LOAN PERFORMANCE AND BANK FAILURE IN NIGERIA

BY

AGBONLAHOR WISDOM OSASERE

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FACULTY OF SOCIAL SCIENCES

UNIVERSITY OF BENIN

BENIN CITY

Dedication

This work is dedicated to God Almighty and all those who struggle with accepting themselves and loving who they are ; I say your life count , press on for your victory is only sure when you fight to the end without giving up along the way.

CERTIFICATION

This is to certify that this project was carried out by Agbonlahor Wisdom osasere. It was done under my supervision.

We certify that the work is in partial fulfillment of the Degree of Bachelor of Science in Economics, University of Benin, Benin city.

Prof R.I Udegbunam. Date

Project supervisor

Dr S.O igbinedion. Date

Project coordinator

Dr S.O igbinedion. Date

Head of Department.

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ABSTRACT

This project work examines the impact of loan performance on bank failure in Nigeria. The work referred to both theoretical and empirical approaches in determining the extent to which loan performance (credit risk) affects the chances of bank survival in Nigeria. This has become necessary as bank failure poses a serious danger to stakeholders in the financial system. This work focused on impact of loan performance on bank failure using annual panel data of 17 selected banks for the period of 2004-2007. The Binary Logit model was used for the study. From the study, it was deduced that excess risk taking by banks Results to high volume of non-performing loans which accumulates as credit Risks and builds up over time to reduce their asset quality and predispose them to Failure. Thereafter, adequate lending policies should be be put in place to help check excess risk taking by banks so as to reduce the tendency of accumulating bad loans over time In order to promote a strong and stable financial system Nigeria.

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The existence of banks, especially money deposit banks are crucial for the successful conduct of business in an economy. By driving commerce, banks also drive economic growth and development. Strong financial institutions provide credit for trade and under variant conditions have been employed to predict the size, growth and strength of a country's financial system and economic performance over time.

Banks are at the Centre of financial intermediation in an economy they mobilize funds from the surplus units in forms of savings and make such available to the deficit units through loans for investment purposes. This credit creation function has been identified as one of the main income generating function of banks (Kargi, 2011). It can then be slightly argued that one of the major functions of banks is profit generation to the shareholders through credit extension to the needing public.

However, this singular main activity (Lending) of banks also tend to be very risky as there is often the problem of non-performing loans, which has over time become one of the major problems that the banking system has to deal with

(Muhammed, 2012). The problem of non-performing loans is a serious case because it can cause outright failure of bank.

In 1986, following the bad and precarious state of the Nigerian economy, the country accepted the international monetary fund (IMF) proposed, structural adjustment program.one of the major components of the program was financial sector reforms so as to have exchange and interest rates that are market determined. This deregulation powerful and economic inducing incentives for the expansion of both size and number of banks in the country. This phenomenal increase in banks was also accompanied by competition among banks. Since this period, all banks in the country have continually engaged in competitive activities so as to grab their fair share of the economic dividends that such deregulations provide. This competitiveness also resulted to increased risk taking especially in granting of poor loans. This poor credit behavior erodes banks capital in the case of the loan becoming bad and invariably increases the chances of bank failure.

Apart from intense competition, political stability, personal interest of management, corporate irresponsibility, escalating inflation, high inflation, high incidence of fraud, embezzlement, worsening financial and economic conditions with accompanying credit defaults. Non-performing loans have greatly greatly increased the chances of bank failure and not just in Nigeria but the world in general. Also, the inconsistent policies of the central bank of Nigeria (CBN) have not helped the situation. The official policies and regulatory response of the apex bank to the rapid development in the financial system appears to be slow, inadequate and have been characterized by poor anticipation, inadequate supervisory and regulatory interventions. The CBN surveillance and regulatory measures were unfortunately unable to keep pace with the rapidity of the changes in the financial system (Iyoha, 1997).

All these factors created a fragile and dangerous financial system in the country. And of the obvious and greatest consequences of these challenges was the rapid decline in bank's profitability and asset quality due to large to large amount of non-performing loans that these banks tend to have in their portfolio. This huge credit risk among other things invariably reduced the profitability and asset quality of these banks, hence , increasing greatly their chances of distress and consequent failure (see: Ologun, 1994; udegbunam, 1996; iyoha, 1997)

However, it might be fair to say that things have improved in the financial sector as the regulatory authority have risen to call off providing a more robust policy and regulatory response in the financial system. This explains one of the reasons why there have been increased cases of bank failures in the economy. But this cannot provide enough of financial sanity, for it is possible for a bank to be distressed and be at the brink of failure, yet appear to be striving given to the possibility of balance sheet massaging. It can then be right to say that the current situation might not be too different from the past, therefore, an empirical analysis of banks provide a useful judgement of the situation thud far.

1.2 STATEMENT OF THE PROBLEM

Recently, banks witnessed rising non-performing loan portfolios and these significantly contributed to financial distress in the banking sector. Banks collect deposits and lend to customers bit when customers fail to meet up their obligations, the problem of non-performing arises (Kargi, 2011). N0n-performing loans in the form of credit risks is critical since the default 0f a small number of important customers can generate large losses, which can lead insolvency. (Bessis, 2002). Robert and Gary (1994) state that the most obvious characteristics of failed banks is not poor operating efficiency, however, but an increased volume of non-performing loans. This study tries to identify the extent to which non-performing loans can impact on the possibility of bank failure in Nigeria. Also, this study aside evaluating the impact of non-performing loans on bank's health, the study tries to show how capital adequacy, profitability and management quality decides the fates of banks in Nigeria. This work is in line with other similar works that have been done in the area over the years.

1.3 RESEARCH QUESTIONS

- Does loan performance affect bank heath in Nigeria

- To what extent do management quality, capital adequacy and profitability affect bank survival or failure in Nigeria?

1.4 RESEARCH HYPOTHESIS

H1: Loan performance affects bank health in Nigeria.

H1: management quality, capital adequacy and profitability affect bank health in Nigeria.

1.5 OBJECTIVE OF THE STUDY

- To investigate the impact of loan performance on bank failure in Nigeria.
- To examine the relationship between management quality, capital adequacy and profitability and bank failure in Nigeria.
- To recommend the study the appropriate economic units of concern.
- To support the findings of other scholars in this area.

1.6 SIGNIFICANCE OF THE STUDY

It is important to know the extent to which loan performances affect bank failure in Nigeria. This study would examine to what extent loan performance and other bank specific factors affects bank failure in Nigeria. This research would be an addition to many other researchers that have been over the years in this area and would be helpful to bankers, economists, the government, CBN and other groups.

1.7 SCOPE OF THE STUDY

This study focuses on the Nigerian banking system. a sample period of 4 years, encompassing 2004-2007 would be considered and would serve as the time horizon of this study. This period is chosen because it falls within the consideration period, which happens to be the era of the recent most notable bank failures in Nigeria since the closer the failure date approached, the better (Iyoha, 1999). This period would also give the necessary financial information on both the failed banks and some of the currently existing banks as many banks have altered financial statements due to mergers and acquisitions brought about by the consolidation exercise.

