# DEBT MANAGEMENT AND ITS IMPLICATIONS ON DEPOSIT MONEY BANKS PERFORMANCE IN NIGERIA

BY

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**APPROVAL**

This project titled "**Debt Management and Its Implications on Deposit Money Banks Performance in Nigeria**" has been assessed and approved by defense committee of Department of Banking and Finance, School of Business Studies, Auchi Polytechnic, Auchi.

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## CERTIFICATION

We the undersigned hereby certify that this project work was carried out by **MOMODU RUBABAT** with **Mat No: NO: SBS/2282070046** in the department of Banking and Finance, under our supervision and that it is adequate in scope and quality in partial fulfillment of the requirements for the award of Higher National Diploma (HND) in Banking and Finance.

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## DEDICATION

This project work is dedicated to Almighty Allah the most high, the fountains of knowledge and giver of our life, without whom my project would not have been possible

## ACKNOWLEDGEMENTS

I wish to start by giving a deserved acknowledgement to God almighty. I also acknowledge with sincere appreciation the contribution of my parent and my siblings

My sincere gratitude goes to my project supervisor and HOD Dr Abdulai Musa for taking time to effect the necessary correction in spite of time schedule may God continue to bless you sir.

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Special thanks goes to my mother who has always be there for me, who has always being responsible for my education and all

Finally, I really thank Almighty Allah who spare my life to witness this day.

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***ABSTRACT***

*This project work examining debt management and its implications on deposit money banks performance in Nigeria. The broad objective of the study is to investigate if short term debt (STD) has significant impact on Return on Equity. The research design adopted was the survey design, data ware gathered through secondary sources. The result was analyzed using regression analysis. The study reveals that Short term debt (STD) has significant impact on return on equity, long term debt (LTD) has no significant impact on return on equity and total bad debts*

*(TBDR) has no effect on the return on equity (ROE) of banks in Nigeria. The study concludes that debt capital on performance of listed deposit money banks in Nigeria. Given this, the study observed that 84.4% of the total capital of banks in Nigeria during the period of this study was made up of debt. This is a reaffirmation of the fact that banks are highly levered financial institutions. The study also recommends that bank management should consider a tradeoff between STD and LTD in deciding on debt capital in order to optimize their performance, total debt (DR) is a significant determinant of listed banks' financial performance, and thus due diligence needs to be undertaken whenever the bank decides to borrow funds for investment. Finally, there is a need for the government to formulate policies that will fast track the development of a more vibrant capital market where DMBs and other firms will have access to equity and bond at globally competitive rates.*

# CHAPTER ONE

# INTRODUCTION

## 1.1 Introduction

Debt management in our banking sector today has taken a different dimension from what it used to be. The banking industry has adopted a lot of strategies in checking debt management in order to stay in business. Thu the banking industry in Nigeria has lost large amount of money as a result of the turning source of credit exposure and taken interest rate position. Nigerian banks are being required in the market because of their competence to provide transaction efficiency, market knowledge and funding capability. To perform these roles, the banks act as the most important participants in their transaction process of which they use their own balance sheet to make it easier and making sure that their associated risk is absorbed.

Credit extension is essential function of banks and the bank management strives to satisfy the legitimate credit needs of the community it tends to serve. This credit advances by banks as a debtor to the depositor requires exercising prudence in handling the funds of depositors. The Central Bank of Nigeria established a credit act in 1990 which empowered banks to render returns to the credit risk management system in respect to its entire customers with aggregate outstanding debit balance of one million naira and above (Ijaiya G.T and

Abdulraheem A (2020). This made Nigerian banks to universally embark on upgrading their control system and risk management because this coincidental activity is recognized as the industry physiological weakness to financial risk. The researcher, a New yolk-based, said that 40% of Nigerian banks that made up exchange rate value in west Africa, has reduced the operating lending as a result of bad debts which hit more than $10 billion in 2009 and this has led to a tied-up questioning asset that is holding almost half of Nigerian banks.

There are three classes of debts, and these are the short-term debt with a maturing period of one year or less, medium-term maturing between one to five years and long- term debt maturing after five years. However, short term debt mainly sourced from depositors remains the most crucial source of finance available to deposit-taking institutions. The optimal capital decision is always desirable to management, for the simple fact that it represents the best combination of debts and shareholders fund that produces a low cost of capital and maximises the firm's value. Consequently, poor capital decision, for example, the wrong mix of debt and equity may lead to the high cost of capital, increase financial risk, lower the firm's financial performance and eventually hinder its survival (Anarfo, 2015). This implies that an inefficient debt capital decision

may force a firm to extinction.

Financial performance determines the firm's efficiency in resources utilisation, as well as its ability to make a profit (Aymen, 2013). Financial

performance of banks is essential because of the critical role the industry plays in the economy in terms of provision of financial intermediation, the transmission mechanism of monetary policy and maintenance of economic stability (Abbadi and Abu-rub, 2012). Stressing the importance of sound financial performance in the banking industry, Scott and Timothy (2006) as cited in Ronoh and Ntoiti, (2015) pointed out that banks with sound financial performance and sufficient capital can withstand adverse shocks. This implies that a sound banking sector will remain firm and continue to provide the needed financial intermediation services. Thus, a healthy and sound banking sector enhances financial deepening, creates more employment opportunities and promotes financial stability (Hafiz, 2018). However, financial stability report indicates a declining trend in the Nigerian banks' financial performance metrics. For instance, return on equity (ROE) and return on assets (ROA) have dropped from 14.90 %, and 2.67 % in 2019 to 1.18 %, and 0.16 % in 2020 (IMF, 2017; CBN, 2020). This development is capable of eroding public confidence and in the extreme, could trigger runs on the banks. Hence, the need for improvement in the key decision areas such as capital structure becomes imperative, because of their close relationship with the bank’s performance and survival.

