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ACCOUNTING INFORMATION AND BANK LENDING DECISION**Francis Kehinde Emeni**

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Abstract

The purpose of this paper is to examine the impact of accounting information in banks lending decision. The cluster sampling and simple random sampling techniques were adopted in this study. A sample of one hundred and thirty two companies was selected. A cross-sectional data of companies for the year 2012 was collected from the Nigerian Stock Exchange Factbook. The data collected were analysed using the Ordinary Least Square (OLS) regression technique. The result suggests that accounting information (proxied by value of collateral, cash availability and borrowing firm's characteristics as contained in the financials) have a significant relationship with bank lending decision. The implication of this result is a policy shift on the part of government towards adequate financial reporting amongst firms in Nigeria, by ensuring external auditors and audit committees of borrowing firms comply with government regulations as it affects financial reporting.

Keywords: Accounting information; bank lending; collateral; firm characteristics

Introduction

A great deal of useful information comes from accounting functions as it provides data which when processed, serves as useful information to the management in its planning process. The information provided by the accounting functions serves as important and effective tool in bank lending decisions because it provides a picture of the performance (income statement) of an organization and its current financial position (balance sheet). Such accounting information as may be contained in the financials of a borrowing firm includes cash balance, profit level and monetary value of assets which can be used as collaterals (Pritchard, 2013).

The bank as business organization that need to plan greatly need not just any information but much of relevant, current and useful accounting information for the purpose of operating their business effectively and efficiently towards the attainment of their objectives. Much of the business of banks revolves round granting of loans and advances to their customers. In fact, it should be realized that the most profitable business of banks is lending.

The use of accounting information in bank lending decision is an issue of concern to stakeholders in the Nigerian banking industry. This is largely as a result of scandals involving Chief Executive Officers of major banks in Nigeria in the 2000s. It is now a question of whether the banks have refused to use information provided by borrowers or borrowers do not provide any accounting information or worst still, the lending decision is not dependent on accounting information.

Evidences from the US and UK show that bank managers rely on information derived from audited financial statements in order to assess a company's past record (Berry, Faulkner, Hughes & Jarvis, 1993). The data collected is often put into bank-in-house analysis sheets, which typically highlights key figures. Stephens (1980) revealed that half of bank lending officers would refuse to loan to a company that did not submit financial statements, even though these might not be explicitly requested. Furthermore, banking systems demand for information showing marked differences between countries (Berry et al., 1993). Lenders place great weight on accounting information. Historical financial statements and financial documentation using financial projections which are the conveyors of accounting information are indicators of the future performance of a business (Lear & Pannepacker, 2004).

Literature on bank lending have focused on lending criteria and their roles in lending. In this capacity, banks develop lending procedures over time. Some of these procedures are heavily reliant on accounting information provided by the borrower (e.g. value of assets used as collateral, cash position, firm profitability). Several studies (Mann, 1997a, 1997b; Blazy & Weill, 1998; Sharma, 2001; Manove, Padilla & Pagano, 2001; Elsas & Krahnén, 2002; Niinimäki, 2007; Lear & Pannepacker, 2009; Atwood, 2009) have been carried out on bank lending and the results show that secured credit limit the firms ability to obtain future loans from other lenders or reduces the risk of excessive future borrowings. This result is in consonance with that of other researchers (e.g. Blazy & Weill, 1998; Elsas & Krahnén, 2002; Niinimäki, 2007) where it was found that there is a significant relationship between collateral and lending decisions. However, researchers like Manove et al (2001) have a contrary view when in their study on collateral versus project screening; found out that there is a negative and no significant relationship between collateral and bank lending. The point is that the results are mixed which; therefore, makes the issue inconclusive.

Added to the above motivation for this study, most of the empirical studies on borrowing firm characteristics and bank lending (Lear & Pannepacker, 2004; Atwood, 2009) are based on findings from developed economies. Compared to the developed economies, only one study (Okpara, 2008) on the use of accounting information in the bank lending decisions has been conducted in developing economies. However, this study covered only First Bank of Nigeria Plc, which poses questions about its sample impartiality. Excluding other banks, makes the sample size not to be representative of the population. Therefore, the sample size of this study covered all the companies transacting businesses with the fifteen listed banks in Nigeria. This study, therefore, sets out to fill this gap by finding out the nature of the relationship between bank lending decisions and some explanatory variable (collateral security, firm characteristics, cash and cash equivalents) in an emerging market like that of Nigeria.

