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Impact of Credit Management on Firm's Performance and Profitability: A Study of Selected Banks within Lagos Metropolis

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Abstract

The study investigated the impact of credit management on firm's performance and profitability; using Stanbic IBTC Nig Plc and Access Bank Nig PLC, Lagos State as case study. The choice of the topic was influenced by the impact of short term financial management of trade credit on profitability of companies. This study employed a descriptive survey design. The population of the study was 145 staff of the two selected banks mention earlier. A sample size of 59 respondents was selected using Yaro Yamani's Model and Stratified sampling technique of which 59 respondents filled and returned the questionnaire. Data from the questionnaire was analyzed using special software for statistics which is called statistical package for social science (SPSS) version 21. The study found out that credit management has an effect on organizational performance, the study also revealed that there is a significant relationship between credit policy and organizational profitability and therefore recommends that the banking industry should ensure to a great extent on the adoption of credit standard, credit policy, credit terms and collection policies as this will help to determine whether to extend a loan, or line of credit to an applicant.

Keywords*: Credit management, Credit policy, Credit risk management, Client appraisal, Payment Default, Portfolio theory, Debtors turnover and Organizational performance and profitability.*

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Background to the Study

While providing credit as a main source of generating income, banks take into account many considerations as a factor of credit management, which helps them to minimize the risk of default that results in financial distress and bankruptcy. This is due to the reason that while banks provide credit they are exposed to risk of default (risk of interest and principal repayment) which need to be managed effectively to acquire the required level of loan growth and performance. The types and degree of risks to which banks are exposed depends upon a number of factors such as its size, complexity of the business activities, volume etc. It is believed that generally banks face Credit, Market, Liquidity, Operational, Compliance/legal/regulatory and reputation risks among which credit risk is known to have the adverse impact on profitability and growth. Hence, the success of most commercial banks lies on the achievements in credit management mitigating risk to the acceptable level. Credit risk management has always been in the vicinity of concern throughout the world.

Credit Management is one of the core functions of every Commercial Bank. As banks heavily rely on this activity for revenue generation, efficient credit management is therefore vital to the profitability of every commercial bank. Hence, conducting a research in this area has brought out a number of issues that probably have served as hindrance to increase profit maximization in a number of financial institutions. Credit management (its creation and control) is therefore the process of controlling and collecting payments from customers. This is the function within a bank or company to control credit policies that will improve revenues and reduce financial risk.

Credit creation has proved to be an important function of commercial banks since it is the main source of commercial banks' internally generated revenue. From the commercial perspective, credit involves giving out resources obtained from depositors held in their customers' accounts, to another party at an interest rate higher than what they pay to suppliers of funds with the aim of maximizing profit. Credit creation is considered one of the oldest and most sensitive functions of the commercial banks. Thus, Credit Management by commercial banks is of great importance to the general economic growth and development of any country as it allows funds to be available through the credit creation to areas such as mining, agriculture, industries, manufacturing, etc. This will have positive impact on the level of employment, development and economic growth and per-capita income.

Statement of Research Problem

Competent credit management seeks not only to protect the vendor from possible losses but also to protect customers from creating more debt obligations that cannot be settle in a timely manner. However in the pursuit of this core function of credit managers are faced with some challenges and obstacles, thus, these challenges prompt the need for this research to be carried out on, subject to this, they are as follows: there is high rate of bad debts because some corporations take advantage of the credit that is extended to them and find themselves not able to pay debt later. Another one is that the poor level of trade

credit management is reflected in the liquidity and profitability position of the firm. Furthermore, there is inability of business policy makers to certainly say how effectively, credit management other makes or mars the performance of the business in terms of profitability. Another major challenge that hinders the activity of credit management is lack of experience staff or officers to tackle onerous and vital duties of managing debt appropriately. Also limitation and inadequate training opportunities for key treasury or supporting staff. Finally, credit management encounters challenges in the aspect of failure to comply with the agreed terms of agreement with the company upon when paying the debt. It is to this effect that the study stands out to investigate the impact of credit management on organizational profitability and performance using Stanbic IBTC Nig PLC and Access Bank Nig PLC, Lagos.

Purpose and Objectives of the Study

The main purpose of the study was to determine the effect of credit management on organizational performance and profitability.

