



IMPACT OF CREDIT RISK ON FINANCIAL PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

The study examined the impact of credit risk on financial performance of listed deposit money banks in Nigeria. The study adopted correlation and ex-post factor research design. The population of the study consist of all listed deposit money banks in Nigeria. Census sampling technique is employed. Multiple Regression model based on ordinary least square (OLS) was adopted in analyzing the panel data obtained from audited financial statement of listed samples banks via Nigeria exchange group the period between (2013-2022) The findings revealed that loan loss provision has a positive and significant influence on financial performance of deposit money banks in Nigeria. On the other hand, non-performing loan has a positive but insignificant influence on financial performance of listed deposit money banks. Liquidity has a negative but significant relationship. Therefore, it is recommended that deposit money banks in Nigeria should adopt a comprehensive financial policy in order to encourage loan loss provision and non- performing loan policies which will ultimately help in enhancing the listed deposits money banks financial performance in Nigeria,

keywords: credit risk, financial performance, listed deposit money banks, Nigeria

1. Introduction

One of the banks measuring policy and all operations in monetary terms is the financial performance. It again reveals a bank's overall and ultimate financial health over a given period of time, and in the same vein, helps in comparing banks from different industry at the same space of time. Toutou (2011) defined the financial performance as an overall measure of how well bank raised revenue using its capital. Suka (2010), considered performance of banks in relations to its finances as a subjective means or measure of how efficient a firm asset is put into used to generate some revenue from its business. To determine the commercial banks financial performance, there are different indicators which could be used. these major indicators of financial performance include Return on Equity (ROE), Return on Asset (ROA), Risk Adjusted Return on Capital (RAROC) and Profitability.

Financial performance is the reflection of how the resources of banks are put into used to achieve its major objectives. This is based on the set of indicators adopted that are measures of the bank's present status, efficiency and effectiveness. Performance of bank demonstrates and reveals the efficient and effective use of the resources available and business ability to make gain (Ikpefan, 2013). Therefore. It is crucial the performance of banks to the different stakeholders such as shareholders, creditors, depositors, government as well as the managers.

Basel Committee on Banking Supervision (1999) defined credit risk as the potential that a bank borrower or counter party will fail to meet its obligation in accordance with agreed terms. The further observed that banks are increasingly facing credit risk, or counter party risk in various financial instruments other than loans, including acceptances, interbank transactions, trade financing foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitment s and guarantees, and the settlement of transaction. Basel Committee on Banking Supervision (1982) stated that lending involves a number of risks such as funding risk, interest rate risk,



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clearing risk and foreign exchange risk. Basel Committee on Banking Supervision (2006) observed that historical experience shows that concentration of credit risk in asset portfolios has been one of the major causes of bank distress. According to Robert and Gary (1994), the most obvious characteristics of failed banks is not poor operating efficiency, however, but an increased volume of non-performing loans and nonperforming loans in failed banks have typically been associated with regional macroeconomic problems.

The main objectives of the study were, to investigate the impact of credit risks on the financial performances of Nigeria money banks. The specific objectives were to:

- i. examine the impact of loan losses provision on the financial performance of deposit money banks in Nigeria,
- ii. investigate the effect of liquidity on the financial performance of deposit money banks in Nigeria.
- iii. assess the effect of non-performing loan on the financial performance of deposit money banks in Nigeria.

Based on objective of the studies, hypotheses were formulated in null form:

- H_{01} : Loan loss provision has no significant impact on the performance of money banks in Nigeria.
- H_{02} : Liquidity has no significant impact on the financial performance of Nigeria deposit money banks
- H_{03} : Non-performing loan has no significant impact on the financial performance of deposit money banks in Nigeria

2. Literature Review

Conceptual Review

Credit risk is defined by Agu, and Ogbuagu (2015) as losses from the inability or complete denial of creditors paying back their owing at the stipulated period of time. The major credit risk sources of may include among others, institutional inadequacies in terms of its capacity, inappropriate and a poor credit policy, interest rates that is very volatile, inappropriate rules and regulations, poor management, low capital level and the level of liquidity, banks mass licensing, a very bad loan underwriting, reckless and in appropriate lending system, a very poor and horrible credit assessment, laxity in credit assessment, poor and bad lending system of practices, the unexpected interference of the government and the Central Bank inadequate and proper supervision. To minimize these risks, it is as a matter of urgency that the financial institutions put in place strong policies, rules and regulations that can spell out clearly the adverse effect of all the credit risk mention and to also ensure the strict adherence to these rules and regulation for positive outcome.

