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Review Article

A Review of the Effect of Credit Risk Management on Financial Performance of JAIZ Bank-Nigeria (2015-2020)

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Abstract

Credit risk management of Deposit Money Banks (DMBs) has turn out to be more central not only because of the financial difficulty that the entire banking industry is facing but as an essential concept which determines the industries' survival, growth and financial performance. The main aim of this review study is to conceptually review the effect of credit risk management on financial performance of JAIZ bank in Nigeria. Twenty 25 selected and relevant literatures were reviewed which were used to analyze for five years (2015 – 2020). Return on Equity (ROE) and Return on Asset (ROA) were used as the performance indicators while Loans-to-Deposit Ratio (LDR), Non-Performing Loans (NPL) and Capital Adequacy Ratio (CAR) as credit risk management indicators. The findings indicated that credit risk management has a significant impact on financial performance of JAIZ bank in Nigeria. It is therefore advocated that to enhance financial performance and minimize the risk of non-performing loans in the future, JAIZ bank management must watch very carefully the loans' performance and analyze thoroughly the clients' credit payments history as well as their debts accumulated prior to any approval of loan applications to be granted to them. Furthermore, Deposit Money Banks financial managers should continuously improve firm's assets utilization, liquidity, and techniques of managing operating costs, improve the effect of capital adequacy, and the use of deposits for lending activities from a weak positive impact to a significant positive impact on their liquidity and profitability. The researchers recommend that future studies on credit risk management influence on banks' financial performance should consider more independent variables and longer periods of study such as twenty or thirty years to have more accuracy and generalized results.

Keywords: Firm size, Credit risk, management, JAIZ, Profitability, Bank and Financial Performance

Introduction

Financial performance of firms globally is the center and the pillars of every nation's economic and financial system; hence, the stability and underlying economic performance of banking industries is vital and paramount to the economic development of a developing nation like Nigeria. The stakeholders in the industry ranging from shareholders, investors and the policy makers have high agitation on the financial performance of the industry because of the existing risks of not getting adequate returns on the investment. The lengthy history of corporate failure linked to poor bank financial performance and reporting failure are very worrisome as the cumulative impact of these high-profile cases had led to steady bank losses in investments, credibility and confidence of stakeholders in the ability of company's handling of investor's funds and the inherent credit risks (Mehmood, Hunjra & Chani, 2019).

Banks are the key players in economic development through effective financing of economic activities, and contribute to the stability of the countries' financial systems, as they are they are able to withstand economic shocks and are the most capable of directing available profits or dividends and funds to areas where liquidity deficits and demand for

these investments are made through the practice of credit activity (Bessis, 2010), which is one of the main sources of the industry's income, and on the other hand, credit activity involves many risks facing the lender and borrower such as liquidity risk, Market risk, credit risk, capital risk, interest rate risk, exchange rate risk, political risk, and other types of risks.

However, the current study will focus on credit risk as one of the most important types of risk faced by the banking industries. In addition, this type of risk is one of the risks that cement lenders face because of the weak ability of borrowers to pay back their loans which puts the money of savers at risk and therefore the industry will face significant losses that may lead to financial distress that negatively affects the economic growth and development. This type of risk cannot be avoided by banks as it is linked to their core activity, which is credit, so they are constantly trying hard to reduce these risks by developing credit policies that will raise the quality of loans and reduce the volume of non-performing loans, as the higher the credit risk at the company or factory, the greater the probability of financial crises and vice versa. Therefore, the banking industry always seek to reduce these risks by ensuring that debtors have guarantees and assets that exceed the value of their loans in proportions determined by the Deposit Money Banks based on many factors, including the instructions of corporate stakeholders.

Furthermore, Gaturo (2018) added that firms's ability to manage credit risk is of important for the its business performance, continuity, and survival since the major source of income of the banks is the interest margin gained from productions and sales activities. The sound management of credit activities of the firm and the ability to deal with its risks of these activities significantly affects its profitability and overall performance (Athanasoglou et al., 2008). Accurate measurement of the size and ability to deal with credit risk reduces the marginal cost of debt and capital and thus decreases the cost of money owed by the company (Basel, 1999). Therefore, good credit risk management (Bhattarai, 2016) keep the business from reaching financial hardship and unexpected losses, besides poorly performing banks, which are exacerbated by increased credit risk and continued negative effects, may leave their customers to their destiny or reschedule their plans, change their strategies, change their capital structure, or even resort to merging with other better factories on terms that may be difficult for them and may therefore have to do so as a difficult option or a last resort. Therefore, Deposit Money Banks that perform poorly because of the inability to manage their credit activity may have to liquidate or merge when they are exposed to financial hardship that turns from temporary to permanent, thus resulting in large losses in debt, part of which eventually turns into bad debt and, as a result, hundreds or thousands of employees lose their jobs and thus negatively affect the economy and development.