Monetary value of collateral and Bank Lending Decisions

In extant literature, links between the value of assets used as collateral by borrowers and lending decision have been identified. Some are stated directly by authors like Blazy & Weill, (1998). Others are expressed indirectly through definitions. For example, Pritchard (2013) defines collateral as something of value - an asset or property - that you pledge when getting a loan. In some cases, collateral security is a compulsory

lending criterion. This means that, there is a positive and significant relationship between collateral and bank lending.

The independence of collateral and ease of realization is very crucial. Research has shown that excessive reliance on loan poses risk for a bank. Song (2002) used an example of illiquidity and difficulty in realization of collateral to buttress this point. This presents a possibility that default in repayment of loans would be costly to the bank as compared to when the borrower repays in due time. That is bank lending may not be positively associated with collateral.

Berger & Udell, (1990) however observed that collateral is most often associated with riskier borrowers, riskier loans and riskier banks. Consistent with this view are the findings of Chen (2006). He stated that if the amount of collateral pledged in a loan contract exceeds a critical value, the borrower's project may be inefficiently liquidated once he becomes financially distressed. Blazy & Weill (1998) while testing empirically the reasons for using collateral concluded that collateral contributes to reduce loss in the event of default. They however observed also that collateral does not solve adverse selection problems; neither does it solve moral hazard, as secured loans associated with a lower probability of moral hazard behaviour. Niinimäki (2007) affirmed this result when he concluded that if the collateral value is certain, the introduction of collateral alleviates the volatility of bank returns, thereby making banks more safe and mitigating moral hazard. That is to say that under certainty, bank lending may be positively associated with collateral.

It is a common view that collateral in loan contracts acts as a cushion against shocks to borrower liquidity, or as a signaling device to solve problems of adverse selection, or even as a substitute for monitoring of the borrower. Elsas & Krahnén (2002) found that the provision of collateral is an important contractual element that helps to ensure lender's involvement in distress. Elsas & Krahnén (2002) findings also support the view that collateral is a strategic instrument intended to influence the bargaining position of banks. Boot (2000) shared a similar opinion when he stated that collateral could strengthen the bank's bargaining position vis-à-vis the borrower and facilitate timely intervention. This position is in tandem with that of researchers like Niinimäki (2007).

Cash Availability and Bank Lending Decision

Empirical studies concerning the relationship between cash availability and bank lending is rather scanty. Cash considered in the lending decision making process covers the money that goes in and out of the business from its operations, also any cash flow from investments or financial activities. What influence does cash availability have on the lending decision? The answer to this question depends on how cash is treated as a lending criterion by individual lenders.

Cash information gives lenders insights into significant changes in the business over time, most especially in terms of liquidity. Every lender's primary goal is to be repaid. The first avenue for repayment is the business entity. For an existing business, lenders request prior year historical financial statements, and the credit analyst will first look to see if the existing business cash flow or income can meet the debt payments (Lear & Pannepacker, 2004). The main reason behind cash consideration in lending is to enable the lender determine whether cash receipts by the borrower could represent a sufficient

and regular source of cash for repayment on a loan. In fact, it can be used as a measure of how prudent the lender is because prudent lenders always look first to the cash flow of business as the way the loan will be repaid (Rioux, 2013). Therefore, according to Rioux (2013), there is a significant and positive relationship between cash availability and bank lending decision.

Cash availability/liquidity is a reflection of the capacity of the lender to repay the loan (Okpara, 2008). Lenders consider the cash flow of the business to determine the probability of successful repayment of the loan (Atwood, 2009). He further opined that the payment history on existing credit relationships (some of which can be obtained from the statement of cash flow) is considered an indicator of future payment performance and bank lending. Cash flow plays a relevant role in the future reflection of the borrowing firm. They can show the ability of a business to fail or continue in the nearest future. Bankers may lend at premium interest rates to companies that are classified in the failed group that have a marginal probability of failure (Sharma, 2001).

Borrowing firm profit level and Bank Lending Decision

As earlier pointed out, literature on borrowing firm profitability and bank lending is scanty. However, according to Atwood (2009) a key requirement in loan documentation for an existing business is the income statements and business balance sheets for the past three years. It is quite known that income statement is a measure of the profitability of a business. This indicates that profitability is of interest to a lender.

