbanking.com).)

1.8.2 First Bank of Nigeria Plc

The bank was incorporated as a limited company on March 31, 1948 as Bank of British West Africa Limited with Head Office in Liver Pool UK. In 1969, the bank was incorporated locally as the Standard Bank of Nigeria Limited in line with the companies decree of 1968. The Bank was converted to public company in 1970 and got listed on the Nigeria Stock Exchange (NSE) in March 1972.

Changes in the name of the Bank occurred in 1979 and 1991, to First bank of Nigeria Plc. respectively. The Bank engages in universal banking. That is, it carries on the business of commercial banking, registrar, trusteeship and capital market (First Bank of Nigeria Plc. Annual Report 2004, 2006, 2007).

1.9 Acronyms and Definition of Terms

CBN:	Central bank of Nigeria Plc
Commercial Loan:	An unsecured obligation issued by a corporation or banks to finance its short-term credit needs, such as accounts receivables and inventory.
Loan:	A sum of money transferred to another for temporary use to be repaid with or without interest according to terms of the loan agreement.
Commercial banks:	Banks that deals on retail banking by accepting deposit from customers and granting loan to companies and individuals
Liquidity:	Ability of banks to meets up its financial obligations using its assets.
Risk:	This is the potential that event expected may occur or not
Risk management:	This is a comprehensive process adopted by an organization that seeks to minimize

the adverse effect it is exposed due to
various factors inherent in the business.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction: The Changing Banking Environment:

The changing banking environment offers the opportunity for the assessment, analysis, and management of financial risk in the field of banking. This project is an attempt to provide a high level framework (aimed at non-specialist executives) attuned to the current realities of changing economies and financial markets.

This approach emphasizes the accountability of key players in the corporate governance process in relation of the management of different dimension of financial risk.

In the past decade, rapid innovations in financial markets and the internationalization of financial flows have changed the face of banking almost beyond recognition. Technological progress and deregulation have both provided new opportunities for and increased competitive pressure among banks and non-banks alike.

In the late 1980's, margin attained from traditional banking business began to diminish and capital adequacy

requirement began to increase and loan demand also at increase thereby increasing credit risk.

A prime motivation for innovation has been the introduction of prudential capital requirements, which has in turn led to a variety of new “off balance sheet” financial instruments.

Financial substitutes such as guarantees and letter of credit, as well as derivative instruments such as futures and options, are not always shown as assets or liabilities even though they expose banks to certain risk. Some instruments are technically very complicated and are poorly understood except by market experts, while many other pose complex problems in terms of risk measurement, management and control. Moreover, profits associated with some of these instruments are high, and like the financial market from which they are derived are also highly volatile and they thus expose banks to new or higher degree of risk.

Today more general concern exist that financial innovation in banking, especially with regard to off-balance-sheet instrument, may have the effect of concentrating risk

and increasing volatility within the banking system as a whole. This is particularly true in the case of currency and interest rate risk in terms of debt instrument. The correlation between different types of risk, both within an individual bank and throughout the banking system, has increased and become more complex.

These developments have increased the need for and complicated the function of risk measurement, management and control.

The quality of corporate governance of banks has become a much debated topic, and the approach to regulation and supervision has changed dramatically. Within an individual bank, the new banking environment and increased market volatility have necessitated an integrated approach to asset-liability and risk management techniques.

2.2 Bank Exposure to Risk

Banks are subjected to wide array of risk in the course of their operation.

In general, banking risks fall into four categories according to (Berger, Herringe and Szego 1995 P.38) financial

risk, operational risk, business risk and events risk. Financial risk according to them in turn comprise two types of risk: - pure risk-including liquidity, credit and solvency risk-can result in loss for a bank if they are not properly managed.

Speculative risk, based on financial arbitrage, can result in a profit if the arbitrage is correct, of a loss if it is incorrect. The main categories of speculative risk are interest rate, currency, and market price of shares or position risk.

Financial risks are also subject to complex interdependencies that may significantly increase a bank's over all risk profile.

Spong (1990: 316) maintains that operational risks are related to a bank's overall organization and functioning of internal system, including computer-related and other technologies.

Emma et al (2000:220): "Compliance with bank's policies and procedure" and measures against mismanagement and fraud in Nigeria banking industries is a guide against bank risk which credit risk is one of the key risk inherent in their financial risk.

According to him business risk are associated with bank's business environment; including macroeconomics and policy concerns, legal and regulatory factors, and the over-all financial infrastructure and payment system.

Event risk includes all types of exogenous risk which, if they were to materialize, could jeopardize a bank's operations or undermine its financial condition and capital adequacy.

2.3 Corporate Governance

It is a known fact that liberalization and the volatility of financial markets, increased competition, and diversification expose banks to new risk and challenges, requiring the continuous innovation of ways to manage business and its associated risks in order to remain competitive.

The increasing market orientation of banks has also necessitated changes in the approach to regulation and supervision. The responsibility for maintenance of the banking system and markets is being redefined according to J.O.

Ubeze (1989) In one country after another, as a partnership among a number of key players who manage various dimensions of financial and operational risks. This

approach reconfirms that the quality of bank management, and especially the risk management process, are the key concern in ensuring the safety and stability of both individual banks and the banking system as a whole.

Erickson et al (1999:330) portrays a risk management partnership in a way in which each key player has clearly defined accountability for specific dimension of every risk area. Following a holistic overview of the banking system, the importance of banking supervision in the context of corporate governance can not be over emphasized.

In summary, bank regulators and supervisors can not prevent bank failures. Their primary role is to act as facilitators in the process of risk management and to enhance and monitor the statutory framework in which risk management is undertaken. By creating a sound enabling environment they have a crucial role in influencing the other key players.

The shareholders are in a position to appoint the people in charge of the corporate governance process and should be carefully screened to ensure that they do not intend to use the

bank solely to finance their own or their associate's enterprises.

Ultimate responsibility for the way in which a bank's business is conducted lies with the board of directors (sometimes called the supervisory board). The board has to set the strategic direction, appoint management, establish operational policies, and most importantly, take responsibility for ensuring the soundness of a bank.

Executive Management not only that managers subscribe to standard of ethical behaviour, but also that they have the competence and experience necessary to run the bank. Because the management is responsible for the implementation of the board's policies through its running of the bank on a day-to-day basis, it is vital that it has intimate knowledge of the financial risks that are being managed.

The audit committee and the internal auditors should be regarded as an extension of the board's risk management policy function.

The internal auditors traditionally performed an independent appraisal of bank's compliance with its internal

control system, accounting practices, and information system. Most modern internal auditors would, however, describe their task as providing assurance regarding the bank's corporate governance, control system, and risk management process. External auditors on their own have come to play an important evaluative role in the risk based financial information process. Since bank supervisors neither can nor should repeat the work done by external auditors, proper liaison mechanism is necessary between these two parties, particularly on a trilateral basis that includes bank management.

The public/ consumers are to accept responsibility for their own investment decision as market participants. In order to do so, they require transparent disclosure of financial information an informed financial analysis.

The public can be assisted in its role as risk manager if the definition of public is widened to include the financial media, financial analyst such as stockbrokers, and rating agencies. The small or unsophisticated depositor would

normally need more protection than simple transparent disclosure.

2.4 Risk-Based Analysis of Banks

Banking supervision, which is based on an ongoing analytical review of banks, continues to be one of the key factors in maintaining stability and confidence in the financial system.

Abdul- Maliq, Y.O (2006) states in his book title analytical management that banks embark on activities that explores bank supervision, arrangement, the supervision process, and the role of supervisor in ensuring that banks operate in a safe and sound manner, that they understand and adequately manage risk associated with their operations, and that they hold sufficient capital and reserve to support these risks.

The methodology adopted by him in analytical review of banks, during the off-site surveillance and on-site supervision process, is similar to that of private sector analysts (for example, external auditors or a bank's risk managers), except

that the ultimate objective of the analysis is somewhat different.

Bank appraisal in a competitive and volatile market environment and supervision, other factors necessary to ensure the safety of banking institution and the stability of financial systems and markets include sound and sustainable macroeconomic policies and well-developed and consistent legal frameworks. Adequate financial sector infrastructure, effective market discipline, and sufficient banking sector safety nets are also crucial. To attain a meaningful assessment and interpretation of particular findings, estimates of future potential, a diagnosis of key issues, and formulation of effective and practical course of action, a bank analyst must have extensive knowledge of the particular regulatory, market, and economic environment in which a bank operates. In short, to be able to do the job well, an analyst must have a holistic perspective on the financial system even when considering a specific bank.

The practices of bank supervisors and the appraisal methods practiced by financial analyst continue to evolve. This

evaluation is necessary in part to meet the challenges of innovation and new developments and in part to accommodate the boarder process of convergence of internal supervisory standards and practices, which are themselves continually discussed by the based committee on banking supervision.

Traditional banking analysis has been based on a range of quantitative supervisory tools to assess a bank's condition, including ratios. Rations normally relate to liquidity, the adequacy of capital, loan portfolio quality, insider and connected lending, large exposures, and open foreign exchange positions. While these measurements are extremely useful, they are not in themselves an adequate indication of the risk profile of bank, the stability of its financial condition, or its prospects.

The central technique for analyzing financial risk is the detailed review of a bank.

Risk based bank analysis includes important qualitative factors, and places financial ratios within a broad framework of risk assessment and risk management credit wise and

changes or trend in such risk, as well as underscoring the relevant institutional aspects.

Such aspects include the quality and style of corporate governance and management; the adequacy, completeness or internal control; and the timelines and accuracy of management information system and information support.

It has been said that credit risk rises exponentially with the pace of change in credit facilities, but that bankers are slow to adjust their perception of risk. In practical terms, this implies that the market's ability to understand and properly accommodate the accompanying risk. Traditionally, banks have seen the management of credit risk as their most important task, but as banking has changed and the market environment has become more complex and volatile, awareness has developed of the critical need of manage exposure to other operational and financial risks. The element of the risk- based analytical review covered in this project is very important for effective risk management in commercial banks.

2.5 Analytical tools provided

Osho, M (2004:214), provided an analytical tool for credit risk management in banks especially the commercial ones. According to him the overall analysis or analytical process has many consistent aspects with regard to off-site surveillance, on-site examination, a bank's own risk management, or evaluation by technical professional. This project provides tools to assist with the bank analysis, including a questionnaire and model consisting of a series of spreadsheet based data input tables to enable an analyst to collect and manipulate data in systematic manner.

2.6 Justification for Bank Regulation

It is a known fact that banks are the most leveraged companies in an economy, necessitating bank regulators to introduce certain capital adequacy requirements.