Accordingly, poor credit risk management in any industry is a main reason behind their failures (Kalui, 2015). The link between Deposit Money Banks performance and risk management is critical in understanding an empirical analysis of the determinants of banking industry performance and their impact on risk management practices. It presents available theories and empirical evidence on the link between its profitability and credit risk management (Ebrahim Almekhlafi et al., 2015). Due to their intermediary function between lenders and borrowers, today Deposit Money Banks have an important role for all economies. On the other hand, savers can have a chance to gain interest income with their excess funds (Gaturo, 2018).

As a result of being a developing economy, Nigerian financial system (JAIZ Bank included) has since its inception witnessed significant challenges both domestically and internationally. In addition to economic challenges, the political issue and heightened security risk increased the crystallization of political risks which caused negative fallout in business environment. Recently, there is shortfall of income from export of crude oil as well as foreign exchange reserve, given rise to increase in inflation as well as currency pressure (Kanu & Nwali, 2019). Financial Performance is a measure of the results of a firm's policies and operations in monetary terms. These results are shown in the firm's return on investment, return on assets, shareholder value, accounting profitability and its components. It is the subjective measure of how efficient a firm can use assets from its primary mode of business and generate revenues and create value for its shareholders (Gaturo, 2018). Financial stability when guaranteed is vital for any nation so therefore such activities need to be properly and adequately managed. The velocity of loan creation in an economy has significant impact on the productive activities in a nation which literally has impact on the firm's performance (Taiwo et al., 2017).

Financial risk is integral in any business enterprise, and good risk management is an essential aspect of running a successful business (Maverick, 2021). Credit risk management has been an essential part of the loan process in banking. According to Choudhary (2021), credit risk is in fact regarded as the most important mediating role of Deposit Money Banks‟ (DMBs). Credit risk is an endogenic determinant of bank performance, therefore, risk management toward credit affects the profitability of banks. Through effective credit risk management, banks not only support the sustainability and profitability of their operations but also contribute to economic stability and efficient allocation of capital within the economy (Ramazan & Gulden, 2019). Credit risk is the most important risk faced by the financial institutions, particularly by banks. It is defined as the probability that borrowers will fail in fulfilling their obligations on the due date (on the terms and conditions agreed in the loan agreement). It is compulsory by law for all the banks to maintain loan loss reserves to protect from such losses (Shahid Gul & Naheed, 2019). Risk management is to maximize performing

asset and minimize nonperforming asset as well ensuring the optimal point of loan and advance and their efficient management (Verdiyani, 2019).

In the same vein, sound credit risk management policies maximize banks' performance by handling credit risk exposure within the acceptable standards. Banks usually monitor closely and conduct rigorous credit analysis of counterparties and different products. This results in interest rate risk which is directly connected to credit risk, and this implies that an increase in interest rates raises the probability of loan default (Serwada, 2018).

Due to ineffective risk management practices and non-compliance to the rules, the financial performance of banks is adversely affected. However, to improve the financial performance, the Pakistani banking sector has introduced modern ways (internet banking) to run their financial activities, which has great exposure to default credit risk and risk of losing customers (Gaturo, 2018, Ongore & Kusa, 2013). Due to a lack of financial risk management formalization and a lack of utilization of financial risk management tools, responsibility for the financial resources is still lacking. Abubakar et al (2016) opined that efficient credit risk management in banks is germane not only because of the consistent financial distress and crises, but also a major factor which determines banks' survival, growth and profitability. However, credit extension which is at the core of banking operation is possibly the most significant of all risks in terms of quantum of potential losses. For most banks, loans are the largest source of credit risk. Hence, the focus of banks' risk management is mainly on credit risk.

Credit risk cannot be avoided by banks as it is linked to their core activity, which is credit, so banks are constantly trying hard to reduce these risks by developing credit policies that will raise the quality of loans and reduce the volume of non-performing loans, as the higher the credit risk at banks, the greater the probability of financial crises and vice versa. Therefore, banks always seek to reduce these risks by ensuring that borrowers have guarantees and assets that exceed the value of their loans in proportions determined by the bank based on many factors, including the instructions of central banks.

