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Debt management strategies and money deposit banks' profitability in Rivers state

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Abstract

The study examined debt management strategies and money deposit bank's profitability in Rivers State. The correlational research was conducted using senior managers in 230 branches of 21 commercial banks and the entire population of 230 senior managers was sampled and used. Debt Management Questionnaire (DMQ) and Banks' profitability Questionnaire (BPQ) were developed and the reliability was computed with Cronbach Alpha to produced 0.77 and 0.73 coefficients respectively. Quantitative data collected from the study group were analyzed using descriptive statistics - mean and standard deviation while the hypotheses have been tested with Pearson Product Moment Correlation Coefficient at 0.05 level of significant. Senior managers strongly believed that the determination of customers' eligibility for loan reassured them of customers' worthiness, customers' cash flow in doing their business, clients' business conditions, assess the value of collateral and as well as customers' purpose for the loan. Again, regular visitation to customers' business office/factory provided relevant information about firm's operational efficiency. Thus, the study further revealed that assessment of customer's credit risk profile and debt monitoring as bank management loan recovery strategies positively and significantly contributed to banks' profitability. Among other things, qualified credit risk analysts should be employed by banks to conduct thorough assessment prior to loan issuance to determine customers' credit worthiness and capacity for loan repayment. Commercial banks must desist from granting loans on personal recognition rather implement the 5Cs strategies in order to mitigate the inherent negative consequences of non-performing loans. Again, commercial banks should regularly monitor and visit their borrowers' offices to avoid loss of contact, communication gaps and ensure full repayment of loans.

Keywords: Debt Management, Recovery Strategies, Credit risk Management and Bank Profitability.

Introduction

Loan is a fundamental service of commercial banks to customers. Bank creates money through its operational services. Business organizations despite their size oftentimes are supported by commercial banks with credit facility. Commercial banks lend money to credit worthy entrepreneurs that have the capacity for repayment of borrowed advances within speculated agreement. Bill (2017) posited that 75 percent of start-ups capital of small medium scale businesses comes from bank loans, and that financing is very important to the growth and success of the enterprise. Edward, Reed and Gill (2010) pointed out that banks' source of revenue is from lending. Furthermore, commercial banks offer economic values by rendering services that in turn compensate them in values either with cash or materials commensurate to the cash. According to Tejvan (2007) banks are monetary establishments which receive deposits and give loan to customers. Banks accept deposits from customers, trade with these monies by way of lending to other customers at certain interest rates thereby maximizing profits. Interest payable by banks to depositors on savings and fixed deposit accounts is insignificant in comparison to the interest rate banks charge borrowers. The difference between the two interest rates is the profit for the banks. Shekhar and Lekshmy (2013) posited that commercial banks mobilized the reserved funds of the general public and give out this cash as credits to individuals in need; issue out overdrafts and fixed advances. The banks assemble the reserve funds of people which subsequently reduce the amount of inert cash and thus consolidate these little properties in sums. These resources are productively put into undertakings where they are most called for and require, giving out as loans to borrowers. Debt management and recovery policies adequately implemented boost the profitability of the banks. According to International Monetary Fund (IMF, 2003) debt management is the way toward building up and executing strategies for overseeing debts so as to raise the necessary funding amount to accomplish its framework objectives. Carysforth, Neild and Richard (2010) equally noted that credits effectively managed and collected efficiently enable the up and doing of banks. Like every business venture, return on investment (ROI) is a predominant purpose; the internal management system; that is, credit risk management analyzes and determines the risks associated with loan. Multitude of studies has linked the non-performing loan (NPLs) to number of internal and external factors. Institute of Chartered Accountants (2015) opined that the internal factors such as poor underwriting standards, excessive lending and credit concentrations, poor credit governance structures and lack of technical competence predominantly undermine organisational internal cohesion and culture. Apart from the internal causes and consequences, the external factors which fundamentally include the prevalent macro-economic conditions, unstable market conditions and competitive pressure hold unhealthy influence on bank profitability.

