Significance of Return on Investment on Performance of Deposit Money Banks in Nigeria

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Abstract
The performance of deposit money banks in Nigeria is predicated on a number of factors and these need to be well developed into in order to ascertain their impact on the performance of deposit money banks in this country. This therefore, led to this paper which considered the significance of return on investment on the performance of deposit money banks in Nigeria. The secondary method of data gathering was adopted for this study. It involved a five year period of ten banks, spanning between 2012 and 2017 and the data was generated from the publications of the sampled banks. Statistical Package for Social Sciences 21.0 (IBM SPSS Statistics 21) was used to analyse the data, with the test statistic of multiple regression analysis being used. The findings of the study suggest that income-generating assets (e.g., loan, large capital asset base, salary and other cash advances, overdrafts, etc.), and that efficient utilization of asset, strongly predict the level of performance in a bank; there is a strong relationship between banks' performance and other macro-economic factors such as inflation and interest rate. It was recommended that the Central Bank of Nigeria should come up with frameworks that would facilitate standard practice and modern banking system in Nigerian deposit money banks and which can be used in its key policy indicators to reduce the interest rates so as to be investor-friendly; that human resources in the deposit money banks should be well trained and given adequate exposure on the modern banking practice and that the system adopted by the banks on loan recovery and other measures should be holistic in ensuring the maintenance of best performance practice by the banks' employees.
Keywords: *Deposit Money Banks, Performance, Return on Investment, Significance, Nigeria.*

1.0 INTRODUCTION

According to (Ani, Ugwunta, Ezeudu, and Ugwuanyi, 2012), a performing banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. They further opined that the performance of a financial institution is affected by numerous factors. These factors include elements internal to each financial institution and several important external forces shaping earnings performance. It is noteworthy that in banking, the determinants of performance are well observed and explored as it is increasingly important to strengthen the foundations of the domestic financial system as a way to build-up flexibility for capital flow volatility (Ani, et. al. 2012). There are some studies that have identified the external and internal factors contributing to the performance of banks. Some of these factors would be explored in the study. The internal factors include liquidity, capital adequacy, asset quality, and cost/expenditure; while external factors include inflation, interest rate. More recent studies distinguish between managerial (internal) and environmental (external) factors that affect bank performance (Ani et. al, 2012). The internal factors affecting banks' performance can also be seen as a capital ratio, credit risk, productivity growth and size of the bank (Smirlock, 1985; Bourke, 1989; Molyneux and Thornton, 1992; Stienherr and Huveneers, 1994). A number of other studies have examined bank performance in an effort to isolate the factors that account for differences in bank performance (Ani et. al. 2012).

2.0 LITERATURE REVIEW

In the assertion of (Goddard et al., 2004) a bank's capacity to absorb unforeseen losses determines its level of risk. Several ratios are commonly used to proxy for risk, including the CAR and the liquidity ratio. In theory, an excessively high CAR could signify that a bank is operating over-cautiously and ignoring potentially performing investment opportunities. A bank holding a relatively high proportion of liquid assets is unlikely to earn high profits but is also less exposed to risk; therefore, shareholders should be willing to accept a lower

return on equity (Goddard et al., 2004). An overview of previous studies indicates various ways that performance was examined. Some studies were country specific and few of them considered a panel of countries reviewing the determinants of performance. Such empirical studies on bank performance literature that focused mainly on specific countries include those of the US (Berger, 1995) Greece (Kosmidou, 2006); Australia (Pasiouras et al., 2005), Malaysia (Guru et al., 1999); Colombia (Barajas et al., 1999); and Tunisia (Naceur, 2003). Molyneux and Thorton (1992) were the first to investigate a multicounty setting by examining the determinants of bank performance for a panel of European countries. This is followed by the study of Abreu and Mendes (2000), Staikouras and Wood (2003), and Pasiouras et al. (2005).

Hassan and Bashir (2003), who examined performance for a sample of Islamic banks from 21 countries; and Demirguc-Kunt and Huizinga (1999) who considered a comprehensive set of bank-specific characteristics, as well as macroeconomic conditions, taxation, regulations, financial structure and legal indicators to examine the determinants of bank net interest margins in over 80 countries. The main conclusion emerging from these studies is that internal factors explain a large proportion of banks' performance; nevertheless, external factors have also had an impact on their performance. The performance of European banks during the 1990s was investigated by Goddard et al. (2004) using cross-sectional, pooled cross-sectional time-series and dynamic panel models. Their model for the determinant of performance incorporates size, diversification, risk and ownership type, as well as dynamic effects. They found that despite intensifying competition, there is a significant persistence of abnormal profit from year to year.