Furthermore, the bank's ability to manage credit risk is of important for the bank business performance, continuity, and survival since the banks' major source of income is the interest margin gained from lending activities (Salem & Omar, 2021). Efficient and effective risk management is ideal for the survival of banks as it enables them to allocate resources to risk units considering a trade-off between risk and return on investments (Ogbol & Okallo, 2013). Credit risk management is a strategy that banks worldwide have resorted to in protecting bank balance sheets and depositors' savings. Relaxed regulatory measures typically result in what is perceived as institutional governance failure or, in short, systemic market failure (Jackson & Jabbie, 2019).

According to Serwadda (2018), given a couple of risks faced by banks, management of credit risk is always given particular attention since losses incurred on loans directly affect banks profitability. Thus, sound credit risk management policies maximize banks' performance by handling credit risk exposure within the acceptable standards. Banks usually monitor closely and conduct rigorous credit analysis of counterparties and different products.

This study is motivated by the recent classification and licensing of Deposit Money Banks (DMBs) in Nigeria into international, national and regional banks. The classification was based on meeting specified minimum capital limit set by the Central Bank of Nigeria. In spite of this classification and the minimum capital requirements, banks still develop symptoms of distress. And, the performance of a bank can be measured in various ways using different parameters.

In this study the researcher chose Capital Adequacy Ratio, Non-performing Loan and Loan-to Deposit Ratios as measures of JAIZ bank performance. This is to afford the researcher an opportunity to assess whether selected variables of credit risk affect return on assets and return on equity similarly or differently. The driving force for this study is the fact that financial intermediation which is the core function of financial institutions/intermediaries which involves transfer of funds from surplus economic units to deficit economic units, like every other business, is faced with several risks' factors, major among them is credit risk.

The review of past empirical literature indicated a lack of agreement in the findings of most scholars. This lack of consensus points to the existence of a research gap and therefore the need for further research on this subject. The problem of bank failures and its costs, and the lack of consensus in the findings of previous studies are the motivation for this study. It is based on this background that this study conceptually looks into the impact credit risk management on banks performance in Nigeria by reviewing current literature and assesses their effects on performance of Deposit Money Banks (DMBs) in Nigeria by using unique proxies of credit risks management in the field.

Objective of the Study

The main objective of the study review literatures on the moderating effect of firm size on the relationship between credit risks management and financial performance JAIZ bank Nigeria. Specifically, the study aimed to review and:

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1. Determine the effect of Capital Adequacy Ratio on JAIZ bank financial performance in Nigeria
2. Evaluate the effect of Non-performing Loans on financial performance of JAIZ banks Nigeria
3. Determine the effect of Loans-to-deposit ratio on financial performance of JAIZ bank in Nigeria.

Statement of Problem

The economic development of any nation depends on the existence of well-organized financial system. This is possible because it is the financial system that could provide inputs for the production of goods and provision of service that in turn will affect the standard of living of nations or even continent (Franklin & Elena, 2012).. The financial system is a complex system that comprises of financial institutions, financial markets and instruments. Financial institutions are intermediaries that transfer funds from the surplus unit to deficit unit of the economy (Teshome, Debela and Sultan, 2018).

Financial institutions have played a very important role in financing an economy and some studies have appreciated the role of commercial Banks in any economy as conduits of financial resources through savings mobilization (Franklin & Elena, 2012). However, most Deposit Money Banks engage in transactions that put banks at the risk of incurring bad debts, which if incurred reduce Loan Performance (Selene, 2017). The Nigeria banking system (JAIZ bank included) still encounters a lot of problems, which has disrupted its operation in the country. It was reported that the non-performing loans of banks in Nigeria raised by 5.3 percent an indication of how borrowers are unable to fulfil their repayment obligation (Premium Times, 2021).

Despite the measures taken, the Nigerian banks still encounters series of problems leading to the closure of 234 bank branches and 649 Automated Teller Machines (ATM) in 2020 leading to decline in the country’s Financial Access Score (FAS) to 4.44 in the year as against 4.78 percent in 2019. The two FAS indicators are Number of Commercial Bank Branches per 100,000 Adults and Number of ATMs per 100,000 Adults. According to the report, Nigeria recorded declines in these two critical FAS indicators and 12 other indicators among the 64 indicators measured by the FAS. This according to the report, was due to the decline in the number of Deposit Money Banks branches in Nigeria to 5,158 in 2020 from 5,392 in 2019 (IMF,2021).