Data are sourced from the financial statements of banks, CBN statistical bulletin, reports of Nigerian deposit insurance commission, text books, financial and economic journals and other relevant materials and sources,

1.8 LIMITATIONS OF THE STUDY

The imitations of this work, includes financial constrain, availability of data, time constrain and other factors. However, I put my best efforts to ensure that the wok was well done and the results and conclusion reliable.

CHAPTER TWO

LITERATURE REVIEW

2.1 CONCEPTUAL FRAMEWORK

2.1.1 The Concept of Bank Failure

The failure of banks and the related costs have been emphasized by many writers. Kaufman (1996) explained that banking crisis generates losses to stakeholders by disturbing the settlement system, and even has a systemic effect on the entire economy. Most empirical studies on bank failures consider a financial institution (bank) to have failed if either received external support or was directly closed. The causes of bank failure are numerous in theory and include regulation problems of banking activities; asymmetric information leading to a moral hazard and other problems. The number of failing banks has been on the increase not just in Nigeria but around the world. Bank failures are usually followed by unfavorable consequences on stakeholders outside the failed banks themselves. Sometimes the consequences are felt by the non-banking system as a whole. A failure can result in much harm to employment, earnings, financial development and other associated public interests. According to Hooks (1994), the failure of a bank has great adverse effect on the economy and so is considered very important. Being a deposit taking institution, the liabilities of a bank at any given point in time are fixed and a fixed interest is promised on them. Whereas its assets are in the form of loan earning, variable interests, hence, subject to credit risk. Similarly, its demand deposits by nature are of shorter maturity while its loans are for longer duration. Therefore, there always exists a risk of maturity mismatch. These features of the assets and liabilities render the banking sector prone to crisis in the wake of any shock or decreased confidence of the depositors. According to Fadaro (2011), unlike the many determinants, non-performing loans is a significant predictor of financial crisis in Nigeria and the world over. His results suggest that the probability of financial crisis increases in tandem with increases in non-performing loan, because as banks invest in funds and operation cost; while trying to generate enough returns on shareholders capital, they also endanger their survival.

As the prime movers of the economic life of any economy, banks occupy a significant place in the economy of every nation. It is therefore not surprising that their operations are perhaps the most heavily scrutinized of all businesses. (Soyibo and Adekanye, 1991). Policy makers, economists and monetary authorities recognize that the stability of banks to achieve the desired results and to continue to play the role embarked for them, depends not only on the existence of an enabling (regulating) environment and the number of operating banks (and perhaps the spread of bank branches) but more importantly on their performance from one financial year to another. Quite obviously, the greater the number of operating banks that are resistant to adverse financial conditions, the better for monetary policy and ultimately the economy. The performance of banks attracts considerable attention from bank regulators and monetary authorities, because of the adverse implications that bank failure will have on public confidence and the banking system in general. This is why, from country to country such classifications differ as problem/non-problem (Sinkey, 1975), failed/surviving (Siems, 1992), financially successful/non-financially successful (Arshadi and Lawrence, 1987) and, vulnerable/resistant (Korobow and stuhr, 1997; Adekanyye 1930) have been used to classify and distinguish banks and their performance.

In recent times, the monetary authorities in Nigeria have classified the banks as healthy or distressed in an attempt to distinguish the performance of the country's bank. For the majority of the so-called distressed banks, some steps are taken to minimize the potential impact in the banking system and the economy in the case of eventual failure though the ultimate desire is that they ultimately revert to sound health (Olugbenga and Olakunle, 1998). This proper soundness in the banking system is achieved through proper supervision of banking activities especially in the area of lending behavior of banks. This therefore goes ahead to show that proper lending practices are essential in saving the banking system from failure and one of the very effective ways of saving banks from sliding Into massive problems which might become systematic is by noticing signs of distress early enough and taking urgent steps in implementing appropriate corrective measures (Douguwa, 1996).

Adverse rumor weather founded or precipitated financial panic can cause a run on a bank. According to Umoh (2002) and Ferguson (2003) few banks can able to withstand a persistent run, even in the presence of a good leader of last resort. As depositors take out their funds, the bank loses a lot of funds, and in the absence of liquidity support, the bank is forced eventually to close its doors. Thus, the risks faced by banks can be endogenous, associated with the nature of banking business itself or exogenous to the banking system as said by Owojoro (2011) that available statistics from the liquidated banks clearly showed the 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.

The initial indigenous banks were established to address perceived discrimination against Nigerian borrowed from by foreign banks. Their main objectives were to encourage local Investors, support building entrepreneurs hence, foster economic growth. Unfortunately, many of them failed, hindering their contributions to the economy (Ezekie, 1997; Onoh, 2002). Several reasons accounted for the high rate of failure of these early indigenous banks. One of the major reasons was that they operated in an unregulated banking environment. In order to check the incidence of failure among the banks and strengthen them to perform favorably, the Central Bank of Nigeria (CBN) was established with the principal mandate of regulating the banking industry (Onoh,2002). From the rules, guidelines policies and statements issued by the CBN, it is clear the agency sought to promote the contributions of banks to economic growth. It's guidelines, such as these prioritizing agriculture and manufacturing for credit purposes (The Agricultural credit Guarantee Fund scheme (ACGFS), 1978) and Microfinance fund (2005), and policies like deregulation (1986) and consolidation (2004) are all aimed at positioning the banks as engines of economic growth. However, the apex Institution could not through its beautiful policies guarantee a strong financial system as bank failure continued to be a problem in the system.

2.1.2 Emergence of Bank Failure in Nigeria

Bank Failure in Nigeria can be said to have started in 1894 when the African Banking corporation was taken over by the Bank of British west Africa now knows as First Bank of Nigeria PLC (Obamuyi, 2012). The periods of 1927 to 1951 witnessed both banking boom and doom as 22 out of the indigenous banks failed within that period (Impala, 2005). Following the liberalization exercise of the 1986 SAP program, licensing requirements of banks became relaxed and this dramatically increased the number of banks that existed in the country from 40 in 1985 to about 120 banks in 1993. However, all didn't seem well with the system as between 1994 and 200, a total of 33 sick banks were identified and liquidated (CBN, 2001). Also, the remaining banks were further reduced to 24 banks by the end of 2005. When banking business commenced in Nigeria in 1892, it was solely a business for foreigners. Largely contributed to the observed lack of access to banks credit by indigenous Nigerian entrepreneur during that period. Nigerian entrepreneurs who came into the banking sector from the late 1920s to early 1950s did so with the principal aim of redressing the situation and meeting the financial requirements of Nigerian businesses. Due to the problems such an inadequate capita, mismanagement, overtrading, lack of regulation and unfair competition from the foreign-owned banks, 21 out of 25 Indigenous banks that were established up to 1954 failed. The failures were resolved mainly through self - liquidation. The mass back failure was a bitter experience for the economy as it brought untold hardship to depositors who lost their money and lost confidence in the ability of Nigerians to manage a banking business. It was not until government started to regulate banking through the banking ordinance of 1952 and the establishment of the CBN in 1959, which was followed by the promulgation of the Banking decree of 1969 that the banking system started to stabilize in the country. When banking business commenced in Nigeria by 1892, it was solely a business for foreigners. The skewness in the ownership structure in favor of foreigners largely contributed to the observed lack of access to bank's credit by indigenous Nigerian entrepreneur during that period. The biggest Global banks in many important industrial nations have experienced upsetting bank failures, even the bank of Credit and Commerce international (BCCI), founded in Karachi Pakistan in 1971 and once the 7th largest private bank in the world and binding over $20 billion USD in assets failed in July 1991 because of widespread fraud. It can be then said that the bank failure is not one peculiar to the Nigerian economy in any way as it does not relate necessarily to the nature of the economy (Odusola, 2001).

