

The Impact of Financial Decisions on the Profit Margin of Selected Commercial Bank's in Lagos, Nigeria

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Received: 12 December 2017 Accepted: 2 January 2018 Published: 15 January 2018

Abstract

The study was carried out to determine the effect financial decisions have on the profit margin of commercial banks in Lagos, Nigeria. Seven commercial bank were selected spanning the first, second and third generation banks from 1995-2004. 375 questionnaires were administered on the management cadre of the selected banks of which 350(93

Index terms— commercial banks, financial decisions, financial management, profits, profit margins, regression analysis.

1 I. Introduction

he importance of a good and virile banking system cannot be over-emphasized, as finance is the key to investment and hence, to economic growth and development. It occupies a central position in a country's financial system. They are essential agents in the development and economic growth of a nation. Their success or failure depends on the quality of decisions taken and management of resources.

These decisions are performed simultaneously and continuously in the normal course of business of the organization. They call for skillful planning, control and execution of a firm's activity. These decisions form the bedrock on which firm's will either make good returns or not at the end of the accounting year (Solomon, 1969). The determinants of these crucial decisions that shape the trend of activities facilitating how the firm is run are the management team. They, amongst other factors will determine whether a firm will make profit or sustain a loss at the close of books as, the sole running of the business lies in their attitude, discretion and performance.

Financial management is a necessary tool for supporting an organization's goal and objectives. It is all about analyzing financial performance, identifying ways to use resources efficiently and finding creative ways to use resources (funds) to generate additional resources (funds). An efficient allocation of capital is a very important finance function in modern times. It involves decisions to commit the funds to investments. Such decisions are of considerable importance to firm's since they tend to determine its value size by influencing its growth, profitability and risk. Business firms and individuals now show much more concern for the management of their investments in order to obtain adequate returns. The importance of management can be observed from the concern of the business owners for adequate returns of their investment, the quest for standard service amongst the firm's customers and the acceptability of the firm among the members of the community it covers. It can be said that profitability is one of the net results of the banks management. Increase in profits must then relate to the capital invested in the firm.

Profits are measures of performance that indicate what the bank is earning on equity and other sources of funds. According to Adam (2004), profits not only provide an index by which decisions within a firm can be taken, they give ultimate answers about the effectiveness with which an organization is being managed and the efficiency of its operation. Banks came into existence because of the desire to provide services to the society at a profit. A bank should be able to generate adequate profits on each (N) Naira of sales. If the sales fail to generate sufficient profits, it may be Year 2018 () D very difficult for the company to cover its operating expenses and interest charges. This will lead to unjustified investment and failure. Thus, preventing it from earning profit for its owners .

3 III. DATA ANALYSIS

46 Over the years there has been a high level of distress in the Nigerian banking industry. The recent crisis of
47 financial failure in the industry and its grievous consequences were unequalled in the history of Nigerian economy.
48 Similar crisis in the 1920's, 30's and 50's were midges compared to the heights of bank failure in the 1990's and
49 early 2000 (CBN/NDIC reports, 1995 reports, , 1999 reports, , 2002)).

50 In the Nigeria banking industry, the level of distress in banks during the previous years has mainly been
51 due to bad financial decisions made by the management of the banks. These decisions affect all transactions
52 and allocation of funds and operations of the bank. Ogunleye (2003); Ejiofor (1997) and Ebhodagbe (1994),
53 asserted that " bad financial decisions has been traced to bad credit administration and management, purchase
54 of unnecessary assets and luxury, payment of dividends when the bank is not doing well to retain shareholders,
55 insufficient liquidity, excessive and unnecessary spending". In order to reduce the menace of distress in the
56 banking industry a lot of guidelines, strategies and plans have been put in place by the Central Bank of Nigeria,
57 banking professionals and analysts. In spite of this, the extents to which financial decisions affect the profit
58 margin of commercial banks remain uncertain and highly unpredictable. This study therefore generally intends
59 to examine the effect of financial decisions on selected commercial banks' profit margin in Lagos, Nigeria and
60 specifically examine (i) the effect of financial decisions on the profit margin of the selected banks, (ii) to determine
61 the relationship between the quality of financial decisions and bank performance, (iii) to determine how financial
62 decisions can improve the profitability of commercial banks and the effect of other variables on the profit margin.

