CHAPTER ONE

INTRODUCTION

1.1 Background to the study

Banks and banking activities have evolved significantly through time and with the introduction of money. Financial services like deposit taking, lending money, currency exchange and money transfers became important due to the role being played by money, as no good financial system can do without well-structured and efficient financial institutions, specifically the banking industry. Banks had and still have an important role in the economy, by mediating between supply and demand of securities, and transforming short-term deposits into medium-term and long-term credits through credit creation. Through credit creation, deposit money banks are able to create new money through deposit multiplier effect and formed part of the main income generating activity of banks, though exposing them to credit risk (Kargi, 2011).
The Basel Committee on Banking Supervision (2001) defined credit risk as the possibility of losing the outstanding loan partially or totally, due to credit events (default risk) or the likelihood of losses when a borrower fails to repay a debt of any kind.
Credit risk is an internal determinant of bank performance and the efficiency of the banks performance is a function of how they are able to satisfy their customers at a minimum risk level and maximum profitability level. The higher the exposure of a bank to credit risk, the higher the tendency of the bank to experience financial crisis and vice-versa, thus necessitate its management.
According to Statement of Accounting Standards, credit risk management is the process of managing capital assets of banks and loss of loan reserves. These necessitate the appropriate management of the risks and serves as a key issue in reducing the earnings risk of banks and improving its value in the capital market.
Nigeria deposit money banks has experienced high non-performing loans, low reserve for loan loss provisions, inadequate secured loans, loans and advances and low capital adequacy.

Credit risk is a serious threat to the performance of banks, as some of the reviewed studies showing a negative effect; therefore necessitate its management. Credit risk management provides a leading indicator of the quality of banks credit portfolio which is because it greatly influences or prevents the failure of a bank, as the failure of a bank is influenced to a large extent by the quality of credit decisions and thus the quality of the risk assets, which can be deterred as a result of poor corporate governance such as CEO duality etc.The importance of strong credit risk management for building quality loan portfolio is of paramount important to firm performance of deposit money banks as well as overall economy (Charles & Kenneth, 2013).

The growing stock of studies in accounting, finance and economics, underscores the failure in credit risk management as one of the main source of banking sector crises which possibly led to economic failure experienced in the past, including 2001 global financial crises (Fofack, 2005). Due to increasing spate of non-performing loans and its attendant consequences, the Central Bank authorities through its accords (Basel I and II) emphasized on the importance of capital adequacy for mitigating credit risk. Capital adequacy in banking business provides protection against sudden financial losses and serves as a distress prevention strategy (Greuning, 2003). The level of capital, a cushion to absorb credit and other losses, is matched to the portfolio risk depending on the risk characteristics of individual transactions, their concentration and correlation. All organizations, including banks, need to optimally allocate capital in relation tothe selective investments made. Hence, efficient tools and techniques for risk measurement are a key cornerstone of a good credit risk management

Other measures put in place in managing the risk associated with lending include making provisions to loans in case of loss or default in repayment, which could turn out to improve the firm performance of deposit money banks, most especially when specific assets are set aside for claims in terms of secured loans. In addition, when banks have adequate capital, it not only solves insolvency but also avoid the failure of the financial system.

EFFECT OF CREDIT RISK MANAGEMENT ON MARKET PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA