CREDIT RISK AND FINANCIAL PERFORMANCE OF DEPOSIT MONEY BANKS IN NIGERIA: CASE STUDY OF ACCESS BANK PLC

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Abstract

Credit risk is a treat to going concern of deposit money banks but without giving credit to customers, it will be practically impossible for banks to create money and remain in business. This study investigates how loans and advances to individual and corporate organization that are past due affect return on capital employed by banks. It is a case study work that focuses on Access Bank Plc. Data for the analysis was gathered from financial accounts and report. Findings show that loans and advances to corporate organization that are past due have significant effect on financial performance of deposit money banks. We recommend among others that the regulatory authority should encourage banks to be publishing the names of individuals or corporate organization that failed to meet their debt obligation as at when due in their financial accounts and report. This may serve as a tool to reduce risky credit assets.

Keyword: *loans; advances; return on capital employed.*

Introduction

Bank statutory duty is to safe keep deposit cash and cash equivalent from their customers and gives loans with advances to their customers. Loans, advances and overdraft given to individuals, corporate entities, other banks and even government is refer to as credit that Kargi, (2011) refers to as major avenue for deposit money banks to create money or generate revenue. Therefore, many entrepreneurs and corporate organizations relied heavily on deposit money banks because of credit facility they enjoyed from the banks. The credit facility given by banks to their customers exposed them to credit risk.

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Coyle (2000) see loss incurred when the borrower was unable or unwilling to pay the money borrowed from the bank is a risk. It is observed by Committee on Banking Supervision (1999) that credit risk is a situation when customer that take credit facility from the bank fail to meet his obligation or paying back is loan in accordance with agreed terms. International Financial Reporting Standards 7 in Schedule A described credit risk as risk in incurring financial loss if a party to a financial instrument failed to perform his obligation to other party as agreed.

Deposit money banks gives out funds to customers for investment purpose that later impact positively on the economy. Banks make funds available by moblising surplus money from customers that saved current consumption for future consumption. This mobilized fund will now be given or lend out to customers for investment purpose. Therefore, banks are exposed to credit risk when customers failed to pay up his debt obligation as at when due.

Kargi (2011) observed that the degree of exposure of deposit money banks to credit risk is inimical to her profitability. Failure to meet credit obligation by debtor serves as a treat to going concern of the bank. The rate at which debtors failed to meet their debt obligation in Nigeria is worrisome. Ahmad & Ariff (2007) said the amount of nonperforming loans in bank credit portfolio hindered their performance because it reduces their liquidity.

Due to multiplier implication of bank credit portfolio, bank credit management becomes a thing of concern for bank stakeholders. In their financial accounts and report, banks are silent about those customers that failed to meet their debt obligations. The question asked by academia and financial analysts is the influence of loans, advances on bank profitability. However some scholars investigate the relationship between credit risk and banks performance. For instance, Felix & Claudine (2008); Epure & Lafuente (2012); Roni & Teddy (2019) found that non performing loans does not affects bank profitability. While Kodithuwakku (2015); Patrick, Ikenna & Ekemezie (2017) revealed that credit risk has a positive impact on profitability. Therefore, inconsistence findings of prior studies serve as a gap for this study to be filled.

Objectives of this study are:

i. To know the influence of loans, advances to individual past due on return on capital employed
ii. To know the influence of loans, advances to corporate organization past due on return on capital employed.

The null hypotheses are:

i. Loans, advances to individual past due have no effect on return on capital employed

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ii. Loans, advances to corporate organization past due have no effect on return on capital employed.

This study focused on International Financial Reporting 7 (schedule A). We narrow our focus to credit risk disclosed and its implication on deposit money banks. This study is a case study of Access Bank Plc, Nigeria. Period covered is 2014 to 2019. We focused on bank and not the group.

Empirical Review

Kargi (2011) studied bank profitability, non performance loans and deposits among Nigeria banks the researcher found negative relationship between nonperforming loans and profitability. Epure & Lafuente (2012) examined bank profitability and loans among Costa-Rican banks. Researcher discovered negative relationship between non-performing loans and return on assets.

Kithinji (2010) study reveals that bank profit does not really depend on amount of nonperforming loans and credit. Felix & Claudine (2008) shows that non performing loans lead to low return on equity and return on assets.

Kayode, Obamuyi, Owoputi, & Adeyefa (2015) investigate relationship between credit risk portfolio and return on assets for the period of 2000 to 2013.they discovered that credit risk portfolio affect return on asset. Roni & Teddy (2019) found negative significant between credit risk and bank performance.

Sheeba (2017) notes that non performing credit facilities is significant but have negative effect on bank performance. Isanzu (2017) observe negative significant between financial performance and non performing loans. The work shows that loan impairment did not have any relationship with bank profitability. While Kodithuwakku (2015) study reveals a significant relationship between credit risk and bank performance in Sri Lankan. To support Kodithuwakku (2015) findings, Patrick, Ikenna & Ekemezie (2017) shows in their study conducted in Nigeria that there is significant relationship between credit risk management and profitability.

Methodology

Expo – facto design was used for this work. Data for the analysis was gathered from financial account and reports of Access Bank Plc that was downloaded from her website. Linear regression statistics was used to analyse the data.