## 1.2 Statement of the Problem

In the history of development of the Nigerian banking industry, it can be seen that most of the failures experienced in the industry prior to the consolidation

era were results of imprudent lending that finally led to bad loans and some other unethical factors. Also the problem of poor attention given to distribution of loans has its effect on the bank's performance. Most of the people collected loan from the banks and diverted the money to unprofitable ventures. Some bankers are not actually considering the necessary criteria for disbursement of loans to the customer. This work therefore intends to outline, explain these problems identify the causes and suggests lasting solutions to the problems associated with credit management and consequently banks debts.

## 1.3 Objective of the Study

i. To investigate if short term debt (STD) has significant impact on Return on Equity
ii. To investigate if long term debt (LTD) has significant impact on Return on Equity
iii. To determine Total Bad debts (TBDR) has no effect on the return on equity (ROE) of banks in Nigeria

## 1.4 Research Question

The research questions gathered for the purpose of this study are as follows;

i. Does short term debt (STD) have significant impact on Return on Equity?
ii. Does long term debt (LTD) have significant impact on Return on Equity?
iii. Do bad debts have any impact on the return on equity (ROE) of banks in Nigeria?

## 1.5 Statement of Hypothesis

For the purpose of this study which seeks to evaluate debt management and its implication on deposit money banks performance in Nigeria, the following hypotheses have been formulated and will be tested based on the data that will be gathered by the researcher.

**Hypothesis One**

$H_o$: Short term debt (STD) has no significant impact on Return on Equity

**Hypothesis Two**

$H_o$: Long term debt (LTD) has no significant impact on Return on Equity

**Hypothesis Three**

$H_o$: Total Bad debts (TBDR) has no effect on the return on equity (ROE) of banks in Nigeria

## 1.6 Significance of the Study

This study will be useful to the executive and managers in the banking industry and other financial institutions. This is because it provides guidance which will enhance effect and efficient credit management aimed at attaining and boosting maximum profitability and liquidity in their banks. The depositor (public) on the other hand will be more enlightened on the need to be honest and fulfil the responsibilities in credit transaction with the banks so that they can look up to improve service from the banks.

Finally to the researcher, this is an eye opener because as a potential manager it will guide one in future on how to manage credit facilities.

## 1.7 Scope of the Study

This study is aimed at analyzing the debt management and its implications on in deposit money banks in Nigeria. The study intends to analyses the credit facilities in banking industry. It also reviews the various concepts procedures for efficient and effective credit management. It examines the success and failure (if any) as well as recommending corrective measure. Also for the purpose of this study, secondary data will be gathered from ten (15) banks listed on the Nigerian Stock Exchange and would be studied for a selected period of six (8) years spread between 2014- 2021.

## 1.8 Limitation of the Study

The Limitations are constrained to lack of fund, human error and limited time frame, which imposed difficulties when serious attempt to effect a general in – depth towards this study.

## 1.9 Operational Definition of Terms

Below are the major terms used in the course of this research work.

**Bank:** A financial institution that accepts deposits and channels the money into lending activities

**Bankruptcy:** A state where a person or firm is unable to meet their financial obligations.

**Management:** management is the study of decision-makers from the supervisor and line managers at lower levels to the Board of Directors.

**Loans and Advances:** These are credit facilities granted by banks to their customers. They could be short, medium or long term depending on the length of period of repayment

**Overdraft:** A credit facility (usually short term) granted by banks to current account holders and it carries interest charges on daily basis

**Customer:** A person is a customer if he or she has account with the bank.

**Debt:** This is what one owes to another person

**Default:** The means failure to pay ones debt in credit extended which has fallen due.

**Financial Intermediation:** This is defined as financial transactions, which savings surplus unit together with savings deficit so that saving can be redistributed into their most productive uses.

**Securities:** This may be defined as something that provides safety, freedom, from danger or anxiety, something valuable for example a life insurance policy given as pledge for the repayment of a loan or fulfillment of a promise or undertaking.

**Collateral Security:** This is any security deposited by s third party to secure the indebtedness of the customer with the advantage that in the event of bankeupty or liquidation of the borrower, the value of such securities may be ignored in the proof of dividend against the fail estate.

# CHAPTER TWO

# REVIEW OF RELATED LITERATURE

## 2.1 Conceptual Review

### 2.1.1 Credit Management

According to (Odofuye, 2019) Credit management is the process for controlling and collecting payments from your customers. A good credit management system will help you reduce the amount of capital tied up with debtors (people who owe you money) and minimize your exposure to bad debts. It is a function performed within a company to improve and control credit policies that will lead to increased revenues and lower risk including increasing collections, reducing credit costs, extending more credit to creditworthy customers, and developing competitive credit terms. Through credit control otherwise known as credit management, it is sometimes possible to increase sales by granting credit to selected clients who may choose to do business with you because of the convenience offered by a credit account. If you choose to provide this option be sure to develop a sound credit application process which includes a thorough check of client credit ratings before granting approval. Every bank has to develop and implement comprehensive procedure and information systems to follow up the condition of individual credits. An effective loan monitoring system according to Odofuye (2019) will include measures to:

i. Monitor compliance with established covenants,

ii. Assess, where applicable, collateral covenants, relative to creditors current condition,

iii. Identify contractual payment delinquencies and classify potential credits on a timely basis, and.

iv. Direct actions at solving problems promptly for remedial management

### 2.1.2 Types of Bank Credit

#### 2.1.2.1 Loan and Advances

**i. Overdrafts:** These are the most common and simplest forms of credit facilities. They are usually granted for working capital purposes and the amount outstanding is expected to fluctuate over the life of the facilities, depending on the borrower's working capital financing needs, at any material time. Overdrafts permit the borrower to use those amounts required on a day to day basis, thus saving unnecessary interest charges. In accordance with general banking practice, overdrafts are repayable on demand and can be cancelled at the bank's option without prior notice to the borrower. The overdraft limit is usually communicated to the customer and this limit serves as the bank's reference point in all drawings by the beneficiary.