Credit risk in other words can as well be said to be the risk that a firm or organization is vulnerable or exposed to due to the inability of counter party to discharge its agreeable contractual given mandate or obligation (including in ability or failure to carry them out as schedule or as at when due) as well as losses from downgrades and other negative discrepancies and changes that may likely arise base on the failure from the counter party (Kelliher & Wilmot, 2011). Credit risk to the best of my knowledge is the inability or complete refusal for a client to pay back what he is owing which could be due to the reason base known to him. This refers to loan loss reserve which help and allowed banks recognition in their loss and profit statements of anticipated of loss from a given a particular a loan portfolio. Main Depositors are preserved and protected from unexpected loss through the reserve of capital adequacy a and against loss anticipated base through the loan loss reserve provisions(Lawrence & Fuloso, 2017).



Credits risk based on Andersonna, and Saurinaa, (2002 refers to that credit risk borrowers defaulted based on all kinds of debt by the inability or failure of making the payment that is required. The risk primarily is that lenders risk and consist of loss of interest and principal, there may be partial or complete disrupt loss and can come up due to so many circumstances, such as banks in ability to return depositors fund or cash as a result of insolvency. To minimize the risk of lenders, the lender is expected to carry out prospective borrower checked on credit, which may require taking appropriate insurance measures by the borrower, such as guarantees or seek security of third parties or mortgage insurance. Ultimately, the higher the risk, the rate of interest that the debtors are expected to pay relative to debt will be higher as well (Owojori, & Adidu, 2011).

Provision of loans is one of the major responsibilities of the institutions of finance. This is basically considered to be the source of banks income, credit and bank loans also form part of the channels of multiplying money through. The more and higher the provision is or become, in relation to the size of a total loans, the riskier the loan asset becomes. Increase in the provision value for the loan losses in respects to loan total is an indication showing that the bank's assets are gradually transforming to a more collection difficulties (Hull & John 2012). Beatty and Lioa, (2009) shows that loan loss provision is defined as a policy which is followed by the deposit banks by dropping some amount of money aside i.e., reserves which is to face potential loan defaults, which in the other hand will help to preserve banks stand in terms of profit and capital. The basic objectives of loan loss provision LLP among others are to provide some special future information's concerning bank, reduce taxes by earnings managing, as well as management of the regulatory capital (Bouchchoun, 2012) managing of income volatility and earnings of volatility (Nordens& Stoians, 2013) and dodging fluctuation and variation that may possibly occur in the risk weighted asset which may in turn affects the risk of banks and its profitability (Nordens& Stoian, 2013).

Liquidity risk is referred to as the risk of liquid assets which is insufficient in meeting payouts of all surrendered policies, maturities and expenses etc. Which may result to untimely lowered price as a result of the sale, which could lead to losses, despite the solvency of the company (Kamau, & Njeru, 2016). Yousfi (2014) reveals that risk of liquidity considered as the potential loss coming up from the inability of the bank's either to meet its obligated mandate, or incurring unacceptable costs or losses due to the fund invested to increase its assets as they fall due. Liquidity risk is the probability of a banks lacking the cash whenever it is needed for to all of operational activities and the ability to settle the credit requires of the customers then is seen as liquidity risk. In ability to have the access to required cash timely may lead to the great loss of customer and other important stakeholders and also reduce the organizational earnings. If the cash crunch really perseveres, a company then may really end in an ultimate degradation and ultimately collapses. (Gweji & Karanja, 2014). The study adopted (Kamau, & Njeru, 2016) who asserted that Liquidity Risk is the risk of liquid assets which is insufficient in meeting payouts of all surrendered policies, maturities and expenses etc. Which may result to untimely lowered price as a result of the sale, which could lead to losses, despite the solvency of the company.