The dependent variable, financial performance, was proxy by return on capital employed. Return on capital employed is derived by dividing profit before tax by capital employed and multiplied by 100%. While independent variable was proxies by; loans and advances to individual past due ratio and loans and advances to corporate organization past due ratio

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The statistical functional model is:

Cr = f (fp) eq 1

Where:

Cr = credit risk

Fp = financial performance

The statistical models: for hypotheses

roce = $\beta_0 + \beta_1$laipdt $+\varepsilon_t$ eq.2

roce = $=\beta_0 + \beta_1$lacopdt $+\varepsilon_t$ eq3

Where:

$\beta 1 > 0$; $r^2 > 0$

β1 is a measure of the effect of credit risk on financial performance.

roce = return on capital employed

laipd = loans and advances to individual past due

lacopd = loans and advances to corporate organization past due

ε_t = error term

β_0 = regression coefficient

RESULTS AND DISCUSSION

Hypothesis One

Hi: Loans, advances to individual past due have effect on return on capital employed

Ho: Loans, advances to individual past due have no effect on return on capital employed

Table 1: model for loans and advances to individual past due and return on capital employed

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.353[a]	.125	-.094	1.16339	1.824

Note: $r^2 = 0.125$, f (1,4) = .569, p = 0.493

Table 2: ANOVA[a] for loans and advances to individual past due and return on capital employed

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.771	1	.771	.569	.493[b]
	Residual	5.414	4	1.353		
	Total	6.184	5			
a. Dependent Variable: return on capital employed						
b. Predictors: (Constant), loans and advances to individual past due						

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Table 3: Coefficients for loans and advances to individual past due and return on capital employed

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	22.466	8.335		2.695	.054
	loans and advances to individual past due	-2.109	2.795	-.353	-.755	.493

R^2 value of 0.125 is the coefficient of determination that shows the proportion of the total variation in dependent variable explained by independent variable. Therefore, it signifies that 12% of the total variation in financial performance of deposit money banks in Nigeria was caused by loans and advances to individual that are past due. The F statistic (0.569) indicates that loans and advances to individual that are past due is not a major problem for bank profitability but it is one the factors that affects bank profitability negatively. It is observed that loans and advances to individual that are past due do not have positive influence bank profit.

The regression coefficient of loans and advances to individual that are past due (-2.109) with p value of 0.493 which is not statistically significant at 5% level of significant. The alternate hypothesis is rejected and null hypothesis is accepted. Therefore, loans and advances to individual past due does not significantly affects return on capital employed. Our finding supported Epure & Lafuente (2012); Roni & Teddy (2019) that discovered that non performing loans do not affects bank profitability.

Hypothesis Two

Hi: Loans, advances to corporate organization past due have effect on return on capital employed.

Ho: Loans, advances to corporate organization past due have no effect on return on capital employed.

Table 4: Summary for loans and advances to corporate organization past due and return on capital employed.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.893[a]	.797	.746	.56026	1.238

Note: $r^2 = 0.797$, $f(1,4) = 15.703$, $p = 0.01$

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Table 5: ANOVA[a] for loans and advances to corporate organization past due and return on capital employed.

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	4.929	1	4.929	15.703	.017[b]
	Residual	1.256	4	.314		
	Total	6.184	5			
a. Dependent Variable: return on capital employed						
b. Predictors: (Constant), loans and advances to corporate organization past due						

Table 6: Coefficients for loans and advances to corporate organization past due and return on capital employed.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	19.488	.864		22.557	.000
	loans and advances to corporate organization past due	-1.247	.315	-.893	-3.963	.017

R^2 value of 0.797 is the coefficient of determination that gave the proportion of the total variation in dependent variable explained by independent variable. Therefore, it signifies that 79% of the total variation in deposit money banks profit 0was caused by loans and advances to corporate organization that are past due. The F statistic (15.703) indicates that loans and advances to corporate organization that are past due is one of the major factors that affect deposit money banks profit. It is observed that loans and advances to corporate organization that are past due do not influence bank profit.

The regression coefficient of loans and advances to corporate organization that are past due (-1.247) with p value of 0.017 which is statistically significant at 5% level of significant. Therefore, the null hypothesis is rejected and alternate hypothesis is accepted. Therefore, loans and advances to corporate organization past due significantly affects return on capital employed . Our finding supported Kodithuwakku (2015); Patrick, Ikenna & Ekemezie (2017) that observed significant relationship between credit risk and bank performance.

Conclusion and recommendation

Deposit money banks have been acknowledged as a supporter or promoter of investors and entrepreneurs in Nigeria economy. In carrying on their statutory duties

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of mobilizing fund from surplus account and provide credit facilities for their customers to finance their businesses, banks are exposed to credit risk.

We investigate degree of relationship between loans and advances to individual that are past due, loans and advances to corporate organization that are past due and return on capital employed by Access bank within year 2014 - 2019. Our analysis shows that loans and advances to individual that are past due have no positive influence on return on capital employed while loans; advances given to corporate organization that are past due have significant effect on financial performance of deposit money banks.

On the premises of our findings, we recommend that Access bank Plc should improve and be more dynamic in credit risk management. The study shows that the sum totals of loans and advances past due to corporate organization is very high compared to individual. However, the regulatory authority should encourage deposit money banks to be publishing the names of individuals or corporate organization that failed to meet their debt obligation as at when due in their financial accounts and report. This may serve as a tool to reduce risky credit assets.

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