**ii. Advances:** An advance is a short-term credit which is granted for a definite period, usually between 30 and 180 days. They are usually granted for

specific purposes, for example, payment of various collections, refinancing of maturing loans, project bridging finance, refinancing of letters of credit for project equipment imported etc. The exact maturity date of an advance is normally determined at the onset and this makes it possible for the project to have a lower interest charge on the advance due to the reduced risk (money rate and credit risk). Short-term loans are also used in financing seasonal increases in working capital and also in temporary accommodations of a project capital expenditure needs, and other long-term commitments, pending final negotiation of long-term loan. Most times, short term loans are usually renewed at maturity. Banks predominantly extend substantial amounts of short-term loans to farming, manufacturing, small-scale project etc. Short-term loans may be secured or unsecured. Banks extend secured loans to borrowers who have a high debt/equity ratio, or projects that have not established a record of satisfactory performance and stable earnings or generated enough sales revenue in relation to their capital. Large exposures are also often secured. Unsecured loans, although disallowed by banking laws in Nigeria, are granted in exceptional cases to projects that are properly financed, have adequate capital and net worth, competent management, stable earnings, a record of prompt payment of obligations, and a bright future. Unsecured loans, however, often crystallize into bad debts in the Nigerian banking scene

iii. **Medium- Term Loans:** These constitute important sources of intermediate funds for projects and businesses. Medium-term loans are usually granted for specific purposes such as investments, equipment financing, housing, share acquisitions, agricultural financing, construction etc. A medium-terms loan is a facility with an original maturity of more than one year or a loan granted under a formal agreement (revolving credit or credits) on which the original maturity of the commitment is in excess of one year. Medium-term loans have maturities of between 1 and 5 years. They are negotiated between a borrower and a lender and are most prevalent in industrial projects characterized by heavy fixed capital requirements. Most of the loans however are made to small projects and businesses which rely on these sources, due to their limited access to the capital market. Medium-term loans provide flexibility for the user and are amortized in fixed installments on a monthly, quarterly, semi-annual or even annual basis, as the case may be. The interest rates on this type of loan amongst other factors depend on the general level of interest rates prevailing in the market, the amount and maturity of the loan and the credit standing of the borrower. Generally, the interest rates is higher than in ordinary advances or short-term loans due to higher money and credit risks and the fact that it is less liquid.

iv. **Long-Term Loans:** Banks in Nigeria do not usually provide much of long-term loans. This is due to the nature of their deposit liabilities from where

the loans are granted. Recently, however banks have been engaging in long-term lending through syndicated loan arrangements. Long-term loans are usually provided by investment banks, development banks and various international lending agencies. Long-term loans are granted for periods exceeding five years, and are usually provided for fixed capital requirements. They are amortized in fixed instilments like medium-term loans.

#### 2.1.2.2 Special Credits

These are special types of credit facilities extended by banks in favour of various projects and businesses. They are usually non-fund based and are classified as credit since they entail some risks on the part of the bank/financial institution providing the facility

a. **Public Works Bond:** These are three types of public works bond.
   - **The Bid Bonds or Tender Bonds:** The essence of bid bonds is to ensure that the party, to whom a project or contract has been awarded, will execute the contract successfully. The bid bond is called for the employer as soon as the contractor fails to accept the award. This is because failure to accept the terms of the contract may result in an additional cost of rewarding the contract to another contractor.
   - **Advance Payment Guarantees:** Most times, a bank is required to issue a guarantee on an advanced payment made to a contractor by the

employer, prior to the commencement of the contract. The guarantee is in terms of the contractor's financial and technical standing.

- **Performance Bonds:** Banks issue this type of bond on behalf of their clients who have contracts. The bond provides a guarantee on the contractor's capability of handing the contract, his financial standing and credit rating.

**b. Customs and Excise Bonds:** this type of bond is issued a by the bank to guarantee a third party ( usually a government organ) with regards to an importer's capability of making payment of customs duties (for imports) and excise duties ( for manufactured goods in Nigeria). As soon as the customer defaults, the bank would be held liable to pay the sum guaranteed.

**c. Bills of lading indemnities:** A bill of lading is a quasi-negotiable document which confers title to goods. Banks usually issue a bill of lading indemnity to their customers, in cases where the goods imported into the country arrive before the importer (customer) receives the bill of lading. This indemnity issued will thus assist the customer in clearing the goods

**d. Documentary Credits:** A documentary credit or letter of credit is a written commitment of one bank addressed to an identifiable party to pay the seller of goods or services, an agreed sum of money on condition that the seller produces documents evidencing that the goods have been shipped or that he has performed the services required of him. There are different types of

documentary credits. These include: the revocable documentary credits, the irrevocable and confirmed credits. Others are revolving credits, red clause, „bank to bank" credit and stand-by letters of credit.

### 2.1.3 Credit Risk Management

Credit risk management greatly influences or prevent the failure of a bank. This is because the failure of a bank is influenced to a large extent by the quality of credit decisions and thus the quality of the risk assets. Credit risk management provides a leading indicator of the quality of banks credit portfolio. (McNaugton 2019). The key element in an effective credit management includes:

- Well-developed credit policy framework and procedures
- Strong portfolio management
- Effective credit controls
- Well-trained human resource to implement system

Bank management must conduct a market definition as a starting point in credit risk management. This also includes the determination of the target markets. The credit policies are a necessary guide for the determination of the target market, and customers, and define the acceptable and unacceptable risks.

Credit origination usually is at the instance of the customer. The credit officer must identify the reasons when the borrower needs the loan and crosscheck all facts about the proposal and thus have all relevant information for evaluating the proposal. The credit officer should also evaluate the proposal as to the management

and nature of business. Thereafter the officer must be certain on the source of repayment, ascertain if the proposal fits into the banks objectives and the government policies in place, assess the government policies in place, assess the business risks that could inhibit repayment and then conduct a financial analysis. All the issues here are assessed under the credit analysis. In addition the collateral package is appraised. Approval is then sought from the deciding authorities. Banks usually adopt either a committee or a sequential process of credit approval in the committee system, the ultimate approval of a credit proposal is done by a committee consisting of members of a senior management and sectional heads. It could also be a board committee made up of members of the board of directors. The sequential process is applied in smaller loans and consists of an approval chain of individual loan officers with ascending level of authority.

