DEBT RECOVERY STRATEGIES AND PERFORMANCE OF COMMERCIAL BANKS IN NIGERIA

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ABSTRACT

The study examined debt recovery strategies of Commercial banks in First Bank of Nigeria Plc. Data were drawn from a sample size of 109 staff of First Bank Nigeria Plc., Calabar, Cross River State, using purposive sampling technique. Sample percentage and frequency distribution was used for demographic data analysis. Survey research design was used as well as simple linear regression. The findings revealed that; there was significant positive effect of guarantors on return on assets. Collateral and litigation also have a significant positive effect on return on assets. Based on the findings it was recommended that commercial banks should ensure that owners of collateral pay their loans on time to ensure returns on assets. Moreover, the commercial banks should strengthen the use of guarantors to reduce the burden of bad debts and risks.

Key words: *Loanee, Bad debt, Litigation, Return on assets, credit and debt recovery.*

INTRODUCTION

Corporate organizations cannot survive without the use facility called debt. A customer must owe the owner of a business to create a customer –owner relationship. Debt strengthens the financial base of any business enterprise. The banking industry plays a great influence and in the provision of credit facilities in Nigeria. When businesses face financial losses due to failure to repay loans or credit facilities by borrowers, it is regarded as debt which most often faced by banking institutions in the financial sector (Muhammad & Shabid, 2012).

One primary objective of banking system is mobilization of funds from surplus unit to deficit unit of the economy through deposit mobilization and subsequent lending to customers through loans and advances. (Orji, 1996). The bank becomes the creditor and customer, the debtor. The risk involve in lending is high because repayment of the loan is not guaranteed. It is pertinent to note that effective management of loans facilitate banks performance and portrays a good image on the part of the borrower thereby promoting the country's economic growth at large (Van, 2001).

Debt recovery is the procedural way of pursuing loans that are unpaid and managing to recover them by convincing the customers to repay the outstanding loans. The recovery process sometime follows a litigation process and long drawn and in the meantime, the banks continuously deprived of the opportunity to earn from such funds. The strategies put in place for debt recovery include: the loans must be secured, trainings of relationship officers, visiting the customers, auctioneers for recovery, use of guarantors and alerting customers on payment Litigation and use of collaterals There are three ways to secure debts generally. One is for banks to handle them themselves, use courts to enforce. Their rights or auction them in asset management companies (AMC). The AMC in Nigeria is known as Asset Management Corporation in Nigeria (AMCON).

Mora (2011) opined that it is quite unfortunate that in spite of the degree of carefulness, skillfulness, experience or tact of a loan officer, most of the loan facilities granted to borrowers sometimes go bad. The introduction of the prudential guideline in 1990 for banks licensed in Nigeria enable banks to properly classify bad and doubtful debts. These guidelines made it compulsory for licensed banks to at least in a quarter, have their credit portfolios reviewed and credit classified appropriately. However, this study used three basic strategies: use of guarantors, collaterals and litigation which played major roles in recovering debts, thereby allowing the commercial banks generate profitable return on assets.

Statement of the problem

Debt recovery in banks plays a catalytic role in survival and performance of commercial banks in Nigeria. The problem of debt recovering in commercial or money deposit banks is failure to repay the facility as at when due. The fact is that banks receive collateral from prospective borrowers. However, sometimes the collateral may or may not be measurable with the loan collected during the payback period. Banks make profit through issuance of loans. Eventually, when this loans are not recovered, the bank's performance is affected. Loans are easily granted than recovered from customers. During the course of debt collection, banks lose millions of money yearly. Many bad and doubtful debts are incurred through facilities backed up by directors and top management or executive of banks. Consequently, when loans, advances and other credits are not recovered, it normally pose a big challenge to banks leading to insolvency, illiquidity and other managerial bottleneck. That is why there is need for strategies to be put in place for efficient debt recovery and management. Loan portfolio constitutes the major operating Current assets and source of income of some deposit money banks in Nigeria. Over time, part of these loans giving out become non-performing and result to bad debts which in turn affects the returns of the banks.

OBJECTIVES OF THE STUDY

The main objective of the study was to examine debt recovery procedures of commercial banks in Nigeria. Other specific objectives were: to establish the effect of guarantors on return on assets of banks in Nigeria; to assess the effect of the use of collateral on the return of assets of banks in Nigeria and to examine the use of litigation on banks' return on assets.

LITERATURE AND EMPIRICAL REVIEW

The theory upon which this paper was anchored is credit value- at- risk models theory. The concept of this theory is as old as bank. Customers have been facing credit risk right from when banking system started. However, the studies of credit risk started about two decades ago. Melton (1974) in Olokoyo (2011) propounded the credit risk theory.