Banks are also the first set of “financial institutions to be subjected to internationally coordinated capital regulation” (Berger, Herring and Szego (1995:38). This is exemplified by the capital guidelines put out by the based committee on

banking supervision. Were it not so, some banks would attempt to operate only with depositors' fund.

Adequate capital is important for a number of reasons. As Spong (1990) put it: "commercial banks must have capital to provide a cushion for absorbing possible loan losses or other problems, funds for internal needs and expansion, and added security for depositors and the deposit insurance system. In addition, higher capital serves to increase the financial stake that stockholders have in the safe and sound operation of the banks. Consequently, bank regulators view capital as an important element in holding banking risks to an acceptable level"

There is unanimity of opinion amongst bank regulators about the role of capital in absorbing operational losses, funding fixed assets, and fostering depositor confidence.

Creuning and Bratanovic (2003:348), have agreed that in addition to serving as a "safety-net for a variety of risk exposures and absorbing losses", adequate capital is a determinate of a bank's lending capacity and maximum level of assets.

In other words, the volume of loan and advances that a bank is capable of creating is directly related to the level of the bank's capital, ceteris-paribus. Furthermore, Emory University Economist, George J Beston (2009), identifies five main reasons why banks have been experiencing credit risk management problems: poor capital management of banks, dubious character of Lendees, Lack of proper evaluation of the C'S of lending, improper loan utilization and bad policy implementation strategy regarding credit instrument.

In an effort to ensure that banks maintain adequate level of capital for their credit risk exposures, the based committee on banking supervision issued in 1988, what has now been popularly known as the "Capital Accord" which linked banks' credit risk to capital.

2.7 The Political Economy of the Basel Accord of 1988

The main impetus for the regulation of banks at the international level came from the United States (Kapstein, 1991).

In August 1982, the Mexican government announced that it would be unable to roll over its debt to private creditors

and would therefore be forced to suspend principal payments. Soon after, other developing countries such as Argentina, Brazil, Venezuela, among others, found themselves in financial difficulties. U.S. banks, which had lent recklessly to Latin American countries in the 1970s and early 1980s, faced huge losses. Indeed, the nine largest U.S. banks had loans outstanding to the most indebted countries that were equivalent to almost twice their capital at the end of 1982. Those banks had also lent 140 percent of their capital to Mexico, Brazil and Argentina (Ogley, 2000:28). Although U.S. banks curtailed substantially their lending to developing nations after the possibility of becoming insolvent if the debtor countries defaulted. It was at this stage that the U.S. government orchestrated a resolution to the crisis.

First, the Reagan administration provided bilateral loans to Mexico. Second, it instructed the International Monetary Fund to organize rescue packages for the countries in difficulties.

Those new IMF loans would allow debtor countries to service their loans. The loans also had the effect of transferring

developing countries debt from the banks to the public sector, in what amounted to a bailout of large money centers in New York (Oatley, 2000). Third, the administration encouraged the banks to restructure loans and provide new loans to developing countries.

For its part, the IMF requested from member countries an increase in its resources of 47 percent, of which the United States would have to contribute \$ 8.4 billion. That request was initially met with skepticism by U.S. legislators. The U.S. Congress finally agreed to provide the new funds in 1983 as part of the Internal Lending Supervision Act in exchange for a series of reforms and new regulations of the banking industry, including, higher capital requirements. Congress also instructed U.S. banking regulators to “encourage... other major banking countries to work towards maintaining, and where appropriate strengthening, the capital bases of banking institutions involved in internal lending”. See (Public Law, 1983).

Not surprisingly, U.S. banks initially opposed these new regulations. They were fearful that the regulations, in

particular the requirement to increase their minimum capital levels, would set them at a disadvantage vis-à-vis other banks, especially Japanese banks, which were gaining market share globally and domestically, and other non-banking financial institutions.

Consequently, they pressed bank regulators in the United States to try to make the new regulations international. Despite the objections of Japanese and German banking regulators, which greeted the U.S proposal for harmonization with great skepticism, the G-10 countries has little choice but to agree to the harmonization of capital standards for banks when the United States and Great Britain signed a bilateral agreement on minimum capital standard in 1986. as Oakely and Nabors (1998) suggested:

By concluding a stringent bilateral accord with Great Britain and threatening to apply the terms of this accord to foreign banks operating in the U.S market, American policy makers effectively eliminated the regulatory status quo from G-10 policy-makers' choice set. Rather than a choice between a multilateral accord and the regulatory status quo ante, G-10

policy makers confronted a choice between a costly multilateral accord and an even more costly bilateral accord. Given this option, G-10 policy makers chose the multilateral accord.

And so 1987 saw the beginning of negotiation between Japan on one hand and the United States and Great Britain on the other hand, under the auspices of the Basel committee on banking supervision to harmonize banking regulations in the G-10 countries.

2.8.0 **The Basel Accord of 1988**

On December 10, 1987, after years of negotiation among the supervisory institutions of its member countries, the based committee released a proposal on the “International convergence of capital measurement and capital standard”.

After a brief period of consultation, the committee issued a final proposal, agreed upon by all its member countries. On July 15, 1988, the stated objectives of the Based Accord of its member countries in 1988 were “firstly, that the new framework should serve to strengthen the soundness and stability of the international banking system; and secondly,

that the new framework should be fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing and existing source of competitive inequality among international banks”.

(Basel committee, 1988). To achieve those goals, the committee set out a framework for measuring capital adequacy in relation to credit risk. That framework can be divided into (i) Definition of capital (ii) The determination of risk- weighted assets, (iii) The required ratio of capital to risk-weighted assets and (I v) the conversion of off-balance sheet instruments into risk-weighted assets.

2.8.1 Definition of Capital

The Basel Accord divides capital into two tiers. Tier (or core) capital is made up of equity capital and disclosed reserves from post tax earnings. Tier 2 (or supplementary) capital comprises undisclosed reserves from post-tax earnings, revaluation reserves from assets that have been revalued to reflect more accurately their market value, general provision/general loan-loss reserves, which are created

against the possibility of losses not yet identified, and debt capital instruments.

According to Basel committee (1988), the Limits and restrictions in the composition of capital set by the Basel Accord are as follows: - Tier 2 capital is limited to a maximum of 100 percent of Tier 1 capital. Subordinated debt is limited to a maximum of 50% (percent) of Tier 1 capital. General loan-loss reserve is limited to a maximum of 25 percent of Tier 2 capital.

2.8.2 Determination of Risk-Weighted Assets

The Basel committee (1988) considered that “a weighted risk ratio in which capital is related to different categories of asset or off-balance sheet exposure, weighted according to broad categories of relative riskness, is the preferred method for assessing the capital adequacy of banks”, Although there are different kinds of risk that banks have to manage, the accord initially addressed only credit risk-that is, the risk of counterpart failure. Other types of risk, such as investment risk, interest rate risk, exchange rate risk, concentration risk, and operational risk were not made part of the accord (these

risk were incur-operated in the modified Basel Accord in January 1996). The Basel Accord in assets according to four risk-weight categories Zero percent, 20 percent, 50 percent and 100 percent which are measured at book value rather than market value.

2.8.3 Required Ratio of Capital to Risk Weighted Assets

The Basel Accord set the ratio of capital to risk-weighted asset as 8 percent, of which tier 1 capital must be at least 4 percent. For instance, if a bank has assets in the form of Nigeria treasury bills worth N100. The capital charge required for those assets is zero. If, alternatively, a bank has asset in the form of corporate bonds worth N100, the capital charge required is equal to N8, of which at least N4 must be in Tier 1 capital.

Internationally, active banks had until 1992 to bring their capital ratios to that level.

2.8.4 Off-Balance Sheet Exposures

The Basel Accord converts all categories of off-balance sheet engagement to credit risk equivalent by multiplying the nominal principal amounts by a credit conversion factor, the

resulting amount then being weighted according to the nature of the counterparty;

Basel committee (1988). The conversion factors are 100 percent for instruments that substitute for loans, such as stand by letters of credit; 50 percent for transaction related contingencies, such as letters of credit for a particular transaction and 20 percent for short term transaction and 20 percent for short term, self-liquidating trade-related contingent liabilities, such as commercial letters of credit. For example, a commercial letter of credit worth N20, and the capital charge for that asset would be N1.6 (N20 times 0.08 i.e. 20×0.08).

2.8.5 Criticism of the Basel Accord

The original Basel Accord has several problems:

- The Use of arbitrary risk categories and arbitrary weights that bears no relation to default rates.
- The risk assessment methodology is flawed in that it assumes that a portfolio's total risk is equal to the sum of the risk of the individual asset in portfolio
- The accord gives preferential treatments to government securities which are considered risk-free.

- Following political considerations more than economic reasoning, the accord divided capital into two tiers.
- The existence of risk categories that create a divergence between economic risk and measures of regulatory capital has led to widespread regulatory capital arbitrage.

These shortcomings of Basel I accord paves way to Basel Accord 2

2.9.0 The Basle Accord (Basel II)

The new proposal is based on “three mutually reinforcing pillars”. Minimum capital requirements, supervisory review, and market discipline. Having three pillars (as opposed to just one) is in sharp contrast to the 1988 accord, which dealt almost exclusively with minimum capital standard.

However, minimum capital standards continue to be the main focus of the Basel committee, as evidenced by the length treatment they receive in the new proposal.

2.9.1 The First Pillar: Minimum Capital Standard

Under the new Basel Accord, the definition of regulatory capital – that is, its division into Tier 1 and 2 capital and the rules limiting its composition remains unchanged. The ratio of

capital to risk weighted asset also remains unchanged at 8 percent. But the accord introduces significant changes in the way risk are measured. The first change is that the New Basel Accord contains a new capital charge for operational risk-defined as “the risk of loss resulting from inadequate or failed internal process, people and system or from external events (BASEL ACCORD COMMITTEE 2001).

2.9.2 The Second Pillar: Supervisory Review

The new Basel Accord set four supervisory principles “to ensure that banks have adequate capital to support all the risk in their business.

The four principles include:

- Bank should have a process for assessing their overall capital in relation to their risk profile and a strategy for maintaining their capital levels.
- Supervisors should review and evaluate banks internal capital adequacy assessment and strategies as well as their ability to monitor and ensure their compliance with regulatory capital ratios.

- Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.
- Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

2.9.3 The Third Pillar: Market Discipline

The final pillar of the three pronged approach of the New Basel Accord is market discipline, which the Basel Committee understands as disclosure requirements that would allow market participants to assess the strength of individual banks. The new Basel Accord sets out disclosure recommendations and requirements in four key areas:

- Scope of application, that is, which entities within a banking company are subject to the accord.

- Composition of capital that is, the amount of Tier 1 and 2 capital, the total amount of capital, and the accounting policies for the valuation of assets and liabilities.
- Exposure assessment and management process that is, information relating to the banks balance sheet, in particular, to assets side, the different types of risk to which the banks is exposed.
- Capital adequacy that is, the capital requirement for each different types of risk and the total capital requirement.

