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# AN APPRAISAL OF LENDING PERFORMANCE OF COMMERCIAL BANKS IN NIGERIA

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**Abstract:**

*The intermediation role of Commercial Banking in any Under-Developed Country like Nigeria cannot be over emphasized. This is due to dualism of the capital market existing in Nigeria and the structure of Nigerian Money Market.*

*This paper appraised the lending performance of Nigerian Commercial Banks in light of deposit mobilized using ratio analysis and product moment analysis to explain the vital relationship between the various deposits and the lending activities of the banks.*

*It was discovered that, the Nigeria Commercial Bank's performance were statistically satisfactory but optimal performance have not been achieved.*

## INTRODUCTION:

Commercial banking is a general all-purpose retail banking. The primary role of commercial banks is to intermediate funds between the surplus and the deficit economic units in the Community, especially at the retail segment of the money market. In this process, they mobilize deposit of all sizes and from all and sundry in retail as well as in wholesale markets, stimulate investment and economic growth through their lending operations, assist in resource allocation and promote domestic and international trade and payment systems.

The commercial banks lend to all and sundry, both wholesale and retail and for all-purpose. In this way, they differ from many other financial intermediaries like Merchant Banks, development Bank etc. that specialize in particular loan or deposit markets and in particular economic sectors. While the risks are similar, it follows, by definition, that Commercial Banks' lending is more diverse and the criteria for such lending is more complex. (Nwankwo, 1991).

This paper addressed the issue of loan and advance as the major lending activities of the Commercial Banks, since it constitutes the biggest component among the hard or less liquid assets. Although these activities are the most profitable and the most liquid of bank assets, but due to their relative illiquidity and because of banks' concern for their obligation of maximum liquidity to their depositors and lenders, banks do not invest all their funds in these most profitable assets (Nwankwo, 1980). This paper examines the lending performance of selected Commercial Banks and its determination over a period of ten years, i.e. from to 1992-2001.

The paper focused on measuring the performances of the Commercial Banks in Nigeria through their lending activities. Likewise, the intermediation role of the Banks was examined in the course of this work. Finally, the effect of branch net working in Commercial Banking was identified.

## THEORETICAL FRAME AND LITERATURE REVIEW:

Lewis (1954) in emphasizing the importance of capital in developing economies, suggested that:

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*The central problem in the theory of economic development is to understand the process by which a community which was previously saving and investing 4 or 5 percent of its national income or less, converts itself in to an economy where voluntary saving is running at about 12 to 15 per cent of national income or more. This is the central problem because the central fact of economic development is rapid capital accumulation.*

The role of Commercial Banks in the saving-investment process has been associated with two hypotheses namely:

(1) Financial Repression hypothesis and

(2) The Structuralist hypothesis.

The structuralist hypothesis is associated with Gerschenkron's (1962) analysis of the role of the banking system in the early stage of industrialization of the Western European Countries and the Soviet Union.

The theory emphasizes imperfection in banking systems and differences on the demand size of financial services in the initial stages of economic development. Gerschenkron (1962) argued that as the relative backwardness of the economy increases, the role of the banks in industrial capital formation declines.

Using perhaps somewhat questionable criteria, the structuralists have categorized the countries of Europe according to degrees of historical backwardness with Britain coming first as the most developed, Russia last as the most backward, and Germany midway in the classification. In a comparatively developed economy like that of Britain, the role of banks in financing economic development was minimal because alternative sources of finance were available. In a moderately backward' economy like Germany the bank may be expected to play a more prominent role as a source of capital and entrepreneurship in promoting industrialization. In the case of extremely backward economies like Russia, their economic structure is such that not even the banks could supply the capital and entrepreneurship necessary for industrialization.

Gerschenkron (1962) cited Russia industrialization as an example of extreme backwardness and wrote:

*The scarcity of capital in Russia was such that no banking system could conceivably succeed in attracting sufficient funds to finance large-scale industrialization: the standards of honesty in business were so disastrously low, the general distrust of the public was so great, that no bank could have hoped to attract even such small capital funds as were available, and no bank could have successfully engaged in long-term credit policies in an economy where fraudulent bankruptcy had been almost elevated to the rank of a general business practice.*

The financial repression hypothesis on the other hand, is usually associated with the work of Cameron et al (1972), McKinnon (1973), and Shaw (1973). They argued that financial development would contribute most significantly to economic growth if the monetary authorities were not to interfere in the operations of the financial institutions.

