THE EVALUATION OF CREDIT MANAGEMENT ON THE PERFORMANCE OF SMALL SCALE ENTERPRISES IN NIGERIA

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Abstract

This paper presents a framework for understanding the importance of credit management as it affects the performance of small scale enterprises. Invariably credit management involves the matter of bad debts and its management. No matter how efficient managers of credit are, there is always the incidence of bad debts; evaluation of credit management therefore must involve methods of debt recovery. Credit management examines how financial institutions respond to credit facilities given to their customers and how the small scale enterprises react to methods of credit management. Small scale enterprises are basically grass-root businesses that support the livelihood of entrepreneurs and in turn create jobs and reduce poverty to a large extent. It is essential that credit facilities extended by the financial institution to the small scale enterprises are properly managed in order to ensure repayment of facilities and growth of the small scale business. This brings us to how the management of credit influences the performance of such businesses. Primary Data were utilized through the Questionnaires administered on deposit money banks, micro finance banks as well as selected small scale business owners. Descriptive statistics were employed to analyze the data using SPSS so as to test the hypotheses. It was observed that most small scale owners do not have the expertise to maintain proper records of their activities. Banks should enlighten their customers on importance of proper record keeping, utilization of the credit facilities given to them, and the necessity for prompt repayment of facilities. The study is expected to be useful to entrepreneurs, players in financial institutions and policy makers of the economy.

Keywords: credit management, small scale enterprises, Entrepreneurs.

1. INTRODUCTION

Financial institutions are global phenomena, a universal institution. Banks intermediate between surplus and deficit economic units, therefore, acting as machinery for the allocation of scarce financial resources (Mohammed, 2002). Consequently, financial institutions occupy a pivotal position in the economy as it is the crux of the money market and the central nervous system of the economy. The banking industry worldwide, and in Nigeria particularly, have been witnessing a lot of structural changes. These changes are meant for the improvement of services for the development of its operators and for the benefit of the customers, shareholders as well as the economy at large.

Generally, banks render series of services to the economy, foremost of which is the provision of finance which has been described as a lube for economic growth (CARMERO 1967). A critical factor in this growth process is adequate supply of credit to the various sectors of the economy to carry on their activities. The role of the financial institutions in this regard is that of financial intermediation which entails moving funds from the surplus unit to deficit unit of the economy, to facilitate trade and capital process. Banking as a service industry is organized to make profit for the shareholders via provision of banking services and supply of financial needs to individuals and corporates bodies. In order to achieve this, banks accept deposits from customers and lend to others (an example in this case would be the small scale entrepreneurs). A bank must therefore understand the importance of credit and credit management if it is to stay afloat.

Developments in the Nigerian economy in the last decade, specifically, from 1992 to date have had considerable impact on the functioning of the banks and other non-financial institutions. The decade witnessed a down–hill trend in the Nigerian economy, occasional dwindling oil revenue and the global economic recession. However, banks as a sub-system of national economy was not immune to it and has since been having its own share of increased loan defaults because of the inability of borrowers to redeem their loans, this has resulted in banks distress and some have failed.

Through credit, banks promote investments and sales of a wide range of goods and services. Financial institutions in Nigeria have been performing this financial intermediation role in the economy. Thus, loans and advances today constitute a major asset of the total asset structure of banks in the country

The banking sector, in most developing economies has been segmented in terms of different institutions using varied methods to serve different customers. Loans constitute the largest assets on the financial report of most banks; revenue from loans is a significant part of the entire revenue generated within the financial year. Loans can also be described to as assets that are very delicate to banks as they have the potential of making or breaking them. For this reason, credit portfolio should be managed effectively so that it does not cause disconnect in the economy.

Lang and Jagtiani (2010), states that loan administration is a process which is designed to avoid damages to an organization as a result of events unanticipated even though possible. According to Asiedu-Mante (2011) credit management includes instituting proper rightful policies and measures that will make sure that authorities give out loans, the loans get to the right customers, and the loan is given for productive reasons which are economically viable, being thus The loan should be repaid as at when due.

STATEMENT OF RESEARCH PROBLEM

Looking as far back as 1985 (Shekhar, 1985), credit plays an important role in the lives of many people and in almost all industries that involve monetary investment of any form. Credit is mainly granted by banks including to several other functions like mobilizing deposits, local and international transfers, and currency exchange service. Hence, the issue of credit management has a profound implication both at the micro and macro level but for the purpose of this study we are concentrating on the micro level.

