Nexus between Credit Management and Financial Performance in the Financial Institutions in Nigeria

Dr. KASALI Taofeek Aremu¹, Dr. FASHANU Felix Adeniyi²
¹Moshood Abiola Polytechnic, School of Business and Management Studies, Abeokuta, Ogun State Nigeria.
²McPherson University, Department of Economics, Seriki-Sotayo Village, Abeokuta, Ogun State Nigeria.

Abstract: Achieving success in any business firm requires a formidable credit management with critical customer appraisal. This study, therefore, aims at establishing the relationship between the credit management and financial performance in financial institutions in Nigeria. To achieve this objective, the study adopted descriptive survey research design method and data were collected from the staff and customers of two selected prominent financial institutions in Nigeria. Correlation and Regression analyses were used to estimate the causal relationships between credit management and financial performance and other related variables. The results of the analyses revealed that when a company implements effective credit management systems, the firm’s efficiency is enhanced. This has an impact on the level of financial performance in terms of debtors’ turnover, financial growth, management and ultimately profitability. It was recommended that financial institutions should take proper cognizance of effective credit management that would enhance organisational profitability.

Keywords: Credit Management, profitability, Financial Performance, descriptive survey, Nigeria, correlation and regression analyses

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I. Introduction

Credit has been defined as the situation whereby goods and services are possessed without instant payment but with a contractual agreement that the payment would be made later in future date. However, it is expedient to identify potential credit default as timely recognition of default is lead to decreased cash flows, lower liquidity levels and financial distress, hence, Ifuruze (2013) opines that one of the business strategies operated by business organizations in their attempts to make profit is allowing credit to customers. In the same vein, Akinselure and Akinola (2019) assert that default by borrowers in repayment of loan (credit risk) adversely affect the financial performance of financial institutions. No wonder that Scheufler(2002) affirms that the current business environment, risk management and improvement of cash flows are very difficult to manage. He (Scheufler) therefore suggested that for credit professionals to imbibe in proven best practices, they must avoid five pitfalls which are: failure to recognize potential frauds, underestimation of the contribution of current customers to bad debts, getting caught off guard by bankruptcy, failure to take full advantage of effective and efficient credit policy, and spending too much time and resources on credit or client evaluations that are not related to reduction of credit defaults. It is therefore advisable that credit appraisal should be carried out by the experts in the field of credit management who are experienced and competent in order to avoid or reduce vulnerable credit risk at the earliest possible opportunity (Eno, Ukpe, & Essien, 2018).

The role of credit management cannot be overemphasized in any firm that engages itself in credit. It involves guidelines and strategies adopted by a firm to ascertain that they maintain an optimal level of credit and achieve its effective management (Myers and Brealey, 2003). Credit Management, according to Nelson(2002) is the method by which an entity manages its credit sales. It serves as a requirement for any organisation dealing with credit transactions. It can also be described as an aspect of financial management that involves formulating of credit policy, credit analysis, client capacity, credit rating, credit risk management, credit classification, and credit reporting. One of the intricacies of credit management is that it usually poses higher finance costs to maintain higher amount of accounts receivables and their age. Suffice to say that if these receivables are not collectible on time and urgent cash needs arise, a firm may result to borrowing and the consequence of this is the interest expense paid. It is therefore expedient for the financial institutions to develop rigorous and robust credit policies that will enable them to effectively assess the creditworthiness of their customers as recommended by Kajola, Olabisi, Adeleji and Babatolu (2018).

According to Nzotta (2004) credit management usually influences the success or failure of commercial banks and other financial institutions. He concluded that credit decisions to grant credit, degree of credit policy and thus the quality of the risky assets determine the failure of deposit banks. Therefore, credit management
always serves as a leading indicator of the quality of deposit bank’s credit portfolio. Hence, Nwanna and Oguezue (2017) conclude in their study that sound credit management heightens profitability and holds the financial strength of the Deposit Money Banks. In fact, credit management commences with the sale and does not end until the full and final payment has been made. It significantly ends the sale. Of course, as a business technically not asauntilitisproceedshas been realised.

An effective credit management requires remarkable efforts to manage customer credit lines in order to reduce bad debt exposure, over reserving and bankruptcies. It is important that business firms must not be oblivious of customer financial strength (client appraisal), credit score history and changing payment patterns through effective credit policy.