The evidence for any consistent or systematic size–performance relationship is relatively weak. The relationship between the importance of off-balance-sheet business in a bank's portfolio and performance is positive for the UK, but either neutral or negative elsewhere. The relationship between the capital–assets ratio and performance is positive. Javaid et al. (2011) analyzed the determinants of the top 10 banks' performance in Pakistan over the period 2004 to 2008. They focused on internal factors only. Javaid et al. (2011) used the pooled ordinary least square (POLS) method to investigate the impact of assets, loans, equity, and deposits on one of the major performance indicators of banks which is the return on asset (ROA). The empirical results found strong evidence that these variables have a strong influence on performance. However, the results show that higher total assets may not necessarily lead to higher profits due to the diseconomies of scales. Also, higher loans contribute towards performance but their impact is not significant. Equity and deposits have a significant impact on performance.

Imad et al. (2011) studied a balanced panel dataset of Jordanian banks for the purpose of investigating the nature of the relationship between the performance of banks and the characteristics of internal and external factors for 10 banks over the period 2001 to 2010. Using two measures of bank's performance: the rate of return on assets (ROA) and the rate of return on equity (ROE), the results show that the Jordanian bank's characteristics explain a significant part of the variation in bank performance. High Jordanian bank performance tends to be associated with well-capitalized banks, high lending activities, low credit risk, and the efficiency of cost management. Results also show that the estimated effect of size did not support the significant scale economies for Jordanian banks. Due to the fact that some of the differential slope coefficients are statistically significant, they conclude that the estimation results indicate that individual effects on the performance are present.

Scott and Arias (2011) developed an appropriate econometric model whereby the primary determinants of performance of the top five bank holding companies in the United States could be examined and understood. The econometric model was based on internal aspects of the banking organizations as they relate to their return on assets and external aspects of the environment in which they compete as measured by growth in GDP was developed based on guidance provided by economists and industry experts to determine the impact of the external national economy of these five leading banks according to their size as measured by total assets. The results show that performance determinants for the banking industry include a positive relationship between the return on equity and capital to asset ratio as well as the annual percentage changes in the external per capita income.

Gull et al. (2011) examined the relationship between bank-specific and macro-economic characteristics over bank performance by using data of the top fifteen Pakistani commercial banks over the period 2005 to 2009. The paper used the pooled ordinary least square (POLS) method to investigate the impact of assets, loans, equity, deposits, economic growth, inflation and market capitalization on major performance indicators that is, return on asset (ROA), return on equity (ROE), return on capital employed (ROCE) and net interest margin (NIM) separately. The empirical results showed strong evidence that both internal and external factors have a strong influence on performance.

Goddard et al. (2004) investigated the performance of European banks during the 1990s using cross-sectional, pooled cross-sectional time-series and dynamic panel models. Models for the determinants of performance incorporate size, diversification, risk and ownership type, as well as dynamic effects. They found that despite intensifying competition, there was a significant persistence of abnormal profit from year to year. Their results suggest that evidence for any consistent or systematic size–performance relationship is relatively weak; the relationship between the importance of off-balance-sheet business in a bank's portfolio and performance is positive for the UK, but either neutral or negative elsewhere. Furthermore, the relationship between the capital–assets ratio and performance was positive.

Naceur (2003) observed that high net interest margin and performance are likely to be associated with banks with a high amount of capital and large overheads. Several studies have been conducted in various countries about the determinants of banks' performance. Naceur, (2003) investigated the determinants within the Tunisian banking industry performance for the period from (1980– 2000); he found that high net interest margin and performance are associated with banks that are highly capitalized, and who have large overheads. It was also found that the macro-economic indicators such as inflation and growth rates have no impact on a bank's interest margins and performance.

Determinants of Banks Performance

The determinants of banks' performance could either be internal or external. These factors are as shown below:

Internal Factors:

Total assets (TA)/ Size of the Bank

Total assets determine the size of a bank. Size is used to capture the fact that larger banks are better placed than smaller banks in harnessing economies of scale in transactions to the plain effect that they will tend to enjoy a higher level of profit. In most of the finance literature, the total assets of the banks are used as a proxy for bank size. Consequently, a positive relationship is expected between size and profits. Molyneux and Thornton (1992), Bikker and Hu (2002) and Goddard et al. (2004) find the size to be positively related to performance. The size of the bank is included as an independent variable in this study to account for size-related economies and/or diseconomies of scale. However, since the dependent variable in the model (ROA) was deflated by total assets, it would be appropriate to take the natural logarithm total assets before including it in the model to reduce the scale effect of numbers and be consistent with other ratios.