A credit risk is the risk of default on a liability that may arise from a debtor who failed to pay back facility or loan received. In credit risk theory, the risk is that of the lender and comprises lost principal and interest, cash flows distortions, and an upsurge in collection costs. Sometimes the bank may incur complete or partial loses in the course of giving out loans. Credit risk assess the financial health of customers, and extend credit (or not) accordingly. This model is useful because majority of lenders or commercial banks use this model to rank potential and existing customers base on their risk profile and then apply appropriate strategies (Huang, 2012). For unsecured personal loans or mortgages; banks or lenders charge a higher price for higher-risk customers and lower price for lower-risk customers (Edelman, 2012).

Nelson (2002) in their study examined the effect of guarantors on performance of financial institutions in Eldoret town using correlation and regression analysis. The expected utility theory and customer supplier relationship theory were used. This study made use of questionnaires. It was discovered that the use of bounced cheques was one of the determinants of the transaction of the borrower for the performance of the bank as well as determining the transaction of the borrower in facilitating the debt recovery technique. The study therefore, recommended that banks should ensure that owners of collateral pay their loans on time for improved performance. Hamisu (2011) ascertained the extent to which government intervention in lending policies of deposit money banks had influenced bad debts in Nigeria, also highlighted the rate at which inadequate collateral security provision affect debts in Nigeria. Descriptive statistics were used.

The study noted that government intervention has a positive influence on United Bank for Africa Plc bad debt in Nigeria. They therefore stated that government should reduce the incidence of conflicting policy procurements which is unfavorable to business projection.

Felix & Claudine (2008) studied the link between credit risk management and the performance of banks. It was revealed that return on assets and return on capital was inversely related to NPLS ratio to total loans and consequently causing decline in performance. Ahmad and Ariff, 2007, in their investigation revealed that for banks that specialize in multi-services and products, regulation is quite critical; while the quality of management is critical for banks that are loan-dominants in an emerging market. According to them, increase in the provision for loan losses is a major factor in facilitating potential credit risk. They concluded that the credit risk in developed market is lower than that of the emerging markets.

Kargi (2011) in his study, examined the effect of credit risk on Nigerian bank's profitability and using financial ratios collected from the financial books of the selected banks and analyzed using regression, correlation and descriptive statistical techniques. His findings showed that there was a significant effect between credit risk management and bank profitability in Nigeria. The study concluded that the degree of loans and advances, deposits and NPLS was inversely related to bank profitability, thus, exposing the banks to the possibility of distress and illiquidity.

Chen & Pan (2012) pointed out major principles in the process of managing credit risk to include: setting precise structure, responsibility allocation, disciplined and prioritized processes should be properly defined, communicated and evaluated credit risk hedging strategies include; securitization of credit, Basel accord compliance, credit bureau, adoption of internal sound lending policy.

Williams (2004) revealed that increase in the provision for loan losses reflects increased deterioration in loan quality and credit risk, hence, adversely impacting the performance of banks. The strategies for managing credit risk are the mechanisms applied by banks to escape or reduce the negative effective of credit risk. A sound framework for managing credit risk is critical for the survival of banks and attainment of set goals. Frye (2000) maintained that expected recovery rates may increase as a result of high growth rate of GDP, initialy, Fama, Eugene and Kenneth (2002) expected expansionary economic recovery rates to be higher. Their multivariate and univariate regression results agreed together although the degree of the impacts of their estimation was reportedly smaller.

METHODOLOGY

The study utilized the survey research. The primary source of data was close ended questionnaire adopted in collecting data from the respondents. The sample size was gotten using the purposive sampling technique. The population of the study is made up of staff in credit unit that are responsible for consumer loans, commercial loan and corporate loans. To arrive at the actual sample size of the study, Taro Yamane formula was used as given below:

N were correctly filed and returned, while 25

n = $_2$

$1\square N(e)$ copies of questionnaire representing 19 %

were not returned. We re-specify the model

Where; N = Actual population, n= Sample to capture the objectives of the study in size, e = the level of significant (unit of econometric term as: toleration error 5%), 1= constant.

ROA = $\square_0$ + $\square_1$ GA + $\square_2$ CO + $\square_3$ UOL + $\square_0$

$$n = \frac{150}{1+150(0.05)^2} \qquad = \frac{150}{1+0.375}$$

Where, ROA = Return on Asset, GA

150 =Guarantor, CO= Collateral, UOL=

= = 109

1.375 Use of Litigation, $\square_0$ =Error term

Out of 109 copies of questionnaires administered, 88 copies representing 81%

RESULTS AND dISCUSSION

Table 1. Guarantors and return on assets of banks

ITEMS	*SA*	*%*	*A*	*%*	*D*	*%*	*SD*	*%*	*U*	*%*
Guarantors assist in recovery debts in case of default customers	20	23	32	35	5	7	4	5	27	30
Guarantors repay debts of default customers	28	32	25	28	12	14	8	9	15	17
Banks are efficient as a result of debt recovery strategies	32	35	28	32	8	9	5	7	15	17