Therefore, poor performance by banks and other financial institutions is often attributed to interest rate regulation, ceiling of deposits and official guidelines pertaining to lending operations. The proponents of this hypothesis advocate a positive real interest rate and financial liberalization. Studies of the factors that influence the operating performance of the Nigerian Banking system have received very scanty attention and in particular, studies on the impact of banking structure on the performance of the bank are virtually non-existent.

A start in this area has being made by Ojo (1979), who discovered the possibility of the existence of economies of scale for the Nigerian Banks. He compared rates of return on investment or profit earnings of individual banks and came up with the following conclusions:

1. *That Commercial Banks in Nigeria have been performing satisfactory in terms of their profitability and growth however, most of the banks are still far from realizing the great potential of scale economies.*
2. *That although, the effect of size on profitability is not yet defined in any precise manner in favour of large or small banks and*
3. *That there has been no conclusion about the existent to which scale economies are present in banks of different sizes and that it is difficult to obtain details or the cost of bank's operations.*

Another important effort in this area of study has being made by Soyode et al (1975). Their study touched on the structure-performance of the Nigerian Banks. The study was, however, restricted to the impact of branch network on bank profitability. With cross-sectional data on the 14 Commercial Banks then in existence in Nigeria for the year 1973/74, the impact of the branch network on bank profitability was estimated using standard regression technique. Their findings show the following:-

1. *A confirmed positive and statistical significant relationship between branch networks.*
2. *That profitability tended to increase with the number as well as the proportion of large city branch offices operated by banks.*

However, it could be argued that depending upon how banks compete with other, some of the potential economies and benefits often associated with branch network expansion could be frittered away through competitive duplication of branches.

Furthermore, one of the most tested relationships in industrial organization literature is the profitability-concentration hypothesis. Economic theory suggests that, other things being equal, firms having significant market positions in a highly concentrated market will tend to restrict output, charge higher prices, earn higher rates of returns and use their entrenched position to retard the Competitive efforts of other firms (Allardice and Erdevig, 1981).

Since the Nigerian banking system consists of many competing banks and yet a few large ones exert a great deal of influence on the market, there is the need for an index that measures the relationship between the number of firms and their shares of the market..

Curry et al (1983) state that no satisfactory explanation of the size distribution of firms has yet been derived from economic theory. While, Shepherd (1964) argued that

*For all its shortcomings the homely concentration ratio is a direct and fairly clear indication of industry structure.*

In addition, Bryan (1972) found that most important single factor explaining profitability was the ratio of time plus saving deposits to total deposits i.e. the deposit mix which determines the liquidity needs of the banking system, and affect the volume of earning assets.

Furthermore, the volume of bank loans and investment depends on the volume of deposits available to the banks, the deposit mix, therefore is of particular interest in determining the lending capacity of the banks. This is because some components of the total deposit seem to be more stable than others, for instance there is saving deposit, Time deposit and fixed deposit. Since banks grant loans on the strength of their deposits, the more volatile or unstable the deposits, (e.g. Saving deposit) the less confidence the bank will have in employing them on a long-term basis. Therefore, the longer the term of deposit; (e.g. fixed deposit) the more the banks should be confident and willing to part with them by way of loans.

**METHODOLOGY AND ANALYSIS OF FINDING**

The population under study is represented by the 65 commercial banks, which has 2,216 branches all over the Federation. The three biggest Commercial Banks were selected as sample because the Banking System in Nigeria has Oligopolistic market structure given the fact that the three banks controls over 68% of Assets and Liabilities of the Commercial Banking sector in Nigeria.

The Secondary source of data was used in this study. The data were collected from two major publications namely:

(1) Annual Reports and Statement of Accounts of the selected banks and
(2) Central Bank's Statistical Bulletin.

The study therefore measured performance of banks using the following ratio analysis:

(1) Time plus Saving deposits / Total deposit.
(2) Loan and Advances / Total Assets.
(3) Loan and Advances / Total Deposits.

The number of bank office network was considered in the study to confirm its effect on banks performances. Percentages were used and lastly the product movement coefficient of correlation was used to established relationship between Time plus Saving deposits / Total deposit and Loan and Advances / Total Assets.