Credit management is one of the most important activities in any financial institution and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature." One of the major risk faced by financial institutions relates to unrecovered credits i.e unpaid loans. According to Craig Churchill and Dan Coster (2001), credit risk is a particular concern for financial institutions because most micro lending is unsecured (i.e., traditional collateral is not often used to secure microloans). Hence this study seeks to assess the gap in credit management performance as it particularly relates to small scale enterprises.

Following the adoption of Economic reform programme in Nigeria in 1981, there have been several decisions to switch from capital intensive and large scale industrial projects which was based on the philosophy of import development to Small and Medium Scale Enterprises which have better prospects for developing domestic economy, thereby generating the required goods and services that will propel the economy of Nigeria towards development. It is based on this premise that Ojo .O. (2009), argued that one of the responses to the challenges of development in developing countries particularly, in Nigeria, is the encouragement of entrepreneurial development scheme. Despite the abundant natural resources, the country still finds it very difficult to discover her developmental bearing since independence.

According to Babgana (2010) in Moruf (2013), there is no doubt that small scale enterprises need financial assistance to become sustainable and competitive. These enterprises play a major role in the development of a nation, in-terms of job creation, general development, as well as marketing of goods and services, it is important that they have access to the right facilities needed. However, the principal concern of this study is to evaluate credit management on the performance of small scale enterprise in Nigeria.

The following questions are expected to be answered during the course of this study

1. How effective are the monitoring and supervisory mechanisms put in place for SSE development?
2. To what extent have the SSEs entrepreneurs receptive to credit management?

STUDY HYPOTHESIS

All hypothesis are presented in their null form

H_0: Inadequate loan supervision and monitoring is not a major cause of Small Scale Enterprises bad debt.

H_0: Small Scale Enterprises entrepreneurs receptive to credit management of the financial institution.

SIGNIFICANCE OF THE STUDY

A study of this nature is invaluable not only to the bank's management, share-holders, SSEs, potential investors and depositors but to the economy as a whole. To the bank's management, the study would draw their attention to the importance of assets (loans and advances) to the overall success and growth of their organizations. This spring from the truth that the proper credit management of this resource will enhance reasonable returns on shareholders' investment, this study also seeks to verify if Small Scale Enterprises performs as a result of proper credit management of intermediation activity involves accepting deposits from surplus unit of the economy and channeling it to the deficit units. The role ensures proper allocation of scarce financial sources to the diverse sectors of the financial system thereby improving the overall growth and development of the economic. It also expected that it will aid policy makers in their effort to revamp the sector. Therefore, it is timely, current and relevant not only for the continued visibility of the financial system but the overall growth and development of the economy.

Other than section one that introduced the paper, the remaining segment of the paper is divided into four: section two reviews literature based on empirical and theoretical reviews, section three describes the methodology adopted in the study, section four analyses data and findings lastly, section five concludes the paper and provides recommendations where appropriate.

2. LITERATURE REVIEW

Credit Management

Credit management refers to the total process of lending starting from inquiring about the potential borrowers up to recovering the amount granted (both principal and interest). In the banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, recovery of non-performing loans, etc. (Shekhar, 1985). The issue of credit management has a profound implication both at the micro and macro level. When credit is allocated poorly it raises costs to borrowers, erodes the funds, and reduces banks flexibility in redirecting resources towards alternative activities. Moreover, the more the credit, the higher is the risk associated with it. The problem of loan default, which results from poor credit management, reduces the lending capacity of a bank. It also denies new applicants' access to credit as the bank's cash flow management becomes problematic. In other words, it may disturb the normal inflow and outflow of funds which a bank needs to sustain its lending capacity.

Process of Credit Management

The process of credit management begins with accurately assessing the credit-worthiness of the customer base and his/her business viability. This is particularly important if the bank chooses to extend some type of credit line or revolving credit to certain customers. Competent credit management seeks to not only protect the bank or any financial institution involved from possible losses, but also protects the customer from creating more debt obligations that cannot be settled in a timely manner. When the process of credit management functions efficiently, everyone involved benefits. This study considered Client Appraisal as a variable of Credit Management.