In the same vein The Nigerian economy recorded marginal growth of 2.01% in Q1 and 1.94% in Q2, 2019, suggesting that recovery from recession was still weak, however with a promising outlook. Inflation, declined slightly from 11.44% in Q4 2018 to 11.25% in Q1 2019, and then rose to 11.40% in Q2 2019. Relative stability remained in both the Investors’ and Exporters’ (I&E) window of the foreign exchange market due to autonomous inflows and sustained intervention efforts of the CBN. Nigeria’s External Reserves which stood at US$43.11 billion in Q4 2018 rose to US$44.43 billion in Q1 2019 and US$45.07 billion in Q2 2019. The CBN continued to maintain MPR rate at 13.50%, with implications for increase in firms’ access to credit, improvement in Loan to Deposit Ratio, and reduction in Non-Performing Loans. However, in order to further invigorate economic growth through investment in the real sector, the CBN had directed that all DMBs should maintain a minimum Loan to Deposit Ratio (LDR) of 60% by September 30, 2019.

In addition to the recent special MSME intervention funds where small businesses could have access to affordable financing. These economic developments impacted financial sector performance in Q1 and Q2 of 2019, as reflected in key financial indicators which were mostly on an increasing trend. Total Industry Assets increased from ₦35.10 trillion in Q4 2018 to ₦36.54 trillion and ₦38.04 trillion in Q1 and Q2 2019, respectively. Total Deposits from Customers also increased from ₦21.73 trillion in Q4 of 2018 to ₦22.00 trillion in Q1 of 2019 and ₦22.84 trillion in Q2 of 2019. The Capital to Risk-Weighted Assets Ratio (CAR) declined slightly from 15.55% in Q1 2019 to 15.26% in Q2 2019. Moreover, Statistics also indicated that the banking industry maintained a virtually stable performance in the first two quarters of 2019. During the period, the banking industry average CAR decreased from 15.55% in Q1 2019 to 15.26% in Q2 2019. Total Industry Assets increased by 2.79% between Q1 and Q2 2019. The Net Credit to Deposits Ratio remained at an acceptable position, that is, below 80%. Profit before Tax (PBT) decreased by 3.29%, Operating Expenses increased by 7.82%, while Recoveries rose by 120.08% during the period under review. Impaired Credits to Total Credits, while above the prudential threshold continued on a decreasing trend.

Nigerian Deposit Money Banks suffered following the 2009 and 2016 recession, ultimately leading to the creation of a bridge banks, Keystone Bank took over the operation of Bank PHB, Afribank taken over by Mainstreet Bank Limited, Spring Bank by Enterprise Bank then of recent Polaris Bank taken over Skye Bank’s operations and assets in 2018. Without a doubt, recent challenges with Nigeria’s banking system have affected the wider economy. The Central Bank of Nigeria (CBN) has been instantaneous in strengthening the sector, from the 2009 intervention that created the Asset Management Corporation of Nigeria (AMCON), to the aforementioned rescue of Skye Bank. Despite these efforts, the Nigerian banking system is yet to reach true stability (Vanguard 2020).

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Given that a bank's core business activity is giving out loans and earning interest on them, Nigerian banks' failure to do so is an issue and has impacted profitability. As much as 40% (₦577 billion) of these NPLs can be traced to the oil & gas sector, which Nigerian banks have historically favored, but has suffered since the 2014 and 2020 oil price crash (NBS, 2019). But high NPLs don't just hurt banks, the whole economy suffers. Borrowers struggle to get additional funding because Deposit Money Banks become risk averse and conscious of their poor asset quality, leading them to focus more on debt recovery. Many individuals and small businesses in Nigeria struggle to get decently priced loans and their plight is not helped when a bank is risk-averse because it already has lots of bad loans on its books. Nigerian banks are exposing to the oil & gas and power industry have increased the vulnerability of banks to headwinds from these sectors. Average non-performing loan ratio of Nigeria banks ascended to 11.6%, compared to less than 5% at the end of 2015 (Premium times, 2017). Nigerian commercial banks have an average of 30% loan-book exposure to the oil and gas industry. Given the lower price of oil, it is no surprise that many oil companies have struggled to service these loans. First Bank of Nigeria, a Tier 1 bank, has seen its non-performing loans ratio skyrocket and is currently one of the highest in the country. Many banks also have high exposure to the power sector due to over $1.3 billion in credit facilities extended to power companies. (Bloomberg, 2017). Against this backdrop, several Nigerian banks have had to make higher provisions for loan losses.