Non-performing loans (NPLs) interchangeably representing with the concept "debt" in banking parlance is a real challenge for bank profitability and financial stability, shrinking the credit expansion, delayed economic recovery, and breach of relationship (Louri, 2017). According to Duff & Phelps (2017) it places the burden of higher capital requirements on banks to absorb potential losses, increase funding. The problem of no expectation of payment continuity has invariably resulted to unrecoverable principal and reduced cash flow. These internal and external factors not only have negative impacts on banks' financial, technical and management intermediary role to the economy but have been found to lower bank profitability. However, other studies use different approaches to empirically discuss the management of NPLs and arrived at different conclusions. Thanh (2014) discovered that NPLs management embedded in quality of disbursement monitoring reflects increased profitability of investment and development banks, Peter (2014) had observed that the effectiveness of debt collection in commercial banks is dependent on information management, induction training and staff remuneration, Emmanuel (2012) assessed credit management practices of agricultural development banks in Ghana and discovered that process management ensures compliance with internal guidelines and completion of credit application forms, creation of credit management department and establishment of payment guidelines. On the other hand, Zimba (2013) assessed the effectiveness of loan appraisal procedures and identification of levels of loan approval and repayment using 10 senior managers and 30 customers in Tanzania, discovered that the non-compliance and unequal fairness of loan officers to customers, criteria and conditions to be too rigid for low income earners and unemployed in the society to request for loans. These studies however, fall short of the concept "debt management" and the attendant relationship to bank profitability. This recurrent incidence threatened the future of banks and the economy hence this topical issue is commissioned to investigate how the bivariate variables identified in the study is a bolster of commercial banks' profitability.

Debt Management and Loan Recovery Strategies

Debt financing of business enterprises remains crucial to healthy economic growth and national Gross Domestic Product of countries. Business contributes to economic growth, raise income per capital and create employment and social; inclusiveness. Predominantly, business performance has significantly been related to accessible loans facility. Haque & Sharman (2011) have noted that the health of an economy is determined by studying the financial performance of its banks. However, the ease of access is determined by the character of the organisation's assets, the seasonal and cyclical flows in the volume of business, continuous growth, anticipated stability of profits and continuity of operations and the size which affect its position as a potential borrower (Harelimana, 2017). These factors fundamentally shape the financial policy and management preference of a particular source of financing more than others. Most importantly, profits are the sole objective of both the lender and the borrower; therefore, the borrower demonstrates the capacity to repay the loans in obedience to agree –upon service charges within specific timeline. The likelihood of defaults frequently witnessed by money deposit banks could out-rightly be reduced implementing the strategic management and debt recovery policies in order to ensure borrower loan repayment. These policies established and executed by banks are effective tools for managing debts and to recoup funds to achieve their organisation goals. The monetary theory of Mitchell Innes (1864-1950) codenamed "Credit

Theory of Money" was based on the assumption that money, in essence, is credit. The position of the theory is that the value of credit or money does not depend on the value of any metal or metals but confers the creditor with the right to payment. This places the obligation to pay on the debtor and thus wholly redeeming himself from debts. Mitchell Innes (1914) maintains that credit nature of money can be viewed in the perspective of bank money or fractional reserve demand deposits, a form of negotiation, transferrable credit. Debt payment, in the end, is the promise to cancel our debt by an equivalent credit expressed in terms of intangible monetary standard. Non-payment of such loans places weighty burdens on the borrowers. The lender (bank) invokes the terms and conditions of the loans to take over the borrower business and other non-business assets offered as collaterals to secure the loan. In late 80's, Central Bank of Nigeria established the credit risk management system by an Act No. 24 of 1991 to foreclose the growing problem of non-performing credit portfolios and multiple loans obtained by business owners from other banks, conflicting the status of enquiry. The credit risk management system strengthened credit appraisal procedure, storage of credit data and tracking excesses of borrowers accessing the CRMS database while conducting status enquiry of borrowers. Tracy (2017) had observed that credit analysis by banks is to determine the risks associated with granting of loans especially using 5Cs framework of character, conditions, capitals, capacity and collateral. The 5Cs help banks to determine the identity and eligibility of proposed borrowers, budgetary status of the business, client history, the purpose of the loan, worth and estimation of the business resources. According to James (2013) the 5Cs credit framework are typical reference to significant components of bank investigations of client worthiness. Therefore, banks ensure that management and recovery strategies of loans are fully implemented before and after the granting of loans, until the loan is fully paid and the contract ends successfully. Ukessay (2008) posited that when loans are granted to customers, banks should be committed to monitor borrowers in compliance to credit terms leading occasional valuation of collateral and convenient reimbursements. Credit monitoring strategy entails regular visits to factory location and business offices for regular contacts and check compliance with faithfulness in the loan agreements. Credit risk management and credit monitoring are core strategies meant for effective recovery of loans for the profitability of banks. According to Statistical Analysis System (SAS, 2016) credit risk management is the act of moderating misfortunes by understanding the sufficiency of a bank's capital and credit at given time. The credit improves performance and bank competitive advantage. Credit risk management limits the dangers of bank balance pace of return keeping up credit risk within the parameters. Banks for international settlement (BIS, 2017) stated that management of credit risk is a foremost segment of an extensive way to deal with credit risk to the accomplishment of any financial association. Credit risk management is the procedure of risk evaluation that arrives in an investment of risk and in the allotment of capital. Evaluation of risk is done to acquire sound venture choice in order to avoid dangers associated with loans granted to shameful indebted clients. Wells (2008) when a loan application is made by customers, banks survey of clients' credit worthiness is dependent on various variables such as the historical background of client's credit installment, income and overall financial situation. Besides, the 5Cs is significantly used by banks (lender) assess customers past record of credit fulfillment, income and employment history, evaluation of collateral worthiness, savings, investment and to determine the purpose for the loans. Minority Business Development Agency (MBDA, 2010) differentiated the 5Cs thus: capacity is the ability of clients to reimburse the loan. Capital is personal cash or resources invested in the business. Collateral are assets owned by the borrowers, Conditions portray the expected reason for the credit, and Character is the bank general impression of the clients.