2.9.4 **Criticism of the New Basel Accord**

- The added complexities of the new accord do not translate to accuracy.
- Use of over prescriptive approach amounting to vagueness.
- It leaves so much discretion to national regulators that one could make the case that international capital standard does not or has ceased to exist.
- It used IRB approaches because banks are still measuring risk one asset at a time.

- Even in the areas the New Basel Accord represents an improvement over the current one, the improvement falls short of what could have been achieved.

Adekanye, F (1999): *The Element of Banking in Nigeria (3rd Edition)* Lagos; F and A publishers

Basel Accord Committee (1988, 1996, 2001)

Central Bank of Nigeria and Nigeria deposit Insurance

Corporation (1995): *Distress in the Nigeria Financial services industry, Lagos.*

Emma et al (2000): *Banking policies and procedure in Nigeria*

Erickson et al (1999): *Banking regulation strategies in Nigeria:* Edison publisher, Enugu.

First Bank of Nigeria Plc (2007): *Annual reports and Accounts 2007*

First Bank of Nigeria Plc. (2008) *Annual reports and Account 2008*

First Bank of Nigeria Plc. (2009) *Annual reports and Account 2009*

Union Bank of Nigeria Plc (2007) *Annual reports and Accounts 2007*

Union Bank of Nigeria Plc (2008) *Annual reports and Accounts*
2008

Union Bank of Nigeria Plc (2009) *Annual reports and Accounts*
2009

Government of Nigeria (1969): *The Nigeria Banking Decree*:
Lagos Government Press

Osho, M (2004) “Consolidation Through manager and
Acquisition. *The African experience*”, a paper
presented at the central bank of Nigeria fourth
annual monetary policy conference in Abuja.

Spong (1990): *Risk management analysis in Banking sector*
Ann publisher London

Ubeze (1989): *Banking Operation (2nd edition)* Marigold
Publishers Enugu.

CHAPTER THREE

METHODOLOGY

3.1 Research Design:

According to Asika (1991:27), research design means the structuring of investigation aimed at identifying variables and their relationships to another. This is used for the purpose of obtaining data to enable the researcher answer research questions or test hypothesis.

This study is concerned with an evaluation of credit risk management in Nigeria commercial banks. For this reason, a case study design would be used. According to Udo (2004:74), a case study refers to a family intensive non-experimental examination of a single unit, such as an organization, an event or a person. Of multiple subjects, Osuala (2005:188) refers to it as multi-case studies. The researcher audited annual reports of banks cannot be manipulated unlike the survey design that is based on opinion of individuals who can be prone to bias. Udo (2004:75), in support of the superiority of this type of design, asserts that a case study is useful in comparative analysis of different organizations or companies.

3.2 Nature and Sources of Data

A quantitative ratio form of data will be used in this study. Ratio data allow for application of any type of financial, mathematical and statistical calculations. Most of the data to be collected for this study would be derived mainly from documentary or secondary sources and primary data source will also be consulted minimally.

3.2.1 Primary Sources:

Data are here collected first hand by the researcher himself. The use of questionnaires and other primary data instrument are effective here but mostly observation method.

3.2.2 Secondary Sources:

According to Abdul-maliq (2006:156-157), and Vosistrydam, fouche, Delport et al (2003:322), secondary sources of data comprises data, which though needed for the current study, but were collected primary for another purpose. Relevant official documents and their annual repots constitute the data for this study.

3.3 Method of Data Collection

In line with the case design adopted for this study, anecdotal records would be used for obtaining data for this research. Such records include the income and balance sheet statements as reported in various annual reports of First bank Nigeria Plc and Union bank Nigeria plc.

3.3.1 **Validity and Test of Validity**

According to Asika (1999:167-72), validity is defined, as the degree to which a measuring instrument measures what is designed to measure. We would approach this by looking at the validity of findings and validity of measurement.

- (i) **Validity of Findings:** This refers to the adequacy of a research design in eliciting the type of response that is designed to generate (Asika: 1991). To elicit the right information, the researcher will use audited annual reports of the banks to avoid the bias and equally the loss of subjects (Human) due to resignations, apathy and death.
- (ii) **Validity of Measurement:** This is the ability of the instruments to measure what they are supposed to measure (Asika, 1991:71). Capital Adequacy Ratio's and

Leverage capital ratio have been considered by many scholars and financial institution: they also consider credit risk management ratio as the appropriate instruments for evaluating the credit risk management position of commercial banks. Hence, relevant capital and credit ratios would be applied in this study. Again, correlation and Regression analysis would be used to establish the relationships between capital and return and their impact in credit risk management. These measurement instruments will cover the scope implied by the topic under study hence content validity.

3.32. Reliability and Test of Reliability: Reliability can be defined as the consistency between independent measurements of the same phenomenon. It could also mean the stability, dependability and predictability of measuring instruments. It is also the accuracy or precision of measuring instrument. (Asika, 1991:72-74).

The reliability of the study is ensured as follows:

- (i) By the apparent homogeneity of items in Nigeria Commercial banks statement which allows for the

application of Uniform capital ratios, correlation and regression analysis.

- (ii) By the Three year time serial and cross-sectional analysis between the selected Nigeria commercial banks financial statement.
- (iii) By test of relationship between capital and credit risk as would be extracted and analyzed from the banks financial statement.

Correlation and regression tools are the appropriate and reliable instruments for such measure of strength and degree of relationships.

3.4 Population and Sample Determination

Population has been defined variously by different scholars. Onwumere (2005:21), defines population to comprise all elements, subjects and perhaps observations in relations to a particular phenomenon. Ikeagwu (1998:172) defines it as the aggregate of individual persons or objects for investigations i.e., the sum total of the units of analysis. A more comprehensive definition is given by Vos, strydom, fouche, Delport et al (2002, 1999), as “the totality of persons, events,

organizational units, case records or other sampling unit with which the research problem is concerned”.

The First bank of Nigeria Plc and Union bank of Nigeria Plc constitute the sample and population of study. A sample refers to the total subjects chosen from the population for the study (see Avwokeni; 2004:108). The choice of two banks as the sample is made on purpose and judgmental basis and not by any random sampling methods. Hence, this purposive sample includes all the elements in the population.

3.5 Methods of Data Presentation

The data secured from the selected Nigeria commercial banks under study, when ready for presentation, will be guttered, codified, arranged, organized and separated into segments, which correspond to each segment of the objectives of this study.

Data relating to research questions will be classifies, tabulated and subsequently subjected to analysis using credit risk ratio, capital adequacy ratio, correlation and regression techniques.

3.5.1 Data Presentation

Summarized data from the results of the financial and statistical analysis are presented using tables and charts.

3.5.2 Data Analysis

Data from the selected commercial income and the balance sheet statement will be analyzed using leverage capital ratio, total risk base capital ratio and multiple linear regression techniques on the three years financial periods. Subsequently, the results of the analysis would be used to establish how well the banks are capitalized and how they manage their credit risk; the degree between risk based capital and returns and predicting the optimum credit risk management that would make them boost their capital position.

3.5.3 Research Questions and Analytical Techniques or Models

(1) Question 1

To what extent are credit losses affecting the operational efficiency of commercial banks?

Ratio analysis which is a basic tool for financial analyst can be used here to examine the effectiveness of bank's risk

management process. It can measure the extent which credit losses affect the overall operational efficiency of commercial banks in Nigeria.

Changes in ratios over time offer a dynamic view of banks performance. The output of the framework includes ratios on profitability, capital adequacy, leverage, liquidity and currency risks.

(a) Profitability which measures the degree of profit in relation to sales over time can be computed thus:

$$\text{Net profit margin} = \frac{\text{profit after tax}}{\text{sales}} \times \frac{100}{1}$$

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{sales}} \times \frac{100}{1}$$

$$\text{or} \\ \frac{\text{Profit before tax and interest}}{\text{Sales}} \times \frac{100}{1}$$

(b) Capital adequacy:

The following three models on capital standard will be used to analyze the adequacy of capital of the selected commercial banks.

- Tier 1 Risk Base Capital Ratio Model

$$= \frac{\text{Tier 1 capital}}{\text{Tier 1 capital}} \times \frac{100}{1}$$

Total Risk Weighted Asset 1

- Total Risk Base Capital Ratio Model

$$= \frac{\text{Tier 1 + Tier 2 capital}}{\text{Total Risk Weighted Asset}} \times \frac{100}{1}$$

- Leverage Capital Ratio Model

$$= \frac{\text{Tier 1 capital}}{\text{Total Tangible Asset}} \times \frac{100}{1}$$

(c) Liquidity ratio: This is comprised of

- Current ratio = $\frac{\text{Current asset}}{\text{Current Liabilities}}$

- Acid test ratio = $\frac{\text{Current Assets} - \text{stock}}{\text{Current Liabilities.}}$

(d) Currency Risk Model which can be represented in a graphical model to analyze the trends and structures.

All these can be used to facilitate comparison of performance and structures over time.

(ii) Question 2

What constitute the strength of the commercial banks in combating credit risk?

This question would be considered using statistical tool in analyzing the various factors that constitute the strength of

the banks in fighting credit risk. The regression analysis which describes the nature of the relationship in a mathematical form would be employed here. In other words, regression analysis provides an estimating equation which expresses the functional relationship between dependent variable (y) and independent variable (x). when it incorporates more than one independent variables ($x_1, x_2, x_3, x_4 \dots x_n$), the models is known as multiple regression gives the expected mean value of y (Return on asset due to the banks strength in fighting credit risk) conditioned upon given fixed values of repressors i.e. x_1 (total risk base capital ratio), x_2 (tier 1 risk base capital ratio) and x_3 (Leverage capital ratio).

Thus:

Multiple regression function:

$$Y = a + b_1x_1 + b_2x_2 + b_3x_3$$

where $x_2 \leq x_1$

y = Expected strength of commercial banks in fighting credit risk.

x_1 = Total risk base capital ratio

x_2 = Tier 1 risk base capital ratio

x_3 = Leverage capital ratio

a = y-intercept

b_1 = Rate of change in the expected value of 'y' caused by
Per unit change in value of x_1 i.e. the co-efficient of
 x_1 .

b_2 = Rate of change in the expected value of 'y' caused by
per unit change in the value of x_2 i.e. the co-
efficient of x_2

b_3 = Rate of change in the expected value of 'y' caused by
Per unit change in the value of x_3 i.e. the co-efficient
of x_3

Finally the analysis of this would proffer solution to the
constituent strength of commercial banks in fighting credit
risk.

Question 3

Does central bank of Nigeria assist commercial banks in
mitigating credit risk?