The few previous studies on the effect of management of credit risk on the financial performance of Deposit Money Banks in Nigeria (Abiola & Olausi,2014), The Effect of Credit Risk on Financial Performance of Deposit Money Banks in Turkey (Poyraz & Ekinci, 2019) and Bhattarai (2019) all looked at similar topic but inconsistent in findings on the relationship between credit risk and financial performance of Deposit Money Banks. In another study by Kurui & Kalio (2014) investigated impact of management of credit risk on the loan performance of MFIs. The study established that management of credit risk practices has influence on loan performance of MFIs but the study was on loan performance and not financial performance. Most studies have dealt with management of credit risk measured in terms of non-performing loans (NPLs) and not on management of credit risk practices of the banks. Thus, the question; what are the impacts of credit risk management on performance in financial perspective of Nigerian commercial banks? This study will look at current state based on a different methodology in Nigerian context.

While some studies in the literature show that credit risk has a positive effect on the financial performance of banks, the majority of the studies concluded that there is a negative relationship between credit risk and financial performance. Another group of studies suggest that other factors apart from credit risk management impacts on bank's performance. Hence, a further study on credit risk management and financial performance of deposit money banks in Nigeria will not only help in the formulation of effective policies to ensure the sustained stability of the country's banking sector but also bridge the gaps in the literature.

The problem that led to this conceptual review is poor credit risk management which has been unstable, and this is a virus that has cause a great disturbing effect on the performance of deposit banks in Nigeria especially at JAIZ Bank. Existing research like Adewunmi (2021), Onyenwe (2019) and Taiwo, Ucheaga and Achugamonu (2017) have all examined the impact the financial performance of DMBs operating in Nigeria have produced mixed results and in different context. While some concluded that credit risk management has a positive relationship with banks performance, other results appeared to contradict. Also, several other studies have concluded that credit risk management has helped Deposit Money Banks improve on their profitability. The actual relationship between risk management (credit and liquidity) and its impact on Deposit Money Banks performance is yet to be settled and researchers do not necessarily split these risk factors into categories while embarking on finding a solution.

The current study attempts to close the gap and identify the risk factors affecting the financial performance of Deposit Money Banks and the soundness of their financial performance in Nigeria due to the importance of the banking sector and the lack of sufficient research studies to highlight the effect of credit risk management on Deposit Money Banks' financial performance. Therefore, the main objective of this research is to conceptually assess the impact of credit risk management and financial performance of Nigerian Deposit Money Banks in Nigeria (2012-2021)

The Conceptual Review of Literature

Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Tobash M. I. (2016).. The term is also used as a general measure of a firm's overall financial health over a given period. Financial performance measures an organization's ability to manage finances. It is evaluated based on a firm's assets, liabilities, revenue, expenses, equity, and profitability. Financial ratios serve as crucial indicators. It measures firms' financial well-being using data provided in financial statements.

The financial performance of deposit money banks has critical implications for the economic growth of any given country. Appah &Inini (2019) stated that financial performance of corporations' construct has two different perspectives, namely, growth and profitability, and each of these perspectives might be operationalized by using one or more

indicators. Firm financial performance is commonly reflected in the calculation of financial ratios that show the link between numbers in the financial statement. The financial ratios may include the computation of the profitability, efficiency, liquidity, gearing, and investment of a firm. Moreover, firm financial performance generally may also be reflected in market-based (investor returns) and accounting-based (accounting returns) measures. Examples of market-based indicators to measure firm financial performance are price per share and Tobin's Q which indicate the market value or the share of the firm as well as the financial prospect of the firm in the future. Financial performance depends on various factors. Some of them are Capital Adequacy, Asset Quality, Management Efficiency, Liquidity, Gross Domestic Product etc. Therefore, in order to ensure sound financial performance banks should focus on the factors likely to affect profitability and the extent of their impact, 2010). These factors can be classified into bank specific (internal) and macroeconomic variables. The internal factors are individual bank characteristics which affect the bank's performance. These factors are basically influenced by the internal decisions of management and board. The external factors are sector wide or country wide factors which are beyond the control of the company and affect the profitability of banks Teimet & Lishenga (2019).

The empirical results of the researches (Raza, Farhan &Akram,2011) explained that a company, which has better efficiency, does not mean that always it will show the better effectiveness. Their study settles that ranking of banks differ as the financial ratio changes. The ability to support the present and future operations of a bank depends on the quality of its earnings and profitability profile (Shar, Shah & Jamali, 2011). Kolapo & Ayeni (2012) carried out an empirical investigation into the quantitative effect of credit risk on the performance of commercial banks in Nigeria over the period of 11 years (2000-2010). The results showed that an increase in non-performing loan and loan loss provision reduce profitability (ROA) of banks while an increase in total loan and advances lead to increase profitability. The determinants of bank performance can be put into three groups: variables that are induced by management decision and policy objectives (bank-specific factors), variables that capture the industry structure and market growth (industry-specific factors) and elements that reflect the economic atmosphere under which the bank operates (macroeconomic factors).Appah and Inini (2019) stated that financial performance of corporations construct has two different perspectives, namely, growth and profitability, and each of these perspectives might be operationalized by using one or more indicators. Profitability, for example, can be measured by variables such as Return on Equity (ROE), Return on Assets (ROA), or even the Return on Investments (ROI), while growth can be measured by increase in sales.