**THE RESULT: -**

The liquidity ratio which is the proportion of Liquid Assets of the bank that must be kept in its volt; is one of the Monetary instruments used by the apex bank in the Nigeria financial system to control the level of liquidity in the banking sector and also to improve the public confidence in the banking sector. The prescribed liquidity ratio for the period under study was steady at 30% until 1999 when it was increased to 40% and dropped to 35% in year 2000 (table 1 in the appendix).

The actual liquidity ratio of Commercial bank fell below prescription level in 1993 when it was 26.7%. It was all time higher than the prescribed ratio ranging from 31.4% in 1992 to 56.2% in 2000 (table 1 in the appendix). The higher ratio maintained by commercial banks show that they are not investing all necessary funds in loans and advances that must have adverse effect on their profit performance over the period of study. The reason may not be unconnected with the economic depression experienced in the Country during the period under review.

The dispersal of bank branches all over the Country is bound to make a significant improvement on the lending performance of the banks. Branches are avenues for the mobilization of fund and outlets for the majority of bank loans in value and number (Adewumi, 1981).

The number of Commercial bank's branches fluctuates during the period under review, while it was 2,275 in 1992; it increases to 2,400 in 1996 and 1997 but dropped to 2,185 in 1998. The reason is very obvious this is due to liquidation of some distressed commercial banks in the previous year. It increased to 2,216 in 2000 because of some Merchant Banks that converted to Commercial banks (table II n the appendix). A large number of bank branches provides convenience for customers in the process of obtaining prompt financial services, therefore the greater the number of bank offices, the more efficient will bank lending be.

There is a positive relationship between the amount of bank financial resources devoted to lending and the number of bank branches. As shown in Table VII, the statistical association between the number of bank offices and the loan asset ratio is positive. The significantly low correlation of 0.085 refutes the argument that the output performance of a bank is significantly affected by the market structure.

According to Bricker (1970), the greater the proportion of the bank's resources placed in loans the better the bank's performance. This ratio measures the ability and the willingness of banks to convert their idle cash deposit into productive resources.

As shown in table V the selected indicator of Nigeria Commercial banks performance indicate that there have being a steady increase in every indicator over the period under review. The ratio of total loan and advances to total asset of the Nigeria banking system fluctuate during the period under review (table VI in the appendix). The ratio increases from 22.4% in 1992 to 30.2% in 1995, rises to 39.8% in 1997 and there after dropped consistently to 22.7% in 2000.

The associated fall in this ratio over the period 1997 to 2000 can be as a result of a number of reasons such as momentum and sharp increase in financial saving due to increase in disposable income of civil servant since 1998. Another reason is the improvement in prices of crude oil during the period 1997 to 2000 which has reduced pressure on Government borrowing and the fiscal policy of Government that is tightened not to allow for excessive budget deficit evident by the budget.

The volume of bank loans and investment depends on the volume of deposit available to the banks, the deposit mix, which is measured by ratio of time plus saving deposit to total deposits. This ratio determined the lending capacity of the banks, since some component of total deposit seem to be more stable than others, i.e. time deposit, saving deposit, and fixed deposit.

The time saving deposit constituted over 50 per cent of the total banks' deposit during the period under review, it may be correct to argue that time and savings deposit not only represent the more stable and reliable portion of bank deposits but also constitute the core deposit of the banks.

Furthermore, the longer the term of deposits, the more banks should be confident and willing to part with their money by way of loans and advances given stability of other fact such as credit worthiness availability of security, liable project etc.

From table VI, the maturity profiles of deposits liabilities of the 3 biggest banks in Nigeria were analyzed for 2000 and 2001 financial years. It was discover that Bank A has 68% and 78% of its deposits maturing less than 1 month in 2000 and 2001 respectively. While Bank C, experienced a sharp increase from 45% in 2000 to 60% in 2001.

However, evidence from the Boards of Director of Bank C revealed that the bank has lower ratio in 2000 because of various new product innovations that was introduced to the customers, which make them to switch from under 1 month to 1-3 month (because of the features of the new products). This trend was quickly reversed inline with other banks status on deposits structure i. e. a rise to 60%.

Given the above deposit structure of these banks it is obvious that the banks can only transform higher percentages of their total deposit liabilities to loans and advances for economic growth on short term bases i.e. only short term finances can be sourced from Nigeria Commercial banks. Nevertheless, less than 1% of the 3 biggest banks deposit liabilities fell under the category "over 12 month" which re-affirms the inability of Commercial banks to give medium term loan to its customer.