In order to answer this question the degree of
relationship between the central banks of Nigeria and

commercial banks of Nigeria in helping the later fight credit risk need to be established.

The relationship between variables is best measured statistically using co-efficient of correlation techniques. Nwabuoke (2001:3-9) defines product-moment co-efficient of correlation as a precise quantitative relationship between two variables. The relationship between the central banks of Nigeria and the commercial banks of Nigeria in fighting credit risk would be measured by the following correlation co-efficient formula:

Correlation co-efficient model:

$$R = \frac{n\sum xy - \sum x \sum y}{\sqrt{(n\sum x^2 - (\sum x)^2)(n\sum y^2 - (\sum y)^2)}}$$

where r = correlation co-efficient

n = number of observation

x = Total degree of central bank assistant to
Commercial banks.

Y = Credit risk level

E = Summation notation.

The value of correlation co-efficient vary between the limit of $+1$ or -1 where

$r = +1$ or -1 indicates perfect positive or negative relationships.

$r > 0.5$ or < -0.5 indicates strong positive or negative relationship.

$r < 0.5$ or < -0.5 indicate weak positive or negative relationship

$r = 0.5$ or -0.5 indicate moderate positive or negative relationships

$r = 0$ indicates no relationship.

Finally, the application of the above analytical tools in chapter four of this study would be held to a great extent in realizing the research objectives. However, data analytical tool park of Microsoft Excel would be used to perform the correlation and regression analysis to ensure accuracy, speed and simplicity of the computations and can possibly enhance clearer understanding.

3.6 Primary Data Analysis Method

3.6.1 Samples Size Determination

To arrive at a sample size, the researcher conducted a pilot survey to determine the proportion of the respondent that believe that credit losses affect the operational efficiency of commercial banks and that central banks of Nigeria assist commercial banks in fighting credit risk. From randomly selected 18 (eighteen) respondents, 9 (nine) each from the two selected banks, 17 or 94.5% of the respondents indicated that credit losses do really affect the operational efficiency of commercial banks and that commercial banks do receive assistance form central banks of Nigeria in fighting credit risk while 1 or 5.5% of the respondent has a contrary or different view. Based on the findings the sample size was determined using the following statistical.

Formulae by Topman.

$$N = \frac{Z^2 pq}{e^2}$$

where N= Sample size to be computed

£= Number of standard deviation for the derived level of confidence (1.96)

p= Percentage of positive response

q= Percentage of negative response

e= the limit of tolerable error at 95% confidence level

Z= 1.96% deviation at 5% tolerable error.

Therefore, the sample size is determined thus:

$$N = \frac{1.96^2 \times 94.5\% \times 55\%}{5\%^2}$$

$$= \frac{1.96^2 \times 0.945 \times 0.055}{0.0025}$$

$$= \frac{1.96^2 \times 0.945 \times 0.055}{0.0025}$$

$$= \frac{3.8416 \times 0.945 \times 0.055}{0.0025}$$

$$= \frac{0.19966716}{0.0025}$$

$$= 79.866$$

$$= 80$$

Based on the above computation, the sample size of 80 was used for the study

3.6.2 **Test of Hypothesis**

The data collected using the research instrument were analyzed using tables and percentages

The hypothesis will be tested using Chi-Square (χ^2) formulae as follows:

$$\chi^2 = \sum \frac{(O-e)^2}{e}$$

Where: O:= observed frequencies
e= expected frequencies
 $\sum$ = summation sign
 χ^2 = Chi-Square

When the Chi-Square is used, the decision rule is as follows:

if the calculated Chi-Square (χ^2) is compared with the Chi-Square in the standard table known as:

χ^2 = Chi-Square

r= number of rows

k=number of columns

(r-1) (k-1)= degree of freedom

α = error leveling significance

Any of the conclusions below is drawn:

if $\chi^2 \leq \chi^2_{(r-1)(k-1)}(\alpha)$ Accept H_0 rejects H_1

if $\chi^2 > \chi^2_{(r-1)(k-1)}(\alpha)$ reject H_0 Accept H_1

Where

H_0 = Null hypothesis

H_1 = Alternative hypothesis

References

Avdul-Maliq Y.O (2006). Research Methodology in *business and the social science*. Abuja: all maliq and company.

Asika, N. (1991), *Research Methodology in the behavioral sciences*. Lagos: Longman Nigeria Plc.

Nwabuoka, P.O (2001) *Fundamentals of Statistics*. Enugu: Koruna Books

Onwumere, J.U.J (2005) *Business and Economic Research Method*. Lagos: Don Vinton Ltd

Osuala, E.C (2005) *Introduction to Research Methodology (3rd Edn)*. Onitsha: Africa –first publishers Ltd.

Udo, G.O. (2004). *A guide to modern Research Methods*. Enugu: Institute for Development studies.

VOS, A; Strydom, it; fouche, C, Deplort, R and other (2003). *Research for grassroots (2nd edn)* Pretoria: Van Schiak Publishers.

Rose, P.S and Husgins, S.C. (2008) *Bank Management and financial Services (17th end)* New York: Mc Graw-Hill
Iirwih

Wariboko, N. (1994). *Principles and practices of Bank Analysis and Valuation*. Ibandan: Sepectrum Books Ltd.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS OF FINDINGS

4.1 Introduction:

The data are secured from the annual reports of the selected Nigerian commercial banks under review. The data so secured are computed, codified, arranged, organized and presented to correspond to each of the objectives and research questions of this study.

The data will be presented in tables and charts and subsequently analyze using Tier 1 risk base ratio, Total risk base ratio, leverage capital ratio, return on total asset ratio, correlation co-efficient and regression techniques on the three-years financial period of the banks country from 2007 to 2009.

The aim of this chapter is to evaluate the effect of credit losses on the capital adequacy of the selected Nigeria commercial banks and how it affects her banks earning and overall efficiency.

This is achieved by applying the methodology as explained in chapter three of this work.

4.2 **Data Presentation and Analysis 1**

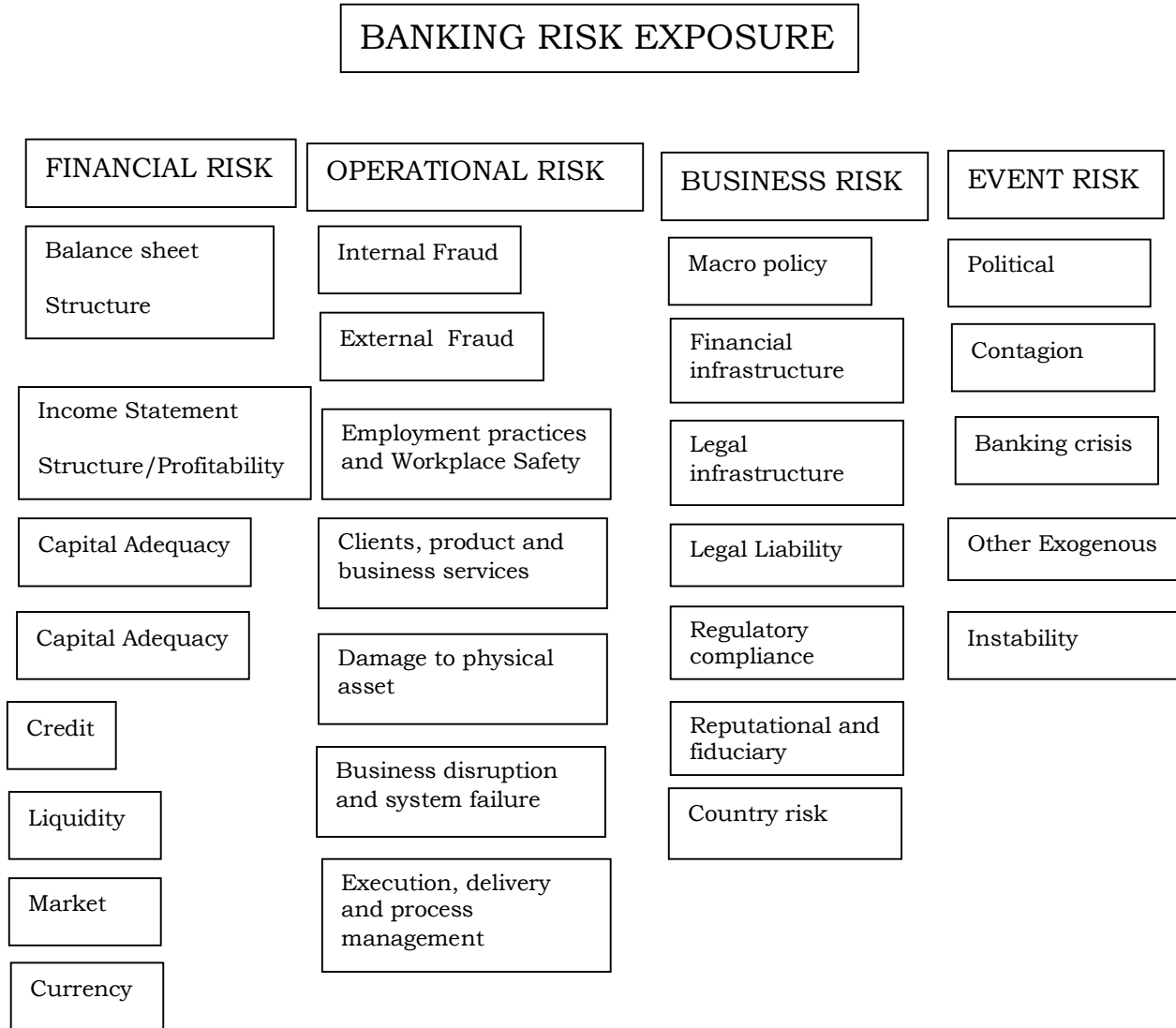
In line with the first objective of this study which is to critically ascertain what constitute credit risk to commercial banks in Nigeria and how this risk affect capital adequacy of the affected banks.

Banks are subjected to a wide array of risks in the course of their operations as illustrated in figure 1.1. In general, banking risk fall into four categories: Financial, operational, business and event risk. Financial risk in turn comprise two types of risk: pure risk-including liquidity, credit and solvency risk- can result in Loss for a bank if they are not properly managed.

Speculative risk, based on financial arbitrage can result in a profit if the arbitrage is correct or a loss if it is incorrect. The main categories of speculative risk are interest rate, currency and market price (or position) risks.

Financial risks which are our main scope of study are also subject to complex interdependencies that may significantly increase a bank's overall risk profile.

FIGURE 1.1 THE BANKING RISK SPECTRUM (TABLE 1)



Sources:

Operational risks and related to a banks overall organization and functioning of internal systems, including computed related and other technologies; compliance with banks policies and procedures; and measures against mismanagement and fraud. (Although these type of risks are

extremely important and are covered by a bank's in this publication, which focuses on financial risk.