Credit Risk Management

Risk means the perceived uncertainty connected with some event Musyoka, K. B. (2017). Bankers maybe most interested in achieving high stock values and high profitability, but none can fail to pay attentions to the risks they are attached to these decisions. Bankers are concerned with many types of risks such as credit risk, liquidity risk, market risk, interest rate risk, earnings risk, foreign exchange risk and solvency risk (Chen, 2012; Kargi, 2011).

Credit risk refers to delinquency and default by borrowers, that is failure to make payment as at when due or make payment by those owing the bank or firm. Credit risk is found in all activities in which success depends on counterparty, issues or borrower performance.

Credit risk management in banks has become more important not only because of the financial crisis that the industry is experiencing currently, but also a crucial concept which determine banks' survival, growth and profitability. The exposure to credit risk is particularly large for financial institutions such as commercial and merchant banks. When firms borrow money, they are in turn expose to credit risk. However, credit risk arises from nonperformance by a borrower. It may arise from either an inability or unwillingness to perform in the contracted transactions. This can affect the entity holding the loan contract as well as other lenders to the creditors. Consequently, borrowing exposes the firm's owners to the risk that the firm generally will have to pay more to borrow money because of credit risk (Onyenwe, 2019).

Kithinji, (2010) assessed the effect of credit risk management on the profitability of Deposit money banks in Kenya. Data on the amount of credit, level of non-performing loans and profits were collected for the period 2004 to 2008. The findings revealed that the bulk of the profits of commercial banks are not influenced by the amount of credit and non-performing loans, therefore suggesting that other variables other than credit and non-performing loans impact on profits. The study did not examine the casual link between risk management and performance of deposit money bank rather the casual link was established on sectoral level.

The Nigerian economy in specific and the world in general were partially explained by Felix and Claudine, (2008), the writers centered their work on impacts causes, natures of risk management. A bank exists not only to accept deposit but also to grant credit facilities and therefore is inevitably exposed to credit risk. In other words, the intermediation function of a bank naturally exposes them to credit risk: Credit risk is by far the most significant risk faced by banks and the success of their business depends on accurate measurement and efficient management of credit risk more than any other risks (Gieseche, 2004).

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Chen and Pan (2012) argue that credit risk is the degree of value fluctuations in debt instruments and counterparties. Coyle (2000) defines credit risk as losses from the refusal or inability of credit customers to pay what is owed in full and on time. Credit risk is the exposure faced by banks when a borrower (customer) defaults in honoring debt obligations on due date or at maturity. The risk interchangeably called „counterparty risk" can put the bank in distress if not adequately managed.

The credit risk policies are measures employed by banks management and is crucial to banks to enhance profitability and guarantee its survival. The main sources of credit risk include, limited institutional capacity, inappropriate credit policies, volatile interest rates, poor management, inappropriate laws, low capital and liquidity levels, direct lending, massive licensing of banks, poor loan underwriting, laxity in credit assessment, poor lending practices, government interferences and inadequate supervision by the regulators (Kithinji, 2010). An increase in bank credit gradually leads to liquidity and solvency problems. Credit risk may increase if the bank lends to borrowers, it does not have adequate knowledge about. Credit risk management maximizes bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable limits in order to provide framework for understanding the impact of credit risk management on banks" profitability (Kargi, 2011).

Capital Adequacy Ratio (CAR)

Capital adequacy (CAR) ratio according to Yüksel, Özsarı (2018) is an internal measure of total capital to total assets. This ratio indicates whether the bank needs external sources of financing or not, as the higher the capital adequacy ratio, the lower the need for external financing and therefore the lower external financing costs and lower bankruptcy costs and risks (Staikouras CH & Wood, 2003). Capital adequacy ratio according to the Basel criteria amounts to 8% of risk weighted assets and based on the principle of caution: the banking regulatory and supervision agency (BRSA) imposed an additional 4% requirement. This ratio shows the bank's ability to deal with potential losses and bankruptcy risks, so there is a statistical positive relationship between the capital adequacy ratio and banks' profitability (Athanasoglou et al., 2008).