Credit management can be regarded as a catalyst for increasing financial performance. Hence, Collins, Mepbari, Sira, and Miebaka, (2018) concluded in their study that credit management has a significant impact on bank performance in Nigeria. Financial performance entails measuring the results the firm’s policies and operations in monetary terms which are reflected in the firm’s return on investment, return on assets and value added. According to Stoner (2003) as cited in Turyaha (2013), financial performance is the efforts exalted to operate efficiently, profitably, survive, and react to the environmental opportunities and threats. Also in line with this, Sollenberg and Anderson (1995) assert that, performance is measured by how efficient the enterprise is in making the optimal use of resources in achieving its objectives.

It is against the backdrop of the above analysis that this study is set to investigate the nexus between the credit management and financial performance of financial institutions in Nigeria.

The study is grouped into five sections. Following the introduction is the literature review in section 2 where the relevant literature to the study are discussed. Section 3 explains the methodology of the study while the findings of the analyses are discussed in section 4. The concluding part of the study is explained in section 5 with recommendations from the findings of this study.

II. Literature review

Credit management connotes the ability to intelligently and efficiently manage customer credit lines. It is the means by which an entity manages its credit sales. Pandey (2004) opines that credit should possess three characteristics viz:

I. It should involve an element of risk that should be carefully analyzed.

II. It should be based on economic value. To the buyer, the economic value in goods or services possessed immediately at the time of sale, whilst the seller expects an equivalent value to be received later on.

III. It should be futuristic. The buyer will make the cash payment for goods or services received by him in the nearest future.

In their study on credit management Raymond, Adigwe, and John, (2015) revealed that timely identification of potential credit default is important as high default rates lead to decreased cash flows, lower liquidity levels and financial distress. Also, Alice and Jaya (2016) observe that credit management as a concept is of most importance in any company and should not be treated with levity by any economic enterprise engaged in credit irrespective of its business nature. It is based on the expectation that customers will pay for the products delivered or the services rendered. By granting credit, a business firm is creating trade debts in business which can lead to good debts, doubtful and bad debts.

Credit management is also very important in the management of working capital because poor management of trade debt can result to the provision of large sum of funds for bad and doubtful debts. Bad debts losses occur when the firms unable to collect its accounts receivable.

Financial performance is a measure of financial management that acts as a catalyst for increasing financial performance. It can be measured on the basis of financial ratio analysis. Financial ratios serve as powerful tools used in measuring organizational financial performance. The ratios give the necessary and required information to the interested parties inside and outside the company. These information and data, if properly analyzed, would aid decision making and measurement of company’s performance and efficiency over time (Kasali and Salako, 2016). Financial performance measures how a business firm can make the optimal use of its assets. It can also be used as a general measure of a firm's financial health over a given period of time which can be used as comparison among similar firms across the same industry or to compare industries or sectors in aggregation.

Several studies have been conducted to establish the relationship between credit management and financial performance of business organisations particularly in the banking industry. Gizaw, Kebede and Selvaraj, (2015) examined the impact of credit risk management on profitability of commercial banks in Ethiopia. Data collected from 8 sample commercial banks from annual reports of respective banks and National Bank of Ethiopia were analyzed using a descriptive statistics and panel data regression model.
Theresultshowedthatcreditriskmeasures,non-performingloans, loan loss provisions and capital adequacy have a significant impact on the profitability of commercial banks in Ethiopia. Ntiamoah, Diana and Kwamega (2014) carried out a study on assessment of the relationship between credit management practices and loan performance using some selected microfinance institutions in the Greater Accraregion of Ghana as case study. Results of the study revealed that there was high positive correlation between the credit terms and policy, lending, credit analysis and appraisal, and credit risk control and loan performance. Ayodele, Thomas, Raphael & Ajayi (2014) carried out a study on impact of credit policy on the performance of Nigerian Commercial Banks using Zenith Bank Plc as case study. Primary data were collected through questionnaire served on sixty (60) respondents of the bank. The findings from the study showed that having a good credit policy in place goes a long way in minimizing the incidence of bad debts.