Total equity (TE) to total assets (TA)

Capital – assets ratio is taken as the ratio of equity capital to total assets. It's interesting to note that higher capital levels breed higher performance levels since by having more capital, a bank can easily adhere to regulatory capital standards so that excess capital can be provided as loans (Berger, 1995). The capital ratio (TE/TA), which is measured by total equity over the total asset, reveals capital adequacy and should capture the general safety and soundness of the financial institution (Gull, 2011). It indicates the ability of a bank to absorb losses and handle risk exposure for shareholders. Previous studies have found a positive relationship between TE/TA and performance (Hassan and Bashir, 2004). TE/TA is expected to have a positive relationship with performance because well-capitalized banks are less risky and more performing (Bourke, 1989). TE/TA is included as an independent variable to examine banking performance.

Total loans and advances (TL&A) to total assets (TA)

Asset composition of loans and advances are the main source of income and are expected to have a positive impact on bank performance. Other things constant, the more deposits are transformed into loans, the higher the interest margin and profits. However, if a bank needs to increase the risk to have a higher loan-to asset ratio, then profits may decrease. In addition, like bank loans and advances are the principal source of income, we expect that non-interest bearing assets impact negatively on profits (Gul et al., 2011). Asset composition (TL&A/TA), which is explained by total loans divided by total assets, provides a measure of income source and measures the liquidity of bank assets tied to loans (Javaid et al., 2011: 3798). TL/TA is included in the study of performance as an independent variable to determine the impact of loans on banks' performance. Performance is primarily measured by return on assets. The details of these metrics follow in the succeeding section. The ROA is a functional indicator of a bank's performance. It is a ratio calculated by dividing net income by total assets. ROA shows the profit earned per dollar of assets which reflects the bank's management ability to utilize the bank's financial and real investment resources to generate profits (Naceur, 2003).

Capital Adequacy

It has been depicted that highly capitalized banks should have high profits compared to those who are lowly capitalized. The main reason for this is the presence of bankruptcy costs, for a bank that is capitalized below its equilibrium ratio, the expected bankruptcy costs are relatively high, and an increment in capital ratios boosts the expected profits by lowering interest expenses on uninsured debt (Berger, 1995).

Staikouras & Wood (2003) and (Abreu & Mendes, 2001) have shown that there exists a positive correlation between capital adequacy and performance. This positive relationship is necessary for the bank to fund its assets at more favourable interest rates, increasing expected profits and offsetting the cost of equity, which is considered to be the most expensive bank liability in terms of expected return (García-Herrero et al., 2009).

Asset Quality

Alexiou and Sofoklis (2009), DeYoung and Rice (2004), Chiorazzo et al. (2008) portray that bank performance is directly related to the quality of the assets shown on the statement of financial position. For instance, poor quality of credits/loans has a negative impact on the banks' profits. They have further shown that this correlation exists because an increase in the assets of poor quality requires a bank to allocate a significant portion of its gross margin to provisions to cover expected credit losses; this lowers the banks' profits.

Liquidity

Liquidity in banks plays a major role in determining their performance; this is due to the fact that the lack of sufficient liquidity is one of the major reasons for bank failures. Bourke (1989) narrated that holding liquid assets has an opportunity cost of higher returns and there exists a strong positive significant link between bank liquidity and performance. However, in times of instability banks may choose to increase their cash holdings to mitigate risk.

Cost/Expenditure

Abreu & Mendes (2001) narrate that a bank's operating costs are expected to have a negative correlation with performance and the level of operating expenses is viewed as an indicator of the management's efficiency. This negative correlation between operating costs and performance exist measures despite their positive effect on net interest margins.

Macroeconomic Determinants

Inflation

Ravel (1979) portrayed that inflation is a significant macroeconomic determinant of bank's performance. The impact of inflation on the bank's profits depends on whether the bank's salaries and operating expenses increase

faster than that of the inflation rate. So, the effect of inflation is dependent on the overall macroeconomic stability that allows the correct prediction of inflation. The relationship between inflation and bank performance is dependent on whether inflation is fully anticipated by a bank's management. If the inflation rate is fully anticipated by the bank's management, the bank can adjust interest rates appropriately to increase revenues faster than costs, which should have a positive impact on performance (Perry, 1992).

Interest Rate

An economy characterized by low interest rates and stiff competition among banks could limit the possibilities for banks to establish appropriate prices for their credit facilities and deposits, putting pressure on the operating margin and negatively affecting banks' performance. Demirguç- Kunt& Huizinga (1999), Claeys & Vennet (2008), Molyneux & Thornton (1992) have all narrated that there is a positive relationship that can be seen between interest rates and a bank's profits.