Ombaba (2013) postulated that non-loan performing is the facility in relation to credit which the interest or the principal remained past overdue over a giving time period. It can also be defined as loans that the principal or interest has remained unsettled for at least the period of ninety days. This represents loan defaults leading to the possible loss of funds. In other words, is the ratio of non-loan performing to loans total for a given period. It gives the total defaults of borrower's assessment base on conditions relative to advances and loans over a given time period.

Non-performing loan can simply be described as the loans which is in complete default or almost in shamble. Many of the loans are considered and declared non-performing after being in that condition for over a period of three months, it depends on the terms of contract. A loan is said to be non-performing if the principal and the interest is due for payment are gone for a period of ninety (90) days



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and beyond, or at least ninety (90) days of the payment of the interest is been capitalized, delayed or refinanced base on agreement or the settlements is less than the period of ninety (90) days long overdue, thou, there is basic good and valid reason to be skeptical and doubt that the complete plans of payments could be done (Adebayo et al., 2017).

None performing loan (NPL) is one of the independent variables, which is selected because it is one of the management risk indicators. Non- performing loan, particularly, reveals and shows the way banks handle and manage their risk because it defines the amount of loses in respect to the proportion of the total of loan (Hosana, 2009). The study adopted Adebayo (2017) which shows that non-performing loan can simply be described as the loans which is in complete default or almost in shamble. Many of the loans are considered and declared non-performing after being in that condition for over a period of three months. Though it depends on the terms of contract.

Empirical Review

The study conducted by Ifeanyi and Franciss (2017) investigated the nexus that transpired between credit risk and performance of Deposits Money a Banks in the city of Nigeria for the time period between 2006 and 2015. The output of the findings reveals that we have a significant a positive effect among the provision of loan loss and the bank performances, while a negative insignificant effect was noticed on the non-performing loan.

Adebayo and Oluwaremi (2017) carried an investigative study on risk management in respect of the performance of banks using the of the entire population of twenty- one (21) of Money Banks in the six geo- political zone in the country. The banks used for the research were selected, Simple Randomize Sampling technique was adopted to identify the targeted population for the study which may include the First a Bank Nigeria Plc, Eco Bank Plc, guarantee trust bank GT Bank P.lc, Access Bank P.lc and UBA bank Plc. The finding of Regressive analysis shows a significant and negative of correlation that exist among the Loan a Loss of Provision and the finance performances of Moneys Deposit Banks in the country of Nigeria.

Lawrence and Ajayi (2017)in their study, examined and looked into main effects of risk management in terms of credit relative to the money deposit banks performance in the city of Nigeria from the year 2001 to the year 2015. The study employed the use of the panel regression analysis. Fixed regress effect was also conducted, random and Houseman test of specification were as well investigated on all the chosen variables. In the study it was discovered and observed that profitability related to banks negatively affected and is influenced by loan loss provision.

The study of Semere and Chenyan (2017) laid emphasis on the risk impact on the commercials banks performances in the country of Eritrea. One of the indicators captured in this particular study was the ratio of the Non- Performing of Loans (NPLR), the research collected data from Eritrea Commercial Bank taking into consideration from the year 1998 to 2015. Panel and Descriptive data regression analysis was adopted and put into used to help test the existing correlation among the main indicators in respect performance of Eritrea banks. The result based on the research investigations reveals that risk credit is inversely related with the performance of the Eritrea banks. The non-performing loan affect significantly and negatively the performance of money deposit banks.

A study was conducted by Fredrick (2017)he adopted in order to observing the relationship that exist among Credit Risk relative to the non-perming loan prevalence employing the used of descriptive research design. Questionnaires were administered to enable the researcher retrieve information that is relevant from the respondents taking into consideration one hungered (100) credit risk managers in money deposit banks main office and branch offices in Kenya. judgmental sampling technique was adopted with the incorporation of non-probability sampling technique which enhances getting desirable components which is in light with the researcher's judgment. The outcome reveals the fact that non-loans performing shows a quite negative impact on the banks' profits.



Theoretical Review

The study adopted the theory of credit risk due to the fact that the study focuses on credit risk and how to cope with it is to ensure the survival of the deposit money banks in Nigeria. More so that whenever borrowers defaulted in anyway, it will impacton the financial performance of the banks adversely.