Debt or credit monitoring alerts clients of likely changes made on one's credit reports. This gives the chance to quickly confirm the accuracy of the change and, if necessary, solving the problems before they really get out of hand (Wallet, 2016). According to Public Sector Commission (PSC, 2008) monitoring is a continuing function that uses systematic collection of data on specified indicators to provide management and stakeholders' on-going intervention of extent of progress and achievements of objectives and progress in the use of allocated funds. Monitoring emphasizes on checking progress towards the achievement of an objective. A good monitoring scheme gives warning early on the implementation of a course of action so as to reach the end planned goal. It however, suggests that after loans are granted to customers, the bank immediately monitors borrowers to achieve repayment of loans so far invested. This technique as part of credit risk management effectively employed by banks guarantee the returns on investment, that is, Profitability. Profitability is the main expectation for all business endeavours. According to Monica (2014) profitability is a combination of two words, namely, profit and ability. Profit is the remaining returns after deduction of all expenses while ability is the power of a business entity to earn profits. Thus profitability is the ability of a given investment to earn a return from its use.

Profitability is simply the efficient use of all available resources to make profits. Again, profitability can be defined as the ability of a given investment to earn a return from its use. It implies management efficient utilization of resources within the business organization for profit generation. Profitability is essential indicators of good business performance emanating from its operations (Griffith & Carroll, 2001). Profitability is the firm's ability to increase revenues and reduce costs and it shows how well the business is doing. According to Balunywa (1992), Lipsey, Kenneth, Carlow and Richard (2003), Oga, Bagshaw & Blue-Jack (2018) profit is the driving force that maintains firm's continuity and survival in competitive business environment hence non-profitable businesses discontinue their operations. Profitability is measured based on return of capital employed (ROCE), Net Profit Margin (NPM), Gross Profit Margin (GPM) and capital turnover. Profit sustains growth; diversifies operational service and builds healthy organization. Consequently, the inability of a given investment to earn a return from its use is loss and banks inclusive. Despite loan is a major source of revenue, it has been associated with risks such as defaulted loans (debts); having great drawbacks on bank profitability. These drawbacks usually arise from many factors such as lenders and borrowers' ill-conduct, ineffective debt recovery strategies, improper management of credit risks and faulty lending practice. Central Bank Nigeria (CBN, 2016) decried this high rate of non-performing loans and put the figure at 1.7 trillion bad loans across banks in Nigeria.

Research Questions

The following research questions are raised to guide the study;

1. How does credit risk management strategy contribute to bank's profitability?
2. How does debt monitoring recovery strategy enhance bank's profitability?

Hypotheses

The following null hypotheses were formulated to guide the study;

H_{o1}: There is no significant relationship between credit risk management as loan recovery strategy and money deposit bank's profitability.

H_{o2}: There is no significant relationship between credit monitoring as loan recovery strategy and money deposit bank's profitability.