Source: Authors' computation, 2020

The result in Table 1 revealed that 20 (23%) respondents strongly agreed that guarantors assist in recovery debts in case of default customers , 32 (35%) agreed, 5 (7%) disagreed, 4 (5%) strongly disagreed, while 27 (30%) were undecided. 28 (32%) respondents strongly agreed that guarantors repay debts of default customers, 25 (28%) agreed, 12 (14%) disagreed, 8 (9%) strongly disagreed, while 15 (17%) were undecided. Also, 32 (35%)

Table 2. Collateral and return on assets of banks

ITEMS	*SA*	*%*	*A*	*%*	*D*	*%*	*SD*	*%*	*U*	*%*
Collateral is a basic security used as strategy in debt recovery	28	32	29	33	12	14	6	6	13	15
Collaterals reduce credit risk of customers	29	33	28	32	11	13	10	11	10	11
Effective evaluation is needed before collateral is being used as security on loans	32	36	30	34	9	10	7	9	10	11

strongly agreed that banks are efficient as a result of debt recovery strategies, 28 (32%) agreed, 8 (9%) disagreed, 5 (7%) strongly disagreed, while 15 (17%) were undecided.

Source: Authors' computation, 2020

The result in Table 2 revealed that 28 (32%) respondents strongly agreed that Collateral is a basic security used as strategy in debt recovery , 29 (33%) agreed, 12 (14%) disagreed, 6 (6%) strongly disagreed, while 13 (15%) were undecided. 29 (33%) respondents strongly agreed that Collaterals reduce credit risk of customers, 28 (32%) agreed, 11 (13%) disagreed, 10 (11%) strongly disagreed, while 10 (11%) were undecided. Also, 32 (36%) strongly agreed that effective evaluation is needed before collateral is being used as security on loans, 30 (34%) agreed, 9 (10%) disagreed, 7 (9%) strongly disagreed, while 10 (11%) were undecided.

Table 3. Use of litigation and return on assets of banks

ITEMS	*SA*	*%*	*A*	*%*	*D*	*%*	*SD*	*%*	*U*	*%*
Litigation makes the process of recovery loan simple	25	28	26	30	12	14	10	11	15	17
Services of litigation are essential strategy for repayment of debts	24	27	25	28	13	15	12	14	14	16
Litigation is an important tool against default risk	26	30	29	33	9	10	8	9	16	18

Source: Authors' computation, 2020

The result in Table 3 revealed that 25 (28%) respondents strongly agreed that litigation makes the process of recovery loan simple, 26 (30%) agreed, 12 (14%) disagreed, 10 (11%) strongly disagreed, while 15 (17%)

were undecided. 24 (27%) respondents strongly agreed that services of litigation are essential strategy for repayment of debts , 25 (28%) agreed, 13 (15%) disagreed, 12 (14%) strongly disagreed, while 14 (16%) were undecided.

Also, 26 (30%) strongly agreed that Litigation is an important tool against default risk, 29 (33%) agreed, 9 (10%) disagreed, 8 (9%) strongly disagreed, while 16 (18%) were undecided.

From the test of hypothesis one, there was significant effect of guarantors and return on assets of banks in Nigeria.

This implies that when credit or facilities from first bank are being giving out, guarantors play a crucial role in securing the loan. That is, the guarantor basically provides a sort of security on behalf of the borrower to the bank in case the borrower fails to repay the loan amount due to the bank. This finding is in line with Mohammad & Shahid (2012) who found out that a positive relationship exists between guarantor and return on assets of banks.

Hypothesis two revealed that collateral has effect on return on assets of first bank of Nigeria Plc. This implies that collateral such as land, building, machinery or equipment could be pledged as secondary security by a borrower or guarantor. This will facilitate the process or procedure of loan/credit facility received by borrower. The findings, is in line with Kargi (2011) who examined the effect of credit risk on Nigeria banks profitability using financial ratios from annual reports of banks.

In hypothesis three, litigation has effect on return on assets of bank in Nigeria. This finding is in line with Felix & Claudine (2008) who examined the relationship between the loan recovering rate strategies adopted by many banks. This implies that facilities or credit received by borrowers are being secured through litigation which is ultimate legal method for settling controversies or disputes between and among the customer and banks in question.

CONCLUSION

The study revealed that there was significant positive effect of guarantors on return on assets. Moreover, collateral has a significant positive relationship with return on assets of banks. Litigation and return on assets of banks were positively related. Therefore, the presence of these procedures ensures the loanees and other default customers to pay up their debts.

RECOMMENDATIONS

Based on the findings, the study recommended that commercial banks should strengthen the use of guarantors as security to reduce the degree of debts and risks and ensure that owners of collateral pay their loans on time for improved performance of banks. The study also recommended that commercial banks should strengthen the use of litigation to assist in efficient and effective recovery of debts.

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