63 2 II. Methodology

64 The study was carried out at the headquarters' of the purposively selected first, second and new generation banks
65 in Lagos, Nigeria. The study area was chosen because of its precedence and its geographical location and because
66 of the fact that most of the banks have their headquarters situated in the study area. Seven commercial banks
67 were purposely chosen for the study.

68 The senior officials of the selected commercial banks constituted the population of the study. Data was
69 purposively collected from the senior spectrum of selected banks as the source of primary data while the annual
70 and financial reports of the selected commercial banks of the study were the sources of secondary data. The
71 study covered ten (10) A total of 375 questionnaires were purposively administered on the senior spectrum of the
72 selected commercial banks of which 350, were only completed and analyzable.

73 The variables studied in this research include: a) The Dependent Variable i) Profit Margin of the selected
74 banks. This is a measure of profitability. It is an indicator of a company pricing policy and its ability to control
75 cost. Measured as Earnings/sales.

76 b) The Independent Variables as i) Debt Ratio of the selected banks. This is a measure that tells us how much
77 the company relies on debt to finance assets. Measured as Total Debt/ Total Assets. ii) Return on Assets of the
78 selected banks. This is a measure of how much profit a company generates on each Naira of asset. Measured as
79 PAT/Total Assets. iii) Liquidity Ratio of the selected banks. This measures the extent to which a firm can quickly
80 liquidate assets and cover short term liabilities. Measured as Net loans/Total Deposit. iv) Dividend Cover of the
81 selected banks. This ratio tells us how easily a company can pay its dividend from profits. Measured as Dividend/
82 Net Income. v) Earning per share of the selected banks. This is a portion of a company's profit allocated to
83 each outstanding share of common stock. Measured as Net Income-Dividend on preferred stock/Market value of
84 share.

85 3 III. Data Analysis

86 In estimating the relationship between financial decisions and the profit margin, inferential statistics such as the
87 multiple regression analysis and Tobit logit regression was adopted. Descriptive statistics such as tables, graphs,
88 ratios and percentages were used to analyze the data. The independent and dependent variables were measured
89 using financial ratios.

90 These financial ratios are used by financial analyst to appraise/measure financial decisions of banks. Since all
91 activities in the bank are measured in quantitative forms, the various decisions were analyzed thus as financial
92 ratios. They are: Profit margin, Debt ratio, Return on investment, liquidity ratio, dividend cover and earnings
93 per share.

94 Where Y-PM (PROFIT MARGIN) which interprets the profit margin is the dependent variable and X 1
95 -DR (DEBT RATIO) which interprets the finance decision, X 2 -ROI (RETURN ON INVESTMENT) which
96 interprets the investment decision, X 3 -LIR (LIQUIDITY RATIO) which interprets the liquidity decision, X 4
97 -DC (DIVIDEND COVER) which interprets the dividend decision, X 5 -EPS (EARNING PER SHARE) which
98 interprets the dividend decision are the independent variables.

99 For the Multiple regression analysis a model of the equation used was depicted as follows:
$$Y = b_0 + B_1 X_1 + B_2 X_2 + \dots + B_n X_n + e$$
$$B_i = (i = 1, 2, 3, 4, \dots, n)$$
 is the regression co-efficient to be estimated.

100 Where X 1 , X 2 , X 3 ?? . X n are the independent variables (financial decisions). DR -Total Debt/Total
101 Assets (X 1) RO -PAT/Total Assets (X 2) LIR -Net loans/Total Deposit (X 3) DC -Dividend/Net income (X
102 4) EPS -Net Income-Dividend on preferred stock/ Market value of share (X 5)

103 The validity of the regression model was tested using the following statistics:F -Ratio R 2 -Estimated (Co-
104 Efficient of the multiple determinant) and R t test

106 The tobit regression was also used in the study to determine the impact of certain variables on the profit
107 margin

108 The model is in explicit form: $K_{it} = f(\beta_0 + \beta_7 FD_{it} + \beta_9 PER_{it} + \beta_{10} MI_{it} + \beta_{11} RPM_{it} + \beta_{12} DP_{it} + \beta_{13} DY_{it} + \beta_{14} PG_{it} + \beta_{16} CA_{it} + \mu_{it} + \dots)$ $Y = f(X_7 X_9 X_{10} \dots X_n) + e$ (xi)