The oil boom of the 1970s, and the economic growth which ensued, made banking thrive and to be very lucrative. However, the economic downturn noticed from mid-1981, brought strains to the Nigerian economy that soon became depressed. As economic agents were not able to moderate their boom consumption habits in line with the realities of the depressed economy, the financial conditions of individuals, firms and government worsened and they were able to honor their contractual obligations of loan repayment to backs thus impairing bank's portfolios quality. This Economic predicament, combined with other factors such as mismanagement, adversely affected the health of many banks and created unfavorable backing environment in the country (Obamuyi, 2012).

2.1.3 Identification, Examination and Supervision of Bank Problems in Nigeria

The main purpose of bank examination and supervision is to ensure safety and soundness in the banking system (Iyoha, 1999). Bank supervision and regulation which Include both on-site and off-site strategies are aimed at reducing riskiness and excessive risks taken by banks so as to proffer corrective measures (see: Iyoha, 1999; Udegbunam, 1999; Ahmed and Stuff, 2007; Scharts,1985).

In Nigeria, just like any other countries of the works, the basic on-site examination took is the CAMEL. The supervisory authority accesses the performance of banks on five areas which are:

C=capital adequacy

A=Asset quality

M=Management competence

E=Earning capacity

L=Liquidity sufficiency

Based on these parameters, appropriate financial ratios are employed to determine the health status of a bank. When the established ratios deviate significantly from the predetermined critical level, the bank is said to have exhibited symptoms of distress, hence calls for appropriate and adequate actions. According to Ebhodaghe (1993), where evaluation depicts a poor condition in all or most of these five areas, eminent problem is said to be present. Having experienced high level of bank failure in the Nigerian financial system, the need for more frequent use of both on and off sites examinations cannot be overemphasized as it assists greatly in the early identification and correction of problems in the system. Also, warning model as proposed by Atman (1968) which provides the necessary warning signals is distress early enough should be used so as to allow appropriate action to be taken by the central bank early enough (Olumba, 2008; Babalola,2011).

2.1.4 Consequences of Bank failure

A number of empirical studies have examined not only what causes bank crises but also how the crises can affect the rest of the economy in general. For example, summarizing several case studies, Lundgren, Garcia and Saal (1996) concluded that bank fragility adversely affects economic growth. Also, Hoggarth et Al (2002) made the point that output losses associated with banking crises are not more severe in developing countries than in developed countries. A distressed banking sector, in turn, may be a serious obstacle to economic activity and aggravate the effect of adverse shocks. For instance, when banks are distressed, firms may be unable to credit to deal with a period of low internal cash flow. In fact, lack of credit may force available firms into bankruptcy. Similarly, lack of consumer credit may worsen declining consumption and aggregate demand during a recession, thereby aggravating unemployment. In extreme cases, bank runs and bank failure can threaten the soundness of the payment system, making transactions more difficult and expensive. These mechanisms suggest that fragile banks hinder economic activity (the credit crunch hypothesis). On the other hand, there are several channels through which exogenous adverse shock to the economy might cause a decline in credit and economic activity even if the banking sector itself is relatively healthy. For instance, adverse shocks may trigger a fall on aggregate demand, leading forms to cut production and investment, and consequently, credit demand (Kargi, 2011). Increased uncertainty may also cause firms to delay investment and borrowing decisions, adverse shocks might worsen agency problems and complicate lending relationships for instance by reducing the net worth of borrowers. This, in turn, might cause banks to abandon high risk borrowers (flight to quality) or raise lending spreads. So output and back credit may degenerate around banking crises even if there is no feedback effect from bank availability (Odusola, 2001).

Some existing studies of individual country experiences have found conflicting evidence of the relationship between back distress and real activity. In a study of the so-called capital crunch in the United States in 1990, (Bernrke, 1991) argued that a shortage of bank capita had little to do with recession. Doma and Ferri (1999) did a study for Malaysia and Korea during 1997-1998. They found small and medium sized firms to have suffered more large firms during financial crisis since these firms are usually more dependent on bank credit than large firms. Data from a surgery of Thai firms, on the other hand, suggest that poor demand rather than lack of credit cause decline in economic activity. It can then be inferred that bank problems do not stop with the banking sector but also spreads to the real sectors of the economy, thereby worsen the general economic outlook of the economy. This suggests that bank problems should not be handled carelessly.

2.1.5 The Concept of Loan Performance

Loan performance can be seen as the extent to which a loan is serviced and paid back as at when due and when this is not the case, the problem of non-performing loans results. Alton and Hazen (2001) described non-performing loans as loans that are ninety days or more past due or no longer accruing interest. Caprio and Klingebiel (1990), consider non-performing loans as loans which for a relatively long period of time do not generate income, that is, the principal and or interest on these loans have been left unpaid for at least ninety days. Non-performing loan is the percentage of loan values that are not serviced for three months and above (Ahmad and Stuff, 2007). Critical appraisal of the foregoing definitions of bad loan points to the fact that loans for which both principal and interest have not been paid for at least ninety days are considered non-performing. According to Berger and De young (1997), such loans could be injurious to the financial performance of banking institutions.

Increasing amount of non-performing loans in the credit portfolio is inimical to banks achieving their objectives. Due to the increasing spate of non-performing loans, the Basel II Accord means that a sound approach to tacking credit risks has been taken and thus ultimately improves bank loan performance. Through the effective management of credit risk exposure, banks not only support the viability and profitably of their own business, they also contribute to systemic stability and to an efficient allocation of capital in the economy (Psillaki, Tsolas, and Margaritis, 2010).