A deposit-banking firm like most financial institutions tend to hold little owner's capital relative to the aggregate value of its assets. The implication of this is that only a small percentage of total loans need to turn bad to push the entire credit portfolio to the brink of failure.

According to Peter and Sylvia (2018) the probability that a deposit banking institutions credit portfolio will decline in value and perhaps become worthless is known as credit risk while various attempts designed to control and protect banks against adversities associated with these risk exposure are referred to as credit risk management processes. The process of analyzing credit risk, ranking and

quantifying them constitute a substantial aspect of the framework and governance structures for most bank management. Among the reasons advanced for CRM include managerial self-interest and appraisal goal; high cost of financial distress and the existence of capital market imperfection. Other motivation for expending managerial resources on CRM according to Meyer (2019) is the need for insolvency avoidance, given the likelihood of poor credit risk management snowballing into financial crisis.

### 2.1.4 Credit Policy of Banks

Every bank puts in place a credit policy to guide its lending decisions, taking into consideration its overall corporate objectives Conceptually, a bank‟s corporate objectives influence its overall banking operation including issues like:

i. Liquidity management
ii. Profitability posture and earning capacity
iii. Bank portfolio management
iv. Service delivery and level efficiency
v. Deposit mix and structure
vi. Credit management
vii. Capital adequacy

Credit management is the most important aspect of banking operations outside liquidity considerations, as it influences and ensures the survival and safety of a bank. Credit policies are thus the most important aspect of the various operational

policies of a bank. Credit policy provides the framework for the entire credit management process. The basic reason for policy is to ensure operational consistency and adherence to uniform and sound practices. A sound policy contributes to a bank's success by supporting prompt and good credit decisions. According to Robert Bench (1991) the scope of lending (credit) policies should include: who receive the credit; who grants it (and how); the pricing of the credit; the amount of credit and organizational structure for its distribution. Other issues like what kind of credit and under what circumstances they are granted, also come into this preview of credit policymaking. The above definition by Bench seeks to specify the scope of credit policy. However, the definition could be stretched further by pointing out the fact that credit policy influences and affects the administration and management of credits. Credit policies are usually documented by banks in the form of credit manuals. The manuals specify the course of action, procedures and guides to sound lending. A properly articulated manual would usually consolidate and update all lending policies instructions, procedures and any relevant correspondence on credit matters and administration that would be evolved by top management from time to time, based on new exigencies, new developments in the industry, changes in environmental factors and other changes evolved by the monetary authorities as the need arise.

The absence of a properly articulated, formally written policy document coupled with the failure of credit officers, managers, and directors to monitor the

implementation and administration of bank credits, are critical factors leading to unsuccessful bank lending or non-performing exposures and credits. It must be emphasized here that putting sound policies into practice calls for the establishment of an effective organization and the adoption of appropriate procedures. Experience has however shown that most banks do not have a clearly spelt out and formalized policy framework, hence credit decision-making is adhoc and thus cumbersome, leading to loan losses and impairment of capital adequacy

### 2.1.5 The Purpose of Credit Policy

Credit policy serves various purposes for banks. These include:

**i.** They provide bank credit officers, branch managers, credit controllers and financial analysts with basic guidelines and rules for efficient risk selection, credit analysis, credit administration and management.

**ii.** They assist a bank in ensuring that it maintains high quality risk assets and also high level of performance assets.

**iii.** They also assist a bank in meeting the legal and statutory requirements imposed by the monetary authorities, especially issues like capital adequacy, loan capital ratios, loan-deposit ratios, permissible credit expansion and legal requirements for granting credit to one individual

**iv.** Credit policy assists a bank in attaining the overall corporate mission and objectives, especially issues like achieving a high level of liquidity, profitability and earnings per share for the bank.

v. They provide a framework for the effective examination of the credit operations of a bank by both external and internal inspectors. This is because the availability of a codified policy easily yields grounds for an assessment of the performance of bank operators, assessing the deviation from the prescribed normal and the areas for possible normalization. It also provides a standard framework for predicting future trends in the credit operations of the bank based on available data and information.

vi. They assist a bank in the training and retraining of credit officers, bank managers, credit controllers and most time the top management.

vii. They are useful when a bank must adapt to a complex and rapidly changing economic environment and faces issues that formerly received little or no attention.

### 2.1.6 Constraints on Bank Credit Portfolio

Constraints in credit creation in banks are the factor that banks do not have limitless capacity for the creation of risk assets. Several factors determine bank's ability to expand its credit portfolio. The factors that determine bank's capacity to lend include;

i. **Macro-Economic Environment:** This could affect the bank's lending portfolio since the state of the economy determines the investments and viabilities of businesses.

ii. **Capital Adequacy:** Bank's risk asset, apart from being constrained by the restrictions on liquid assets is, on the other hand, limited by the availability of capital. Capital may be viewed as shareholder's fund and defined as equity plus reserves.

iii. **Credit Policy:** Banks capacity to create risk assets is constrained by requirement to keep high cash ratio's, to meet demand for withdrawals by depositors, liquidity ratios, stabilization by the effect of policy reversal and counter reversals.

iv. **Capacity for Liability Generation:** The bulk of the funds banks use in creation of credit are depositor's funds. Therefore, the extent to which bank expands its credit portfolio depends largely on the level of its deposit. Shrinkage in credit portfolio through loans could occur if there is a reduction in deposit base. This was visible in the Late 1980s when accounts of parastatals and government agencies were withdrawn by the government.