Client Appraisal

The first step in limiting credit risk involves screening clients to ensure that they have the willingness and ability to repay a loan. Microfinance Institutions use the 5Cs model of credit to evaluate a customer as a potential borrower (Abedi, 2000). The 5Cs help FIs to increase loan performance, as they get to know their customers better. These 5Cs are: character, capacity, collateral, capital and condition. A credit analyst typically gives primary attention to the first two C's-character and Capacity-because they represent the most basic requirements for extending credit to an applicant. Consideration of the last three C's-Capital, Collateral, and Conditions- is important in structuring the credit management and making the final credit decision, which is affected by the credit analyst's experience and judgment.

According to Golden and Walker (1993), there are also five Cs of bad debt; which represents things to guard against in order to help prevent problems. They include: Complacency, Carelessness, Communication-breakdown, Contingency, and Competition.

The credit scoring model is a classification procedure in which data collected from application forms for new or existing credit facility are used to assign credit applicants to good or bad credit risk classes (Constantinescu et al., 2010). Inkumbi (2009) notes that capital (equity contributions) and collateral (the security required by lenders) as major stumbling blocks for entrepreneurs trying to access capital. This is especially true for small scale enterprises or young entrepreneurs or entrepreneurs with no money to invest as equity; or with no assets they can offer as security for a loan. Any effort to access finance has to address the challenges related to access to capital and collateral. One way to guarantee the recovery of loaned money is to take some sort of collateral on a loan. This is a straightforward way of dealing with the aspect of securing depositors‟ funds.

Some Problems Facing Small Scale Enterpprises in Nigeria

According to Ekhator (2001:32), the major problems of small scale enterprises sometimes arise from the nature and characteristics of the enterprise. He therefore classifies their problems into two main categories:

1. Problems inherent in the small enterprise.
2. Problems arising from weak institutional support.

Babajide (2002:17) is of the opinion that small scale enterprises major problem is not so with avenues of sourcing funds but their accessibility. Since 1970, when the government changed its industrialization policy to give focus and pre-eminence to small and medium scale enterprises away from import substitution and large scale industrialization, there have been series of incentives, financial, institutional and otherwise by successive governments to promote small and medium scale enterprises. The private initiatives are also legendary. The achievements recorded cannot be said to commensurate with the efforts put into it.

Mordi (2002:35) believes that funding is not the major problems of small scale enterprises. He prefers to view the situation from two perspectives. According to him, most small scale enterprises find it difficult to differentiate between the owner of the business and the business itself. He said that many small business managers run the business without some shape of financial duty and show off gross lack of knowledge about the need to seek equity participation that is capable of lifting the enterprise to more heights but this is grossly neglected.

On the policy side, the fundamental problem he sees is the hassle of offering marketing protection for small scale enterprises. He stated that the authorities do not provide market protection for small scale companies in the country. Taking the local manufacturers into consideration, they face stiff competition from their overseas counterparts, who produce who produce beneath economy of scale that give them unfair advantage. An example is the textile industry in Nigeria. He cited that Nigerian wax used to be the satisfactory among others locally and sold well inside the marketplace before the importation of Hollandies Wax which is being seen as the modern wax and in flip has introduced down the rate of Nigerian wax. He stated so many other reasons to buttress his belief that fund is not the major problem because if you give funds for somebody to produce and you are not buying his products, especially in a place where government is the largest buyer, you are not creating any market for him.

Another area the government can assist small scale enterprises, is in the area of "encouraging patronage". He said that it is not simply enough for the government to champion the "produce more and buy made- in-Nigeria goods" crusade. He said that the government should take practical steps by patronizing small scale enterprises to serve as morale booster. He said that a lot of keyboards used in churches and other places in Nigeria currently are products of small scale enterprises in developed countries. He recalled that when some small scale enterprises in Japan built the keyboard, the government made it compulsory for all public schools to purchase them for use in music lessons. This, thus, enabled the manufacturers to add more mellifluent notes before they were shipped down to Nigeria. Small scale enterprises expert, however, observed that the government appears to have come to grips with the situation by taking a long over-due step to ban the importation of some products such as turkey, beer, bottled water and cigarette lighters.