3.0 Methodology

This research data was strictly secondary and generated from 10 selected Commercial Banks in Nigeria, spanning from 2012 to 2017. The ten commercial banks are Access Bank, Polaris Bank, Fidelity Bank, Eco Bank, First bank, First City Monument Bank, Guaranty Trust Bank, Wema Bank, Union Bank, and Stanbic IBTC Bank PLC. This study considers the Return on Total Assets as the dependent variable, in order to determine the extent of the banks' performance overtime; other factors or internal determinants such as Utilization of the Asset (AUT), Adequacy of Capital (CA), Liquidity (LQ), Size of the Bank (SoB), and Efficiency of Operation (EOP) and external or macroeconomic determinants such as Inflation (InF) and Interest Rate (InR) will be the independent variables. The study adopts Statistical Package for the Social Sciences Version 21.0 (SPSS IBM 21) to analyze the data. The test statistic that was used to find the relationship between the stated variables is multiple regression coefficients.

4.0 Results and Findings

Table Showing F Statistic and Adjusted R Square of Deposit Money Banks in Nigeria

	Value	Sig.
F Statistic	32.17	.000
Adjusted R Square	0.712	

Source : Authors' Compilation, 2019

The result from Table 1 shows that the Adjusted R Square for deposit is 0.712, which implies that 71.2% of the deposit money banks' performance is subjected to their level of utilization of asset, the extent of their liquidity, their ability to be credit risk worthy, the size of the bank and adequacy of capital, inflation and interest rate. It goes to show that these factors jointly influence the level of performance that the banks would make at any point in time.

Table 2 showing the regression coefficients of the determinants of Performance in Nigerian Deposit Money Banks

	Beta	Sig.
Constant	-.065	.073
AUT	.321	.003
CA	.728	.001
LQ	.025	.004
SoB	.217	.362
EOP	.541	.001
InF	.714	.000
InR	.291	.004

Table 2 above shows the internal determinants of performance by Nigerian deposit money banks. The Utilization of the Asset (AUT) at $P < 0.05$; $\beta = .321$. This shows that efficient asset utilization could significantly optimize the level of profit within the banks. The more a deposit money bank is able to utilize its assets, the more efficient its efficiently. This was consistent with the position of Alexiou and Sofoklis (2009), DeYoung and Rice (2004), Chiorazzo et al. (2008). Capital adequacy (CA) at $P < 0.05$; $\beta = .728$. This depicts that the existence of adequate capital will significantly boost banks' performance levels. The higher the share capital the more the profit tends to be in the long run. This position was confirmed by Wood (2003) and (Abreu & Mendes, 2001). Efficiency of operation (EoP) at < 0.05; $\beta = 0.541$. This implies that the efficiency of operation significantly influenced the level of performance of commercial banks in Nigeria. The implication is that the more efficient the banks are in terms of efficiently using both their human and capital resource, the more optimized their performance tends to be. This position was corroborated by the work of Bashir (2000).

Table 2 above shows the external or macroeconomic determinants of the performance of commercial banks in Nigeria. Inflation (InF) at $P < 0.05$; $\beta = 0.741$. This shows that inflation significantly influences the rate of performance of deposit money banks in Nigeria. This result was confirmed by Uhomoibhi, (2008). Therefore inflation is a significant external or macroeconomic factor affecting commercial banks' performance in Nigeria. Interest rate (InR) at $P < 0.05$; $\beta = 0.291$. This shows that there is a significant relationship between the interest rate and commercial banks' performance. This implies that a consistent interest rate will add value to the level of profit of the banks in Nigeria. This position was confirmed by Ravel (1979).

5.0 Conclusion

The deposit money banks in Nigeria are the most vital tools for ensuring economic revamp and sustenance. It becomes essential to know how the performance of these banks can be optimized; and in order to ensure this, the key indicators or determinants of return on investment should be considered. It is important from this study to know that efficiency of operation, interest rate, adequacy of capital, utilization of asset, inflation will significantly affect the performance level of deposit money banks in Nigeria. However, the size of the bank and its liquidity do not have a significant effect on the performance of the banks in Nigeria.

5.1 Recommendation

The researcher recommended as follows:

1. That the Central Bank of Nigeria should come up with frameworks that would facilitate standard practice and the modern banking system in Nigerian deposit money banks.
2. That there is a need for the Central Bank to use its key policy indicators to reduce the interest rates so as to be investor-friendly.
3. That human resources in the deposit money banks should be well trained and given adequate exposure to modern banking practice.
4. The system adopted by the banks on loan recovery and other measures should be holistic in ensuring the maintenance of the best performance practice by the banks' employees.

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