Specifically, this research was aimed to achieve a number of objectives by filling a knowledge gap. These objectives include the following:

1. To identify if there is a significant relationship between credit policy and organizational profitability.
2. To examine if proper credit management affects organizational performance.

Research Questions

The above research objectives necessitate the following research questions:

1. Is there a significant relationship between credit policy and organizational profitability?
2. Is there any effect of proper credit management on organizational performance?

Research Hypotheses

Based on the research questions formulated above, the following are the hypothetical statements:

H_{01}: There is no significant relationship between credit policy and organizational profitability.

H_{02}: There is no effect of proper credit management on organizational performance.

Justification for the Study

Over time researches have concentrated more efforts on credit management as it affects the performance of an organization. Most of these researches fail to acknowledge the effect of credit management through proper credit policy, credit risk management and successful client appraisal on company's profitability, organizational performance and payment default. Hence the study stands out to cover the following areas of credit management, credit policy, client appraisal, default payment as it affects organizational granting of credit facilities. The survey also became necessary because of the misconception of managers toward granting of credit facilities, this apparently is due to

inefficient credit management measures and knowledge in the banking sectors. Understanding of the above statement, that is inefficient knowledge of credit management is one of the major underlying causes that can make the customer perform below expectation of payment, will help management to identify how credit measures will be utilized and structured in a way to avoid delay in payment, conflict between organization and customers. By doing these, it will improve organizational performance and also enhance organizational profitability.

There are three main groups that will benefit from this study. The first group consists of management of business organizations; they may learn to identify ways that credit facilities negatively affect their performance identifying the negative effect may enable them to take necessary action to cope with the situation.

The second group that will benefit from this study is customers who may have insight as to how credit facilities are important to the organization. They will also be enlightened as to the positive and negative effect of credit facilities.

Finally, educators can use these findings as valuable guide to incorporate into their curriculum. By emphasizing to students, the importance of development programs to deal with credit measures, the students at the end may be able to transfer this knowledge to the workplace, thereby improving the quality of the work environment.

Literature Review

Concept of Credit Management

Credit is one of the many factors that can be used by a firm to influence demand for its products. According to Horne and Wachowicz (1998), firms can only benefit from credit if the profitability generated from increased sales exceeds the added costs of receivables. Myers and Brealey (2003) define credit as a process whereby possession of goods or services is allowed without spot payment upon a contractual agreement for later payment. Granting of credit no doubt leads to bad debts. In the words of Pandey (2004), a credit has three characteristics:

1. It involves an element of risk that should be carefully analyzed.
2. It is based on economic value. To the buyer, the economic value in goods or services possess immediately at the time of sale, which the seller expects on equivalent value to be received later on.
3. It implies futurity. The buyer will make the cash payment for goods or services received by him in a future period.

The customers from whom receivables have to be collected in future are called trade debtors and they represent a company's claim on assets. Raymond, Adigwe, and John, (2015) in their study on credit management on liquidity and profitability positions of a manufacturing company in Nigeria observes that timely identification of potential credit default is important as high default rates lead to decreased cash flows, lower liquidity levels and financial distress. In contrast, lower credit exposure means an optimal debtors'

level with reduced chances of bad debts and therefore financial health. According to Scheufler (2002), in today's business environment risk management and improvement of cash flows are very challenging.

Alice and Jaja (2016) in their study on effect of credit management on performance of commercial banks emphasizes on credit management as a concept that is of most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. It is the process to ensure that customers will pay for the products delivered or the services rendered. Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Nelson (2002) views credit management as simply the means by which an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk.

Reasons for Granting Credit

Ifurueze (2013) in his study on impact of effective management of credit sales on profitability and liquidity of food and beverage in Nigeria noted that companies in the Financial Sector in Nigeria feel the necessity of granting credit for several reasons. They include:

1. **Competition**: generally, the higher the degree of competition, the more the credit granted by a firm (Pandey, 2004)
2. **Company's bargaining power:** if a company has a higher bargaining power vis-à-vis its buyers, it may grant no or less credit.
3. **Marketing tool:** credit is used as a marketing tool, particularly when a new product is launched or which a company wants to push its weak products.
4. **Buyer's requirement**: in a number of business sectors buyers/dealers are “not able to operate without extending credit. This is particularly so in the case of industrial products.
5. **Buyer's status**: large buyers demand easy credit terms because of buck purchases and higher bargaining power. Some companies follow a policy of not giving much credit to small retailers since it is quite difficult collect dues from them.
6. **Relationship with dealers**: According to Pandey (2004) companies sometimes extend credit to dealers to build long-term relationship with them or to reward them for their loyalty.