### 2.1.7 Factors Responsible for Customer's Default

According to Onwudiegwu (2001), the concept of default is less obvious than it first seems, for it could result from non - or delayed payment of interest and or principal for a given period. One or a combination of the following factors could contribute immensely to default especially in a depressed economy. The more one borrows; the more one would want to borrow consequently. The volume of the loan would increase which decreases the ability to repay as opposed to the

willingness to repay. The ability to repay increases with increased net income although that does not say anything about the willingness to repay. One would expect borrowers with high net income to have low debt/equity ratio, the lower the debt/equity ratio, the higher the ability to repay. The effect of high net income and low debt/equity ratio is a precaution for borrowers to build up valuable assets. Onwudiegwu (2001) equally posited that, as the value of the collateral increases, the default rate is expected to decline. Where there is income variance as a result of economic or natural circumstance, credit service ability per individual borrower decreases and hence default could increase. Such income variances are common in agricultural and manufacturing sectors. The higher the interest rate, the more the outstanding balance the borrowers have to pay considering the principal. Rate of inflation has link with the real interest to be paid by the borrowers. If inflation is higher than the interest rate, it will mean that the lending bank would be paying borrowers to take its loans. The close monitoring of borrowers to ensure a loan is not diverted to unproductive use, though costly, has a lot of bearing on ability of the borrower to repay. The effort is put in ensuring utilization of a facility, the less chance of default.

### 2.1.8 Measures to Avoid Bad and Doubtful Debts

Banks credit analysts ensure that the principles of sound lending are set in motion to achieve a healthy loans and advances portfolio. This entails the establishment of comprehensive lending policies, proper credit analysis which

includes analysis of financial history, viability analysis, feasibility studies, case flow projections, ratio analysis and a proper assessment of the borrower using the basic cannons of lending as discussed earlier, and yield calculations including profitability considerations. It is generally agreed that credit monitoring and controls assist in early detection of bad loans and determination of deteriorating accounts. In this case, the following indicators are usually considered.

1. Increased facility not resulting in increased turnover
2. Fall in credit turnover indicating a reduced sale volume
3. Fall in debit turnover with or without increase in average utilization of facilities.
4. Failure to meet all commitments as they fall due
5. Failure to meet loan repayments/interests as they mature
6. Cross-firing or kite flying
7. Frequent excesses over approved limits
8. Development of hard core-failure to revert to credit or low debit figures when the overdraft is expected to be fluctuating
9. Deterioration of balance sheet or liquidity
10. Deterioration of the account should sound a warning to the lending banker to put corrective measures into effect.

## 2.2 Theoretical Framework

### 2.2.1 Portfolio Theory

Since the 1980s, companies have successfully applied modern portfolio theory to market risk. Many companies are now using value at risk models to manage their interest rate and market risk exposures. Unfortunately, however, even though credit risk remains the largest risk facing most companies, the practice of applying modern portfolio theory to credit risk has lagged (Margrabe, 2007). Traditionally, organizations have taken an asset-by-asset approach to credit risk management. While each company's method varies, in general this approach involves periodically evaluating the quality of credit exposures, applying a credit risk rating, and aggregating the results of this analysis to identify a portfolio's expected losses. The foundation of the asset-by-asset approach is a sound credit review and internal credit risk rating system. This system enables management to identify changes in individual credits, or portfolio trends in a timely manner. Based on the changes identified, credit identification, credit review, and credit risk rating system management can make necessary modifications to portfolio strategies or increase the supervision of credits in a timely manner. While the asset-by-asset approach is a critical component to managing credit risk, it does not provide a complete view of portfolio credit risk, where the term risk refers to the possibility that actual losses exceed expected losses.

### 2.2.2 Arbitrage Pricing Theory (APT)

A more interesting alternative was the Arbitrage Pricing Theory (APT) of Ross (1976). Stephen Ross's APT approach moved away from the risk vs. return logic of the CAPM, and exploited the notion of pricing by arbitrage to its fullest possible extent. As Ross himself has noted, arbitrage-theoretic reasoning is not unique to this particular theory but is in fact the underlying logic and methodology of virtually all of finance theory. This theory subscribes to the fact that an estimate of the benefits of diversification would require that practitioners calculate the covariance of returns between every pair of assets. In their Capital Asset Pricing Model (CAPM), Morris (2001) solved this practical difficulty by demonstrating that one could achieve the same result merely by calculating the covariance of every asset with respect to a general market index. With the necessary calculating power reduced to computing these far fewer terms (betas), optimal portfolio selection became computationally feasible.

### 2.2.3 Information Theory

Derban, Binner and Mullineux (2005) recommended that borrowers should be screened especially by banking institutions in form of credit assessment. Collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening as indicated by symmetric information theory. Qualitative and quantitative techniques can be used in assessing the borrowers although one major challenge of using qualitative models is their subjective

nature. However according to Derban, Binner and Mullineux (2005), borrowers attributes assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique minimizes processing costs, reduces subjective judgments and possible biases.

## 2.3 Empirical Review

It is universally acknowledged that the banking industry plays a catalytic role in the process of economic growth and development (Uwuigbe, Uwuigbe and Daramola, 2014). This acknowledgement is reinforced by contemporary conceptualization to the effect that banks are veritable vehicles for mobilizing resources (funds) from surplus units and channeling them to deficit units. These resources belong to customers so a programme must exist for the management of these funds. Prior studies suggests that a good credit risk architecture, policies and structure of credit risk management, credit rating system, monitoring and control contributes to the success of credit risk management system Bachi (2003). Similarly, Muninarayanappa and Nirmala (2004) in a related study opined that the success of credit risk management require maintenance of proper credit risk environment, credit strategy and policies. Thus the ultimate aim should be to protect and improve the loan quality. In the same vein, findings from Salas and Saurina (2002) revealed that growth in GDP, rapid credit expansion, bank size and capital ratio had a significant impact on the non-performing loans.