Owizy (2013) evaluated the impact of credit management on financial performance of Nigerian banks, with particular reference to UBA Plc. Financial ratios as measures of bank performance and credit indicators were the data collected from secondary sources mainly the annual reports and accounts of sampled banks from 2004-2008. Descriptive, correlation and regression techniques were used in the analysis. The findings revealed that credit management has a significant impact on the profitability of Nigerian banks. Byusa and Nkusi (2012) investigated effects of credit policy on bank performance in selected Rwandan Commercial banks. The aim of their study was to investigate the effects of credit policy on bank performance using data on selected Commercial Banks. The results obtained indicated that the Rwanda’s commercial banks increased their accounts, increased customer base and improved their financial indices, thereby maximizing their profits. However, inadequate competition in the banking system led to high spreads. Banks have unusually high and increasing average interest rate spreads and interest rate margins showing both highly poor competition and inefficiency. Djankov, McLeish and Shleifer (2007) studied the effects of credit management on loan repayment in private credit in 129 countries in Eastern Europe, financial managers of the finance institutions were interviewed and data analysis was conducted using descriptive methods. The findings of the study concluded that credit management practices facilitated payment of loan. In his study, Simiyu (2008) investigated the techniques used by microfinance institutions in the management of credit risk in Kenya, and to examine the main challenges facing the microfinance institutions operating in Kenya in the management of credit risk. To satisfy the research objectives, the study used descriptive research design comprising a sample of thirty (30) microfinance institutions. The sampling frame included the Central Bank of Kenya Directory of microfinance institutions. Purposive sampling was used to select one credit officer and one loan officer from each of the sampled institutions. Primary data were collected using semi-structured questionnaires. The target respondents were the institutions’ loans and credit officers. Once the pertinent data were collected the researcher carried out analysis of the same using means, scores, percentages and standard deviations. The study established that most microfinance institutions use 6 Techniques of credit risk management. The study also revealed that understanding the organizations exposure to the customers is treated as critical by the microfinance institutions. The study established that majority of the institutions used credit matrix to measure the credit migration and default risk. The results concluded that most microfinance institutions face with the challenge of strict operational regulations from the Central Bank of Kenya.

Adgebie and Otitolaiye (2020) investigated the effect of credit risk on financial performance of money deposit banks in Nigeria. The study covered 169 firm-year observations for the period of 2006-2018 in Money Deposit Banks in Nigeria. The result of their analysis revealed that credit management had a positive significant effect on financial performance of the Deposit Money Banks in Nigeria. The summary of empirical review shows that credit risk measures, non-performing loans, loan loss provisions and capital adequacy have a significant impact on the profitability of financial institutions. More so, another study by Ntiamoah, Egyiru, Fiaklou and Kwamega (2014) found that there is positive correlation between the constructs of credit management practices and loan performance. Furthermore, a study by Ayodele et al (2014) shows that a good credit policy in place goes a long way in minimizing the incidence of bad debts. From the foregoing it can be inferred that studies on credit management, financial performance and profitability, particularly in Nigeria is quiescently.

III. Methodology

This study adopted descriptive survey design method. The data were collected through self-administered questionnaires distributed personally to the respondents. Fifty-nine (59) respondents were selected with the use of stratified sampling technique in which the strata consist of staff and customers of two selected prominent financial institutions in Nigeria. Ordinal scale was employed to measure the relationship between variables in the study. Variables measured in the study include: credit management, credit policy, credit risk, client appraisal, financial performance and organizational profitability. The study adopted Correlation and
Regression analysis to estimate the causal relationships between credit management variables and credit policy, client appraisal, credit risk, organizational profitability and financial performance. SPSS software was used for Correlation and Regression analysis. The collected data were analyzed using multiple regression and correlation analysis and the significance of independent variable was tested at a confidence level of 95%.

The test statistic of the analysis adopted is:

\[
r = \frac{n\sum{xy} - \sum{x}\sum{y}}{\sqrt{n\sum{x}^2 - (\sum{x})^2} \sqrt{n\sum{y}^2 - (\sum{y})^2}}
\]

Where \( r \) = correlation coefficient \( y \) = OP, OP and PD.
\( x \) = CM, CP, CA and CR.
\( n \) = Sample Size

The decision rule is to reject \( H_0 \) if sig value \(< 0.01 \).

The method adopted in presentation of the data is simple percentage method of tabular presentation. The correlation test analysis was employed to test the stated hypothesis and to test the significant relationship between the actual and the observed variables: this was done via the aid of Statistical Package for Social Science (SPSS). In analyzing the data, frequency and descriptive tables were used as analytical tools. Qualitative explanations were made of quantitative data to give meaning to them as well as explain their implications. From these, appropriate conclusions and recommendations were made from the findings of the research.