Methodology

The correlational research design was conducted in Rivers State to determine whether relationship exists between debt management and money deposit banks' profitability. As a result, the explanatory design has equally been adopted to explain the dominant independent and dependent variables clearly outlined for statistical analyses. The population of 230 senior managers from 230 branches of 21 commercial banks located in Rivers State was adopted as sample and the univariate measurement scale structured into two independent sections representing credit risk management and credit monitoring (independent variable) while the other instrument represents (commercial bank loan recovery strategy and profitability). The quantitative questionnaire was therefore structured in four point weighted scale - Very High Extent (4) points, High Extent (3) points, Low Extent (2) points and Very Low Extent (1) point. The content validated questionnaire was pilot tested using Cronbach Alpha coefficient in order to determine how debt management as loan recovery strategy consistently correlates with money deposit bank profitability. Using the Nunnally (1978) goodness framework of 0.7, the coefficient alpha computed at 0.77 for debt management and 0.73 for Loan recovery strategy as bolsters of banks' profitability established the internal consistency. Quantitative data collected from the study group was analysed using descriptive statistics, namely, Mean and Standard deviation for research questions while the hypotheses have been tested with Pearson Product Moment Correlation Coefficient at 0.05 level of significant. Thus, the bivariate analysis provides the statistical baseline of either $P <= 0.05$, reject hypothesis based on evidence of significant relationship or $P > 0.05$, accept the results of hypothesis based on existing evidence of non-significant relationship between the variables tested.

Results

Research Question 1: How does credit risk management strategy influence banks' profitability?

Table 1: Mean responses of credit risk management of loan recovery

S/N	Measurement scale N = 230	Cfrq	Mean	SD	Remarks
	Assessing client's character to ensure trustworthiness in payment of loans	810	3.52	0.84	High Extent
	Ensuring that customers have enough cashflow in running their business	795	3.45	0.90	High Extent
	Viewing valid recommendations from related authorities	789	3.43	0.81	High Extent
	Assessing conditions of clients' business	770	3.35	1.01	High Extent
	Considering the value of client's collateral for loans repayment	766	3.33	0.81	High Extent
	Determining the customer's purpose for the loan	800	3.48	0.82	High Extent

The mean results obtained show great extent, that is, clients' character, customer cash flow, valid recommendations, conditions of client business, value of collateral and customer purpose are adopted by money deposit banks in order to avoid the negative consequences of non –performing loans and boosts their profitability.

Research Question 2: How does debt monitoring as loan recover strategy contribute to banks profitability?

Table 2: Mean responses of debt monitoring and Banks' Profitability

S/N	Measurement scale N = 230	Cfrq	Mean	SD	Remarks
	Regular visits to customer's business sites	792	3.44	0.86	High Extent
	Keeping updates of borrowers financial response	768	3.44	0.91	High Extent
	Tracking customers financial state early as possible	801	3.48	0.87	High Extent
	Supporting customers with expert advice on managing of loan	785	3.41	1.04	High Extent
	Stopping customers from diverting funds unnecessarily	782	3.40	1.02	High Extent
	Ensuring customers compliance to loan covenants	766	3.33	0.99	High Extent

The analytical table showed mean results higher than the criterion mean of 2.5. This shows that debt monitoring is fundamental loan recovery strategy adopted by commercial banks to ensure compliance by customers of the conditions.

Bivariate Analysis

This section presents the outcomes of the analysis for the null hypotheses tested and /or the presumed significant correlations of credit risk management strategy and the criterion variable, that is, banks' profitability. The null hypotheses tested at p<0.05 level of significance used PPMC to determine extent of relationship between the two variables. The decision rule is largely influenced by the probability value (P-value) where P>0.05 the hypothesis was rejected and also where P<0.05 is insignificant the null hypotheses is accepted.

H_{O1}: There is no significant relationship between credit risk management and loan recovery for banks profitability in Rivers State.

Table 3: Correlation analysis of credit risk management strategy and banks profitability

Variables	N	Df	r-calculated	r-critical	∝	Decision
CRMS	230					
		228	0.695	0.195	0.05	Rejected Ho
RSBP	230					

Key: **CRMS** – Credit Risk management strategy
RSBP – Recovery Strategies for Banks' Profitability

The test for the correlation between Credit risk management and loan recovery banks' profitability showed r-calculated value 0.695 above the critical value 0.195. Thus, the result showed that credit risk management is positively and significantly related to banks' profitability.

H_{O2}: There is no significant relationship between debt monitoring and loan recovery for banks' profitability.