As earlier stated, Lear & Pannepacker (2004) are of the view that every lender's primary goal is to recover any loan given out to a customer at the end of the day. The first avenue for repayment is the business entity. For an existing business, lenders request prior year historical financial statements, and the credit analyst will first look to see if the existing business cash flow or income can meet the debt payments

Eljelly (2004) tested the relationship between profitability and liquidity measures for 27 Saudi companies, from three non-financial sectors, over the period 1996-2000. The independent variables used in the regression models as measures of liquidity were the current ratio and the cash conversion cycle. The dependent variable was measured using net operating income before depreciation deflated by sales. The overall results showed that besides liquidity as earlier reported above, cash conversion cycle was found to be significantly associated with a firm's profitability and invariably a bank's lending decision.

Methodology

The cross-sectional survey research design was adopted in this study because the data were collected at a particular point in time and many companies were covered. The population of this study consists of companies listed on the Nigerian Stock Exchange as at 31st December, 2012. The cluster sampling technique was adopted in this study. This was complemented with the simple random sampling technique. The reason for the choice of the cluster sampling technique is that the population of study is distributed in clusters/sectors. For each company in a given cluster/sector to have equal chance of being selected, the simple random sampling technique was then introduced to arrive at a sample

of 132 companies. Data for the selected companies were sourced from the Nigerian Stock Exchange fact-book containing annual reports of all the companies sampled.

The nominal and explanatory variables in this study were measured as follows: (1) lending decision was taken to be the total value of bank loans in the liabilities section of the balance sheet of sampled companies (Lear et al, 2004), (2) accounting information was proxied by cash balance, profit level and monetary value of assets which can be used as collaterals (see Pritchard, 2013). Collateral was taken as the total tangible fixed assets in the balance sheet of the borrower (Elsas et al, 2002), (3) cash was taken as cash and its equivalent in the balance sheet and (4) the borrowing firm’s characteristic was measured using the profit or loss value in the income statement (Chen, 2006).

The data collected were analysed with the aid of software. The E-view 7.0 computer software was used to examine the relationship between accounting information and bank lending decision, under the Ordinary Least Square (OLS) regression technique, using cross sectional survey data. Variables captured consists of Bank lending decision (BLD) which is the dependent variable while the independent variables include collateral (COL), cash (CAS), and borrowing firm’s characteristics (FCR).

Model

When testing the relationship between bank lending decision and explanatory variables, it was done from the perspective of the rational choice theory. The rational choice theory implies that a bank will take lending decision after taking into cognizance the possible costs and benefits of such a decision. Therefore, bank lending decision is a function of costs and benefits accruing from such a decision.

$$BLD = (B, C) \dots\dots\dots(1)$$

Where:

- BLD = bank lending decision
- B = economic benefits
- C = cost component

Therefore, the economic benefit derivable by a bank from taking a rational decision to lend can be represented as:

$$BLD = f (COL, CAS, FCR) \dots\dots\dots(2)$$

Where:

- COL= collateral security
- CAS = cash and cash equivalents
- FCR = firm characteristics

Assuming a linear relationship, we can write the above equation (2) in an explicit functional form as:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 \dots \beta_n X_n \dots\dots\dots(3)$$

Where;

- $\beta_0; \beta_1; \beta_2 \dots \beta_n$ are parameters to be estimated
- Y = the dependent variable
- X_1, X_2, X_n = independent variables

In this case, our 'n' is 3

Thus equation (3) becomes:

$$BLD = \beta_0 + \beta_1 COL + \beta_2 CAS + \beta_3 FCR + U \dots\dots\dots (4)$$

Where

$\beta_0, \beta_1, \beta_2,$ and β_3 are parameters to be estimated. The apriori expectation is that; $\beta_1 > 0, \beta_2 > 0,$ and $\beta_3 > 0$

and 'U' is the error term and β_0 is the constant term.

Results

The table below shows that all the co-efficient of the explanatory variables were statistically significant at 5% level of significance. The Durbin-Watson statistics of 1.95 shows clearly an absence of positive auto-correlation and evidence that the results were impressive and suitable for bank lending decisions.