The provisions for bad loans reduce total loan portfolio of banks and such affects interest earnings on such assets; this constitutes huge cost to banks. Study of the financial statement of banks indicates that unsecured loans have a direct effect on profitability of banks. This is because charge for bad debts is treated as expenses on the profit and loss account and as such impact negatively on the profit positions of banks (Price water-House Cooper's, 2009). Berger and De young (1997), indicated that failing banks have huge proportions of bad loans prior to failure and that asset quality is a statically significant predictor of insolvency. Fofack (2005), also reported that during the banking crisis in Indonesia, non-performing loans represented about 74% of total loan assets which led to the collapse of over sixty backs in 1997. This means that banks holding huge bad loans in their books can run into bankruptcy if such institutions are unable to recover their debts. Another possible effect of bad loans is on shareholders earnings. Dividends payments are based on bank's performances in terms of net profit. Thus, since bad loans have adverse effect on profitability of banks, it can affect the amount of dividend to be paid to shareholders. Hence, increasing amount of non-performing loans on the credit portfolio is inimical to banks in achieving their dividend payment objectives. Alternatively, the only way for banks to guarantee their continuous survival and progress in any economy is by putting appropriate measures in place to ensure that loans which they grant are performing both in the short and long run.

Research findings and publications show that bad loans occur as a result of some factors. Berger and De young (1997) identified poor management as one of the major cases of problem loans. They argue that mangers in most banks with problem loans do not practice adequate loan underwriting, monitoring and control. A world Bank policy research working paper on non-performing loans in sub-Saharan Africa revealed that bad loans are caused by adverse economic shocks coupled with high cost of capital and low interest margins (Forfack, 2005). Goldstein and Turner (1996) stated that the accumulation of non-performing loans is generally attributable to a number of factors, including economic downturns and macroeconomic volatility, terms of trade deterioration, high interest rate, excessive reliance on overly high-priced inter-bank borrowings, Insider lending and moral. Rouse (1989) indicated in his work that problem loans can emanate from overdrawn account where there is no overdraft limit, overdraft taken on an account which has not been actively operated for some time and overdraft taken in excess of reasonable operational limits. He also identified lack of good skills and judgement on the part of the lender as a possible cause of bad loans. Bloem and Gorter (2001) indicated that non-performing loans may arise considerably due to less predictable incidents such as the cost of petroleum products, prices of key export products, foreign exchange rates or Interest rates abrupt changes. They also stated that deficient bank management, poor supervision, overoptimistic assessments of credit worthiness during economic boons, and moral Hazard that result from generous government guarantees are some of the factors that lead to bad loans. Sudden depreciation of the Naira against global currencies is also one of the factors that can lead to non-performance of loans (BGL banking report,2010).

According to Ahmad and Stuff (2007), most banks in economies such as Thailand, Indonesia, Malaysia Japan and Mexico, experienced high non-performing loans and significant increase in credit risk during financial and banking crises, which resulted in the. Closing down of several banks in Indonesia and Thailand. Therefore, non-performing loan is a serious financial problem that banks all over the world can face at any point in time and should be watched out for since it can out the financial sector of an economy in great danger of distress and panic which could lead to systematic failure if not carefully managed.

2.2 LOAN PERFORMANCE AND BANK FAILURE

Recently, banks in Nigeria witnessed rising non-performing credit portfolios and these significantly contributed to financial distress in the banking sector. Banks collect deposits and lends to customers but when customers fail to meet their obligations of servicing such loan, problems such as non-performing loans arise as the profitability incurring losses resulting from non-payment of such loans results in credit risks. The biggest credit risk facing banking and financial intermediaries is the risk of customers or counter party default. During the 1990s as the number of players in the banking sector increased substantially in the Nigerian economy, banks witnessed rising non-performing credit portfolios and this significantly contributed to financial distress in the banking sector. Also, identified, was the existence of predatory debtor in the banking sector whose modus operandi was abandoning of their debt obligations in some banks only to contract new debts in other banks.

Credit creation which is the main Income generating activity for banks involves huge risks to both lender and the borrower. The risk of a trading partner not fulfilling his or her obligation as per the contract on due date or anytime thereafter can greatly jeopardize the smooth functioning of the banks business. On the other hand, a bank with high credit risk has high bankruptcy risk that puts the depositors in jeopardy. But in a bid to survive and maintain adequate profit level in a highly competitive environment, banks have tended to take excessive risks and this increased tendency for greater risk and this increased tendency for greater risk taking has resulted in insolvency and failure of large number of the banks. The major cause of serious banking problems continues to be directly related to low credit standards for borrowers, poor portfolio management, and lack of attention to changes in economic or other circumstances that can lead to deterioration in the credit standing of bank's borrowers. Credit risk management comes to maximize a bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable limit in order to provide a framework of managing the impact of credit risk on bank's profitability.

Borrowings (1998) observed that one of the major factors contributing to bank failure were high interest rates charged to borrowers. The most profound impact of high non-performing loans in banks portfolios is reduction in the bank profitability especially when it comes to disposals. BCBS (1982), stated that lending involves a number of risks. In addition to the risks related to the credit worthiness of the borrower, there are others including funding risk, Interest rate risk, clearing risk, and foreign exchange risk. BCBS (2006), observed that historical experience shows that concentration of bad loans in asset portfolio has been one of the major causes of bank distress. Thus, is true for both individual institutions as well as banking systems at large. Robert and Gary (1994) stated that the most obvious characteristics of failed banks is not poor operating efficiency, but an increased volume of non-performance of loans granted to customers.

2.3 OTHER DETERMINANTS OF BANK FAILURE

2.3.1 Management Quality and Bank Failure

Management is the key to a successful business. Mismanagement caused many banks to fail. Banking crisis mostly comes from the absence of good ideas in management decision-making. Therefore, competence and focus play a major role in banking business decision making (Spiegel, 1996). According to Pantalone &Platt (1987, cited by Hooks, 1994), mismanagement, especially excessive risk-taking, is the main cause of bank failure. But, White (1993) notes that even though bankers are accused of misconduct, might be difficult to prove that the negligence of management is the only cause of bank failure. However, in support of more popular opinion Adekanye (1993) represented a notable attempt to isolate factors that distinguish vulnerable from resistant commercial banks in Nigeria. The study, which covered 1984 to 1989 and adopted both multivariate discriminant analysis (MDA) and the logit regression technique, confirmed managerial efficiency to be overriding determinant of commercial bank performance in Nigeria. Therefore, it could be said that there is a consensus in the literature that management quality is one of the ultimate determinant of a bank's long term survival (Cates, 1985; Pantallone and Platt, 1987; Homer, 1988; Seballos and Thompson, 1990; Diems, 1991).

According to Guillord (2008), the first step in attaining a bank loan is for a bank customer to full out a loan application. These applications include personal Information, financial information, and questions about the purpose of the loan. Once submitted, the application will go I to underwriting, where the bank will make a decision on whether or not to grant the loan money and at what rate of interest. The bank will issue the loan sadly, The experience most times is that bank managements do not follow this and other regulatory requirements and this puts the bank in dangerous position because when a loan is not properly appraised, the purpose of the loan not substantiated, the credit profile of the borrower not known, then the tendency of such loan going bad greatly increases and most of the failed. Banks in Nigeria have always been associated with poor management quality which borders on the integrity and foresight of the managers. Palubinskas and Stough (1999), noted that the failure of a bank is mainly seen as a result of mismanagement because of bad lending decisions made with respect to wrong appraisal of credit status, or the repayment of non-performing credits and excessive focus on giving loans to certain customers who might be related to a senior management member. Goodhary (1998) also stated that poor credit control, which results in undue risk. Causes bank failure while Hempel and Simonson (1999) concluded that all banks incur certain losses when some borrowers default in repaying their loans. Irrespective of the extent Risk involved in loan granting and management, good credit management can reduce the default and invariably save a bank from failure.

