BANK LENDING PRINCIPLES IN NIGERIA – AN OVERVIEW

by

Michael. C. Nwafor. Ph. D & IFEKA E. O. Ph.D . CLN

ACCOUNTING, BANKING & FINANCE DEPARTMENT

GODFREY OKOYE UNIVERSITY – ENUGU

AND

LIBRARY AND INFORMATION SCIENCES

NNAMDI AZIKIWE UNIVERSITY – AWKA

E – mail michaelandstephens@yahoo.com

KEYWORDS – Bank Lending, commercial Banking, Investment Banking, Monitoring, Recovery, collaterals, consortium, borrowers, demand and time, deposit, Sell-side, Buy-side.

ABSTRACT

In its real sense, lending will always be the primary function of banks throughout the world economies. Lending naturally attracts some charges otherwise known as interest rates, which make up the greater portion of the banks' earnings. In a developing economy such as Nigeria, the probability that some loans will fail poses problems for both the borrower and the lender, but more importantly, the Nigerian economy. This paper reveals that non-performing loans account for the non-profitability of some banks in Nigeria. Efforts are also made in this paper to review a few past works on the concept of credit and the evaluations of the requests by customers for loans. Distress In the financial systems, which is more prevalent in the banking sector, has not done the economy any good. Depositors have lost huge sums of their deposits due to the unprofessional acts of some corrupt and rather selfish bank staff. This paper did not only treat the basic lending guidelines, but also recommended strict adherence to the implementation of the basic lending principles, which when correctly applied will lead to the increased profitability for the banks and the healthy growth of the Nigerian economy.

INTRODUCTION

A bank is generally accepted to be a financial institution that accepts deposits from its customers and thereafter looks after such deposits on their behalf. The bank also gives cheque books to its customers to facilitate payments to others. The bank also provides some other financial services, which include primarily "Lending". Simply put, a bank's major business is the acceptance of deposits and granting of credits/loans to its classes of customers, but later became intermediaries of funds and from thence started assuming credit risks. Credit therefore became the function of banking and the primary basis upon which the quality and the performance of a bank are assessed.

TYPES OF BANKS

There are basically three types of banks in Nigeria namely: - the Commercial Bank, the Merchant Bank and Investment Bank. Sequel to the introduction of the Universal Banking in Nigeria (under Professor Charles Soludo's era as Governor of Central Bank of Nigeria) with a largely increased minimum capital base of N25 Billion (twenty five Billion Naira), the functions (including Insurance services) of the above types of banks are now offered under one roof in a one stop arrangement.

Commercial Banks are involved in retail banking services via their branch networks with broad deposit base (which is the envy of Merchant Banks) which is made up of ***demand & time*** deposits. In other words, commercial banks provide short-term lending.

Merchant Banks are licensed to statutorily provide wholesale banking services. They also accept large deposits and plan syndicated loan facilities for long-term projects. They, if the need arises, by pooling, arrange a consortium of banks, which might comprise other financial institutions, with a view to financing long-term and capital intensive projects. Import and export financing also form part of the merchant banking businesses. Equipment Leasing is also a major function of the merchant banks.

Investment Banks were introduced to perform certain specialized roles by supplementing the services provided by other banks in the economy. An investment bank is an institution that assists individuals and governments in raising financial capital by acting as a client's agent in the issuance of securities. An investment bank may also assist companies involved in Mergers & Acquisitions (M & A) and provide ancillary services such as Market Making, Trading of Derivatives and Equity Securities and Fixed Income Instruments, Currencies and Commodities (FICC) services. Unlike commercial banks, investment banks do not take deposits. The two main lines of business in investment banking are called the "sell side" and the "buy side". The sell side involves trading securities for cash or for other securities (e.g. facilitating transactions, market making), or the promotion of securities (e.g. underwriting, research. e.t.c.).

The "buy side| involves the provision of advice to institutions that buy investment services. Private equity funds, mutual funds, life insurance companies, unit trusts and hedge funds are the most common type of "buy-side" entities.**(1)**

Universal Banking (which is an amalgam of all banking and insurance services in a one shop arrangement under one roof) came into Nigeria under Professor Charles Soludo's regime as the Governor of Central Bank of Nigeria in order not to miss the global banking train, given the global adoption of the Universal Banking System. Interestingly, the immediate past Governor of the Central Bank of Nigeria, Sanusi Lamido Sanusi (now Emir of Kano) while in office, advocated the dismantling of the Universal Banking System to create room for young and new entrants into the banking business. His recommendation was that the "status quo" be maintained to re-establish specialization of banking businesses namely: - commercial, merchant and investment bank. He was also of the view that banks should hands-off the business of insurance. However his recommendations are yet to come to fruition. **(2)**

LENDING PRINCIPLES.

It is not necessary to the essence of adhering to the all important and basic principles of lending, given the banks' dependence/survival on lending. It is only by strict implementation of the lending principles by the advances departments of the banks that the banks' profitability, depositors' funds, shareholders' funds and appreciable turn-over, will be guaranteed.

The Basic Principles or considerations, being the pre-requisites for bank lending comprise: -

Character of the applicant – The character of the applicant must be above board which implies that he must be an honest and financially disciplined. He must of course have a good record of financial transaction with the creditor bank. Information about the character and lifestyle of the borrower could be got from details from the borrower's guarantor's form or in some cases from the neighborhood.