According to Obitayo (2001:16), small scale enterprises like large scale enterprises assemble finished goods and depend critically on imported raw materials and equipment, and thus suffer from the same problems. But the size, nature, characteristics and isolation of the small scale enterprises have made them more vulnerable to these constraints than the large ones. Hence, the rate of business failures was dominant among small scale enterprises (SSEs).

Despite the efforts made at providing finance and ensuring that the regulatory environment is conducive through the withdrawal of regulations that were inimical to orderly growth and development of small businesses, there are still areas that have not been adequately addressed. Some of these areas are discussed below:

(i). Restricted access to credit facilities:

Finance which is the most critical need of small scale Enterprises (SSE) to establish production plants, upgrade technology, increase capacity etc. has also been identified as their basic problem, reflecting the imperfection in the market. Most Small Scale Enterprises (SSEs) have restricted access to institutional finance including the short-term working capital to meet fluctuating needs. Since the banks are risk adverse, the poor performance of small scale enterprises (SSEs) and the high risks and transaction cost associated with commercial lending have made the banks unwilling to lend to small scale enterprises (SSEs).

Other limiting factors include small scale enterprises (SSEs) inability to provide the required equity capital funds, adequate collateral securities to support loans, shortage of long term loans, restrictive monetary policy and high cost of funds. The wholesale liberalization of the financial sector and the tight monetary policy stance which addressed excess liquidity has resulted in rising interest rates on loans. The specialized target credit scheme such as NERFUND and SME I and II and those provided by the federal and state governments have encountered difficulties due to acute budgetary constraints and lack of counterpart funding and have to a limited extent, succeeded in addressing the funding requirements of small scale Enterprises (SSEs).

(ii) Infrastructure Constraint:

The poor state of the country’s basic infrastructure has remained unsolved, and partly restrained the growth capacities of small scale Enterprises (SSEs). Productive activities in the manufacturing sub-sector are characterized by dysfunctional physical infrastructure, incessant electric power outage and under-utilization of capacities which adversely affect small industries. Also, inadequate provision of essential services, such as telecommunication, access roads electricity and water supply constitutes one of the greatest constraints to small scale industries development.

Most small scale enterprises (SSEs), resort to private provisioning of these facilities at great costs, thereby reducing the available funds of their operations. A World Bank study (1989:3), estimated that such cost accounted for 15-20 percent of the cost of establishing small scale enterprises (SSEs) in Nigeria. This is likely to be much higher today, given the high level deterioration of our basic infrastructure. Contemporary evidence has shown that the relative burden of the compensatory provision of infrastructure facilities is much heavier on small scale enterprises than on a large scale enterprise.

(iii) Technical Constraint:

Like large enterprises, small scale enterprises (SSEs) need modern managerial skills to source resources which are known to be in a short supply in the country. Therefore, government and the organized private sector must jointly ensure that appropriate and functional assistance schemes are put in place for small scale enterprises. In this regard, the National Association of small scale enterprises (NASME) must collaborate with the Industrial Development Centers (IDCs) of the federal government. The Industrial Development Centers must also be better equipped for this purpose.

(iv) Deteriorating Macroeconomic Environment:

The harsh macroeconomic environment in Nigeria has adversely affected the performance of small scale Enterprises (SSEs) and has also become hostile to their survival and growth. Majority of small scale enterprises (SSEs) are grappling with the problem of uncertainty created by the macroeconomic instability and policy shifts. Other sources of uncertainty which impacted negatively on small scale enterprises (SSEs) include high and unpredictable inflation and price instability and foreign debt harden and service obligation.

2.1 Theoretical Review

Credit Risk Theory

Although people have been facing credit risk ever since early ages, credit risk has not been widely studied until recent 30 years. Early literature (before 1974) on credit uses traditional actuarial methods of credit risk whose major difficulty lies in their complete dependence on historical data. Up until now, there are three quantitative approaches of analyzing credit risk: structural approach, reduced form appraisal and incomplete information approach (Crosbie. 2003)

Melton 1974 introduced the credit risk theory otherwise called the structural theory which is said the default event derives from a firm's asset evolution modeled by a diffusion process with constant parameters. Such models are commonly defined "structural model "and based on variables related a specific issuer. An evolution of this category is represented by asset of models where the loss conditional on default is exogenously specific. In these models, the default can happen throughout all the life of a corporate bond and not only in maturity (Long staff and Schwartz.1995).