3. Methodology

The study population consist of the fourteen (14) listed Nigerian money deposit banks as at the December 31, 2022. The researcher considers the use of all the money deposit banks due to the availability of relevant data from all the banks for the period under consideration. The Data used for the research work was from the secondary source only. Data extracted from annual audited financial informed reports of entire sample banks for period under review between the year 2013 and 2022). The data collection was used by the researcher as the optimal and the most effective technique to retrieve the necessary relevant data that was then used for the analysis. The data is mainly about the exact information which is actually needed that enable the researcher obtain the best and an accurate outcome and sound observation that was used in the research work. Data obtain was analyze using descriptive statistics and Multiple regressions for analysis to estimate the coefficient of the independent variables. Pearson's correlation analysis was also used to test for multi collinearity relationship among all explanatory variables that measure the risk management practices. The researcher also employs the use of Stata 13 version as the tools for the analysis. The techniques were chosen due to its robustness and reliability in terms of the outcome

Model Specifications

$$ROA_{it} = f(LLP_{it}, LQT_{it}, NPLR_{it}, FSZ_{it}, LEV_{it}, e_{it})$$

This can explicit be written as:

$$ROA_{it} = \beta_0 + \beta_1 LLP_{it} + \beta_2 LQT_{it} + \beta_3 NPLR_{it} + \beta_4 FSZ_{it} + e_{it}$$

Where: β_0 = Constant; ROA = Return on Asset; LLP = Loan loss provision; LQT = Liquidity Risk
NPL = Non performing loan; FSZ = Firm Size; e = Error term; i = Firm; t = year

Table 1

Variable measurement

S/N	Acronym	Name Of Variable	Measurements	Sources
1	Dependent variable	Returns On Asset (ROA)	Profit after tax /Total Asset	Goudreau, (1992).
3	Independent variable	Loan -Loss Provisions (LLP)	Loan Loss Provision toTotal Asset	Lawrence (2017)
4	Independent variable	Liquidity (LQT)	Current Asset/Current Liabilities	Muriithi (2016)
5	Independent variable	Non- Performing Loan (NPL)	Non- Performing Loan/Total Asset	Ombaba (2013).
6	Control variable	Firm Size (FSZ)	The Log of Total Asset	Khann & Salman, 2016)

Source: Author's Compilation, 2024



4. Result and Discussion

The section begins with preliminary analysis of study, using descriptive statistics. Which was accompanied by the presentations of results of the model estimations and the inferences extracted from the tests of the hypotheses. In addition, the findings were discussed and policy implications were also stated.

Table 2
Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	140	.1777171	.2016105	.001503	.815407
LLP	140	.2536743	.2447076	.001536	.951779
LQT	140	.3570169	.3029827	.002396	.998826
NPL	140	.2295422	.2240474	.001458	.950127
FSZ	140	12.90855	1.489866	10.0077	17.58868

Source: STATA Output (2024)

Table 2 present the descriptive statistics for the dependents and independent of variables respectively. The observation of the study is 140. The study focuses on listed deposit money banks in Nigeria for the period of 10 years. Based on the result, it can be noticed that the average value of returns on asset is 0.1777 which ranges from the minimum of 0.0015 to a maximum of 0.8154 and the standard deviation values stood at 0.2016 which indicate that there is no dispersion because the data is normally distributed.

Loan loss provisions have the average value of 0.25 with a standard deviation value of 0.24 this shows that there is no dispersion in the data arrangement. That signifies the normality of the data. The minimum and maximum value of the data ranges between 0.00 and 0.95 respectively. Liquidity has the average value of .35 with a standard deviation of .30 which prove that the data is normal since there is no dispersion relative to the data arrangement. The minimum and maximum value of the data ranges between the minimum of 0.00 and the maximum of 0.99 respectively. This reveals the fact that liquidity contributed the average value of .35 which represent 35% of banks liquidity. Non-Performing Loans reveals the average value of 0.22 with a standard deviation value of 0.22 this shows that there is no dispersion in the data arrangement. That signifies the normality of the data. The minimum and maximum value of the data ranges between 0.00 and 0.95 respectively.

Correlation Matrix

Table 3 Shows the correlation matrix with the coefficient correlation between all variable's pairs alongside their significance. The values are gotten from the pair-wise correlation of two tail significance.