Non-Performing Loans Ratio (NPLR)

This ratio is an important measure of the quality of assets and good composition and validity of the loan portfolio, in addition to the efficiency of the bank's credit risk management. However, a high non-performing loans ratio is a warning indicator to bank management and supervisors and indicates that banks have a weak quality of assets and a high risk. Accordingly, the ratio of non-performing loans to total loans negatively affects the bank's efficiency and return on asset (Boahene et al., 2012). Moreover, the non-performing loan is a loan in which the customer's payments are late (Kauko, 2012). In addition, the International Monetary Fund (IMF) defines a loan as a non-performing loan once the borrower has delayed the payment of interest and principal payments for more than 90 days; or "more than 90 days' worth of interest has been refinanced, capitalized, or delayed by agreement; or payments are less than 90 days overdue but are no longer anticipated" (Akomeah et al., 2020).

Loans-to-Deposit Ratio (LDR)

The loans-to-deposit ratio indicates the ability of banks to manage their loan portfolios and deposits. It is therefore one of the most important measures of credit management efficiency for lending policy and control and the polarization of deposits from institutions and individuals, and it reflects the level of quality of assets. The higher the loan-to-deposit ratio, the more increase in the level of lending risk and thus reduces the quality of loans or in other words increases the rates of non-performing loans; however, the more the bank can convert deposits into high quality loans, the higher the profit margin from lending interest. Therefore, deposits have a positive effect on the banks' profitability.

Theoretical Review (Anticipated Income Theory)

Anticipated income theory was propounded by Herbert Victor Prochanow in 1944 at the end of World War II as a result of the fact that the compositions of the earnings assets of commercial banks began to change as resources shifted from the government to the private sector. The spectacular rise in the loan demand of the immediate postwar years provided Deposit Money Banks with strong incentives to expand their loan portfolios and hence increase bank earnings. After the postwar, the banks began to make loans that were of longer maturity, covered a much wider variety of borrowers and extended too many more purposes than originally envisaged. As a result, the bank's management acquired more experience in meeting withdrawals and found that through prudent asset management, a mixture of very liquid and not-so-liquid assets could achieve the desired degree of overall liquidity. Thus, the loan portfolios of commercial banks in the postwar years included such items as intermediate and long-term loans to customers, home owners and business firms that would not qualify as liquid assets under the traditional theory of bank liquidity and would qualify only in part, if at all under the theory. However, loans of this type qualify under the anticipated income theory. According to Ibe (2013), while looking at the anticipated income theory holds that a bank's liquidity can be managed through the proper phasing and structuring of the loan commitments made by a bank to its customers. Here the liquidity can be planned if the scheduled loan repayments by a customer are based on the future cash flows of the borrower. The theory also

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emphasizes the earning potential and the credit worthiness of a borrower as the ultimate guarantee for ensuring adequate liquidity.

The Credit Risk Theory

Founded by Robert Merton in 1974 this school of thought states that in spite of the fact that individuals have been confronting credit chance as far back as early ages. According to Emekter, Tu, Jirasakuldech and Lu (2015), credit risk has usually not been focused on until late 30 years. The credit risk theory indicates the risk that the lender will be delayed or defaulting on the installments or interests owed to him or both to the borrower, where the risk is that the lender will be exposed to financial distress after which he cannot return deposits to their owners or meet his other obligation due to the loss of capital and interest and the lender's exposure to significant losses resulting from borrowers not paying their obligation to lenders, which is now called non-performing loans (Dimitrios & Louzis, 2012). Accordingly, lenders would conduct a credit check and request appropriate loan insurance such as mortgage insurance and request enhanced guarantees for mortgages on the borrower's assets such as personal guarantees or guarantees from third parties. Therefore, the level of risk for borrowers directly affects the cost of loans such as interest, fees, etc. This theory is relevant to the research because Deposit Money Banks face credit risk of loan beneficiaries failing to repay the principal and interest as agreed and hereby adopted.

