MODERATING INFLUENCE OF LOAN MONITORING ON THE RELATIONSHIP BETWEEN CREDIT POLICY AND DEBT RECOVERY OF SOME SELECTED COMMERCIAL BANKS IN NIGERIA

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ABSTRACT

This paper examines the moderating effect of loan monitoring on the relationship between credit policy and debt recovery of some commercial banks in Nigeria. The effective credit policy on debt recovery can reduce the risk of banks' failure, lower the non-performing loans and improve the financial stability of the banking sector for economic growth and development. Using panel data of 8 sampled banks for a period of ten years (2014-2023). The data were extracted from the annual accounts and reports of the sample banks. Multiple regression technique was employed in analyzing the data through STATA 14.0. Based on the analyses of the data collected, the paper found that credit collateral requirements and credit assessment procedures are negative and significant in influencing the debt recovery of the listed banks. However, credit terms and credit control procedures are positive and significantly related to debt recovery of the listed commercial banks in Nigeria, while loan monitoring is positive but insignificantly related to the debt recovery of the banks. The paper, therefore, concludes that credit policy can improve the debt recovery of some commercial banks in Nigeria. Based on the findings of this paper, the management of the banks should encourage credit terms and credit control procedures to maximize their debt recovery level.

Keywords: *Credit Policy, Debt Recovery, Loan Monitoring, Credit Terms, Commercial Bank*

1. INTRODUCTION

The banking industry play a vital role in economic development of any nation, they play roles like fund mobilizations, opening of account, letters of credit business guarantees, and mostly give out loans from the part of the money mobilized. Credit policy is a bank's credit risk management strategies and it is a fundamental component of commercial banks (Akinselure & Akinola, 2019). Such policies outline the criteria that potential borrowers need to meet to qualify for loans. Credit policy is a procedure and guideline for issuing credit and collecting debt to manage credit risk (Agbamuche et al., 2022). The lending banks' function of loan monitoring plays an important role in sustaining quality loan portfolios and protects risk assets against deterioration. Banks will ensure that borrowers remain financially healthy and capable of meeting their obligations. The essence of every monitoring is to ensure full compliance with the loan agreement and ensure that the loan is being used for eligible purposes, the quality

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of the loan will be maintained in the future and its repayment sources are protected to guard against unacceptable deterioration of the credit (Nicola & Fulvia, 2022). Therefore, the purpose of this study is to investigate the moderating influence of loan monitoring on the relationship between credit policy and debt recovery in banks.

Debt recovery policy is a very essential component of the performance of commercial banks as it plays a key role in ensuring that the major goal of the bank is to issue loans that result in the preferred outcome of making a profit margin beyond the loan advance (Enadeghe et al., 2022). The debt recovery unit is involved in the day-to-day role of ensuring that the loans issued to the bank's customers are repaid as per the schedule of the contract signed by the customer and bank. The task of debt recovery involves compiling and accumulating a list of unpaid loans and practically managing and organizing the loans by following up on defaulters. Debt recovery means following loans that have not been paid by a borrower to get delinquent obligations paid back (Udenwa et al., 2023).

In Nigeria, commercial banks are critical financial intermediaries that channel funds from surplus units to deficit units. Their credit policies can facilitate or hinder economic growth, depending on their effectiveness (Abimbola, 2020). For example, when credit policies are stringent, fewer borrowers qualify for loans, potentially stifling economic growth. Conversely, lenient policies could increase bad debts, destabilizing the banking sector (Lestari, 2018). One significant challenge facing commercial banks in Nigeria is the high level of Non-performing Loans (NPLs), which could jeopardize the stability and performance of these banks. Hence, the evaluation of credit policies becomes a necessity, to ensure that these banks can effectively recover their debts without significantly reducing their loan portfolios (Gadzo et al., 2019). The borrower always can default on his or her commitments for one or the other reason resulting in the crystallization of credit risk to the bank. These losses usually take the form of total default or losses from changes in portfolio value arising from actual or perceived deterioration in credit quality that is short of default (Umar et al., 2022).