De Young age Whalen (1994), observed that the US office of the comptroller of the currency found that the difference between the failed banks and those that remained healthy or recovered from problems was the caliber of management because superior managers not only run their banks in a cost efficient fashion, thus generating large profits relative to their peers, but also improve better loan underwriting and monitoring standards than their peers which results to better credits quality and stable financial institution. Hence, a good management quality saves a bank from the possibility of failure which bad and non-performing loans can cause.

2.3.2 Credit Risk and Bank Failure.

Chen and Pan (2012), defines risk as losses from the refusal or inability of credit customers to pay what is owed in full and on time. Banks are crucial to economic development through the financial services that offer and provide. Their intermediation role can be said to be a catalyst for economic growth. The efficient and effective performance of the banking industry over time can be an index if financial stability in any nation and the extent to which a bank credit extends to the public for productive activities accelerates the pace of a nation economic growth and it's long term sustainability. The credit function of banks enhances the ability for f investors to exploit desired profitable ventures. However, this activity involves huge risks especially to the lender.

Recently, banks witnessed rising non-performing credit portfolios and these significantly contributed to financial distress in the banking sector (Ahmadu,2011). Banks collect deposits and lends to customers but when customers fail to meet their obligations, problems such as that of non-performing loans become inevitable. The risk of non-performance by a bank's customer can greatly jeopardize the smooth functioning of bank business and put it in great danger of failure because a bank with high credit risk equally Has a high bankruptcy risk that puts the depositors in jeopardy. In a bid to survive and maintain adequate profit level in a highly competitive environment, banks can take excessive risks and this increased their tendency for greater risky businesses which results in insolvency and failure of a large number of the banks In Nigeria banking sector (Kargi, 2012). The poor quality of the Bank's loan assets can hinder banks from extending more credit to the domestic economy, thereby adversely affecting economic performance.

Credit risk has been seen by far as the most significant risk faced by banks and their success of their business depends on accurate measurement and efficient management of this Risk to greater extent than any other risks. The higher the exposure of a bank to experience financial crisis and vice-versa (Giseseche, 2004).

Amongst other risks faced by banks, credit risks plays an important role since a large chunk of bank's revenue accrues from loans which interests is derived and an effective management of this Risk by banks supports their viability and profitably of their own businesses in particular contributes largely to the systemic stability and an efficient allocation of capital in the economy at large (Psillaki, Tsolas, and Margaritis, 2010).

Non-performing loan is a serious threat to the performance of banks; therefore, various researchers have examined it's impact on banks in varying dimensions. Kargi, (2011) evaluated it's impact on the profitability of Nigerian banks. He used financial ratios as measures of bank performance and credit risk which was collected from the annual reports and accounts of sampled banks from 2004-2008 and analyzed using descriptive correlation and regression techniques. The findings revealed that credit risk management has a significant impact on the profitability of Nigerian banks. It concluded that bank's profitability is inversely related to non-performing loans which exposes then to great risks of Liquidity and distress. Epure and Lafuente (2012) examined bank performance in the presence of risk fur coats Rican banking industry during 1998-2007). The results show that risk in non-performing loans negatively affect efficiency and return on assets. Kithinji (2010) assessed the effect of credit risk management on the profitability of commercial banks in Kenya m the findings revealed that the bulk of the profits of commercial banks are not influenced by the amount of credit and non-performing loans, therefore suggesting that other variables other than credit and non-performing loans have significant impact on bank's profitability (Australian Journal of Business and Management Research vol.2 No. 02 2012). Chen and Pan (2012) examined the credit risk efficiency of 34 Taiwanese commercial banks over the period 2005-2008. Their study used financial ratio to assess credit risk and was analyzed using Data Envelopment Analysis (DEA). The credit risk parameters were credit risk technical efficiency (CR-TE), The credit risk allocative efficiency (CR-AE), and credit risk cost efficiency (CR-CE). The results indicated that only one bank is efficient in all types of efficiencies over the evaluated periods. Overall, the DEA results show relatively low average efficiency levels in CR-TE, CR-AE and CR-CE in 2008. Al-Khouri (2011) assessed the impact of banks specific risk characteristic, and the overall banking environment on the performance of 43 commercial banks operating in 6 of the Gulf Cooperation Council (GCC) countries over the period of 1998-2008. Using fixed effect regression analysis, his results showed that credit risk, liquidity risk and capital risk are the major factors that affect bank performance when profitability is measured by return on assets while the only risk that affects profitability when measured by return on equity is Liquidity risk. Ahmed, Takeda and Shawn (1998) in their study found out that an increase in loan loss provision indicates an increase in credit risk due to high volume of non-performing loans and deterioration in the quality of loans consequently affects bank performance and survival and adversely.

2.3.3 Profitability and Bank Failure

The importance of bank profitability can be appraised at the micro and macro levels of the economy. At the micro level, profit is the essential prerequisite of a competitive Banking institution and the cheapest source of funds. It's not merely a result, but also a necessity for successful banking in a period of growing competition in financial markets. Hence, the basic aim of a bank's management is to achieve a profit, as the essential requirement for conducting any business (Sanusi, 2003). At the macro level, a sound and profitable banking sector is better sector is better able to withstand negative shocks and contribute to the stability of the financial system. The importance of bank profitability at both micro and macro levels is crucial because it does not only ensure that the shareholders are satisfied; it also enables the banks to absorb shocks emanating from unexpected business losses (Bobáková, 2003).

Between 1990 and 2004, bank regulators increased the minimum share of capital requirement for banks operating in Nigeria five times. Namely in 1991, 1997, 200, 2001 and 2004 (Anytime and Uche, 2006) so as to enable then operate more profitably. However, these measures were unsuccessful in curtailing the spate of back distress and failures in the 1990s and beyond (Oluranti 1991: Uche,1996, Brown bridge, 2007).

Kithinji (2010), assessed the effect of credit risk management on the profitability of commercial banks in Kenya. Data on the level of non-performing loans and profits were collected for the period 2004 to 2008. The findings revealed that the bulk of the profits of commercial banks are not influenced by the amount of credit and non-performing loans, therefore suggesting that the other variables other than credit and non-performing loans impact on profits. However, Felix and Claudine (2008) instigated the relationship between back performance and Credit Risk management. It could be inferred from their Findings that return on equity (ROE) and return on assets (ROA) both measuring profitably were inversely related to the ratio of non-performing loans to total loans if financial institutions thereby leading to a decline in profitability. Bobakovia (2003) asserts that the profitability of a bank depends on its ability to foresee, avoid and monitor risks, which makes it possible to cover losses brought about by risk of non-performance by the customer. The more profit a bank is able to make, the more profit a bank is able to make, the more it is possible for such bank to withstand adverse shocks that non-performing loans can generate and consequently failure.