Jaiz Bank Plc (JAIZBANK.ng)

Jaiz Bank Plc is a financial services institution providing Islamic non-interest banking services for retail, commercial and corporate sectors. Its full service product offering ranges from transactional accounts and term savings to working capital, real estate, personal, medical, education and project finance. Jaiz Bank provides online banking, leasing, banking cards and bonds and guarantees. The company has a national footprint with 27 branches located in the major towns and cities of Nigeria. Jaiz Bank Plc was founded in 2003. Jaiz Bank Plc was the first Islamic bank established in Nigeria. The bank was license on 11th November 2011 as a foundation trust to operate only in the northern region with majority Muslims, later upgrade to a full nation bank with branches in all the geopolitical zone of the country on the 12th of May 2016. The bank emerged out of the quest for a banking system free of Riba (usury), Maysir (gambling) and haram investment (investment forbidden in Islam) as a substitute to the dominant convention banking system. In addition to other regulatory requirements, the bank, operations, products and activities are all guided by sharia law, i.e. (the Islamic legal system). It begins operation on 1st January 2012 with only 3 branches in Kano, Kaduna and Abuja, as of the year ended 2019 the bank has more than 39 branches across Nigeria. Since its inception in 2012 the assets base, deposits, and profit after tax of the bank continue to grow at an appreciable rate from N14 billion to N170 billion, from N 21billion toover N130 billion and from N0. 9 billion to N1.796 billion respectively.

However, notwithstanding these remarkable growth and performance shown by the bank, the bank similar to other financial institutions is bound to face several issues and challenges that include; management strategic planning, Financial performance improvement, upward and downward movement in the economy, monetary and fiscal policies, wining more deposits and dealing with competitors. Thus, makes it important to appreciate the relevant internal (bank-specific) characteristic or external (environmental) factors that might determine the performance of the bank and use as ingredients for mitigation of the effect of these (economic, policies and competitors) challenges (Abdullahi & Yusuf, 2022).

Conceptual Framework

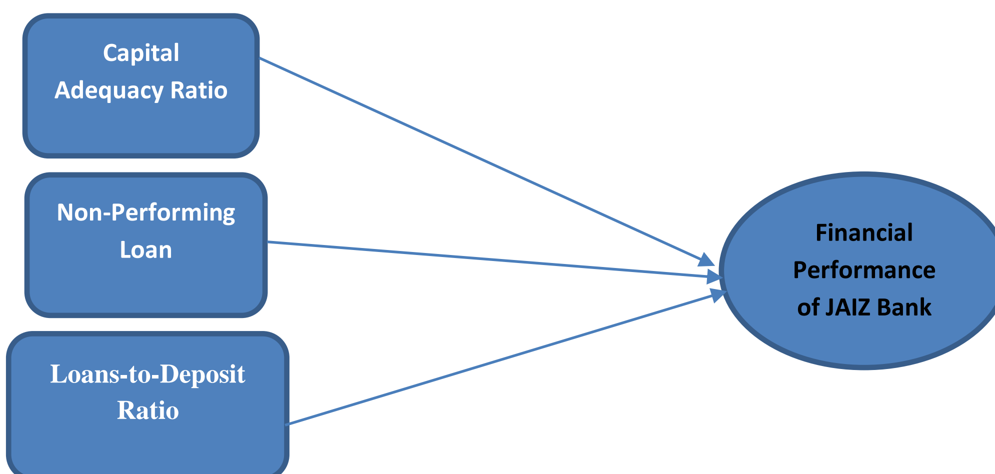

Fig.1. Conceptual Model of the study developed by the researcher, 2023.

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Methodology

This study being conceptual study used secondary data which include peer reviewed published journal articles, text books, balance sheets and reports. Twenty five published articles, four textbooks and five published balance sheets and reports were reviewed that are relevant to the study. Credit risk theory is employed as a powerful theory for understanding the concepts. In this article, the researchers examine the role played by credit risk theory orientation in shaping credit risk management employed by JAIZ bank.

Conclusion and Recommendations

The main aim of the study was to conceptually review the relationship between credit risk management and financial performance of JAIZ bank Nigeria and specifically the objectives are to examine the relationship between Capital Adequacy Ratio (CAR), Non-Performing Loan and Loan to deposit ratio and financial performances of previous studies. After review of related literatures it is found that all the three dimension of credit risks management have direct effects on financial performance of DMBs in Nigeria and that higher rates of interest is likely to discourage microenterprises and individuals from accessing loans from the said banks. Those who are able take up such loans may also find it very difficult to repay because of the exorbitant interest rates. This situation has the tendency of creating *'loan-losses high-interest cycle'* phenomenon.

DMBs are thus recommended to:

1. Establish sound and competent credit risk management units which are run by best practices in risk management such as the institution of a clear loan policy and the adherence to underwriting authority and limits.
2. DMBs with higher capital adequacy ratio should better advance more loans and absorb credit losses whenever they crop up and therefore record better profitability.
3. The regulatory authority should pay more attention to Deposit Money Banks' compliance to relevant provisions of the Bank and other Financial Institutions Act 1991 and prudential guidelines.

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