More over, the evidence from Table III shows a conflating structure about the lending activities of the sampled banks. Bank B has over 50% of its lending in medium term Loans and Advances contrary to prudential guideline of Central Bank. Further investigation shows that the bank was involved in lending to one of the bidder of NITEL privatization that shifts it lending structure, while Bank C has over 80% of its lending activity maturing under 1month. This confirms the transformation role of Commercial Banking in Nigeria.

The ratio of time and saving deposit to total deposit is therefore expected to have a positive correlation with the loan-Asset ratio. In measuring bank lending performance as shown in Table VII, the correlation co-efficient is positive and valued 0.58 which shows that the bank is efficient in terms of cost of attracting deposit. The effectiveness is achieved through supervision and examination of sectional allocation of loan and advances of the Commercial banks in Nigeria over the period under review.

## CONCLUSION AND RECOMMENDATION:

In conclusion, this paper has evaluated the relevance of banking sector to the economic growth by appraising the lending performance of the Nigerian Commercial bank over a period of 10 years. The study uses ratio analysis and product moment analysis to establish relationship between variables such as Time and Saving Deposit/Total Deposit and loan-Asset ratio. The study confirms that the performance of the commercial bank is statistically satisfactory but optimal performances have not been achieved.

From the research the following are recommended for banks and regulatory authorities. For the banks there is the need to minimize their total resources cost by a clever combination of cost-effective source of deposits. The banks should also stimulate demand for their loans by deliberate policies on core factors such as interest rate, packaging of financial services e. t. c.

The regulatory authorities should continue with the policy of expansion of bank offices particularly in the rural areas. They should encourage mergers of the banks of intermediate size so that increase competition for the large existing banks can be achieved. They should create an encouraging environment to enable the banks to adopt policies that will enhance their performance, particularly in their lending activities.

## APPENDIX 1

**TABLE 1: Liquidity ratio of Nigerian Commercial Banks between 1992 to 2000.**

| *Year* | *The prescribe liquidity ratio (%)* | *Actual Average Liquidity Ratio* |
|---|---|---|
| 1992 | 30 | 31 |
| 1993 | 30 | 26.7 |
| 1994 | 30 | 48.5 |
| 1995 | 30 | 37.6 |
| 1996 | 30 | 40.1 |
| 1997 | 30 | 37.8 |
| 1998 | 30 | 42.6 |
| 1999 | 40 | 50.9 |
| 2000 | 35 | 56.2 |
| 2001 | 40 | 55.1 |

SOURCE:- CBN STATISTICAL BULLETIN OF VARIOUS YEARS

**TABLE II: Number of Nigerian Commercial Banks Branches**

| *YEAR* | *NO. OF BANKS* | *TOTAL BRANCHES* |
|---|---|---|
| 1992 | 65 | 2,275 |
| 1993 | 65 | 2,358 |
| 1994 | 65 | 2,403 |
| 1995 | 64 | 2,368 |
| 1996 | 64 | 2,407 |
| 1997 | 64 | 2,407 |
| 1998 | 54 | 2,183 |
| 1999 | 57 | 2,193 |
| 2000 | 65 | 2,216 |
| 2001 | 90 | 2,944 |

SOURCE:- CBN STATISTICAL BULLETIN OF VARIOUS YEARS

**TABLE III: The Maturity profile of Loans and Advances of Selected Nigeria Commercial Banks in 2000 to 2001**

| | BANK A (N' Million) | | | | BANK B (N' Million) | | | | BANK C (N' Million) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2000 | | 2001 | | 2000 | | 2001 | | 2000 | | 2001 | |
| | 22,424 | 50 | 18,035 | 41 | 10,077 | 22 | 11,991 | 20 | 36,632 | 89 | 38,260 | 82 |
| 1-3 Month | 6,609 | 15 | 1,045 | 3 | 5,577 | 13 | 7,644 | 13 | 676 | 2 | 874 | 3 |
| 6-12 Month | 7,541 | 16 | 10,775 | 24 | 4,211 | 10 | 4,636 | 8 | 1,904 | 5 | 4,137 | 9 |
| 1 Yrs-5 Yrs | 4,353 | 10 | 5,691 | 12 | 1,208 | 3 | 4,335 | 7 | 813 | 2 | 1,050 | 4 |
| 5 Yrs-and Above | 3,596 | 9 | 8,633 | 20 | 22,823 | 52 | 31,041 | 52 | 832 | 2 | 722 | 2 |
| | 44,523 | | 44,179 | | 43,896 | | 59,647 | | 40,857 | | 48,043 | |