Asima et al., (2021) state that effective monitoring loans is very important for loan sustainability. Monitoring also allows parties to be more aware of the current conditions of the debtor to bridge the credit risk management process to reduce the level of non-performing loans. According to loan monitoring involves continuously evaluating borrowers' financial health, including their income, assets, and liabilities (Agbamuche et al., 2022). Proper loan management allows borrowers to stay organized, make informed decisions, and avoid potential pitfalls that could lead to financial distress. According to Nicola and Fulvia, (2022), loan monitoring is the work of the relationship manager and in most cases is optional but a must function for effective and efficient credit (loan) administration in the banking sector which include various tools such as notable among them are transaction account monitoring, relationship management, regular reporting requirements, loan covenants, loan stress testing as well as internal credit rating and scoring.

However, the problem of loan delinquency or default which is a result of poor credit policies reduces the lending capacity of banks (Mokaya et al., 2018). Banks need good policies and guidelines for efficient and effective credit operations. Banks need a good or clear procedure and guidelines for issuing credit and collecting debt to manage credit risk cope with the emerging threats in the Nigerian banking industry and proffer solutions to forestall distress in the banking industry (Munangi & Bongani, 2020). Therefore, the effective credit policy on debt recovery can reduce the risk of banks' failure, lowering the non-performing loans and improving the financial stability of the banking sector for economic growth and development.

Good and continuous loan monitoring is the main key to the credit process. Management must develop policies and procedures, establish a credit limit as a whole, have a system to monitor individual credit conditions and an independent internal control system to conduct a continuous assessment of the bank's credit risk management process.

2. LITERATURE REVIEW

2.1 Debt Recovery

Debt recovery policy is a very essential component of the performance of commercial banks as it plays a key role in ensuring that the major goal of the bank is to issue loans that result in the preferred outcome of making a profit margin beyond the loan advance (Enadeghe et al., 2022). Debt recovery means following loans that have not been paid by a borrower to get delinquent obligations paid back (Udenwa et al., 2023). The presence of debt recovery ensures the debtors pay up their debts. The debt recovery unit is involved in the day-to-day role of ensuring that the loans issued to the bank's customers are repaid as per the schedule of the contract signed by the customer and bank. The task of debt recovery involves compiling and accumulating a list of unpaid loans and practically managing and organizing the loans by following up on defaulters. There are several ways that creditors can go about recovering debt. One common method is to send a series of letters or make phone calls to the debtor, reminding them of their outstanding balance and requesting payment. Contacting debtors through multichannel conversational messaging is a proven method of customer engagement that produces high response rates and increased debt recovery. If this does not work, the creditor may hire a debt collection agency to handle the debt recovery process. This is a last resort and is not the preferred method. Debt recovery helps to ensure that creditors are paid for the goods and services they provide. It can be a complex process, but it is important to maintain financial stability and ensure that businesses can continue to operate (Nwosu et al., 2020).

The debt collection process starts when there is a missed payment on a credit card or loan. The debtor has 30 days from the bill due date (not the billing date) to make the payment before it is reported to the credit bureaus. During this time, the creditor will try to contact the debtor by phone, email, or letter to get their payment and any late fees. It's best to take care of the debt during this 30-day window. The debtor can explain his/her situation and set up a repayment plan. After 30 days, the debt is handed off to another department at the same company that specializes in retrieving delinquent debt. This isn't a collection agency, just a department within the lending company. They could report your delinquency to a credit bureau and shut down your credit card account. After 180 days, the creditor usually will contract the debt or write it off their books and sell it to a debt collection agency. Be aware that the creditor might contract or sell the debt at any time before the 180 days, so it's best to act sooner rather than later (Nwosu et al., 2020).