110 Where, $Y =$ Profit Margin $X_7 =$

111 = Quality of Financial Decisions (FD) $X_9 =$ Performance (PER) $X_{10} =$ Main Indicator (MI) $X_{11} =$ Range
112 of Profit Margin (RPM) $X_{12} =$ Dividend Payment (DP) $X_{13} =$ Dividend Yield (DY) $X_{14} =$ Profit Growth
113 (PG) $X_{16} =$ Capital Adequacy (CA) $U_i =$ Error Term U_i is the residual error, which is normally distributed with
114 the expected mean value of zero and variance (σ^2). This study will examine this model by the measurement
115 of all the variables and estimation of their parameters.

116 4 IV. Results and Discussion

117 In the Table 1, 58.1% of the respondents agreed that the management team is the sole determinant of whether a
118 bank makes adequate profits or not through the quality of financial decisions. This is supported by Ebhodagbe
119 (1994), who emphasized that "bank management can make the difference between a healthy and distressed
120 institution". Sound decisions can only be made by sound people. The negative effect of decisions taken by the
121 management of many banks in previous years can be attributed to the poor quality of the decisions made resulting
122 from the caliber of the people in position to make such decisions. This had resulted in the high level of failure
123 and mismanagement experienced.

124 The banking industry has just undergone a reform vis-à-vis the amount of capital base that was increased to
125 25 billion; membership of the board of Directors and Management team; quality of performance in the banking
126 industry, supporting Small Scale Enterprises and competing favorably in the International Market all aimed at
127 improving the Previous era of government in Nigeria have shown that many management members were chosen
128 to office on political grounds and did not have the relevant knowledge to make sound decisions in such offices
129 (Ebhodaghe, 1994). This indicates that the importance of education cannot be over-emphasized especially in
130 banking industry which has to do with a lot of quantitative data.

131 This had not only affected the banking industry but all sectors of the economy. Ofor (2004) argued that the
132 major indicator of banking crisis in Nigeria is poor management based on lack of expertise for prudent management
133 decisions resulting in a decline in the profitability of banks. Thus justifying the need for experienced personnel's
134 in the field of operation for maximum performance. What you do not have, you cannot give.

135 5 Table 2: Distribution of senior officials of selected commercial 136 banks by the factors responsible for the quality of financial 137 decisions

138 6 Note * = Multiple Responses Source: Field Survey 2017

139 A bank without adequate capital cannot stand the test of time as it serves as a media for loss absorption.
140 According to , Capital provides a cushion to withstand abnormal losses not covered by current earnings and
141 enables banks to regain equilibrium. During the period of study it was discovered that most banks were grossly
142 undercapitalized. Thus, the problem of inadequate capital was further worsened by large amounts of non-
143 performing loans which had eroded the banks capital base. Table 3, shows the respondents judgment on the
144 capital adequacy. Only 37% of the respondents agreed that the capital flows of the banks were impressive. This
145 implies that the capital adequacy of the banks was not satisfactory and there is ample room for improvement.

146 This led the federal government to propose a mandatory N25 Billion capital base for commercial banks as 31 st
147 of December, 2005, to further strengthen the banks and enable them compete more effectively both in the global,
148 local and international markets. It resulted in the emergence of only 25 banks out of about 70 banks formally.
149 However, this has yielded great impact, as there has been more innovation, efficiency and diversification in the
150 operations of commercial banks. In the year 2006, most banks had recorded between a (30%-50%) increase in
151 their profits. (CBN Reports, 2006).

152 However in 2008, it was discovered by the central bank of nigeria(CBN), on resumption of the new CBN
153 Governor then Sanusi Lamido Sanusi that a couple of the current banks were actually distressed. It was also
154 compounded by the global meltdown, resulting in the loss of share price to ridiculous level. This also led to a
155 series of mergers and acquisition. This was to further strengthen the banking sector, build a solidified banking
156 environment that can compete in the international market and prevent them from further distress in the future.
157 Currently there are only 19 commercial banks in nigeria. The results of the regression analysis in Table 4 shows
158 that in only three (3) banks, that is Union bank (first generation) Intercontinental bank (second generation) and
159 Chartered bank (new generation), the profit margin was significantly affected by financial decisions collectively
160 at 5% level with f-values of 6.797, 8.412 and 45.043, respectively. These banks had relatively good profit margin
161 growth during the ten year period of study compared to other banks studied.

162 The independent variable X_1 (DR) and X_5 (EPS) representing the Finance and Dividend decisions
163 respectively recorded much more significance on the profit margin of the selected banks than every other variable.

164 It was significant in only Union bank and Chartered bank. However, this was not too impressive. X 2 (ROA)
 165 representing the Investment decisions did not fare any better, as it recorded significant impacts in only Union
 166 bank with a negative co-efficient. The performance of banks is measured through Return on Assets (ROA). It
 167 reflects the ability of the bank to generate profit from the bank's assets ??Naceur, 2006). All decisions in the
 168 business environment have financial implications. It is well known that the management can make the difference
 169 between a healthy and a distressed institution. Thus when management make financial decisions irrespective of
 170 the functional area of the business in which it is made, the risk of the cash flow emanating from the decision, in
 171 addition to their size and timing, should be considered and implemented.

172 The independent variables X 3 (Liquidity decision) and X 4 (Dividend decisions) were only significant in
 173 Intercontinental bank and Union bank respectively. This is very poor and not impressive at all. Liquidity refers
 174 to a company's ability to pay its current bills and expenses. In relates to the availability of cash and other assets
 175 to cover accounts payable, short term debts, and other liabilities (Gryglewicz, 2011).

176 In all, the study showed that all the independent variables tested were in one bank or the other significant.
 177 This is consistent with the findings of Alslehat et al (2014). This shows that there is a great need for continuous
 178 improvement in the financial decisions taken in Nigerian commercial banks for generation of adequate profits for
 179 better performance and stability as been witness currently in the banking industry, as financial decisions play
 180 a major role in the sound performance of any bank. Profit margin indicator is negatively correlated to bank
 181 performance at 1% level of significance. This implies that profit margin is not the only indicator to determine
 182 the performance of the bank. Haron (2004) measured the impact of some of the determinants of profitability.
 183 The factors such as liquidity, deposit items, asset structure, inflation and money supply had a significant long
 184 term impact on profitability. It is always assumed that the higher the level of profit margin, the greater the
 185 performance of the sampled banks. Profit margin is an indicator of a company's pricing strategies and how well
 186 it controls costs. Differences in competitive strategy and product mix cause the profit margin to vary among
 187 different companies. But in this case, the higher the level of banks profit margin, the lesser the performance of
 188 the banks.

189 Range of profit margin is another variable and this is positively significant at 1%. This shows that the higher
 190 the profit margin of the sampled banks, the greater the performance of the banks. Van Horne (1993) supported
 191 this assertion by describing that profit acquisition is an additional asset to the bank and this shows how the
 192 resources of the banks were efficiently used.

193 Dividend yield, this is also negative at 1% level of significance. This reveals that the higher the amount of
 194 dividend paid to the customers, the lower the profit margin for the sampled banks. Pandey (2004) attributed that
 195 dividend allocation decision is a reflection of a firms's investment, financing and asset management decisions. It
 196 was also supported by Van Horne (1993), that the decisions by management are subject to the view that integral
 197 part of the banks dividend should be paid or all the dividend be paid along with the profit or retain all. Where
 198 the dividend are paid the profit margin of the banks will be reduced and this supports the result of the logit
 199 regression.

200 Capital, the sampled banks capital is purposively significant at 1%. This shows that an increase in the capital
 201 base of the banks will eventually leads to an increase in the profit margin of the banks and consequently increases
 202 the performance of the banks. Ghadome (2008), in his study aimed to analyse the determinants of capital
 203 structure through the role played by investment decisions and the financing and distribution of profits on a
 204 sample of companies listed in the Spain of 135 companies from 1990-1999. He adopted the financial reports of
 205 all the companies. A bank without adequate capital cannot stand the test of time as it serves as a media for
 206 loss absorption. Goddard (2004), investigated profitability of European banks using cross sectional data during
 207 1990s. The results showed the relationship between the capitalasset ratio and profitability is positive. This also
 208 reveals that most of the sampled banks are viable, solvent and their performances were healthy and sound to
 209 face future challenges.