Table 3
Correlation Matrix

ROA	LLP	LQT	NPL	FSZ
ROA	1.0000			
LLP	0.5567*		1.0000	
	0.0000			
LQT	-0.0856	-0.0830		1.0000
	0.3148		0.3297	
NPL	0.1472		0.1600	0.0286 1.0000
	0.0826		0.0590	0.7370
FSZ	0.0516		-0.0288	0.0797-0.1143 1.0000
	0.5445		0.7359	0.3493 0.1789

Source: STATA Output (2024)

Table 3 reveals that there is a relatively weak positive and significant correlation ROA and other variables namely loan loss provision, non- performing loans and firm size base on the coefficient value of 0.5567, 0.1472, 0.0516 and the p-value of 0.0000, 0.0826 and 0.5445 respectively. Except that of liquidity with coefficient p-value of -0.0856 and 0.3148. Moreover, it is glaring that correlation preterm among the independent variables themselves indicate that there is none of the explanatory variables that is approaching 0.8 this shows that the variables are free from multicollinearity problem that may affect the outcome of the regression result. However, this is not enough to say that there is no harmful multicollinearity existing among the independent variables of the study until the variance inflation factor VIF and the tolerance values TV are found not exceeding the expected limit or ranges of values specified by their rules of thumbs, being advanced techniques for measuring multicollinearity between the regressors.

Result of Diagnostic test

The robustness test was conducted in the study in order to ascertain the reliability of the result, multicollinearity tests, Breusch-pagan/cook-weisberg test for Heteroscedasticity and Hausman specification test.

Multicollinearity test.

This is conducted to test for multicollinearity effect among independent variables of the study

Table 4
Summary of Multicollinearity test.

VERIABLES	VIF	1/VIF
npl	1.04	0.959787
llp	1.03	0.966713
fsz	1.02	0.980046
lqt	1.02	0.984498

Source: STATA Output (2024)



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As given on the table 4 return on asset models reveals a value of VIF and tolerance value. the variable inflation factor (VIF) is within the acceptable range i.e. higher than one but less than 10, that is an indication of an absence of Multicollinearity proven among all the variables which is further confirm by the overall mean VIF of 1.03 similarly the tolerance value is within the acceptable range of less than one but almost one. Which is the evidence that a variable is not collinear with regressors. This indicate that the independent variables and control variables are appropriate as well as fit into the model.

Langrangian multiplier test.

In order to decide between random effect model output and ordinary least square. the researcher conducted LM TEST and the outcome reveals a significant outcome which suggested for random effect model as the best model to be used.

Presentation, Analysis, Interpretation of regression result

The summary of the random effect regression result obtained from the model of the study ($ROA_{it} = \beta_0 + \beta_1LLP_{it} + \beta_2LQT_{it} + \beta_3NPL_{it} + \beta_4FSZ_{it} + eu$) is presented in table 5.

Table 5

Summary of random effect GLS Regression Results

Variables	Coefficients	T-Statistics	P-valu
-CONS	.0791923	0.45	0.663
LLP	.4277172	4.69	0.000
LQT	-.0569342	-1.67	0.119
NPL	.0767639	1.04	0.317
FSZ	-.0005632	- 0.04	0.968
R ²			0.3213
Adj R ²			0.3012
F. Statistics	15.98		
Significance			0.000

Sources: STATA Outputs , 2024

Regression Results

The adjusted r^2 of 30% shows a strong relationship, and the multiple coefficients of determination R^2 of 32% gives proportion or percentages of total variations in dependent variables explain by explanatory variable jointly. Hence, this signifies that 32% of the whole variation of financial performance of money deposit banks of Nigeria is masterminded by their capital adequacy, loan loss provision, liquidity, non-performing loans, loan losses provision, firm size and leverage, while the other part of 68% is caused by other variables not capture in the regression models. The F-Statistics is 15.98, with p-value of 0.000 reveals that the models is okay or fit and explanatory variable are well and properly chosen, combine and use in the project.

Hypotheses Results

H₀₁: Loan loss provision, no any significant impacts on the financial performances of Nigeria money deposit banks.