Factor Influencing Credit Requirement of a Company.

The company must maintain adequate amount of credit liquidity to meet it daily obligations but liquidity in excess of what is adequately required by the firms to finance its operations may be counter-productive. The credit liquidity requirement of firms differs depending on the circumstances of the company. Pandey (2005) outline the following as some of the factors that influence the credit liquidity requirement of a company.

1. **Nature and Size of Business:** The credit liquidity needs of a firm are basically influenced by the nature of its business. Trading and financial firms generally have a low investment in fixed assets, but require a large investment in working capital. Retail stores, for example, must carry large stocks of a variety of merchandise to satisfy the varied demand of their customers. Some manufacturing businesses' like tobacco, and construction firms also have to invest substantially in working capital but only a nominal amount in fixed assets. In contrast, public utilities have a limited need for working capital and have to invest abundantly in fixed assets. Their working capital requirements are nominal because they have cash sales only and they supply services, not products. Thus, the amount of funds tied up with debtors or in stocks is either nil or very small. The working capital needs of most of the manufacturing concerns fall between the two extreme requirements of trading firms and public utilities.

2. **Manufacturing Cycle:** The manufacturing cycle starts with the purchase of raw materials and is completed with the production of finished goods. If the manufacturing cycle involves a longer period the need for working capital will be more, because an extended manufacturing time span means a larger tie-up of funds in inventories. Any delay at any stage of manufacturing process will result in accumulation of work-in-process and will enhance the requirement of working capital. Firms making heavy machinery or other such products, involving long manufacturing cycle, attempt to minimize their investment in inventories (and thereby in working capital) by seeking advance or periodic payments from customers.

3. **Business Fluctuations:** Seasonal and cyclical fluctuations in demand for a product affect the working capital requirement considerably, especially the temporary working capital requirements of the firm. An upward swing in the economy leads to increased sales, resulting in an increase in the firm's investment in inventory and receivables or book debts. On the other hand, a decline in the economy may register a fall in sales and, consequently, a fall in the levels of stocks and book debts. Seasonal fluctuations may also create production problems. Increase in production level may be expensive during peak period. A firm may follow a policy of steady production in all season and their quick disposal in peak season. Therefore, financial arrangement for seasonal working capital requirement should be made in advance. The financial plan should be flexible enough to take care of any seasonal fluctuation.

Theoretical Framework of the Study

The theoretical framework of the study was based on the portfolio theory. This theory is adopted because of its precision, accuracy and generalized usage of it in the field of financial management. The portfolio approach to accounts receivable management can be used by utilizing the rate of profit (rate of advantage from assets) as one of the basic criteria that the firm giving the trade credit should encourage the purchaser to consider when making decisions (Jajuga 1994)

Portfolio Theory

Harry Markowitz developed the portfolio model in the year 1952. This model includes not only expected return, but also includes the level of risk for a particular return. The model started gaining attention from the 80's. Since the 1980s, companies have successfully applied modern portfolio theory to market risk. Many companies are now using value at risk models to manage their interest rate and market risk exposures. Unfortunately, however, even though credit risk remain the largest risk facing most companies, the practice of applying modern portfolio theory to credit risk has lagged (Margrabe 2007). Companies recognize how credit concentrations can adversely impact financial performance. As a result, a number of institutions are actively pursuing quantitative approaches to credit risk measurement. This industry is also making significant progress toward developing tools that measure credit risk in a portfolio context. The combination of these development has vastly accelerated progress in managing credit risk in a portfolio context.

Empirical Review on Impact of Credit Management on Organizational Profitability and Performance

Studies have been done in relation to credit management practices on organizational profitability and performance in the banking industry in the local setting and globally. Gizaw, Kebede and Selvaraj, (2015) examined the impact of credit risk management on profitability of commercial banks in Ethiopia. The objective of the study was to empirically examine the impact of credit risk on profitability of commercial banks in Ethiopia. Data was collected from 8 sample commercial banks for a 12-year period (2003-2004) from annual reports of respective banks and National Bank of Ethiopia. The data were analyzed using a descriptive statics and panel data regression model and the result showed 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. 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 Accra region of Ghana as a case study. Results of the study indicated 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 was collected through questionnaires 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 Nigeria banks.