**IV. Findings and Discussions**

Responses from the questionnaires were gathered from total of fifty-nine (59) selected respondents. The strength of reliability and validity of the questionnaires was analyzed in Table 1 using the Cronbach’s alpha reliability test statistics. The result revealed that the questions are reliable because the Cronbach’s is close to 1.00.

**Table no1: Reliability Statistics**

<table>
<thead>
<tr>
<th>Cronbach’s Alpha</th>
<th>N of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>.587</td>
<td>28</td>
</tr>
</tbody>
</table>

*Source: Authors’ Survey (2017).*

To achieve the objectives of the study and based on the identified variables through literature, the following hypotheses were tested and their results are discussed in the section. Pearson correlation (r) was employed to test the association between the variables stated in the hypotheses at 0.01 level of significance.

**Decision Rule:** Accept the Alternative Hypotheses and reject the Null Hypotheses if the Pearson correlation (r) is positive. The level of strength between this variable can also be determined as indicated in a table 2.

**Table no2: Benchmark for Measuring Hypotheses**

<table>
<thead>
<tr>
<th>Coefficient Value</th>
<th>Strength of Association</th>
</tr>
</thead>
<tbody>
<tr>
<td>(0.1 &lt;</td>
<td>r</td>
</tr>
<tr>
<td>(0.3 &lt;</td>
<td>r</td>
</tr>
<tr>
<td>(</td>
<td>r</td>
</tr>
</tbody>
</table>

Where \( r \) represents the absolute value of the Pearson correlation coefficient.

**H1:** There is a significant relationship between credit policy and organizational profitability.

\( \alpha = 0.01 \)

**Decision rule:** If sig value \(< 0.01 \), reject \( H_0 \)

**Table no3: Hypothesis one Correlations**

<table>
<thead>
<tr>
<th></th>
<th>Credit Policy</th>
<th>Organizational Profitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td>.445 **</td>
</tr>
</tbody>
</table>

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**. Correlation is significant at the 0.01 level (2-tailed).

**Interpretation:** From table 3, the Sig. value (0.000) is less than 0.01, we, therefore, reject H0. This implies that there is a significant relationship between credit policy and organizational profitability at 1% significant level, also the Pearson correlation coefficient (0.445) shows that there is moderate positive relationship between credit policy and organizational profitability in the selected banks.

H2: There is an effect of proper credit management on financial performance.

α =0.01

Decision rule: If sig value ≤ 0.01, reject H0

**Interpretation:** From table 4, the Sig. value (0.000) is less than 0.01, we therefore reject H0. We conclude that there is an effect of proper credit management on financial performance at 1% significant level, also the Pearson correlation coefficient (0.443) shows that there is moderate positive relationship between credit management and financial performance in the selected banks.

H3: There is an association between successful client appraisal and payment default.

α =0.01

Decision rule: If sig value ≤ 0.01, reject H0

**Interpretation:** From table 5, the Sig. value (0.000) is less than 0.01, we, therefore, reject H0. The study concludes that there is an association between successful client appraisal and payment default at 1% significant level, also the Pearson correlation coefficient (0.553) shows that there is strong positive relationship between client appraisal and payment default in the selected banks.

H4: There is a significant relationship between credit risk and organizational profitability.

α =0.01

Decision rule: If sig value ≤ 0.01, reject H0

**Table no 4: Hypothesis two Correlations**

<table>
<thead>
<tr>
<th></th>
<th>Credit Management</th>
<th>Organizational Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Management</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>59</td>
</tr>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation</td>
<td>.443 **</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>59</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

Source: Authors’ Survey (2017)

**Table no 5: Hypothesis three Correlations**

<table>
<thead>
<tr>
<th></th>
<th>Client Appraisal</th>
<th>Payment Default</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client Appraisal</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>59</td>
</tr>
<tr>
<td>Payment Default</td>
<td>Pearson Correlation</td>
<td>.553</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>59</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

Source: Researcher field study (2017)

**Table no 6: Hypothesis four Correlations**

<table>
<thead>
<tr>
<th></th>
<th>Credit Risk</th>
<th>Organizational Profitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td>.358 **</td>
</tr>
</tbody>
</table>
Credit Risk | Sig. (2-tailed) | N | Pearson Correlation
--- | --- | --- | ---
| | 0.005 | 59 | .358
Organizational Profitability | Sig. (2-tailed) | N | **
--- | --- | --- | ---
| | 0.005 | 59 | 1

**. Correlation is significant at the 0.01 level (2-tailed).

Source: Authors’ Survey (2017)

Interpretation: From table 6, the Sig. value (0.005) is less than 0.01, we therefore reject H0. We conclude that there is a significant relationship between credit risk and organizational profitability at 1% significant level, also the Pearson correlation coefficient (0.358) shows that there is moderate positive relationship between credit risk and organizational profitability in the selected banks.