2.2 Credit Policy

Credit policy is a procedure and guideline for issuing credit and collecting debt to manage credit risk (Agbamuche et al., 2022). Such policies outline the criteria that potential borrowers need to meet to qualify for loans. Oyebowale, (2020) defines credit policy as a blueprint containing management guidelines for use by line officers of a bank in the handling of credit applications. Its objective is to provide corporate direction through a standardized procedure, derived from the operational interest of the bank, in satisfying the customer credit need but with full cognizance of the prevented monetary and fiscal policy guidelines of the government. Tight credit standards make a firm lose a large number of customers and when credit is lost the firm gets an increased number of clients but is at risk of loss through bad debts (Lestari, 2018). In agreement with other scholars Alade et al., (2020) advocate for an optimum credit policy, which would help to cut through weaknesses of both tight and loose credit standards so, the firm can make profits. This is a criterion used to decide the type of client to whom loans should be extended. Gadzo et al (2019) note that it is important that credit standards be based on the individual credit application by considering character assessment, capacity, condition, collateral, and security capital. Character refers to the willingness of a customer to settle his/her obligations.

According to Kajola et al., (2018), the evaluation of an individual should involve; gathering relevant information on the applicant, analyzing the information to determine creditworthiness, and making the decision to extend credit and to what tune. They suggested the use of the 5Cs of lending. The 5Cs of lending are Capacity, Character, Collateral, Condition, and Capital. Capacity refers to the customer's ability to fulfill his/her financial obligations. It is a subjective judgment of a customer's ability to pay. It may be assessed using a customer's ability to pay. It may be assessed using the customer's records, which may be supplemented by physical observation. Collateral is the property, fixed assets, and chattels, pledged as security by clients. Collateral security is what customers offer as savings so that failure to honor his/her obligation the creditor can sell it to recover the loan. It is also a form of security that the client offers as a form of guarantee to acquire loans and surrender in case of failure to pay; if borrowers do not fulfill their obligations the creditor may seize their asset. Capital portends financial strength, more so in respect to net worth and working capital. Evaluation of capital may be by way of analyzing the balance sheet using the financial ratios. Condition is the impact of the present economic trends on the business conditions which affects the firm's ability to recover its money. It includes the assessment of prevailing economic and other factors that may affect the client's ability to pay (Echobu & Okika, 2019).

2.2.1 Credit Terms and Credit Risk

A credit term is the payment terms and conditions made by the lending party in exchange for the credit benefit (Abimbola, 2020). The terms of interest payments, repayments, and loan maturity is detailed. They include the interest rates and date for repayment, if a term loan, or the minimum payment amount and recurring payment dates if a revolving loan. Stephen and Joseph, (2020), observe that credit terms are normally looked at as the credit period terms of discount and the amount of credit and choice of instrument used to evidence credit. Credit terms may include the length of time to approve loans, this is the time taken from applicants to the loan disbursement or receipt. It is evaluated by the position of the client as indicated by the ratio analysis, trends in cash flow, and looking at capital position. Maturity of a loan; this is the period it takes a loan to mature with the interest thereon.

Credit risk is the current and prospective risk to earnings or capital arising from an obligor's failure to meet the terms of a contract with the bank or otherwise to perform as agreed (Adegbie & Otitolaiye, 2020). When banks grant loans to customers, they expect the customers to repay the principal and interest on an agreed date. A credit facility is said to be performing if payment of both principal and interest are up to date under agreed repayment terms. Non-performing loans (NPL) represent credits that the banks perceive as possible loss of funds due to loan defaults. Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations (Kajola, 2018). Traditionally, it refers to the risk that a lender may not receive the owed principal and interest, which results in an interruption of cash flows and increased costs for collection. Interest payments from the borrower or issuer of a debt obligation are a lender's or investor's reward for assuming credit risk. Terms of credit include interest rate, collateral, documentation requirement, and mode of payment (Mokaya, 2018). Credit risk is the risk of loss that may occur from the failure of any party to abide by the terms and conditions of any financial contract, principally the failure to make required payments on loans due to an entity (Munangi & Bongani, 2020).