Capital Base of the borrower and the amount of funds he, the borrower, has committed to the project under consideration, should be ascertained.

Capacity of the borrower to repay the money should also be investigated. Perhaps, the examination of his bank statements could be a good pointer to his capacity to repay the credit extended to him. A case of constant withdrawals constitutes negative sign of his ability to repay.

Collaterals must not only be provided to cover the amount of loan being sought, but must be adequately insured by a very reputable insurance company. **(3)**

The other pre-requisites are in question forms namely: -

How much does the customer really want to borrow?

Why does the customer/borrower want bank finance?

What does the customer want the money for?

How long does he want the money?

How does he intend to repay?

Is the customer's business financially strong to keep going if there is a set-back?

Is the amount of loan/credit sufficient for the project for which the application is made?

What is your assessment of the borrower/customer? **(4)**

Adekanye emphasized that an advances manager must obtain satisfactory answers to the above questions before approving a loan request.

TYPES OF LOANS/CREDITS

The three (3) major types of loans are namely: - Commercial loans, Consumer loans and Investment loans.

Commercial loan/credit comprises bank loans such as overdraft, loans advances, trade credit from suppliers, commercial papers (or notes), invo discounting, bill finance, hire purchase, factoring, e.t.c.

Consumer loan/credit is a form of permission granted to an individual or household to purchase goods like refrigerator, television, car, electroni equipments, which cannot be paid for out-rightly but rather installment payments are arranged over a term or period of time.

Investment loan/credit permit a business outfit like a corporate body, sole proprietorship or partnership to access credit/loan for capital goods for purposes of procuring machinery or expansion of factories. **(5)**

THE MATURITY PERIOD OF A LOAN

The duration or period of repayment varies from short-term, medium-term to long-term to cover 5 years, 10 years or over 10 years respectively, but it depends on the financial institutions, their nature and functions.

EFFECTIVE LOAN/CREDIT MANAGEMENT

For purposes of sound management of loans/credits, the bank management must assign credit officers who are very knowledgeable on lending to be responsible for the receipt and evaluation of reports which findings he reports to the relevant higher schedule officers for further review before the final approval or rejection.

The monitoring and supervision of the projects for which the loans/credits were granted must be implemented with all the seriousness and vigor by all the relevant departments like the legal and security departments. In Nigeria, cases abound where loans/credits were channeled to unproductive projects other than those for which the loans/credits were approved and granted.

For loans already approved and granted, the following actions are very necessary to avoid the loans going bad.

(a) Monitor and ensure that all the legal covenants already established are complied with to the letter.

(b) Evaluate, where necessary, the collateral coverage in relation to the condition of the creditor.

(c) Identify contractual defaults in the repayment schedule and also classify potential loans/credits on a regular/timely basis.

(d) Promptly report problems to the management for early remedial actions.

(e) Recommend a customer with a good record of repayment but has a need for extra credit, to the management for further credit/loan for as long as it does not compromise the financial institution's interest.

(f) The bank management, when duly informed of the genuine need for support for a customer, might without detriment to its interest, waives or alters some terms and conditions of the lending covenants. These could be in the form of request for additional collateral security, where possible, extension of loan repayment period backed by a good cash flow statement.

LOAN RECOVERY METHODS

Notwithstanding the genuine and sincere efforts of both parties to a loan, there might occur, some defaults, in which case the following methods may be applicable with a view to recovering the loans. They are: -

(a) Appeal to debtors.

(b) Use of threats and blackmail.

(c) The bank may use the services of the debt factoring companies.

(d) Legal action may be applicable. Invoice discounting may be used.

(e) The collaterals might be seized or sold.

(f) The services of the Nigerian Deposit Insurance Corporation might be engaged as the last resort. **(6)**

CONCLUSION AND RECOMMENDATIONS

This paper has identified the non-adherence to the laid down principles of lending as the major cause of bank unprofitability. Efforts were also made in this work to further widen the normal Canons of lending to ensure effective credit management. Monitoring and supervision of projects for which credits/loans were granted was re-emphasized to avoid non-performing loans.

It is recommended that internal loans/credit policies should be formulated, implemented and pursued assiduously by the bank management with a view to minimizing default in repayments from the borrowers. Efforts should be made by the schedule officers to monitor and supervise the usage of the loans/credits so granted. Prompt report of problematic loans should be reported to the management at its earliest detection with a view to finding early remedial solution.

REFERENCES

1. en.m.wikipedia.org/.....estment.....functions
2. https://www.prosharengg.com
3. Mather L. C. (1962). *The Lending Banker*, London Water-low and Sons Ltd.
4. Adekanye, F (1983). *Elements of Banking in Nigeria,* 3rd Edition, Lagos, Institute of Bankers.
5. O. S. Aremu, O. J. Suberu & J. A. Oke, (2010). *Effective Credit Processing and Administration as a Panacea for Non-performing Assets in the Nigerian Banking System.* Dept of Banking & Finance, Ibadan Polytechnic,Nigeria.
6. Ademu, W.A, (1998). *Curbing Bad Debts in thr Banking Industry in Nigeria In the 21st Century,* First Bank Biannual Review, December 1998