Business risk is associated with a bank's business environment, including macroeconomic and policy concerns, legal and regulatory factors, and the overall financial sector infrastructure and payment system. Event risk includes all types of exogenous risk which, if they were to materialize, could jeopardize a bank's operation or undermine its financial condition and capital adequacy.

4.2.1 How these risks affects capital adequacy of the commercial banks

The question here is, are the commercial banks adequately capitalized?

According to Ledgerwood (2000:223); capital adequacy refers to the amount of capital a financial institution (banks has relative to its assets. it relate to leverage in terms of the adequacy of the financial institution's (bank's) funding structure. The bank's capital adequacy ratios for the two selected banks for three different periods are evaluated using the following bench mark.

MINIMUM CAPITAL REQUIREMENT ACROSS CAPITAL CATEGORIES

Figure 1.2 (table 2)

Situations	Total Risk Based Ratio	Tier 1 Risk based ratio	Tier 1 Leverage ratio
Well capitalized	≥ 10%	And ≥6%	And ≥5%
Adequately capitalized bank	≥ 8%	And ≥4%	And ≥4%
Under capitalized bank	≥ 6%	And ≥3%	And ≥3%
Significantly under capitalized bank	≥ 6%	or ≥3%	or ≥3%
Critical under capitalized bank			or ≥ 2%

Source: (Koch & Macdonald, 2003:478)

The following summary tables and charts express these ratios for union bank and first bank for the different financial periods.

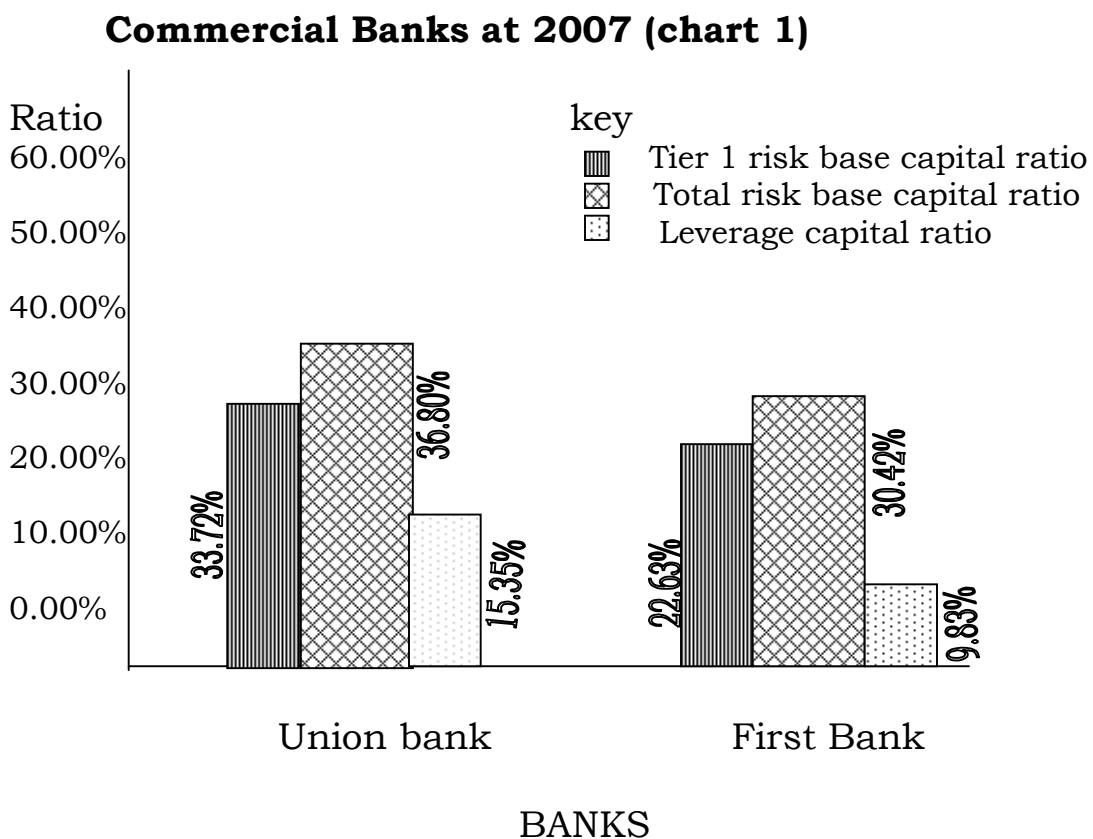
Figure 1.3 BANK CAPITAL ADEQUACY AS AT 2007 (TABLE 3)

	UNION BANK	FIRST BANK
Total Assets	N619,800 million	N762,881 million
Tier 1 capital	N95, 137	N74,972

Tier 2 capital	N8,685	N25,810
Total capital	N103,822	N100,782
Risk weighted asset	N282,127	N331,335
Tier 1 risk based capital ratio	33.72%	22.63%
Total risk base capital ratio	36.80%	30.42%
Leverage capital Ratio	15.35%	9.83/%
Ranking	1	2

Source (several Annual Report of Banks)

Figure 1.4 **Capital Adequacy Chart for two-Nigerian**



From the table 3 and figure 1.3 above for year 2007 Union bank took the lead by recording total risk base capital ratio of 36.80% quite above the Basel Minimum requirement of 10% for well capitalized bank. The bank tier 1 risk- based capital and leverage capital ratios are 33.72% and 15.35% respectively quite above the Basel Minimum requirement of 6% and 5%.

The above minimum ratios imply that the Union Bank core (tier1) capital and supplementary (tier 2) capital were utilized effectively through investment in less risky bank's asset while the leverage ratio ensure that the bank did not invest all its capital in risk free asset such as cash and treasury bill.

The first banks of Nigeria Plc ranked second in this rain of effective utilization of its capital to invest in less risk assets. This is confirmed by its tier 1 risk base ratio of 22.63%; total risk base capital ratio of 30.42%; and leverage capital ratio of 9.83% which are above the Basel Minimum capital ratio requirement of 6%, 10% and 5% respectively for a well

capitalized banks. Hence, the First bank is also considered well capitalized.

Figure 1.5 **Trend in Bank Capital Adequacy as at 2008**

(Table 4)

	UNION BANK	FIRST BANK
Total Assets	N712,700 million	N840,800 million
Tier 1 capital	N96, 288	N92,280
Tier 2 capital	N8,985	N30,334
Total capital	N105,273	N122,614
Risk weighted asset	N362,556	N412,822
Tier 1 risk based capital ratio	26.56%	22.1%
Total risk base capital ratio	29.04%	29.70%
Leverage capital Ratio	13.51%	10.97/%
Ranking	2	1

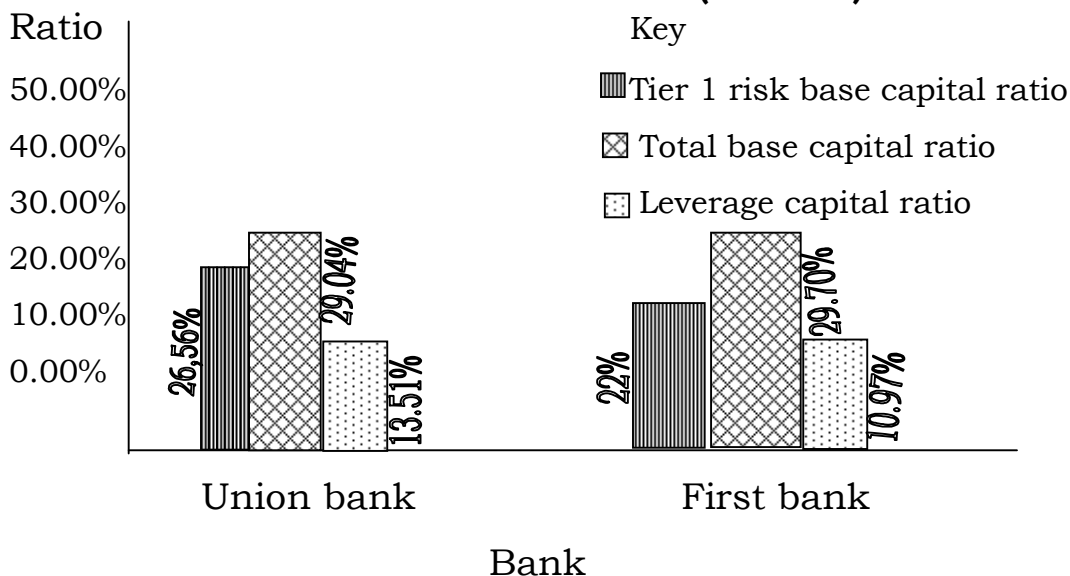
Source (several annual reports covering 2003-2009)

The table above described as table 5 figure 1.5 show the nature of the regulatory capital of Union bank plc and First bank of Nigeria plc in terms of their level of adequacy of capital for the year 2008.

Union bank of Nigeria plc recorded tier 1 risk base capital ratio of 26.56% quite above the Basel Minimum requirement of 6% for well capitalized bank. The bank total risk based capital and leverage capital ratios of 29.04% and 13.51% respectively are also greater than Basel Minimum requirements of 10% and 5%.

These higher ratio imply that the capital were effectively employed in acquisition of less risky bank's asset and credit risk were efficiently managed, while the leverage ratio ensures that the bank did not invest all its capital in risk free asset of cash and treasuring bill only but also on credit-giving transactions.

Figure 1.6 Capital Adequacy Chart for Two Nigerian Commercial Banks as at 2008 (chart 2)



In the case of first bank, its core and supplementary capital are effectively utilized in the acquisition of less risky assets. This is confirmed by the tier 1 risk base ratio of 22.56%, total risk base capital ratio of 29.70% and leverage capital ratio requirement of 10.97% which are above the Basel Minimum capital ratio requirement of 6%, 10% and 5% respectively for a well capitalized bank. First bank ranked first in this analysis on the other hand as described above ranked second.