2.2.2 Non-Performing Loan

This refers to loans that are in default or close to being in default. Many loans become non-performing after being in default for three months, but this can depend on the contract terms (Adegbie & Otitolaiye, 2020). A loan is said to be non-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue (Balogun & Alimi, 2018). A non-performing loan is a sign of the bank's poor performance, an asset becomes non-performing when the customer cannot meet the repayment agreement as of when due. Non-performing loans can be attributed to both controllable and non-controllable factors (Semusu & Turyasingura, 2023). One of the key risks that face banks is the risk of uncertainty about the full repayment of a loan as at when due, non-performing loan is an unavoidable risk to money deposit banks. Poor credit management will not only result in a loss of profit for a bank but also affect the operation of a bank, in terms of customer loyalty, goodwill, service delivery and low return on shareholders' funds (Ramazan, 2019). **2.2.3 Credit Appraisal Procedure**

The purpose of credit appraised is to solicit enough information about the applicant in order to determine willingness and capability to serve the loan if granted, per the terms of the loan agreement it enables the bank to determine the degree of risk they are willing to assume and the amount of credit that can prudently be expected, given the risk involving and the term and condition for granting the loan. It is therefore expected that a good credit appraisal should follow the established cannot of good lending which includes: character, capital, capacity, collateral, condition, and duration (Karanja, 2018).

i. Character – This refers to whether the customer can be trusted enough to keep to the terms and condition of the loan covenant as at times. It relates to the borrower's integrity, responsibility, and creditworthiness based on past insurance.

ii. Capital – This refer to as the soundness of the borrower's financial position in terms of equity is assessed. The loan portfolio of the leading bank should also be considered.

iii. Capacity – This refers to the ability of the borrower to repay the loan. The past performances of the customer will give an insight into whether he has the technical and management capacity to execute the project for which credit is being requested.

iv. Collateral – this is otherwise known as security. It is the right conference for a creditor to make him redeem in is loan obligation. A security base arrangement usually creates an additional moral state on the side of the customer which results in a prudent and effective utilization of available resources.

v. Condition – this considers the external micro-environment and the attendant force over which the borrower has no control. This can render good credit today bad in the future if conditions become favorable to business.

vi. Duration – this is the length of time for which the customer requires the loan. The bank is expected to be liquid on demand. This is the reason why some banks cannot afford to lend in the long term.

2.3 Loan Monitoring

Loan monitoring is instrumental in assessing the creditworthiness of borrowers. It involves continuously evaluating borrowers' financial health, including their income, assets, and liabilities (Lestari, 2018). To build an efficient loan monitoring and auditing process, lenders must ensure the workload is adequately calibrated to the pressure. The lending banks' function of loan monitoring plays an important role in sustaining quality loan portfolios and protects risk assets against deterioration thereby keeping nonperforming loans within acceptable standards. The function of loan monitoring is an integral part of quality credit that should ensure credit facilities remain within the performing loan circle, that is, the days of past-due obligation should be less than 90 days.

The purpose of bank monitoring is to reduce a bank's credit risk by preventing the opportunistic behavior of a borrower's moral hazard (Asima et al., 2021). The role of loan management involves careful monitoring, evaluation, and decision-making at each stage to mitigate risks and maximize returns. According to Nicola and Fulvia, (2022), loan monitoring involves ongoing assessment of the borrower's financial health and their ability to meet obligations under the loan agreement by regular monitoring enables banks to detect early warning signs of financial distress, by assessing the borrower's financial health, banks can adjust loan terms and pricing to reflect changing circumstances, reducing the risks of default and other adverse outcomes and regular monitoring is essential for ensuring regulatory compliance.

Nicola and Fulvia, (2022), state the techniques for effective loan monitoring can help lenders (banks) enhance their problem loan ratio through vigilance. These include; i) loan covenants are conditions that borrowers must meet to maintain their loan agreement. These covenants can include financial ratios, collateral requirements, and other performance metrics, regular credit reviews involve an in-depth analysis of the borrower's financial performance including their income, expenses, and debt obligations, ii) technology can also be an effective tool for loan monitoring. Loan monitoring software can automate many of the loan monitoring tasks, such as tracking payments are missed, iii) site visits are another effective technique for loan monitoring. Site visits involve visiting the borrower's business or property to assess their operations and identify potential problems, iv) by communicating regularly with borrowers, lenders can gain a better understanding of their financial situation and identify potential problems.