Felix and Claudine (2008) examined the association between the performance of banks and credit risk management. As part of their findings, they observed that return on equity and return on assets both measuring profitability were inversely related to the ratio of non performing loans to total loans of financial institutions thereby leading to a decline in profitability. Also, Hosna, et al. (2009) in their study opined that credit risk has a significant positive effect on the profitability of commercial banks in Sweden. Correspondingly, Kithinji (2010) examined the effects of credit risk management on commercial banks profitability in Kenya. They observed that the level of credit was high in the early years of the implementation of Basle II but decreased significantly in 2007 and 2008, probably when the Basle II was implemented by commercial banks. The findings revealed that the bulk of the profits of commercial banks are not influenced by the amount of credit and non-performing loans suggesting that other variables other than credit and non-performing loans impact on profits. Funso et al. (2012) investigates the quantitative effect of credit risk on the performance of commercial banks in Nigeria for the period 2000-2010. Findings from their study showed that the effect of credit risk on bank performance measured by the return on assets of banks is cross sectional invariant.

Robert and Gary (1994) stated that most obvious characteristics of failed banks are not poor operating efficiency, however, but an increased volume of non-performing loans. Nonperforming loans in failed banks have typically been

associated with regional macroeconomic problems. Koehn and Santomero (1980), Kim and Santomero (1988) and Athanasoglou et al. (2005), suggest that bank risk taking has pervasive effects on bank profits and safety. Bobakovia (2003) asserts that the profitability of a bank depends on its ability to foresee, avoid and monitor risks, possible to cover losses brought about by risk arisen.

In Nigeria, Kargi (2011) examined the impact of credit risk on the profitability of Nigerian banks. Findings from the study revealed that credit risk management has a significant impact on the profitability of Nigerian banks. Hence, they opined that banks' profitability is inversely influenced by the levels of loans and advances, non-performing loans and deposits thereby exposing them to great risk of illiquidity and distress. Although, some considerable amount of literature exists on the interaction between finance and credit management on banks liquidity position, however, the same is not true in developing economies like Nigeria where there is a relatively dearth in literature in this area, coupled with the huge institutional differences between Nigeria and other developed economies.

Owojori et al (2011) highlighted that available statistics from the liquidated banks clearly showed that inability to collect loans and advances extended to customers and directors or companies related to directors/managers was a major contributor to the distress of the liquidated banks. At the height of the distress in 1995, when 60 out of the 115 operating banks were distressed, the ratio of the

distressed banks' non-performing loans and leases to their total loans and leases was 67%. The ratio deteriorated to 79% in 1996; to 82% in 1997; and by December 24th the licenses of 35 of the distressed banks had been revoked. In 2003, only one bank (Peak Merchant Bank) was closed. No bank was closed in the year 2004. Therefore, the number of banking licenses revoked by the CBN since 1994 remained at 36 until January 2006, when licenses of 14 more banks were revoked, following their failure to meet the minimum recapitalization directive of the CBN. At the time, the banking licenses were revoked, some of the banks had ratios of performing credits that were less than 10% of loan portfolios. In 2000 for instance, the ratio of non performing loans to total loans of the industry had improved to 21.5% and as at the end of 2001, the ratio stood at 16.9%. In 2002, it deteriorated to 21.27%, 21.59% in 2002 and in 2004, the ratio was 23.08% (NDIC Annual Reports- various years).

## 2.4 Summary of the Study

McNaugton, (2019) stated that credit risk management greatly influences or prevent the failure of a bank. This is because the failure of a bank is influenced to a large extent by the quality of credit decisions and thus the quality of the risk assets. Credit risk management provides a leading indicator of the quality of banks credit portfolio.

According to (Odofuye, 2019) Credit management is the process for controlling and collecting payments from your customers. A good credit

management system will help you reduce the amount of capital tied up with debtors (people who owe you money) and minimize your exposure to bad debts. It is a function performed within a company to improve and control credit policies that will lead to increased revenues and lower risk including increasing collections, reducing credit costs, extending more credit to creditworthy customers, and developing competitive credit terms.

According to Peter and Sylvia (2018) the probability that a deposit banking institutions credit portfolio will decline in value and perhaps become worthless is known as credit risk while various attempts designed to control and protect banks against adversities associated with these risk exposure are referred to as credit risk management processes.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Research Design

The research design adopted for the study is cross-sectional research design. It is sufficient and suitable for determining the relationship that exists between debt management and deposit money banks' lending in Nigeria.

## 3.2 Population and the study

This research work will be focusing on the 11 selected banks in the Nigerian banking industry, currently listed on the Nigerian stock exchange (NSE). Hence, the population size is a total of eleven (11) banks currently listed on the Nigerian Stock Exchange (NSE) and which includes the following; Fidelity bank plc, Union bank plc, Access bank plc, Polaris bank plc First bank plc, United Bank for Africa plc, Zenith bank plc, Eco bank plc, Guarantee Trust bank plc, and the Keystone bank plc.

## 3.3 Sample Size

Studies as this, are supposed to be carried out on all the deposit money banks listed on the NSE, but as a result of the researcher's limited resources available, limited access to the annual financial statement of certain banks (inaccessible population), and the short period of time available for carrying out this research (time constrain), only eleven (11) banks currently listed on the NSE has been included which covers as much as approximately 50% of the entire

population of study. This study will cover a period of eight (8) years ranging between 2014- 2021 financial years

### 3.4 Sampling Techniques

A sampling technique is a plan specifying how elements will be drawn from the population (Olannye, 2006). With regards to this research that deals with deposit money banks in Nigeria, the eleven (11) banks which the researcher intends to study were selected judgmentally (i.e. the judgmental sampling technique) as a result of the researcher's limited access to the required data and financial constrain. However, the sample size of eleven (11) selected banks actually covers as much as 50% of the entire population.

### 3.5 Source of Data Collection

This involves how data is gathered for the study. It involves the development of relevant instruments with satisfactory properties and administering these to the subjects involved in the study (Olannye, 2006). The method of data collection used in this study is the secondary source of data. For the purpose of this study, data will be obtained from two major sources which include the annual financial reports of the ten (10) selected banks and Central Bank of Nigeria statistical bulletins.