2.2 Empirical Review

Pyle (1997), in his study on bank chance administration held that banks and comparable money related establishments need to meet expected administrative necessities for chance estimation and capital. Be that as it may, it is a genuine mistake to imagine that meeting administrative necessities is the sole or even the most essential explanation behind setting up a sound, logical hazard administration framework. It was held, chiefs require dependable hazard measures to guide funding to exercises with the best hazard/compensate proportions. They require gauge of the measure of potential misfortunes to remain inside cutoff points forced by promptly accessible liquidity, by leasers, clients and controllers. They require instruments to screen positions and make motivations for judicious hazard taking by divisions and people.

Nagarajan (2001) in his investigation of hazard administration for microfinance establishments in Mozambique found that hazard administration is a dynamic procedure that could preferably be created amid typical circumstances and tried at the wake of hazard. It requires cautious arranging and responsibility on part of all partners. It is urging to take note of that it is conceivable to limit dangers related misfortunes through persevering administration of portfolio and income, by building hearty institutional framework with talented HR and instilling customer train, through powerful coordination of partners.

Achou and Tenguh (2008) additionally led look into on bank execution and credit chance administration found that there is a noteworthy connection between money related foundations execution (as far as productivity) and credit hazard administration (in terms of advance execution). Better credit hazard administration brings about better execution. In this manner, it is of pivotal significance that budgetary foundations hone judicious credit hazard administration and shielding the benefits of the organizations and ensure the financial specialists "interests. This is additionally valid for small scale back organizations. Strategy utilized by the scientists is blended research technique.

Credit hazard radiates from the way banks manage people, corporate, money related foundations or sovereign substances. A terrible portfolio may pull in liquidity and also credit chance. The point of credit hazard administration is to amplify a bank's chance balanced rate of return by keeping up credit chance introduction inside adequate limit. The effective administration of credit chance is a key piece of the general hazard administration framework and is essential to each bank's base and in the long run the survival of all managing an account foundations. It is in this way critical that credit choices are made by sound investigations of dangers required to maintain a strategic distance from damages to bank's gainfulness. They held powerful administration of credit hazard is a basic part of a far reaching strategy to chance administration and basic to the long haul achievement of all saving money organizations.

Sindani (2012) in her investigation on Effectiveness of Credit Management System on Loan Performance: Empirical Evidence from Micro Finance Sector in Kenya discovered that Credit expressions detailed by the microfinance establishments do influence advance execution; the contribution of credit officers and clients in defining credit terms influences advance execution. Financing costs charged negatively affected the execution of the credits, the higher the financing costs the lower the advance execution.

Brewer (2007) observes that lending to small firms is difficult because of the problems of information asymmetry. However, innovative ways to address the problems have the potential to increase credit availability to the firms. The two different innovations in small business financing are: increased usage of credit scoring technology and the introduction of microfinance lending institutions. Though these two approaches make use of different technologies, they provide a valuable picture of how lending to small firms is evolving over time.

Olomola (2002) found that repayment performance is significantly affected by borrower's characteristics, lenders characteristics and loan characteristics. Repayment problems can be in form of loan delinquency and default. Whatever the form however, the borrowers alone cannot be held responsible wherever problems arise, it is important to examine the extent to which both borrowers and lenders comply with the loan contract as well as the nature and duties, responsibilities and obligations of both parties as reflected in the design of the credit programme rather than heaping blames only on the borrowers.

The above empirical review of literature emphasizes that all the studies so far conducted are mainly discussing the loan recovery problems, determinant factors for default of borrowers in financial institutions in general at Micro-level. Having also observed in the review of literature that there are no studies conducted mainly to evaluate the effectiveness of credit management in the performance of small scale enterprises which is seen as a major catalyst of economic development. Thus, it felt appropriate to take up the present study entitled "THE EVALUATION OF CREDIT MANAGEMENT IN THE PERFORMANCE OF SMALL SCALE ENTERPRISES IN NIGERIA" to conform whether financial institutions are really managing credit as it is to be managed, if the small scale enterprises are been given a chance of survival in the accessing of funds to thrive, if truly thorough credit management aids the performance of the small scale businesses thus identifying credit management problems and thereby to recommend courses of action that are assumed to promote quality loan growth and curtail non-performance as it affects the small scale enterprise.