Banks profits tend to fall drastically in the face of economic downturn. This helps to increase the risk appetite of banks as more loans are made available all in a bid to cover up and report favorably to both shareholders and other stakeholders in the business but more lisn delinquencies tend to emerge in the process. By increasing their risk asset in this way with increased risk taking, deterioration in their asset quality emerge and increased chances of failure accompany it. Therefore, it is wise to say that the more there is rapid growth in the risk assets of banks, such loans , the greater the bank's exposure to failure (see: Emmons, 1993; Udegbunam, 1996; Iyoha et al, 1999; Sanusi,2003).

2.3.4 Supervision and Bank Failure

Proper supervision of the banking system has been seen as a critical factor in protecting banks from failing in an economy. The CBN and other adjourning bodies have been established over the years to help provide proper supervision of the banking business in Nigeria. However, it has been identified over the years that the supervisory role of the apex bank has been ineffective as the main purpose of bank supervision and examination is to ensure safety and soundness of the system which has not been the case for the Nigerian banking system (Iyoha and Udegbunam, 1999). Done (2006), concluded that independence and efficiency of the supervisory agencies impacted positively on bank's soundness, hence suggests great autonomy and pro activeness for the Apex institution. Banking supervision which includes both on site and off site examination should basically be aimed at reducing excessive risk taking among financial institutions as mounting non-performing loans can result to erosion of Profitability and capitalization, thereby making the failure of such banks more pronounced (Pantalon\e and Platt,1987, Robert and Garry,1994).

Given to the role that adequate supervision plays in the banking system, it is o the best interest of the economy for the apex bank to adopt appropriate on site and off site measures of supervision so as to prevent bank failures because proper supervision aids in the timely identification of problem banks and the provision of solutions that would prevent such problems from turning into systemic failures (Philips,1994).

2.3.5 Credit Policy and Bank Failure

A good credit policy is essential for a bank to survive, as it provides banks with good guidelines to follow so as to avoid accumulation of bad loans which could become toxic asset portfolio over time. Kithinji (2010) suggested that thus credit policy should be all compassing putting into consideration the economic conditions m of that time and the industrial Norms.

Sound credit policy plays the positive role of saving banks from failing into unsoundness. This also has a lot to do with the quality of management that would be setting such policy as a good management not only leads to generation of good profit for the invested funds of the shareholders but also helps in imposing a better loan underwriting and monitoring standards which would go a long way in resulting to a better credit quality (De young and Whalen,1994).Thus, a good credit policy impacts positively on the success or failure of a bank.

2.3.6 Capital Adequacy and Bank Failure

CBN, (1995), claimed that banks should maintain adequate capital so as to meet their financial obligations to the banking public in particular and the economy in general. But, before 2095, careful observation of the Nigerian banks showed a high case of undercapitalization and this led to one of the biggest achievements in the financial e of the Nigerian economy in 2005 as the banking reform too place so as to bring sanity to the banking sector in Nigeria through recapitalization. The major aim of the reform was to resolve the case of bank distress due to poor capitalization and to restrict inefficient banks. This achievement of the central bank of Nigeria increased bank's capital in excess of 1000 percent and it resulted in the reduction in the numbers of banks from 89 banks to 24 bigger, Stronger and more resilient financial institutions. The reforms engineered a revolution in the financial service industry leading to an increase both in quality of service and quantity of financial products available to Nigerians and to checkmate the capital inadequacy of the banks (Ajayi, 2005).

Mpuga (2002), argued that the inadequacy of minimum capital standards accounts for risks in banks assets portfolio and could be one of the major factors leading to bank failures and of stakeholders such as back management and regulators do not result in bankruptcy. Adeyemi (2011) observed that the effect of low bank capitalization is the inability of a such bank to withstand economic shocks and to make recoveries from the impacts of non-performing loans maintained by such banks.

Ogundina (1999), argued that capital adequacy of banks is crucial to enable them absorb losses, thereby, providing a cushioning effect on the losses that are not covered by current earnings of such banks. Also, Ogubunka (2003), contended that when a bank is undercapitalized, it can't progress its operations as necessary and if it continues without further injection of capital, failure night ensue. Ben-Naceur and Imran (2008) in attempt to examine the influence of bank regulations, concentration, and financial institutional development on commercial banks margin and profitability in Middle east and North Africa (MENA) countries from 1989-2005 found that bank capitalization has a positive and significant impact on banks net interest margin, cost efficiency and profitability and consequently, survival.

These arguments substantiate the fact that adequate capital is very necessary for a bank to operate more comfortably in any economy. Therefore, any form of poor capitalization could suggest that a bank is in distress and heading for a fail.

2.3.7 Economic Condition and Bank Failure

Anthony (1997), opined that credit risk arises from non-performance by the borrower. However, thus non-performance by the borrower is highly dependent on the economic performance as at the loan period. In a depressed economy, business can go so bad that the borrower does not perform on his contractual obligations unintentionally. The monetary model sees the growth of money stick and its variables as a great factor in making banks unsound. This implies that bank crisis is an endogenous event based upon economic conditions and the banking structure of the country.

The business cycle approach believes that the financial environment responds to the state of the business cycle or some displacement in the economy such as liberalization (Soyinbo and Odusola, 2002). This displacement can lead to swell in the lending activities of banks but declines sharply due to the economic build ups. Also, the market failure approach believes that information asymmetry in the credit market can lead to financial crisis and thus help create sub-optimal investment level and a sharp contraction in the level of economic activities which can further heighten the probability of default among borrowers and subsequent failure of banks (Bernake, 1986; Ogwuma, 1996; Odusola, 2001).

CHAPTER THREE

THEORETICAL FRAMEWORK AND METHODOLOGY

3.1 INTRODUCTION

This chapter gives an overview of the methods, the procedures, the modalities and the sequential steps the researcher intends to adopt in the research work to ensure the results of investigation are dependable, accurate and invalid. It presents a careful description of the theoretical framework, model specification, data collection and data analysis techniques employed in the work.

3.2 THEORETICAL FRAMEWORK

In the presence of other factors that affect bank performance, non performing loans tend to leads to credit risk which appears to be the greatest risk that banks have to deal with. The condition goes ahead to affect the asset quality of such a bank which makes it vulnerable and able to fail in the presence of any form of shock (Kargi,2011). However, there have been theories over time that has tried to explain some of the causes of bank failure.

3.2.1 Monetary Theory of Bank Failure

This theory pioneered by Milton Friedman Schwartz (1963) and further extended by Brunner and Meltzee (1963) emphasizes that monetary growth and it's volatility are the central forces to banking crisis. According to the theory, bank failure arises whenever the central bank's control of the money supply or money reserve is erratic and results in excessive monetary tightening. Banks would then be forced to sell their assets in order to obtain the needed reserves. Such forced sales of assets reduced their prices, raises their interest rates, threatens bank's survival and reduce confidence. This theory suggests that banking and non performing loans crisis is endogenous events conditioned by economic policy, and the banking structure and not by independent or exogenous shocks.