The result reveals Loan losses provisions with a positive coefficient value of .4277172 and a p-value of 0.0000 at 1% significant level. Hence, this indicates evidence for not accepting the null hypothesis **H₀₂** which says Loan loss provisions has no any significant impact on financial



performances of deposit money banks. This result is consistent with finding of Ifeanyi and Francis (2017), Ogboi and Unuafé (2013) while contrary to the negative findings of Lawrence and Ajayi (2017) as well as Adebayo (2017).

H₀₂: Liquidity risk has no any significant impact on the financial performances of deposit Nigeria money banks

Looking at the Liquidity relationship with financial performances of deposits Nigeria money banks, a negative relationship is notice with a coefficient value of -.0569342 and the p- value of 0.119. which statistically is significant. This makes available evidence of rejecting the hypothesis H₀₂: which asserted that Liquidity ratio has no any significant impact on financial performance of deposit Nigeria money banks. This result is in consistent with findings of Egide and Paul (2017), Ogilo and Mugenya (2015). While Mwangi (2013) discovered a positive association.

H₀₃: Non-performing loan has no any significant impact on the financial performance of deposit Nigeria money banks.

The outcome in this case reveals non-performing loan with a positive coefficient value of .0767639 and an insignificant p-value of 0.317. Hence, this makes available evidence of refusing to reject hypothesis four (3), therefore, for Hypothesis 3, we accept H₀₃. This is in conformity with findings of Ifeanyi and Francis (2017), Ogboi and Unuafé (2013), but contrary to the reported results of Alshatti (2015), Abiola and Olausi (2014).

Firm Size also have negative but insignificantly related with the financial performance of deposits Nigeria money banks, as is reveals through the coefficient value of .0039531 and the p- value of 0.968. Hence, this makes evidence to accept hypothesis four (4) for the study. For Hypothesis 4, we accept H₀. This outcome is contrary to the findings of Ifeanyi and Francis (2017), but in agreement with the reported results of Alshatti (2015), who reported a positive relationship between the firm sizes and financial performances of deposit Nigeria money banks.

Discussion and Policy Implication of Findings

The finding reveals that loan loss provision is positively and significantly influencing ROA of listed banks in Nigeria. This result is in line with the prior expectation of the study thus, the result supported the views of Ifeanyi and Francis (2017) Ogboi and Unuafé (2013) while contrary to the view of Lawrence and Ajayi (2017) as well as Adebayo (2017) among others. In same manner, the outcome is also in support of the theory adopted for the study which consider as essential for financial performance of the organization. It was discovered that liquidity has a negative influence on the financial performance of listed deposit money banks. this is in line with the outcome is in consistent with findings of Egide and Paul (2017), Ogilo and Mugenya (2015) while Mwangi (2013) discovered a contrary outcome. None-performing loan has an insignificant effect on financial performance of the listed deposit money banks in Nigeria. This is in conformity with the findings of Ifeanyi and Francis (2017), Ogboi & Unuafé (2013), but contrary to the reported results of Alshatti (2015) Abiola and Olausi (2014). It further validated the under-pinning theory of the study. The only policy implication with regards to the outcome of the hypothesis of the study is that the banks should initiate coherent and comprehensive policies towards encouraging loan loss provision and liquidity that have significant implication to the financial performance of deposit money banks in Nigeria.

5 Conclusion and Recommendations

The study was set out to empirically examine the impact of credit risk on the financial performance of listed deposit money banks in Nigeria for the period of 2013 to 2022. Based on the findings of the study, the following conclusions were drawn: non-performing loan is found to be



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positively but insignificantly related to the financial performance of deposit Nigeria money banks. Liquidity has a negative but significant relationship with the financial performance of deposit Nigeria money banks. Loan loss provision is positively and significantly associated with the financial performance of deposit money bank in Nigeria. Non-performing loans had positive though insignificant effect on the performance of listed deposit money banks in Nigeria, which could be attributable to good corporate governance and the complete adherence to credit risk management practices by the deposit money banks in Nigeria. In line with the findings of the research, the study recommends that: listed deposit money banks in Nigeria should adopt a comprehensive financial policy in order to encourage loan loss provision and non-performing loan policies which will ultimately help in enhancing the listed deposits money banks financial performance in Nigeria.

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