Estimation of Coefficient

Dependent Variable	Independent Variable	Coefficient	Standard Error	T-Statistic	Probability
BLD	C	4.434755	5.574061	0.795606	0.4275
	COL	0.354862	0.037201	9.538994	0.0000
	CAS	0.095493	0.014906	6.406400	0.0000
	FCR	-0.0381607	0.036848	-10.35619	0.0000
	AR(1)	0.922595	0.024943	36.98814	0.0000

$R^2 = 0.97$

Adjusted $R^2 = 0.97$

S.E of regression = 4.66

F-statistic = 1082.05

Durbin-Watson Stat = 1.95

The regression equation in this study is:

$$BLD = \beta_0 + \beta_1 COL + \beta_2 CAS + \beta_3 FCR$$

4.44 0.36 0.096 -0.038

It is deduced that when collateral (COL) stood at a positive coefficient value of 0.36 with Bank Lending Decision (BLD) shows that 1unit increase in collateral will affect lending decision positively by 36%. Cash (CAS) with a positive coefficient value of 0.096 with lending decisions indicates that 1unit increase in cash will affect BLD by about 10%; firm's characteristics (FCR) with a coefficient value of -0.38 with bank lending decision suggests that 1unit decrease in profitability will affect lending decision by -38%.

The coefficient of determination (R^2) with a value of 0.97 indicates that about 97% of the total systematic variations in the dependent variable (BLD) accounted for by the

explanatory variables while the remaining 3% are unaccounted for, hence captured by the stochastic disturbance. After adjusting the degree of freedom for all the independent variables taken together, the adjusted (R^2) stood at 0.97% meaning that 97% of the systematic variations were explained while only about 3% were unexplained indicating that they were captured by the stochastic disturbances.

The F-statistics (goodness-of-fit) test indicates an impressive value of 1082.05 which is good enough for forecasting, because the higher the value of the F-statistic than the S.E of regression, the better the result of for judgment.

Test of Hypotheses

The hypotheses formulated in this study as stated below, are tested in this section. Our decision rule is that we accept the hypothesis if the t-calculated is greater than the t-tabulated, otherwise we reject it. The t-tabulated is 1.96 at 5% (0.05) significance level and 95% confidence.

Hypothesis One

H_0 : There is no significant relationship between collateral and the lending decision.

H_1 : There is a significant relationship between collateral and the lending decision.

Test statistics: from the OLS regression, the t-statistic value is 9.53

Decision: the t-value is 9.53 and t-critical is 1.96. Based on our decision rule, we therefore accept the hypothesis meaning that there is a significant relationship between collateral and the lending decision.

Hypothesis Two

H_0 : There is no significant relationship between cash availability and the lending decision.

H_1 : There is a significant relationship between cash availability and the lending decision.

Test Statistic: from the use of panel regression, the t-statistic value is 6.406

Decision: the value of t-statistic is 6.406 and t-critical value is 1.96. Based on our decision rule, we therefore accept the hypothesis indicating that there is a significant relationship between cash availability and the lending decision.

Hypothesis Three

H_0 : There is no significant relationship between borrowing firm's characteristics and the lending decision

H_1 : There is a significant relationship between borrowing firm's characteristics and the lending decision

Test statistic: from the panel regression, the t-statistic value is -10.35

Decision: the value of t-statistics is -10.35 while the t-critical value stood at 1.96. Based on our decision rule, we therefore accept the hypothesis indicating that there is a significant relationship between borrowing firm's characteristics and the lending decision.

Discussion of Findings

Song (2002) in his study on collateral in loan classification and positioning found out that bank lending may not be positively associated with collateral. He used an example of illiquidity and difficulty in realization of collateral to buttress this point. This presents a possibility that default in repayment of loans would be costly to the bank as compared to when the borrower repays in due time. This result is not in tandem with the finding in this study that there is a positive and significant relationship between bank lending and collateral.

In shedding more light on the negative relationship between bank lending and collateral, Manove, Padilla & Pagano (2001) criticized the unrestricted reliance on collateral and argued that it might have a negative impact on credit-market efficiency. However, according to Niinimäki (2007) if the collateral value is certain, the introduction of collateral alleviates the volatility of bank returns, thereby making banks safer and mitigating moral hazard. That is to say that under certainty, bank lending may be positively associated with collateral. Further support for the findings in this study was got from Elsas & Krahen (2002), when they found that collateral is a strategic instrument intended to influence the bargaining position of banks. Boot (2000) shared a similar opinion when he stated that collateral could strengthen the bank's bargaining position vis-à-vis the borrower and facilitate timely intervention.