Figure 1.7 **Capital Adequacy as at 2009 (table 5)**

	UNION BANK	FIRST BANK
Total Assets	N690,200 million	N896,400million
Tier 1 capital	N94,542	N105,425
Tier 2 capital	N7,445	N31,315
Total capital	N101,987	N136,740
Risk weighted asset	N388,625	N245,712
Tier 1 risk based capital ratio	24.733%	42.91%
Total risk base capital ratio	26.24%	55.465%
Leverage capital Ratio	13.69%	11.76%
Ranking	2	1

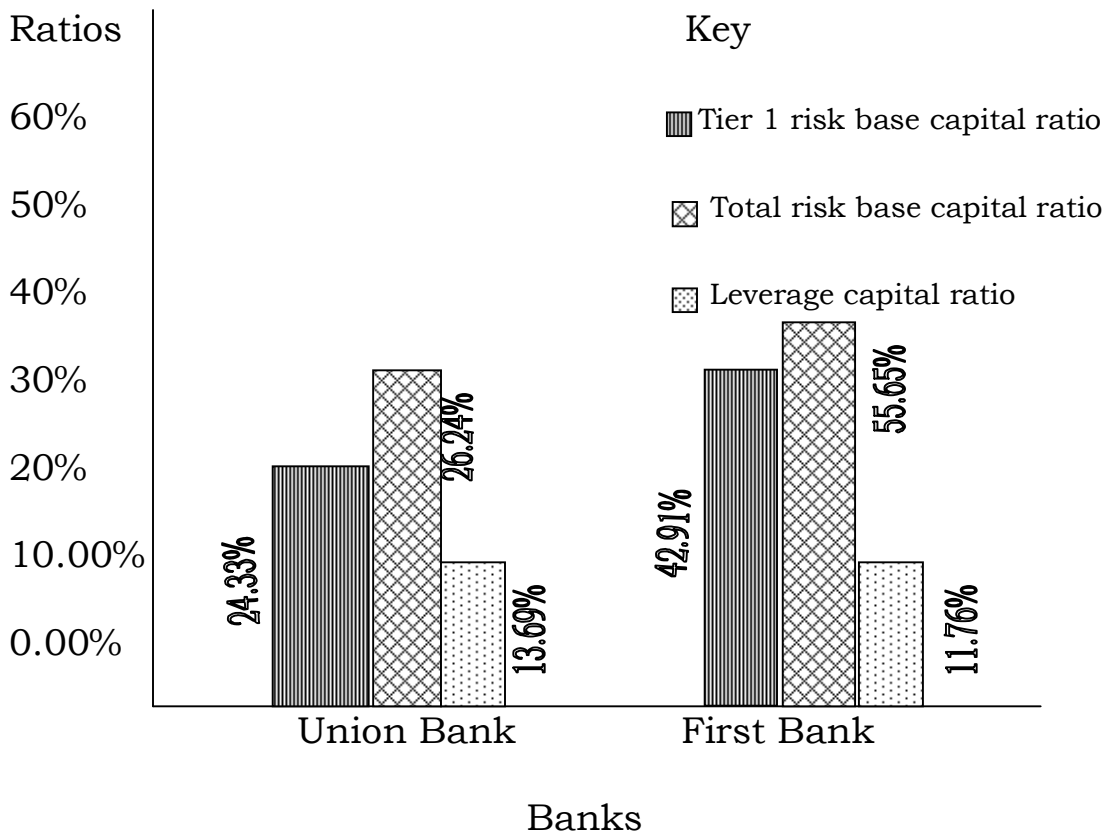
Source (several Annual report of banks from 2007-2009)

The table above described and marked table 7 figure 1.7 show the nature of the regulatory capital of Union bank plc and First bank of Nigeria plc in terms of their level of adequacy of capital for the year 2009.

The capital structure was grouped into tier one (1) and tier two (2) capital. The risk weighted assets of the banks were also looked into and the total assets were consulted to enable us computer the various ratio as seen in the table above.

The chart representing table 7 figure 1.7 is seen below.

Figure 1.8 chart 3



From the above chart it can be seen that the First bank of Nigeria took the lead by recording total risk base capital ratio of 55.65% quite above the Basel Minimum requirement of 10% for well capitalized banks. The bank tier 1 capital base ratio and leverage capital ratio are 42.91% and 11.76% respectively quite above the Basel Minimum requirement of 6% and 5%. The above minimum ratios imply that the First bank of Nigeria plc. Core (Tier 1) capital and supplementary (tier 2) capital were utilized effectively through investment in less risky bank's asset while the leverage ratio ensure that the bank did not invest all its capital in risk- free assets such as cash and treasury bill.

The Union Bank of Nigeria ranked second in effective Utilization of its capital to invest in less risky assets. This is confirmed by its tier 1 risk base capital ratio of 24.33%, total risk capital ratio of 26.24% and leverage capital ratio of 13.69% which are above the Basel Minimum capital ratio requirement of 6%, 10% and 5% respectively for a well capitalized bank. Hence this bank is considered as being capitalized very well.

Figure 1.9 Table 9

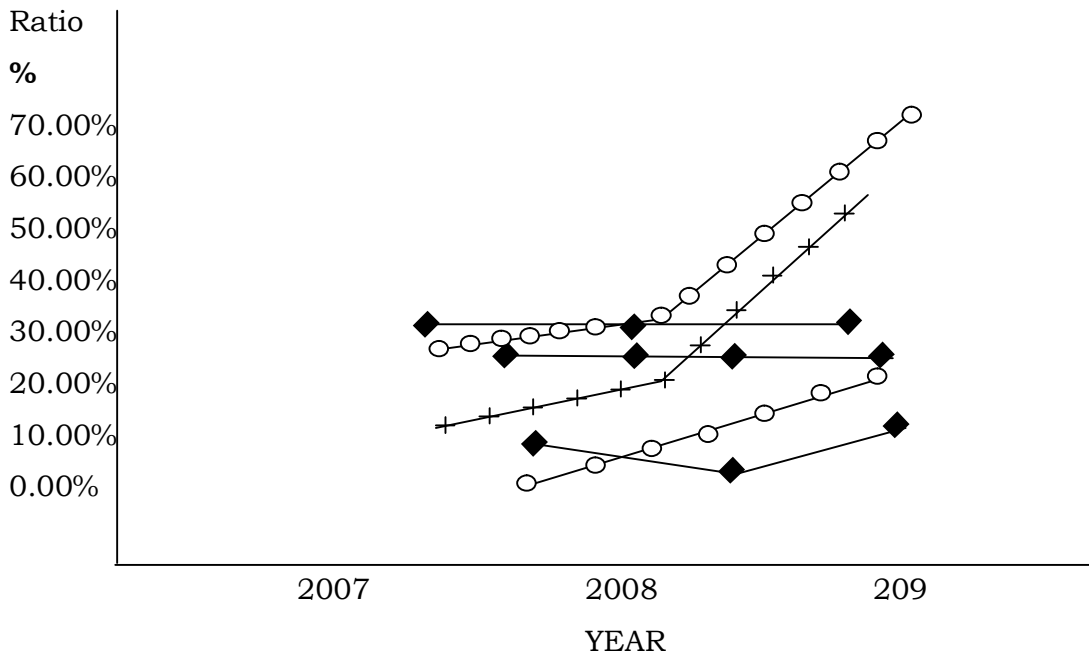
**TREND IN BANKS CAPITAL ADEQUACY FROM YEAR 2007
TO 2009 (TABLE 6)**

	2007	2008	2009
Union Bank			
Tier 1 risk base capital ratio	33.72%	26.56%	24.33%
Total risk base capital ratio	36.80%	29.04%	26.24%
Leverage capital Ratio	15.35%	13.51%	13.69%
FIRST BANK			
Tier 1 risk based capital ratio	22.63%	22.0%	42.91%
Total risk base capital ratio	30.42%	29.70%	55.65%
Leverage capital Ratio	9.83%	10.97%	11.76%

Source (Several Annual Report of Banks from 2007-2009)

Figure 1.10 Chart 4

Trend In capital Adequacy of Bank from Year 2007-2009



Key

—◆—	Union bank Tier capital ratio	(%)
—◆—	Union bank total capital ratio	(%)
—◆—	Union bank leverage capital ratio	(%)
-x-x-	First bank Tier capital ratio	(%)
-o-o-	First bank total capital ratio	(%)
-o-o-	First bank leverage capital ratio	(%)

The figure 1.10 shows historical trend of the capital ratios of the two banks (commercial banks) in Nigeria for the period spanning 2007 to 2009. One would observe that the tier 1 risk based capital ration for each of these banks overtime did not fall below 6% while total risk capital ratios did not fall below 10% and the leverage capital ratios did not fall below 5%. These scenarios indicate that the two banks have maintained their well capitalized position over time despite the fluctuation in value over time. The question is, does the pursuit of higher adequacy of capital in line with the banks objectives of making higher profit?

First let us look at the quality of these banks earning overtime to known how credit risk has affected it together with the effect of this credit losses of the capital adequacy which advocates for degree of banks earning.

4.2.2 To what extent does credit risk affect the overall efficiency of commercial bank?

A sound banking system that wants to achieve efficiency is built on profitability. Profitability is a revealing indicator of bank's competitive position in banking markets and of the quality of its management. The quality of the banks earning will reveal how the capital of the banks has been meaningfully utilized. Credit losses reduce bank's capital adequacy and indirectly affecting the earning capacity of the bank. This quality of earning is analyzed year wise by ratio of return to total assets.

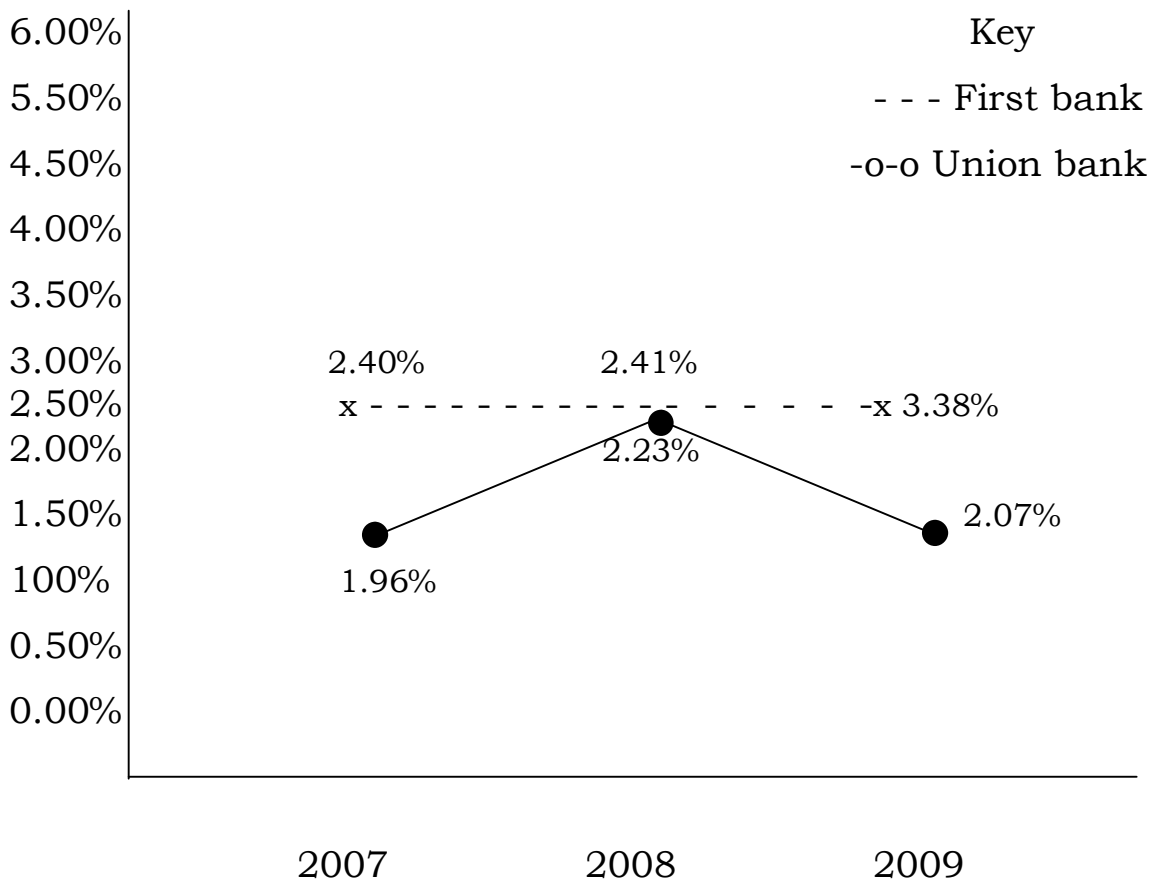
Figure 1.11 Earning quality statistics for two commercial banks overtime (table 7)