This piece of research will adopt the quantitative research techniques. The techniques adopted in any research are carefully guided by the research objectives, philosophy and the nature of data collected. In accomplishing the objectives set in

this research work, the researcher collects quantitative data from the annual report of firms which are generally regarded as secondary data. Consequently, quantitative research techniques become more suitable than a qualitative one. These qualitative data will be collected for a period of seven years ranging from 2014-2021 Data for real GDP per capita growth, Deposit and Lending Interest rate, banking industry credit to private sector and other relevant data will be obtained from the Central Bank of Nigeria Statistical Bulletin.

## 3.6 Method of Data Analysis

The technique of analysis used in analyzing the data of this research work is the ordinary least square (OLS). The correlation analysis will be used to explain the significant relationship among the variables while **the** student t-test will be used in testing the formulated hypotheses subjected for the study. The f-test will be used in explaining the significant level of the model specification while the Durbin Watson model will be used to explain the evidential level of autocorrelation between the dependent variable and independent variables. Moreover, a simple percentage will be used in analyzing the performance of sample banks over the years selected for the study.

## 3.7 Model of Specification

A multiple regression equation is set up to investigate the hypothesized relationships between the dependent variable and the independent variables in this study. The econometric form of the equation is given as:

ROE = F (STD, LTD, TBDW,)……1

The linear equation will become;

ROE = β0 + β1STD + β2LTD + β3 TBDW…….....2

The econometric equation will then be thus;

ROE t-1 = β0t-1 + β1STDt-1 + β2LTDt-1 + βTBDWt-1+ μt-1.....3

Where;

ROE = Return on Equity of selected Banks

STD = Short term debt to total assets

LTD= Long term debt to total assets.

TBDW = Total Bad Debts Written-off of selected Banks in Nigeria

β0 = the intercept, the value of y when the independent variables assume zero as value.

β1 – β4= coefficient of the independent variables or parameters

μ = stochastic variable/error term

# CHAPTER FOUR

# DATA PRESENTATION, ANALYSIS AND FINDINGS

## 4.1 Data Presentation

This session contains clear and accurate findings arising from the study. The various data generated, presented and analyzed in the preceding session form variable instruments for an intellectual exercise in presenting a coherent and concise report of the various findings.

Table 4.1: Statistical data on economic growth, unemployment and monetary policy

## 4.2 Descriptive Statistics

Descriptive statistics enable the transformation of raw data into more meaningful information (Sekaran, 2003). To describe data in this paper, descriptive statistics such as, mean, standard deviation, minimum and maximum were presented in Table 2. Table 3: Descriptive Table (N=25)

| Variable | Obs | Means | Std. Dev | Min | Max |
|---|---|---|---|---|---|
| ROE | 25 | 0.08 | 0.2557 | -2.21 | 0.65 |
| STD | 25 | 0.675 | 0.117 | 0.073 | 0.879 |
| LTD | 25 | 0.169 | 0.110 | 0.033 | 0.814 |
| TBDW | 25 | 13.565 | 0.885 | 11.64 | 15.35 |

**Source: STATA OUTPUT, 2022**

The descriptive statistics table shows that the mean score of ROE is 0.08 for the sampled listed DMBs during the study period. This implies that, for every one

naira invested in the listed DMBs, about eight (8) kobo of profit was from equity. The minimum ROE value recorded during this period was a loss of 221% whereas the return of 65% of equity invested was its corresponding maximum value. Similarly, the standard deviation from the mean of ROE was 0.2557, and this shows that some listed DMBs return to their owners was below average.

Looking at the independent variable, the listed DMBs debt capital measured by STD, LTD and TBDW have mean values of 0.675, 0.169 and 0.844, respectively. The maximum values of 0.879, 0.814, 0.972 and minimum values of 0.073, 0.033 and 0.678 respectively were also found. Implying about 84 % of the listed DMBs' capital structure was made of debt, which is in line with findings of some extant studies, for example (Shaba, Yaaba, & Ibrahim, 2016). Similarly, STD, LTD and D TBDW deviate from their means on both sides by 0.117, 0.110 and 0.056 respectively.

### 4.3 Correlation Matrix

To determine the association between the entire variables of the study, a correlation matrix was obtained as presented in Table 2. Similarly, correlation can be used to determine the presence of multicollinearity among the independent variables.

| Variable | ROE | STD | LTD | TBDW |
|---|---|---|---|---|
| ROE | 1.0000 | - | - | - |
| STD | -0.1550 | 1.0000 | - | - |
| LTD | 0.1055 | -0.8925* | 1.0000 | - |
| TBDW | -0.2253* | 0.2088* | 0.1259 | - |

**Source: STATA OUTPUT, 2022**

To determine the association among the variables of the study, correlation coefficients are obtained as presented in the correlation matrix table. The coefficients values revealed different levels of associations among the variables. For instance, return on equity (ROE) exhibits a weak negative but insignificant association of -0.1550 with short term debt ratio (STD), an insignificant positive correlation of 0.1055 with long term debt ratio (LTD), a significant negative association of -0.2253 with TBDW. In contrast, the correlation between ROE and bank size (BZ) is 0.1951, suggesting a significant positive association. Similarly, the extent of correlation among the independent variables was measured by the coefficient values. When the correlation between two independent variables is substantial, it is known as multicollinearity. Moreover, the implication of multicollinearity is that the multiple regression analysis cannot be relied on. Conventionally, a correlation of more than 0.8 or less than -0.8 between two independent variables is a sign of multicollinearity (Garson, 2012). All coefficient values were less than 0.8 and more than -0.8, indicating the absence of multicollinearity problem.