In his study on working capital loans, Rioux (2013) opines that there is a significant and positive relationship between cash availability and bank lending decision, since the main reason behind cash consideration in lending is to enable the lender determine whether cash receipts by the borrower could represent a sufficient and regular source of cash for repayment on a loan. In further support of the finding in this study, Atwood (2009) opined that the payment history on existing credit relationships (some of which can be obtained from the statement of cash flow) is considered an indicator of future payment performance and bank lending. This result is in consonance with that of Okpara (2008).

With respect to borrowing firms' profit level and bank lending decisions, this study found a significant relationship. This result is in tandem with that of Lear & Pannepacker (2004) who found out that every lender's primary goal is to recover any loan given out to a customer at the end of the day. The first avenue for repayment is the business entity's profit. Likewise, Eljelly (2004) tested the relationship between profitability and liquidity measures for 27 Saudi companies, from three non-financial sectors, over the period 1996-2000. The overall results showed that besides liquidity as earlier reported above, cash conversion cycle was found to be significantly associated with a firm's profitability and invariably a bank's lending decision.

Conclusion

In this study, attempts were made to assess the role of collateral security, cash availability and borrowing firm's characteristics in the bank lending decision by examining financial statements of 132 companies for two years. A few hypotheses were developed and later tested. The hypothesis that collateral security is a significant factor in bank lending was developed and tested. Collateral security refers to the property or goods used as security against a loan and forfeited if the loan is not repaid. By implication from the above, the results of the findings show that there exist a significant relationship between accounting information and the lending decisions of banks.

The regression results also show that there is a significant association between collateral, cash availability and borrowing firm's characteristics with the lending decision.

This result suggests that bank lending decision is greatly influenced by the factors listed above. The evidences in this research can complement the growing literature on the determinants and criteria of bank lending. The decision to lend by banks is conditioned by the bank's lending policy and control from the apex bank. This suggests that the analysis of the decision and its process is very important.

Based on the findings, it was concluded that the use of certain lending criteria to make lending decision is a step in the right direction. Although there are many issues and challenges facing the use of these criteria, the benefits outweigh the challenges. When standard lending criteria is employed by banks, loans can be accounted for and a healthy lending environment is maintained.

Policy Implication of Findings and Recommendations

Based on the result in this study, where it was discovered that there is a significant relationship between accounting information and lending decision in banks; there is need for a policy shift on the part of government towards ensuring accounting information are not just only available but up to date to guide lending decisions of banks and other finance houses.

Given the significant relationship between lending decision and firm characteristics, the Nigerian government through her relevant agencies (e.g. the Central Bank of Nigeria - CBN) should put in place a policy to ensure lending rates and lending procedure of banks in the country are closely supervised by relevant government agencies. This will bring about a transparent lending process; thereby making borrowers to be confident that due lending process will be followed.

Cost of lending on the part of lenders can be reduced because virtually all information needed about present and potential debtors can be provided by accounting information. Details of collateral security can be got from the assets section of the statement of financial position, cash availability from the cash and cash equivalent balance in the statement of financial position of the borrowing firm or from the customers balance in the bank records. Also, information regarding the borrowing firm's characteristic can be obtained by measuring the profitability of the firm or from leverage structure of the borrowing firm. Therefore, both the lenders and borrowers should accept as a matter of policy, need to rely and agree on the annual reports of the borrower in taking lending decisions.

This study found that there is a significant relationship between bank lending and collaterals, cash availability and firm characteristics; there is therefore the need for adequate financial reporting amongst firms in Nigeria, by ensuring external auditors and audit committees of borrowing firms comply with government regulations as it affects financial reporting.

To ensure effective use of accounting information in bank lending decisions in the Nigerian banking sector; the CBN should encourage transparency of lending procedures to check fraud. Compliance with CBN regulations should be mandatory and failure should be marched with appropriate sanctions. These regulations should be well known by all participants, bankers, and borrowers, and should be consistently applied. Top management of banks should ensure that loan officers are experienced and knowledgeable on how accounting information can be used in the lending process. Banks should also establish a program to have reliable and independent professionals periodically monitor and review loan portfolios with the use of proper documentation during on-site inspection.

Professional banking and accounting bodies like the Chartered Institute of Bankers of Nigeria (CIBN) and Institute of Chartered Accountants of Nigeria (ICAN) should infuse

accounting information and bank lending into their training curriculum to allow for adequate knowledge of lending criteria and processes.

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