210 Table ??: Logit Regression on determining the effect of financial decisions on profit margin Dependable
 211 Variable: Profit Margin three of the sampled banks that is Union bank, Intercontinental bank and chartered bank.
 212 These banks were also among the 25 banks, which made it through reconsolidation thus justifying the study. It
 213 thus implies that if more emphases are placed on better, qualitative, and productive financial decision making,
 214 there will be worthwhile improvements in the profit margin of commercial banks in general and, particularly more
 215 impact will be felt in the banking industry and the country at large. Also, close to two thirds of the respondents
 216 agreed that qualitative financial decisions are a very important factor for adequate profits. A greater proportion
 217 of the respondents agreed that sound technical education was a major influencing factor on the quality of financial
 218 decisions. It is essential for banks to focus on how to increase profitability or in other words to create wealth
 219 that compensate their usage of capital resources. The latest developments that have taken place in the financial
 220 markets are proving that money in the future will only be available to those players who are able to create sizeable
 221 returns on capital. Low performances, weak attempts and even poor ways to interact with fund's suppliers will
 222 increasingly lead to higher cost of capital and funding shortage, hence distress. Also, it is therefore recommended
 223 that Management team members should be mandated and encouraged to obtain relevant professionalism with
 224 adequate qualifications in the banking industry. This will also enhance the quality of financial decisions and their
 225 performance. Managers should always have the interest of the shareholders in mind when taking decisions; this

226 would propel them to always make qualitative decisions on how best they can generate adequate returns on their
227 investments.

228 There should be more awareness and intense study on the subject of financial management in relation to
229 decision-making especially in banks. This course helps to emphasize the role played by non-financial and financial
230 managers in the financial process, and assist in linking together the various functional areas. Lastly, more mergers
231 and acquisition should be mandated and proposed by the central bank and the federal government of Nigeria
232 to establish greater mega banks. This would further strengthen the capital base of banks and bring together
233 different field of professionals as a team; thus, encouraging advance diversification; keener competition among
banks and better innovations to produce a healthier and more profitable banking environment.

1

of profit margin

Factors that affect the profit margin	Frequency	Percentage
Quality of financial decisions	122	58.1%
Prudential guidelines	30	14.3%
Economic stability	24	11.4%
Others (loans disbursement, credit administration, fraud, unethical behaviors)	34	16.2%
Total	210	100%

Note *= Multiple Responses

Source: Field Survey 2017

Figure 1: Table 1 :

3

Note *= Multiple Responses

Source: Field Survey, 2017

Figure 2: Table 3 :

4

	X 1	X 2	X 3	X 4	X 5	R	R 2	F -Value	Remarks
First Generation Banks									
Union Bank	0.025 (3.510)	0.047 (-2.842)	0.077 (-2.364)	0.721 (0.383)	0.031 (3.270)	.89	.95	6.797	SG
First Bank	0.539 (0.671)	0.800 (0.271)	0.599 (-0.570)	0.332 (1.103)	0.939 (-0.081)	.75	.86	2.354	NSG
Second Generation Banks									
Intercontinental Bank	0.359 (1.035)	0.082 (2.307)	0.018 (3.884)	0.173 (1.658)	0.593 (1.585)	.91	.96	8.412	SG
Inland Bank	0.232 (1.409)	0.417 (0.905)	0.368 (-1.013)	0.675 (-0.452)	0.771 (-0.312)	.72	.85	2.027	NSG
Access Bank	0.349 (1.060)	0.533 (0.682)	0.870 (-0.175)	0.196 (1.552)	0.287 (-1.226)	.87	.93	5.477	NSG
Third Generation Banks									
Chartered Bank	0.010 (4.666)	0.315 (-1.148)	0.086 (-2.272)	0.249 (-1.346)	0.042 (2.951)	.98	.99	45.043	SG
Guaranty Trust Bank	0.248 (1.352)	0.731 (0.369)	0.338 (1.086)	0.040 (2.990)	0.577 (-0.607)	.82	.91	3.645	NSG

** Significant at 5
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Figure 3: Table 4 :

Figure 4:

235 .1 VII. Conclusion and Recommendations

236 Despite the high rate of distress experienced in the industry in the past years and the irregularity of profit margin
237 growth in the sampled banks, the regression analysis has shown that there was a strong positive relationship and
238 significant impact was observed between the financial decisions and the profit margin of

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