## 4.4 Regression Analysis

**Table 3**

| | **Reg. coefficient** | **Std. Error** | **t-statistic** | **P-value** |
|---|---|---|---|---|
| ROE | 0.0767 | 0.2207 | 0.35 | 0.728*** |
| STD | 0.5769 | 0.5408 | 1.07 | 0.286*** |
| LTD | 0.5769 | 0.5166 | -3.03 | 0.002 |
| TBDW | -1.5658 | 0.0243 | 3.40 | 0.001 *** |

Source: **STATA OUTPUT,** 2022

*** Significance at a level of 1%
** Significance at a level of 5%
Significance at a level of 10%

| | | | |
|---|---|---|---|
| Mean dependent var | 0.270859 | S.D dependent Var | 0.327496 |
| R-squared | 0.661918 | Adjusted R-squared | 0.634319 |
| S.E. of regression | 2.040862 | Akaike info criterion | 235.0427 |
| Sum squared resid | 16.11992 | Schwarz criterion | 244.9876 |
| Log likelihood | -112.521 | F-Statistic | 23.98377 |
| Durbin-Watson stat | 2.041678 | Prob (F-Statistic) | 0.002036 |

As indicated in the methodology, the model was analysed using FGLS techniques. The result presents a Wald value of 22.39 for the model is significant at 5%, and this indicates that this model is statistically fit to explain the listed banks' financial performance (ROE) in Nigeria. Concerning the influence of each of the debt capital indicators with the ROE, the result found both STD and LTD have a positive non-significant relationship of (Coeff= 0.0767; P<z=0.728) and (Coeff= 0.5769; P<z=0.286) respectively. Going by the findings, the null hypotheses (H1 and H2) are accepted. This implies that an increase in STD or LTD has no significant relationship with a decrease in ROE and vice versa. The findings are consistent with Anarfo (2015). The remaining metric DR was however found to

have a negative and significant relationship of (Coeff= -1.5658; P<z=0.002) with ROE.

### 4.3 Hypothesis Testing

The level of significance adopted in this study in testing the stated hypothesis of this study is 5%. This level is usually considered adequate for studies in management and other behavioural sciences

**Decision Rule**

The critical p-value used in these tests is 0.05. Thus, the research accepts a given alternative hypothesis that there is no significant effect.

**Hypothesis One**

$H_o$: Short term debt (STD) has no significant impact on Return on Equity

**Table 4: Computed Values for Testing Hypothesis 1**

| | |
|---|---|
| Coefficient | 0.5769 |
| Probability | 0.286*** |

**Source: E-Views Computation (2022)**

**Decision**

A coefficient 0.5769 of Short term debt (STD) has a positive influence on Return on Equity A probability of 0.286***shows a positive influence of Short term debt (STD) is significant at 5%. This means that the alternative hypothesis is accepted at 5% level of significance.

**Hypothesis Two**

**Computation**

The test statistic is computed by E-Views software and results are as show in table 4.5 below.

$H_o$: Long term debt (LTD) has no significant impact on Return on Equity

**Table 5: Computed Values for Testing Hypothesis 2**

| | |
|---|---|
| Coefficient | 0.5769 |
| Probability | 0.002 |

**Source: E-Views Computation (2022)**

**Decision**

A coefficient 0.5769 of Long term debt (LTD) has a positive influence on return on equity. A probability of 0.002 shows a negative influence on return on equity is not significant at 5%. This means that the alternative hypothesis is rejected at 5% level of significance.

**Hypothesis Three**

$H_o$: Total Bad debts (TBDR) has no effect on the return on equity (ROE) of banks in Nigeria

**Table 5: Computed Values for Testing Hypothesis 2**

| | |
|---|---|
| Coefficient | -1.5658 |
| Probability | 0.001 |

**Source: E-Views Computation (2022)**

**Decision**

A coefficient -1.5658of Total Bad debts (TBDR) has a negative influence on return on equity. A probability of 0.002 shows a negative influence on return on equity is not significant at 5%. This means that the alternative hypothesis is rejected at 5% level of significance.

# CHAPTER FIVE

# SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

## 5.1 Summary of Findings

1. Short term debt (STD) has significant impact on Return on Equity
2. Long term debt (LTD) has no significant impact on Return on Equity
3. Total Bad debts (TBDR) has no effect on the return on equity (ROE) of banks in Nigeria

## 5.2 Conclusion

Impact of debt capital on performance of listed Deposit Money Banks in Nigeria. Given this, the study observed that 84.4% of the total capital of banks in Nigeria during the period of this study was made up of debt. This is a reaffirmation of the fact that banks are highly levered financial institutions. The study found that capital structure indicators are good predictors of listed banks' financial performance in Nigeria as evidence by the significant wald test value of less than 5 %. Based on the findings obtained, the following recommendations are at this moment offered

## 5.3 Recommendations

In line with the findings and conclusion of this study, the following recommendations are deemed pertinent:

i. Bank management should consider a tradeoff between STD and LTD in deciding on debt capital in order to optimize their performance. Similarly,

bank management should give more incentives to STD suppliers, especially the depositors; this will motivate them to allow their deposits to stay with DMBs for a more extended period than the present practice. The adjustment in the maturity structure of STDs will provide DMBs with likely additional assets financing vehicle that could possibly enhance their performance.

ii. Total debt (DR) is a significant determinant of listed banks' financial performance, and thus due diligence needs to be undertaken whenever the bank decides to borrow funds for investment. This will ensure that managerial discipline enforced by debt on managers' performance may not be outweighed by financial distress envisaged from excessive leverage.

iii. There is a need for the government to formulate policies that will fast track the development of a more vibrant capital market where DMBs and other firms will have access to equity and bond at globally competitive rates. This will go a long way in discouraging Nigerian firms from going offshore to seek financing opportunities and at the same time, woos foreign investors to the Nigerian capital market.

iv. Banks in Nigeria should enhance their capacity in credit analysis and loan administration while the regulatory authority should pay more attention to bank compliance to relevant provisions of the Bank and other Financial Institution Act (1999) and prudential guidelines.

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