Table 4: Correlation of monitoring strategy and loan recovery for banks profitability

Variables	N	Df	r-calculated	r-critical	∝	Decision
DMS	230					
		228	0.822	0.195	0.05	Reject Ho
LRBP	230					

Key: **DMS** – Debt Monitoring Strategy
RSBP –Loan Recovery Strategies for Banks' Profitability

Table 4 showed that the r-calculated value of 0.822 at 0.05 level of significant as against the critical value of 0.195 is greater which confirmed positive and significant relationship between monitoring strategy and money deposit banks' profitability.

Discussion of Findings

The findings showed various debt management and loan recovery strategies adopted by money deposit banks in Rivers State for recouping loans granted to their clients. The 5Cs interchangeably represented with clients' character, customer cash flow, conditions of client business, and value of collateral and customer purpose are effective assessment strategies that could possibly determine customers' credit worthiness prior to issuance of loans and significantly contribute to their profitability. International Monetary Fund (IMF, 2003) while corroborating these findings, states that, execution of recovery strategies must be enforced for managing debts in order to raise systems required profits and investments. The pre-recovery information allows banks make sound judgment and decisions about their clients' loan application. So, it brings banks and their clients in close contact in order to ensure that both end goals are achieved. Through credit risk management, banks duly explore the principle of Know Your Customer (KYC), identify and determine credit worthiness of their clients. Peter & Sylva (2010) had noted that credit risk management strategy is the reason behind good loans. Credit risk management as loan recovery strategy is positively and significantly associated with banks' profitability. This infers that credit risk is an essential pre-condition if implemented greatly minimized the risks associated with non-performing loans and positively increased profitability of banks. With proper application of credit risk management banks are able to assess their clients' character, verify the adequacy of customers' cash flow, (James, 2013). The capacity of clients is also pre-determined by banks by viewing valid recommendations from related authorities.

Debt monitoring has been closely linked with bank profitability. From the results, debt monitoring as loan recovery strategy had a significant relationship with banks' profitability. Loans effectively monitored could ensure proper payment (James, 2013). Monitoring helps banks ginger borrowers in loan repayment and undertake constant supervision through regularly visitation to factory and business offices. This provides banks opportunity to have on-the-spot operational assessment and track customer's financial status as early as possible. According to Fortner, Bayens, Levkulich & Garrison (2018) successful collection of loans is a result of accurate and total monitoring. Therefore, debt monitoring strategy is a continuing function which gives a leeway to check the progress of how allocated funds are used to accomplish expected corporate goals. Profit is the essence of business and money deposit banks like other businesses are driven by this objective. Banks generate income in terms of profits to sustain growth, diversify operational service and build healthy organization. The empirical evidence has further been supported by Balunywa (1992) and Oga, Bagshaw & Blue-Jack (2018) who described profit as the driving force for maintaining firm continuity and survival.

Conclusions and Recommendations

The Banks grant loans of different magnitude to different set of customers and business organizations contributing to the economic growth of individuals and countries. This tradition has significantly contributed to commercial bank profits. Credit risk management as loan recovery strategy centrally profiled customer's eligibility information about the clients' character, customer cash flow, conditions of client business, and value of collateral and customer purpose prior to issuance of loans have been found to contributes to banks profitability. These underlying economic gains positively raised the gross profit margin and contribute to longstanding business performance. Also, monitoring and regular visitation to business offices of their customers enable these banks have reliable operational assessment, determine financial status of businesses and constantly reassure them of the possibility of loan repayment. These practices rekindle the business relationship, improved communication and eliminate the growing phenomenon of non-performing loans (NPLs). It thus ensures loans must properly be used to attain predetermined corporate goals. In other words, credit risk management and debt monitoring significantly raised the banks' profitability, business continuity and survival of the banking industry. Consequently, qualified credit risk analysts should be employed in banks to conduct thorough assessment prior to loan issuance to determine customers' credit worthiness and capacity for loan repayment. This would help to gather relevant information for sound judgment and decision making prior to issuance of loans. Notwithstanding, banks must desist from granting loans on personal recognition but implement the 5Cs strategies to determine customers credit worthiness prior to loan approval and thus eliminate the risk associated with non-performing loans. Regular monitoring and visitation to borrower factory and business offices should be conducted so as to avoid loss of contact, communication gap, until the loan is fully paid by the clients. Importantly, banks must follow strictly regulation and policies and not issue out loans beyond the limit set by regulatory authority such as Central Bank of Nigeria, this may have deep negative implications to banks' financial health if not implemented.

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