Byusa and Nkusi (2012) investigated effects of credit policy on bank performance in selected Rwandan Commercial banks. The aim of this 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, McLiesh 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 interview and data analysis was conducted using descriptive methods. The findings of the study concluded that credit management practices facilitated payment of loan.

Methodology

A descriptive research design was used in this study. The target population of this study comprises of the general staff of Stanbic IBTC Nigeria Plc and Access Bank Plc. Thus, Role of Credit management on goal of business firm and its application are relevant at this level prompting the choice of the population. However, a sample size of 59 was determined using the simple random technique. This study is expected to produce both quantitative and qualitative data. Once the questionnaires are received they was coded and edited for completeness and consistency. Quantitative data was analyzed by employing descriptive statistics and inferential analysis using statistical package for social science (SPSS) version 20.This technique gives simple summaries about the sample data and present quantitative descriptions in a manageable form, Gupta (2004). Together with simple graphics analysis, descriptive statistics form the basis of virtually every quantitative analysis to data, Kothari (2004). The significance testing was done at 5% level of significance and SPSS was used for this purpose. The data was then presented using frequency distribution tables, bar charts and pie charts for easier understanding

Findings

A total of 59 Questionnaires (representing 100%) were distributed, in which 59 was returned, a percentage of which is 100%. However, the returned Questionnaires are however shown below:

Credit Management

Level of agreement responses by respondents on credit management practices in First Bank Nig. Plc and Accion Microfinance Bank Ltd.

Table 1

S/N	Statement	N	Minimum	Maximum	Mean	Std. Deviation
1	Accounting system of credit management process is computerized in this bank	59	1.00	5.00	2.42	1.24
2	Accounting system of credit management process monitor accounts that are approaching due date for payment	59	1.00	5.00	2.11	1.00
3	Customers' accounts are strictly monitored prior to the acceptance of every order	59	1.00	5.00	2.07	1.13
4	Amount of information obtained about a customer vary according to the value of order	59	1.00	5.00	2.17	1.16
		Valid N (listwise)	59			

SA=Strongly Agreed (1): A=Agreed (2): UN=Undecided (3): D=Disagreed (4): SD=Strongly Disagreed (5).
Source: Researchers' field study (2018)

The above study sought to establish the level at which respondents agreed or disagreed with the above statements relating to credit management practices in first bank Nig plc and accion microfinance bank ltd. From the findings majority of respondents agreed that accounting system of credit management process is computerized in the above-named banks as shown by a mean of 2.42, accounting system of credit management process monitor accounts that are approaching due date for payment as shown by a mean of 2.11. The findings also revealed that respondents agreed to the statement that customers' accounts are strictly monitored prior to the acceptance of evert order as indicated by the mean 2.07, finally majority of the respondents agreed that the amount of information obtained about a customer vary according to the value of order as indicated by mean 2.17. By implication credit management in both Stanbic IBTC Nig. Plc and Access Bank are computerized.

Credit Policy

Table 2: Level of agreement by respondents on credit policy in First Bank Nigeria PLC and Accion Microfinance Bank Ltd

S/N	Statements	N	Minimum	Maximum	Mean	Std. Deviation
1.	There is perceived effective credit procedure manual in this bank	59	1.00	5.00	2.17	1.13
2.	Decisions are made in the credit department cannot be overruled	59	1.00	5.00	3.25	1.39
3.	Credit limits include VAT	59	1.00	5.00	2.25	1.27
4.	Credit limit is set on individual debtors	59	1.00	5.00	2.09	1.13
5.	Targets are set for measuring and reporting debtors figures	59	1.00	5.00	2.17	1.15
	Valid N (listwise)	59				

SA=Strongly Agreed (1): A=Agreed (2): UN=Undecided (3): D=Disagreed (4): SD=Strongly Disagreed (5).

Source: Researcher field study (2018)

The study sought to establish the level at which respondents agreed or disagreed with the above statements relating to credit policy of FBN Nig. Plc and Accion Microfinance Ltd. From the findings, majority of the respondents agreed that there is perceived effective credit procedure manual in the above-named banks as shown by a mean of 2.17, others were unsure if the decisions made in the credit department cannot be overruled as shown by a mean of 3.25, majority of the respondents agreed to the statement that credit limits include value added tax (VAT), this was further indicated by a mean of 2.25. Majority of the respondents also agreed to the opinion that credit limit is set on individual debtors as indicated by a mean of 2.09. Finally, the above table shows that majority of the respondents agreed that targets are set for measuring and monitoring debtors figure as shown by a mean of 2.17. The implication of the above table shows that credit policy is strictly monitored in relation to debtor's collection in both Stanbic IBTC Nig Plc and Access Bank Plc.