The study was aimed at investigating the relationship between credit management and financial performance with special focus on financial institutions in Nigeria.

The empirical analyses revealed that there exists a moderate significant relationship between credit policy and organizational profitability on the basis of the responses provided by the respondents. This result is in agreement with the result of Byusa and Nkusi (2012), in their study titled “Effect of credit policy on bank performance in selected Rwandan commercial banks”. The implication of this result on the organization shows that when there is a viable credit policy in place, it tends to guide the flow of cash from the source (bank) to the destination (debtors) as well as flow from the destination (debtors) to the bank. It is worthy of note however that this process tends to increase cash flow, thus having a great effect on the financial performance of organisations. A related study carried out by Ayodele, Thomas, Raphael and Ajayi (2014) portray that a good credit policy in place goes a long way in minimizing the incidence of bad debts. Also, the study confirms that there is a significant relationship between credit management and organizations’ financial performance. This corroborates with the outcome of the study of Adegbie and Otitolaiye (2020) where it was confirmed that credit management had a positive significant effect on financial performance of the Deposit Money Banks in Nigeria.

Furthermore, the result of this study affirms that there exists a strong association between client appraisal and payment default which is in tandem with the outcome of the study of Alice and Jaya (2016) who found out that client appraisal has an effect on financial performance of commercial banks. They further asserted that client appraisal is a viable strategy for credit management. Finally, this study established that there exists a moderate significant relationship between credit risk and organizational profitability within the selected banks. The result is in line with the findings of Gizaw, Kebede and Selvaraj (2015). The findings from their study posit that credit risk measures, non-performing loan, loan loss provisions and capital adequacy have a significant impact on the profitability of commercial banks in Ethiopia.

Summarily, the analysis of the hypotheses in relation to the objectives of the study shows that credit policy, credit management, credit risk and successful client appraisal influence less payment default, financial performance, and the limit of the strength of association between these variables is moderate.

V. Conclusion and Recommendation

It has been established that credit facilities to customers can make or mar the goals set by a business firm. Suffice to say that quick credit recovery from customers tends to be favorable for the organization but where there is bad debt on loan advancement to customers; such credit tends to decrease the profitability of the organization. A well-functioning credit management will bring both the economic benefit in terms of profitability and bring good image to the company. It will enable the company to recover its assets as at when due, hence creating a link of relationship between the management and the customers (debtors). When a company implements effective credit management systems, the firm’s efficiency is enhanced. This has an impact on the level of financial performance in terms of debtors’ turnover, financial growth, management and ultimately profitability as purported by previous studies by Gizaw et al (2015), Alice et al (2016), Owizzy (2013), Ayodele et al (2014) and Byusa et al (2012).

Credit management ensures that the firm embarks on effective planning ahead of time to avoid shortages of funds and make sure that borrowed money are returned as at when due and at the right time. Credit management is very important since it enables firms to avoid locking their money in bad debts and help build goodwill and permanent relationship with customers.

The following are recommendations given as an aid in enhancing the efficiency and effectiveness of credit management in the financial institutions:

i. From the finding and conclusions, the financial institutions should ensure the adoption of credit
standards, credit policy, credit terms and collection policies. That is, before giving any loan, the client’s repaying capacity, status of cash flows must be properly assessed.

ii. Banks should develop and maintain a credit administration function that provides guidance to anyone in the credit function of the institution and to ensure safeguards are in place to manage the loan portfolio.

iii. The study recommends that management of banking firms should enhance their collection policy by adopting a more court litigation, collateral assets and enforcing saving. The collection policy should ensure prompt and regular repayment for fast turnover of working capital keeping collection costs and bad debts within limits and hence maintaining collection efficiency.

iv. Finally, management should develop appropriate credit policies to ensure that credit administration is done effectively so as to reduce the rate of bad debts.

References


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