The paper argues that adverse changes in the credit policy of the banking sector can be checked through bank loan monitoring functions by adopting any of the aforementioned monitoring tools. Therefore, there is a need to evaluate the moderating influence of loan monitoring on the relationship between credit policy and debt recovery of listed commercial banks in Nigeria.

3. METHODOLOGY

This paper adopts the ex-post facto research design. The population of the paper is all the listed commercial banks in Nigeria as of December 31, 2023, during the Monetary Policy Committee Meeting only twenty-two (22) banks emerged as the healthiest banks in Nigeria. The sample comprised the eight (8) commercial banks in Nigeria which are listed on the Nigeria Stock Exchange (NSE) and also have an

International Authorization, by ensuring that the sample is representative of the entire population of commercial banks in Nigeria. The paper employed purposive sampling techniques to collect data from eight (8) selected commercial banks in Nigeria. This paper relied on secondary data from annual reports and accounts of listed commercial banks in Nigeria from 2014 to 2023 as well as the publications of the Central Bank of Nigeria statistical bulletin. This paper adopted the panel data analyses. The technique used in this paper is the Pooled Ordinary Least Square (POLS) estimation technique. The model include; moderating variable (Loan monitoring), independent variable (Credit policy consists of four components such as; credit collateral requirement, credit terms, credit assessment procedures and credit control procedures), and dependent variable (Debt recovery).

$$DRit = \beta0 + \beta1\ LM*CCRit + \beta2LM*CTit + \beta3LM*CAPit + \beta4LM*CCPit + £it$$

Where: DR= Debt Recovery, CCR = Credit Collateral Requirement, CT = Credit Terms, CAP = Credit Assessment Procedures, CCP = Credit Control Procedures, LM = Loan Monitoring, β0 =Regression intercept, β1 - β0 = Coefficient of the independent variables. it = Subscript for time series and cross-section in the equation or short and long-term relations coefficients, £i = Error term or contribution of variables not considered by the study.

Results: The moderating effect of loan monitoring on the relationship between credit policy and debt recovery of listed Commercial Banks in Nigeria.

Table 4.1 Regression Results (Moderated Result)

VARIABLES	Coefficients	Z-Statistics	P-Sig	Cumulative results
Constant	-0.286	-10.24	0.000	
CCR	-0.143	-8.60	0.000	
CT	1.158	47.9	0.380	
CAP	-0.014	-0.88	0.000	
CCP	0.423	6.39	0.000	
CCPLM	-0.135	-4.54	0.000	
CTLM	1.093	26.2	0.000	
CAPLM	0.016	0.54	0.594	
CCPLM	0.323	2.75	0.007	
Adj. R^2				0.94
F-Stat.				351.97
F-Sig				0.0000

Source: STATA 14.0 Output based on the data generated (2014-2023)

In testing the hypothesis of the moderating effect, the Hierarchical regression technique was used to show the moderating effect of loan monitoring on the relationship between credit policy and debt recovery of listed Commercial Banks in Nigeria. This technique was one of the appropriate methods of testing whether the prediction of the dependent outcome from independent variables is influenced by an interaction. According to Dalowar et al., (2023), a moderator is expected to strengthen, weaken, or change the direction of the relationship between the dependent and independent variables.

CONCLUSION

Based on the results of this study, the following conclusions were made; the credit collateral requirement and credit assessment procedures can impact negatively on the debt recovery of commercial banks in Nigeria while credit terms and credit control procedures have a positive impact on the debt recovery of banks. It has also been concluded that loan monitoring cannot moderate the relationship between credit policy and debt recovery of some commercial banks in Nigeria.

RECOMMENDATIONS

Based on the findings obtained from this paper, recommended that the management of the banks should encourage the credit terms and credit control procedures to maximize their debt recovery level because of their positive and significantly on debt recovery of banks. The result of the credit assessment procedure and credit collateral requirement are negative and significant relationship on debt recovery of banks. Therefore, the management of the banks should consider less of credit assessment procedure and credit collateral requirement, an increase in credit assessment and credit collateral will lead to decrease debt recovery rapidly. Loan monitoring should not be considered as a moderator in strengthening the relationship between credit policy and debt recovery because the result is not statistically significant.

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