Test of Hypotheses
Hypothesis One
H_1: There is no significant relationship between credit policy and organizational profitability.
α =0.01
Decision rule: If sig value $\leq$ 0.01, reject H_0

Table 3: Hypothesis one Correlations

		Credit Policy	Organizational Profitability
Credit Policy	Pearson Correlation	1	.445**
	Sig. (2-tailed)		.000
	N	59	59
Organizational Profitability	Pearson Correlation	.445**	1
	Sig. (2-tailed)	.000	
	N	59	59

**. Correlation is significant at the 0.01 level (2-tailed).
Source: Researcher field study (2018)

Interpretation: From the table above, the Sig. value (0.000) is less than 0.01, we therefore reject $H_{0.}$ There we conclude 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.

Hypothesis Two
$H_{2:}$ There is no effect of proper credit management on organizational performance.
α =0.01
Decision rule: If sig value < 0.01, reject H_0

Table 4: Hypothesis two Correlations

		Credit Management	Organizational Performance
Credit Management	Pearson Correlation	1	.443**
	Sig. (2-tailed)		.000
	N	59	59
Organizational Performance	Pearson Correlation	.443**	1
	Sig. (2-tailed)	.000	
	N	59	59

**. Correlation is significant at the 0.01 level (2-tailed).
Source: Researcher field study (2018)

Interpretation: From the table above, the Sig. value (0.000) is less than 0.01, we therefore reject H_0. There we conclude that there is an effect of proper credit management on organizational performance at 1% significant level, also the Pearson correlation coefficient (0.443) shows that there is moderate positive relationship between credit management and organizational performance in the selected banks.

Discussion oF Findings, Suggestion for Further Studies and Recommendation

The first objective of the study was to determine if there is a significant relationship between credit policy and organizational profitability. The test hypothesis for this objective however, indicates that there exists a moderate significant relationship between credit policy and organizational profitability on the basis of the responses provided by the respondents. The respondents all indicated in the affirmative that there is a significant relationship between credit policy and organizational profitability. This result is in affirmation with the result given by Byusa and Nkusi (2012), in their study title '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 organizational profitability. 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.

The second objective of the study was aimed at determining the effect of proper credit management on organizational performance. The test analysis for this objective indicates there is an effect of proper credit management on organization performance. This implies that there exists a proportional relationship between credit management and organizational performance, that is when there is increase effectiveness of credit management, organizational performance tends to increase proportionately with that respect. However, an empirical study in relation to this result can be trace to a research carried out on the impact of credit management on financial performance of Nigerian banks with special reference to UBA Plc. This study was carried out by Owizy (2013), the result of the study indicated that there exists a significant relationship between credit management profitability of Nigerian banks.

Recommendations

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

1. From the finding and conclusions, the banking industry should ensure to a very great extent on the adoption of credit standards, credit policy, credit terms and collection policies. Credit standards that a bank uses to determine whether to extend a loan or line of credit to an applicant, the study therefore recommended that there should be optimum credit standards indicating that before giving any loan, client's repaying capacity, status of cash flows must be assessed.

2. Banks should develop and maintain a credit administration function that provide guidance to anyone in the credit function of the institution and to insure safeguards are in place to manage the loan portfolio.
3. Credit approval decision is made using a purely judgmental approach by merely inspecting the application from details of the applicant. The study therefore recommends that management of banking firms should assess client capacity to repay the loan as this helps in taking loan decision whether a client should be given a loan and about appropriate volume of loan.

Suggestion for Further Studies

The following are suggested areas that future researcher investigating on credit management should look into:

1. An assessment on Impact of debt recovery on financial performance should be carried out using financial institution as case study.
2. Also, study on "Strict credit policy; a catalyst for repayment of loans" should be investigated using financial firms as case study.
3. A secondary data should be employed as a means of data analysis. This can be done by collecting financial report of past five years (5) and thereafter using financial ratio to examine the degree of financial stability in the firm.

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