3.2.2 Business Cycle Theory of Bank Failure

This theory posits that the financial environment responds endogenously to the state of the business cycle or to some displacement such as financial sector liberalisation which opens up opportunities for profit making. This approach believes that s bank's financial fragility stems from factors such as the liquidity of the economy, the proportion of firms that needs to borrow in order to honour outstanding loan obligations, debt/equity ratios and the share of shirt term debts in total debts. Financial fragility might also increase because if rising interest rates and overly optimistic expectations during investment boom. It should be noted that interest rate rises partly due to increase in the interest elasticity of the demand for credit. Consequently, leading velocity may increase temporarily but will later decline as the cash flow problems of firms start to accumulate and non performing loans buildup. This development forces banks to restryct lending so as not to jeopardize their prime customers either by drawing down on their non loan investments relative to loans or sometimes, by reducing excess reserves. These developments weaken the strength of the financial system and hence make it more vulnerable to shocks (Odusola,2001). Any abnormal development in terms of any macroeconomic instability that creates some uncertain or unusual microeconomic development such as mismanagement, lack of supervision, inadequate capital, etc. It can easily disturb financial pattern and trigger back failure. This sequence tends to lead to bank run, portfolio shift and a possibility of systemic failure.

3.2.3 Market Failure Theory of Bank Failure

The market failure theorists (Stiglitz and Weiss, 1981; Bernake and Gertler,1989; Mishkon, 1997) used information asymmetry in the credit market to explain bank failure. They postulated that lenders often favor risky projects with potential high returns, while only high risk loving borrowers are willing to borrow. Here, this adverse selection often leads to moral hazards and this increased banks exposure to failure.

The credit risk created by this situation is positively dependent on the debt equity ratios of borrowers and the degree of uncertainty in the system. The insensitivity of credit to interest crates leads to aggravation of the financial conditions of many organisations including banks. Due to the moral Hazards caused by conflict of interest between lenders and borrowed, many lending banks might decide not to make loans available to their customers, thereby creating sub-optimal investment levels and a sharp contraction in economic activities and this further increases the tendency of non-performing loans and bank failure (Bernake, 1986).

3.2.4 Financial Deregulation Theory of Bank Failure

Deregulation of the financial system before an adequate regulatory framework is put in place creates wide tendencies for risk taking and the eventual collapse of banks (Dermique-Kunt and Detriagiache, 1998; Fischer, 1997). Liberalisation of the external sector and the removal of capital accounts before a sound domestic banking system and a stable macroeconomic environment are provided as the case of Nigeria is yet another source of banking fragility (Soyinbo, 2002). This development has been further compounded by the challenges posed. Y globalization of the financial market, through volatile capital outflow and the contagious effects of banking crisis, empirical evidences in Nigeria suggest that this is likely to be the major cause of bank failure in the financial system (See: Soyinbo, Alashine and Ahmed,1997)

3.3 METHODOLOGY AND MODEL SPECIFICATION

The objective of this study is to describe the impact of non performing loans in the form of credit risk and other factors to determine the profitability that a bank would fail or survive. Thus, we try to determine factors that are significant enough in the survival or failure to banks in Nigeria, using binary logit model.

$$z_i = \log \frac{p_i}{1 - p_i} = \propto \; + \beta x + e_i$$

Thus, the model is used to predict the probability that a bank fails or survive and that such outcome is dependent on credit risk (Measuring non performing loans), profitability, management quality and capital adequacy in line with Pathway and Sinkey (1980), Wheelock (1992), Wheelock and Wilson, (1994), Jimoh (1993), Iyoha and Udegbunam (1999). The binary variable which denotes the occurrence or non occurrence of failure is specified as a function of vector of credit risk representing non performing loans and other related factors.

The binary logit model describing the probability of failure or survival in Nigeria is given as:

Where zí is the indicators of financial health of a bank (I) would fail. pì is the probability that bank (I) would fail. V represents parameter estimates, X is a vector of explanatory variable (Credit Risk representing non performing loans, profitability, management quality and capital adequacy and), & is a constant term and ei is the disturbance term. Hence (I) stages for occurrence of the event ; in this case, failure while one (O) stands for survival or non occurrence (see: Diamond and Dybring, 1983; Colbert,1991. Dermirgekunt ,1989, Classeaur and Mas, 1995.

3.4 MODEL CLARIFICATION

Studies in the past have used financial ratios to proxy certain characteristics of failing or surviving banks Beaver (1996) and Atman (1968) popularized the use of financial ratios to predict survival or failure of business. But Atman (1977) and Sinkey (1975) were the first scholars to apply financial ratios on banks and other financial institution Jimoh (1993), Buying (1994), CBN-NDDC (1995), Dogwa (1996), Iyoha and Udegbunam (1999), Logan (2001), Okezie (2011) have all applied financial ratios to determine significant distress factors in the Nigerian banking system. This study also follows this line of thought using data from the financial statements of banks sampled. The ratios are the elements of the X vector in the binary logit model used in this work. The variables are defined below:

A. LAR

Financial ratios: Total loans/ Total Asset. This ratio measures credit risk

Apriori expectations: Positive

B. EXTA

Financial ratios: Total EXP/Total Asset. This ratio measures poor management quality.

Apriori expectations: Positive

C. EQTA

Financial ratios: Equity/Total Asset. This ratio measures Capital Adequacy

Apriori expectations: Negative

D. TRTA

Total revenue/Total Asset. Thus ratio measures profitability

Apriori expectations: Negative

The ratios measuring credit risk and the management quality which are represented by (LAR) and EXTA respectively are expected to be positively related to bank failure. The quality of of management and its objectives in loan appraisal determines the soundness of the credit policy that a bank would have the quality of loans that such policy would allow. When a bank operates on poor credit policies, there would be high percentage of loan defaults and a significant increase in non performing loans which would reduce asset quality, profitability and thus, increased the chances of bank failure. Therefore, they move in the same direction with the profitability of bank failure.

The ratio measuring capital adequacy (EQTA) and profitability (TRTA) tebd to be negatively related to the possibility of failure. The higher the capitalization of a bank, the less likely such is to fail and vice versa. Also, of the profitability level of a bank would be in a better position to absorb shocks and more able to survive. But when the profit level tends to be low, survival and better performance in the financial system becomes unlikely for such a bank (see: Iyoha and Udegbunam, 1999, Emmons,1993, CBN,1995, Sanusi, 2003, Ajayi, 2005 and bankers magazine 2012).

3.5 DATA SOURCE

The data for the study was sourced basically from banks financial statements of the sampled banks, Central bank of Nigeria annual reports and other relevant journals, magazines and textbooks. The data so obtained was analysed for the period of 2004-2007.