3. METHODLOGY

This section concentrates on the research techniques adopted and used for this study with the aim of achieving its research objectives. This study was based on primary data. Primary data were responses collected from both staff and customers (business owners) of selected deposit money bank and microfinance banks. Data collected from the questionnaire were analyzed, interpreted and summarized, accordingly. The questionnaire used was the five point scaled questionnaire (Likert type) consisting of few but relevant questions to the study.

Data analysis

Descriptive statistics of Hypothesis 1

In order to test this hypothesis, the questions generated were administered to the staff of a selected financial institutions located within Ogun and Lagos State in Nigeria. These states were selected because of their proximity to the researchers. A total of 200 questionnaires were administered and 150 questionnaires were returned properly filled. Shown below are the mean and standard deviation of cumulative respondents

Hypothesis 1	Total respondents	Mean	Standard deviation
Inadequate loan supervision and monitoring is not a major cause of Small Scale Enterprises bad debt	150	25.2533	8.79273

Figure 1: Field Survey 2017

From fig 1, the standard deviation of 8.79273 shows that the observations were spread within 3 standard deviation on each side of the mean.

Staffs of Financial institutions agree that inadequate loan supervision and monitoring is not a major cause of Small Scale Enterprises bad debt. Based on the findings of the survey carried out 63% of respondents agreed that they ensure that funds made available to SSE are utilized for the sole purpose of their respective businesses and 67% of the respondents acknowledged the practice of regular visitation to SSE customers to ensure proper monitoring. However, based on the respondents only 27% of the SSE customers repay their loans as at when due. This could be as a result of mismanagement of funds or lack of proper books of account being kept or even as a result of operational negligence of their business.

Descriptive statistics of Hypothesis 2

In order to test this hypothesis, the questions generated were administered to the customers of the financial institutions particularly Small Scale Enterprises or Entrepreneurs within the selected located within Ogun and Lagos State. A total of 300 questionnaires were administered and 200 questionnaires were returned properly filled. Shown below are the mean and standard deviation of cumulative respondents

Hypothesis	Total respondents	Mean	Standard deviation
Credit management do not affect the performance of Small Scale Enterprises	200	28.675	10.9946

Figure 2: Field Survey 2017

From fig.2, the standard deviation of 10.9946 shows that the observations were spread within 2 standard deviations on each side of the mean. Based on the survey carried out 60% of the SSE respondents are of the opinion that the credit facilities obtained from financial institutions have helped improved their businesses. 60% of the respondents are also of the opinion that the success of SSEs lays in the collaboration between financial institution and SSEs. This collaboration could be in form of financial advisory service especially in the areas of management and investment of funds or easier means of transacting business like introduction of POS machines and internet banking.

Furthermore, 73% of the staff of the financial institutions and 62% of SSEs respondents agrees that regular training of credit officials and good governance put in place are key indicators for effective credit management.

4. CONCLUSION AND RECOMMENDATION

From the findings, the study found that inadequate loan supervision and monitoring is not a major cause of Small Scale Enterprises bad debt and also that credit management affects the performance of small scale enterprises. The study revealed that inability for the some small scale enterprises to pay outstanding facilities as at when due could be as a result of result of mismanagement of funds, lack of proper books of account being kept or even the frequent method of transacting business based on Cash payment.

How effective financial institutions manage the credit given to small scale businesses determine the performance of such businesses. The process of appraisal, the process of effectively identifying small businesses that genuinely need credit facility and ensuring the funds are been utilized for that same purpose must be the primary duty of the credit managers or credit staff of financial institution.

It is said that small businesses are catalyst for economic development. This study hereby recommends the need to regularly train credit managers, staff and workers on the methods on appraisal techniques so as to be able to identify entrepreneurs worthy of receiving and utilizing credit for business purpose, and this process in turn reduces non-performing loans. It is also important for the credit staff to be equipped enough to provide their clients especially small scale entrepreneurs with financial advice regarding keeping proper books of records.

There is also need for the financial institutions to introduce modern and easier ways for doing business like the point of sale(POS) to these small scale business so the issue of misappropriation of funds or too much cash in hand will be reduced to the barest minimum and also hasten the pace of doing business.

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