Banks	2007	2008	2009
Union bank Plc.	Million	Million	Million
Total Asset	N619,800	N712,700	N690,200
Profit after tax	N12,126	15,926	14,288
Return on total asset =			

$= \frac{\text{profit after tax}}{\text{Total Asset}} \times \frac{100}{1}$	1.96%	2.23%	2.07%
First bank of Nigeria Plc.			
Total Asset	762,881	840,800	890,400
Profit after tax	18,335	20,224	30,288
Return on total asset			
$= \frac{\text{profit after tax}}{\text{Total Asset}} \times \frac{100}{1}$	2.40%	2.41%	3.38%

Source (several Annual Reports of Banks)

Return on total asset chart (figure 12 chart 5



The ratio above measures how capable the bank management of their credit risk has been over the years. It

shows how efficient management of credit risk manifest in well capitalized position of the banks and how the assets of the banks has been converted into net earnings. It refers to all total asset of the bank not just the earning asset. It is a better measure of efficient performance in a whole. The higher the ratio, the better the bank's overall earning quality.

In the case of first bank, every N100 total assets employed generated N2.40, N2.41, and N3.38 income for year 2007, 2008 and 2009 respectively. The returns maintained an increase every year due to the bank's ability to cub credit losses and maintain good capital position which enables them to be able to cert their total asset into higher returns.

The Union bank of Nigeria on the other hand, has the following situation. For every N100 total asset generated N1.96, N2.23, and N2.07 for years 2007, 2008 and 2009 respectively. The return fluctuates or dwindles over the years indicating management dividing efficiency in converting total asset to higher returns.

4.2.3 What is the degree of relationship between banks quality of Earning and Adequacy of capital and to what extent are

credit losses affecting the operational efficiency of commercial banks in attaining this quality earning?

The relation would be evaluated by the use of correlation analysis. According to Gujarati and Sangeeth (2007), the primary objective of correlation analysis is to measure the strength or degree of linear association between variables. In this study, the relationship between banks quality of earning and capital adequacy will be ascertained by their correlation co-efficient and also relationship between capital adequacy and credit losses in relation to banks operational efficiency will be ascertained through her quality earning.

CORRELATION BETWEEN CAPITAL AND RETURNS BETWEEN NIGERIAN BANKS (TABLE 8)

Rota Return on total assets

CA Capital Adequacy

Year	Union bank	CA-UB	First bank	CA-FB
2007	1.96%	36.80%	2.40%	30.42%
2008	2.23%	29.04%	2.41%	29.70%
2009	2.07%	26.24%	3.38%	55.65%

CORRELATION COEFFICIENTS (SUMMARY OUTPUT)

	ROTA-UB	CA-UB	ROTA-FB	CA-FB
RO TA-UB	1			
CA-UB	-0.308	1		
ROTA -FB	0.09821	-0.8658	1	
CA-FB	0.58055	0.3984	-0.36882	1

Sources: Microsoft Excel computed correlation co-efficient output.

The table 8 above establishes the relationship between return on total assets (RO TA-UB) and capital adequacy (CA-UB) of the Union bank of Nigeria Plc to be -0.308 which indicates a weak negative relationship. This implies the more union bank pursues higher adequacy of capital cussed by credit losses, the more their earning per day decline. Also the relationship between return on total asset (ROTA-FB) and capital adequacy (CA-FB) of the first bank is established to be -0.3688 which also indicate a weak negative relationship. This implies the more first banks pursues higher adequacy of capital, the more their earning per year declines. The conflict between returns and capital adequacy and also the conflict between the returns, credit losses and capital adequacy, how would it be resolved to ensure that banks make optimum return while maintaining a well capitalized position.

4.2.4 To what extent are credit losses affecting the operational efficiency of commercial banks?

In line with this objective of the project which seek to examine the causes of credit losses in Nigeria commercial banks and the extent to which this credit losses is affecting the operational efficiency of commercial banks effected here. Ratio analysis which is a basic tool for financial analysis can be used here to examine the effect of this losses on bank overall performance in profitability wise.

Bankers pay a great deal of attention to the message that is revealed by ratio analysis. Banks usually manage profitability by controlling their credit losses and by trying to beat market average and keep profits steady and predictable. This in turn attracts investors.

Banks profitability Ratio (2007) (table 9)

	Union Bank	First Bank
Gross income before	N million	N
Tax	149,800	154,800
Tax	10,240	12,240
Net income		
After tax	139,560	142,560
Net Profit	<u>Net profit</u> x <u>100</u>	<u>Net profit</u> x <u>100</u>

	Total income	1	Total income	1
margin	=	$\frac{139560}{149,800} \times \frac{100}{1}$	$\frac{142,560}{154,800} \times \frac{100}{1}$	
		93.16%	92.09%	

Source Annual Report (2007)

In the above computation, it reveals that the profitability position of the two banks are very high and this is an indication that the banks competitive position in the banking market and shows that certain risk profit are maintained and this provides a cushion against short-term problems. Union bank of Nigeria plc has Net profit margin of 93.16% as against the first bank net profit margin of 92.09%.

This shows that Union Bank Nigeria Plc performed wonderfully well more than the first bank of Nigeria plc in the year (2007)

Banks profitability ratio (2008) (Table 10)

	Union Bank	First Bank
Gross income	N202,322m	N348,282m
Tax	<u>82,448</u>	<u>98256</u>
Profit or income after tax	119,874	250,026
Net Profit margin	$\frac{\text{Profit after tax} \times 100}{\text{Total income}} \times \frac{100}{1}$ $= \frac{119,874}{202322}$ $= 59.25\%$	$\frac{\text{Profit after tax} \times 100}{\text{Total income}} \times \frac{100}{1}$ $= \frac{250,026}{348,282}$ $= 71.79\%$
Effective tax rate	% of net income	% of net income

Source: Annual report of the affected banks.

From the above analysis, it shows that the profitability margin of the banks dropped drastically due to some factors. But in all their performance is still above average. Union banks of Nigeria plc recorded 59.25% as against 93.16% in 2007 while first bank of Nigeria plc recorded 71.79% as against 92.09% in 2007. This is an indication that first bank of Nigeria plc has more profitability position over Union bank of Nigeria plc. This drop in profit margin may be due to some factors which included credit losses as one.

	Union Bank	First Bank
Gross income	302.482m	362,498m
Tax	<u>100,028</u>	<u>101,222</u>
Profit or income after tax	202,454	261,276
Net Profit margin	$\frac{\text{Net Profit after}}{\text{Total income}} \times \frac{100}{1}$ $\frac{202,454}{302,482} \times \frac{100}{1}$ $= 66.93\%$	$\frac{\text{Net Profit after}}{\text{Total income}} \times \frac{100}{1}$ $= \frac{261,276}{362,498} \times \frac{100}{1}$ $= 72.08\%$

Source: Annual report (2007)

From the above computation, the banks tried to revamp their situation in 2008 by improving on their profitability margin in 2009.

First bank of Nigeria came first with Net profit margin of 72,08% which indicate that there is improvement in the control of their credit losses this year while the union bank of Nigeria plc came second with 66.93% also indicating that they improved in their credit loss control in this year as against 2008.

4.2.5 How does central bank of Nigeria assist commercial banks in mitigating credit risks?

The central bank of Nigeria was established on March 17th 1958 by the central bank ordinance of that year. Section 26 of the CBN Act 2007 empowers the CNB to perform those functions that will help stabilize the banking sector in Nigeria.

Since then, there have been much reformation in this sector by the CBN all geared toward fighting inefficiency in the commercial banking sector of the economy.

Some of these reformations include:

- Consolidation in the Nigeria Banking System through equity capitalization to 25 billion naira.

- Establishment of the proposed asset management company of Nigeria as one of the 13-point reform agenda by the CBN in 2004.
- Establishment of financial analysis and surveillance system (e-FASS) to enhance and strengthen
- Lobbying of IMF technical mission to Nigeria in order to assist commercial banks.
- Moving towards a risk-Banded framework for supervision.
- Liberalization of the Nigeria financial sector.
- The movement toward ten-digit number of bank account etc.

All these reformations are meant to ameliorate the financial losses incurred by banks through credit losses mismanagement techniques. This reform is also aimed at attaining effectiveness and then efficiency in Nigeria banking sector. It constitutes the assistance rendered by central banks in helping commercial banks fight credit risk.

4.3 Testing of Hypotheses

The hypothesis earlier formulated in chapter one is tested based on the responses obtained from the questionnaires.

The hypothesis is tested using the Chi-Square technique as contained in chapter three.

Hypotheses I

Ho: Credit risk management does not affect operational efficiency of commercial banks.

Hi: Credit risk management does affect operational efficiency of commercial banks.