CHAPTER FOUR

THE EMPIRICAL RESULTS

The results obtained from estimation of binary legit mode on the annual cross section data of 17 banks for period 2004-2007 are presented on

Table 4.1

4.1 Presentation of Regression Results

Dependent variable: PROB_OF_FAILURE

Method: ML-Binary Logit (Quadratic hill climbing)

Date: 117

Included observations: 17

Convergence achieved after 7 iterations

Covariance matrix computed using second derivatives . z

Variable	coefficient	std.error-	z-statistic	prob	
C	-2.392400	3.231114	-0,740426	0.4590	
LAR	0.661105	0.068270	3.862130		0.0033
EXTA	76.32463	52.22005	1.461596	0.1439	
EQTA	4.336296	1.129710	4.385526	0.0009	
TRTA	-61.75695	32.92850	-1.875487	0.0607	

McFadden r-squared	0.399891	mean dependent var	0.17671
S.D DEPENDENT VAR	0.395593	S.E of regression	0.349187
Akaike info criterion	1.147536	Sum squared resid	1.463182

Schwarz criterion	1.392.958	Log likelihood	-4.754042
Hannan-Quinn criter.	1.171895	Deviance	9.508104
Restr. deviance	15.84307	Restr.log likelihood	-7.9210987
LR statistic	6.336785	Avg log likelihood	-0.279650
Prob(LR statistic)	0.005430		
Obs with Dep=0	14	Total obs	17
Obs with Dep=1	3		

Source: Author's using E-views 7.0 software package.

4.2 DISCUSSION OF RESULTS

The likelihood ratio [LR] statistic of 6.3 and a Profitability of 0.005 from the results suggest that all the independent variables are adequate in predicting the probability of bank failure in Nigeria. The pseudo R-squared [macfafen R.squared] of 0.399 is quite low. This could be attributed to the nature of the model and the inadequate sample size. However, it does not pose as it is not so significant in measuring goodness of fit in a binary regressand model like this one (see: Gujarati, 2009).

The results reveal that non performing loans measured by credit risk [LAR] has a positive impact on the probability of bank failure in Nigeria as a unit increase in non performing loans increases the chances of bank failure in Nigeria by 0.66 units. Management quality [EXTA] also has a positive impact on bank failure in

Nigeria as a unit increase in poor management quality increases the chances of bank failure by 76 units. Non-performing loans (credit risk) and management quality meet theoretical expectations as they tend to move in the same direction with the probability of bank failure in Nigeria (see: Adekanye, 1993 Berger and De young ; 1997, Ahmad and Stuff; 2007).

However, capital adequacy [EQTA] suggests that a unit increase in capita adequacy increases the probability of bank failure by 4.33 units. This is against a priori expectation which suggest that capital adequacy reduces the probability of bank failure (see: Ogundina, 1999). A unit increase in profitability [TRTA] reduces the chances of bank failure in Nigeria by 61.7 units. Although this ratio follows a priori expectation, it is not significant thereby suggesting that other factors other than profitability are more responsible for determining the chances of bank failure in Nigeria. The results shows that credit risk LAR measuring non performing loans, management quality EXTA, capital adequacy EQTA are significant in predicting the probability of bank failure in Nigeria while profitability TRTA is not so significant.

Non performing loans proxy by credit risk shows from all results that banks with high volume of non-performing loans are more likely to fail as this bad loans tend to reduce the asset quality of such a bank and mskes it unable to compete favourably in the financial system in the long run. Management quality especially in the area of loan appraisal and evaluation is a bank significant factor. A bank that has poor management quality is more likely to accumulate bad loans and this most readily leads to failure.

Capital adequacy was supposed to go in opposite direction with probability of failure, but our result proves otherwise. This goes ahead to suggest that the central bank and other interest groups should not rely strongly on capital adequacy as a good indicator of bank's health as it's relationship with the chances of failure may be misleading.

Profitability helps promotes bank's survival just like any other business it might not be a significant factor in predicting the chances of bank survival. It is possible for a bank that is not readily making a profit to survive and sustain itself in the financial system for a reasonable period of time as long as it is able to keep its volume of non performing loans down just as it is possible also for a sick band to manipulate figures and report a profit which is not real.

CHAPTER FIVE

SUMMARY, RECOMMENDATION AND CONCLUSION

5.1 SUMMARY OF FINDINGS

The rate at of back failure in Nigeria over the years have been a serious issue, therefore, it has raised a lot of questions. Given the prominent position that banks occupy, it has become imperative to access the impact of f non-performing loans measured by credit risk has one determining the fate of a bank. Other bank important factors such as management quality, profitability, capital adequacy was also evaluated to know their impact on bank health in Nigeria.

The primary aim of this with is to show the impact and significant of non-performing loans measured by credit risk, profitability, management quality and capital adequacy on the chances of bank failure in Nigeria. Relevant literatures were reviewed and model was developed to know the impact of these variables in determining bank failure in Nigeria. The study shows that non-performing loans moves in the same direction with the probability of bank Failure in Nigeria. Also, management quality and capital adequacy impacts bank health but, profitability was found not to be so significant

5.2 POLICY IMPLICATIONS OF FINDINGS

- Banks in Nigeria should be more careful in accumulating large volumes of non-performing loans as this has the dangerous implication of increasing the chances of failure. Also, the supervisory authority should increase policies that would reduce the incidence of risk taking by banks which goes ahead to create a more stable financial system in the country.

- The quality and integrity of banks management should be strong quality credit policy making, proper loan appraisal, integrity of loan approval and other managerial issues that boarder on good loan management should be carefully handled so as to reduce the tendency of toxic asset accumulation which increases the profitability of failure.

- Capitalization is a significant factor in ensuring that a bank survives but it does not necessarily follow that an undercapitalized bank is sick and vice versa. Hence, all Interest groups should be more careful in judging a bank's health based on size of the capital.

5.3 RECOMMENDATION

1. Banks should develop a strong credit Policy which would guide their lending to customers as this would greatly reduce the tendency of a loan going bad.

2. The integrity of management is very crucial in the banking business because, poor quality management impacts positively on bank's health and jeopardize the chances of survival.

3. A profitable bank can still have survival problem, therefore, despite the profit size of a bank, such a bank should still be properly monitored.

4. Further studies are recommended and a larger sample size should also be employed as to have a more significant result.

5.4 CONCLUSION

This project work examines the impact of loan performance on bank failure in Nigeria. The work referred to both theoretical and empirical approaches in determining the extent to which loan performance (credit risks) affects the chances of bank survival in Nigeria. This has become as bank failure poses a serious danger to stake holders in the financial system.

This work focused on impact on loan performance on bank failure using annual panel data of 17 selected banks for the period of 2004-2007.

The binary logit regression model was used for the study.

From the study, it was deduced that excess risk taking by banks results to high volume of non-performing loans which build up over time to reduce the asset quality.

Therefore, we conclude that adequate lending practices should be put in place to check excess risk taken by banks so as to reduce the tendency of accumulating bad loans over time in order to promote a stable financial system in particular and a viable economy at large.

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