SOURCE:-THE ANNUAL FINANCIAL STATEMENT OF THE THREE BIGGEST BANKS IN NIGERIA FOR 2000 AND 2001

TABLE IV: The Maturity profile of deposit liabilities of selected Nigeria Commercial Banks in 2000 to 2001 In N' million

| | BANK A (N' Million) | | BANK B (N' Million) | | BANK C (N' Million) | |
|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 | 2000 | 2001 |
| Under 1 month | 86,723 | 114,9666 | 61,690 | 102,492 | 42,457 | 103,477 |
| 1-3 month | 12,151 | 22,308 | 20,300 | 26,991 | 49,027 | 60,144 |
| 3-6 month | 24,722 | 10,000 | 244 | 3,130 | 788 | 714 |
| 6-12 month | 3,610 | 962 | 164 | 348 | 677 | 6,563 |
| Over 12 month | 24 | 43 | 120 | 174 | 86 | 79 |
| | 127,230 | 148,279 | 82,518 | 133,135 | 93,035 | 170,977 |

SOURCE:- THE ANNUAL FINANCIAL STATEMENT OF THE THREE BIGGEST BANKS IN NIGERIA FOR 2000 AND 2001

**TABLE V: Some selected indicators of Nigerian Commercial Banks performance from 1992 to 2000. N' MILLION**

| Years | Total Assets | Loan and Advances | Deposit Liability | Time Saving and Foreign Currency deposit |
|---|---|---|---|---|
| 1992 | 181,736.1 | 40,731.6 | 76,073.3 | 41,784.2 |
| 1993 | 272,285.2 | 58,158.9 | 120,2777.8 | 60,530.0 |
| 1994 | 324,002.1 | 89,756.0 | 142,399.2 | 77,189.0 |
| 1995 | 463,671.4 | 140,225.4 | 186,373.6 | 99,493.0 |
| 1996 | 536,057.9 | 157,568.8 | 225,298.7 | 118,456.0 |
| 1997 | 584,375.0 | 232,516.5 | 269,847.2 | 147,433.6 |
| 1998 | 694,615.1 | 262,529.9 | 314,303.5 | 172,051.4 |
| 1999 | 1,670,019 | 338,160.4 | 476,350.9 | 274,198.8 |
| 2000 | 1,521,158.2 | 345,327.8 | 691,794.3 | 355,570.6 |

SOURCE:- THE ANNUAL FINANCIAL STATEMENT OF THE THREE BIGGEST BANKS IN NIGERIA FOR 2000 AND 2001

**TABLE VI: Ratio analysis of some performance indicator of Nigeria Commercial Banks**

| Year | Time and Saving Deposit/Total Deposit(%) | Loan and Advances /Total Deposit (%) | Loan and Advances/ Total Assets (%) |
|---|---|---|---|
| 1992 | 54.9 | 53.5 | 22.4 |
| 1993 | 50.3 | 48.4 | 21.4 |
| 1994 | 54.2 | 63.0 | 27.7 |
| 1995 | 53.4 | 75.2 | 30.2 |
| 1996 | 52.6 | 69.9 | 29.4 |
| 1997 | 54.6 | 86.2 | 39.8 |
| 1998 | 54.7 | 83.5 | 37.8 |
| 1999 | 57.6 | 71.0 | 31.6 |
| 2000 | 51.4 | 50.0 | 22.7 |

SOURCE:- COMPUTED FROM TABLE V

**TABLE VII: Correlation between the Nigerian Banking Systems lending performance and its determinations:**

| | TIME AND SAVINGS DEPOSIT/TOTAL DEPOSIT | NUMBER OF BANKS BRANCHES |
|---|---|---|
| Loans and Advance/Total Assets | 0.528 | 0.085 |
| Loans and Advance/Total Assets | 0.532 | 0.017 |

SOURCE:- COMPUTED FROM TABLE VI AND II

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