Table:

Banks	Responses does affect	Responses does not affect	Total
First bank (Area office)	15	3	18
First bank (Okpara Av.)	17	1	18
Union bank (Area office)	17	0	17
Union bank (Okpara Av.)	16	3	19
Total	65	7	72

Using the formula $x^2 = \sum \frac{(o-e)^2}{e}$ or $\sum \frac{(Fo-Fe)^2}{Fe}$

where x^2 = Calculated Chi-Square

fo or O = Observed Frequencies

fe or e = Expected frequencies

df = Degree of Freedom

& = Level of significance

Expected value of frequencies = $(A \times A_1)/c$ for row 1 and;
column 2 and $(B \times A_1)/c$ for row I column 4

Given DF = $(R-1) (K-1)$

= $(2-1) (4-1)$

= 1×3

o	e	o-e	$(o-e)^2$	$\frac{(o-e)^2}{e}$
15	16.25	-1.25	1.5625	0.009615384615
3	1.75	1.25	1.5625	0.8928571429
17	16.25	0.75	0.5625	0.003461538462
1	1.75	-0.75	0.5625	0.3214285714
17	16.25	0.75	0.5625	0.003461538462
0	1.75	-1.75	3.0625	1.75
16	16.25	0.25	0.0625	0.0003846153846
3	1.75	1.75	3.0625	1.75
				4.73467033

R_{1k2} = Expected frequency = $\frac{65}{4} = 16.25$

R_{ik4} = Expected frequency = $7/4 = 1.75$

Decision Rule: If the calculated Chi-square is less than the table value, reject the alternative hypothesis and accept the null hypothesis (ie if $\chi^2 = \& (r-1) (k-1)$ and $\chi^2 (Cal) = \text{accept } H_0$,

Reject H_0) and if the calculated Chi-square is greater than the value of Chi-square; reject the null hypothesis and accept the alternative hypothesis.

Decision: Since the calculated Chi-square of $\chi^2=4.73467033$ is greater than the table value of $\chi^2=2.815$, we reject the null hypothesis that credit losses do not affect the operational efficiency of commercial banks and accept the alternative hypothesis that credit losses affect the operational efficiency of commercial banks.

Hypothesis 2:

H_{02} : Central bank of Nigeria does not assist the commercial banks in mitigating credit risk.

H_{i2} : Central bank of Nigeria assists the commercial banks in mitigating credit risk.

Test statistics to be used:

$$\chi^2 = \sum \frac{(o-e)^2}{e}$$

where o = Observed frequency

e = Expected frequency

χ^2 = Chi-square test

Level of significance = 5% = 0.05

Degree of freedom = (r-1) (k-1)

$$= (2-1) (4-1)$$

$$= 1 \times 3$$

$$= 3$$

critical or table value χ^2 at 0.05 = 2.815

Banks	Do assist	Do not assist	Total
First bank (Area office)	15	3	18
First bank (Okpara Av.)	12	6	18
Union bank (Area office)	14	3	17
Union bank (Okpara Av.)	13	6	19
Total	54	18	72

Expected frequency = $54/4$ and $18/4$

$$= 13.5 \text{ and } 4.5$$

o	e	o-e	(o-e) ²	$\frac{(o-e)^2}{e}$
15	13.5	1.5	2.25	0.016666666667
3	4.5	-1.5	2.25	0.500000000000
12	13.5	-1.5	2.25	0.016666666667
6	4.5	1.5	2.25	0.5000 000 0000
14	13.5	0.5	0.25	0.01851851852
3	4.5	-1.5	2.25	0.500000000000
13	13.5	-0.5	0.25	0.01851851852
6	4.5	1.5	2.25	0.500000000000
				$\chi^2=3.228$

Decision Rule: Accept null hypothesis (Ho)

If the calculated chi-square is less than the table value and reject the alternative hypothesis; reject the null hypothesis (Ho) if the calculated value is greater than the table value of chi-square

Decision: Since the calculated value of chi-square ($\chi^2=3.228$) is greater than the table value ($\chi^2=2.815$), we reject the null hypothesis that central bank of Nigeria do not assist commercial banks in fighting credit risk and accept the alternative hypothesis that they do assist commercial banks in fighting credits risk.

Hypothesis 3

Ho3: Commercial banks do not have the required techniques of combating credit risks.

Hi3: Commercial banks have the required techniques of combating credit risks.

Test Statistic to be used:

$$\chi^2 = \sum \frac{(o-e)^2}{e}$$

where o= Observed frequency

e= Expected frequency

χ^2 = Chi-square test

Level of significance = 5% = 0.05

Degree of freedom = (r-1) (k-1)

= (2-1) (4-1)

= 1x3

= 3

5% level of significance at 0.05 =2.815

Banks	They do have	They do not have	Total
First bank (Area office)	11	7	18
First bank (Okpara Av.)	13	5	18
Union bank (Area office)	15	2	17
Union bank (Okpara Av.)	13	6	19
Total	52	20	72

o	e	o-e	(o-e) ²	$\frac{(o-e)^2}{e}$
11	13	-2	4	0.3076923077
7	5	2	4	0.80
13	13	0	0	0.00
5	5	0	0	0.00
15	13	2	4	0.3076923077
2	5	-3	9	1.8
13	13	0	0	0.000
6	15	1	1	0.20
				$\chi^2 = 3.4154$

Expected frequency (do have) = $52/4 = 13$

Expected frequency (do not have) = $20/4 = 5$

Decision Rules: if the calculated chi-square less than the table value accept the null hypothesis and reject the alternative hypothesis but if the calculated value of chi-square is greater than the table values accept the alternative hypothesis and reject the null hypothesis.

Decision: since calculated chi-square is greater than the critical or table value (ie $3.4154 > 2.815$), we reject the null hypothesis that commercial banks do not have the required techniques of fighting credit losses and accept the alternative hypothesis that commercial banks have the required techniques of fighting credit risk.

CHAPTER FIVE

SUMMARY OF FINDINGS, RECOMMENDATIONS AND CONCLUSIONS

5.0 Introduction

The main objective of this study as earlier stated is to critically examine the strategies of credit risk management in Nigeria commercial banks. This chapter was designed to summarize the findings of the study and to offer recommendations as to the strategies to be adopted in enhancing proper credit risk management in commercial banks within the country.

5.1 Summary of Findings

The study was undertaken to evaluate credit risk management strategies of Nigerian commercial banks using first bank of Nigeria plc and union bank of Nigeria Plc as a case study.

In the course of the study, a lot of findings or observations were made by the researcher. The researcher

observed that credit losses have over the years affected the operational efficiency of commercial banks adversely. It was revealed that credit losses have contributed more than seventy percent (70%) of the general inefficiency of commercial banks.

Secondly, the study, revealed that central bank of Nigeria has over the years been committed to assisting commercial banks in fighting credit risk which has been the secret behind the tremendous success recorded by some commercial banks.

Finally, the researcher observed that most of the branches of the two banks under study have the pre-requisite techniques of fighting credit risk, though under-utilization of these techniques was also experienced in the course of the study.

5.2 Recommendations

Based on the findings of the study the following recommendations were made:

First, commercial banks should employ more strategic means in monitoring credit losses in their banking system. Strategies must be backed up with actions for it to be effective.

Secondly, commercial banks should assess the workability of each strategy before implementation since strategies are costly and may involve heavy capital investment. Commercial banks should therefore assess strategies against the credit risk factors. Above all, this should have been better if it has been carried out on a wider scope, for instance on many commercial banks across the country.

More significantly, the sample size for this study was relatively small; the study was only on first banks and union banks within Enugu metropolis (Area office and Okpara Avenue to be specific).

More so, research is needed in the area such as lending behaviour of banks, loan syndication of the banks and the ability of the banks to critically examine the C's of lending (character, capacity, collateral and capital of the lender).

Again, further studies should be directed to investigate risk management ability of the banks employees since this will go a long way in enhancing proper credit risk management in commercial banks across the country.

5.3 Conclusion

From the analysis of the findings, several conclusions can be made in relation to the research objective.

First, there are several causes of credit risk to commercial banks and this was higher in Union bank plc when compared with their first bank of Nigeria plc counterpart.

Secondly, credit losses do really reduce the operational efficiency of these affected banks especially in union bank of Nigeria plc.

Thirdly, the employment of strategies in reducing this risk is higher in first bank of Nigeria plc than in the union bank of Nigeria plc.

Finally, several assistance have been rendered by central bank of Nigeria to the commercial banks in helping the later manage or fight credit risk in their banking business.

Bibliography

- Adekanye F (1999): *The Elements of Banking in Nigeria* (3rd edition) F & A publishers, Lagos
- Basel Accord Committee (1988,1996, 2001)
- Central Bank of Nigeria and Nigeria Deposit insurance corporation (1995): Distress in the Nigeria Financial Services industry Lagos
- Emma et al (2000): *Banking Policies and Procedures in Nigeria*
- Erikson et al (1999): Banking regulation strategies in Nigeria Edison publishers, Enugu.
- First Bank of Nigeria Plc (2007): *Annual reports and Accounts 2007.*
- First Bank of Nigeria Plc (2008): *Annual reports and Accounts 2008.*
- First Bank of Nigeria Plc (2009): *Annual reports and Accounts 2009.*
- Union Bank of Nigeria Plc (2007): *Annual reports and Account 2007*
- Union Bank of Nigeria Plc (2008): *Annual reports and Account*

2008

Union Bank of Nigeria Plc (2009): *Annual reports and Account*

2009

Oshio; M (2004) “*Consolidation through Merger and*

Acquisition, the African experience”, a paper

presented at central Bank of Nigeria Fourth

Annual Monetary Policy conference in Abuja

Spong (1990): Risk Management Analysis in *Banking Sector*.

Ann Publishers, London

Ubeze (1989) *Banking Operations* (2nd Ed) Marigold Publishers

Enugu.

APPENDIX

QUESTIONNAIRES

Department of Banking and Finance
School of Post Graduate Studies
University of Nigeria, Enugu Camps

February 05, 2011

Dear Respondents

I am a post graduate student in the department of Banking and Finance conducting research on the credit risk management in Nigeria Commercial Banks; A case study of First Bank of Nigeria Plc and Union Bank Nigeria Plc.

This research work is being arrived out in particle fulfillment for the award of MBA in Banking and finance.

Every information received will be treated confidentially and for the purpose of this research only.

Thanks for your anticipated co-operation

Yours faithfully,

Eze, Nkechi R.

Please mark (✓) in the box against the response you consider applicable and appropriate to you or supply any information where you find necessary.

SECTION A

Department: Personnel ☐ Marketing ☐ operation ☐

Other ☐ (please specify)

Sex: Male ☐ Female ☐

Qualification: WASSCE/GCE ☐ OND

Equivalent ☐ HND/BSC ☐

MBA/MS/ICAN ☐ others ☐

(Please specify)

Years of experience (1-5yrs) ☐ (6-10yrs) ☐

☐ Above 20 ☐

Section B

1. Are appointment of banking staff especially those in operation base on merit? Yes ☐ No ☐
2. Do credit Losses affect commercial banks Yes ☐ No ☐
3. Do your bank have the required techniques in fighting credit losses if experienced: Yes ☐ No ☐

4. Do central bank of Nigeria assist your bank in fight credit losses Yes ☐ No ☐
5. What other forms of credit risk affect your bank:
(Please specify)
6. In your own opinion what strategy can be used in curbing credit risk in banking industry (Please specify)