



Fund Management and Shareholder's Wealth Maximization in Nigeria's Banks

*Ihenetu Hyginus I. PhD

Department of Banking and Finance Captain Elechi Amadi Polytechnic Rumuola Port Harcourt, Nigeria

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*Corresponding author: Ihenetu Hyginus

Abstract

The paper evaluated the effect of bank's fund management on shareholders' wealth maximization in Nigeria. Data were collected from NDIC annual report for thirteen (13) years. Autoregressive and distributed lag model was used to analyze the data after stationarizing it through Augmented Dicky Fuller (ADF) unit root test. The findings showed that deposit mobilization, shareholders fund and capitals had significant effect on shareholders wealth maximization in Nigeria's bank. Based on the findings, we therefore recommend that bank management should sustain the strategy adopted in managing the deposit mobilized from the public, shareholders' funds and the capitals to maximize the wealth of the shareholders.

Keywords: Fund management, Deposit mobilization, Shareholders' funds, Capitals, Shareholders wealth maximization etc.

INTRODUCTION

Bank's raw materials work in progress and finished goods is money^[1]. The need to manage this money (funds) to maximize the wealth of shareholders becomes very imperative to bank managers.

Fund management has been broadly defined as the policies and approaches designed to obtain funds from deposit and borrowing and to allocate them to loans and investment to maximize the return of the shareholders^[2]. In the context of this study, fund management is seen as the galvanization of all available funds such as deposit mobilization, borrowing from the public, capital paid up by the shareholders, undistributed profit (retained earnings) etc. available to the bank and channeling them to the profitable ventures in order to maximize the wealth of the shareholders^[3]. This means then that, fund management here is concern with all the available disposable cash which the bank management can apply to every profitable venture to earn returns for the shareholders^[3].

In managing these funds, especially deposit mobilized from the public, the key important factor which the management of the bank must take cognizance of is the interest rate differentials. When bank mobilized funds from the public, they pay interest to the saving account holders as a way of inducement to bank with them. These funds then will be lent out to deficit economic unit to earn return in a specific rate of interest^[4]. The interest differentials now become the profit made by the bank.

I need to reiterate here that the interest rate differentials and return on investment by the banks constitute banks profit. Therefore bank management must ensure that all the funds available at their disposal are properly managed in order to earn returns and maximize the wealth of the shareholders.

Shareholders wealth maximization is the mainstay of the shareholders in any organization. They pool all their resources not just for fun but for returns commensurate with the resources committed into the organization. Shareholders wealth maximization is the increase in the current net value of business or shareholders capital gains with the objective of bringing in the highest possible return^[5]. The wealth of shareholders is maximized when the return on equity (or return on investment) especially, earning per share, bonus from the organization, return on assets etc. has increased^[3].

Return on equity (investment) is the key performance index of every bank^[6]. It shows how bank management is able to utilize the resources of the stakeholders to generate return or profit for them. If the return is appreciable, then more stakeholders may wish to join because of the attractiveness but if otherwise, the shareholders may wish to pull out their funds. Thus, this paper shall examine the effect of fund management on the return on equity of the shareholders in Nigerian banks.

The purpose of the work is to determine the effect of fund management on shareholders wealth maximization in Nigeria banks. The hypothesis is stated in a null form: fund management has no significant effect on shareholders wealth maximization. The rest of the work shall be segmented into four subheadings such as literature review, methodology, presentation and analysis and finally conclusion and recommendation.

LITERATURE REVIEW

a) Conceptual Framework

The concepts considered here are:

i. Funds management – As given earlier, is broadly defined as the policies and approaches designed to obtain funds from deposits and borrowing and to apply and allocate them to loans and investments to maximize the wealth of the shareholders^[2].

ii. Shareholders – shareholders are the owners of the business. They pool their resources to the company primarily for the purpose of wealth maximization. They are entitled to dividends after settling the creditors and preference shareholders.

iii. Shareholders wealth maximization – This refers to the generation of sufficient earnings in order to pay adequate dividends^[7]. Dividends represent one of the shareholders return on investment and exert pressure on the market prices of the shares and implicitly shareholders wealth. The wealth maximization actually refers to the present worth of shares in terms of dividend expectations^[5].

iv. Return on investment/equity – This is the most favorites and widely used measures of corporation, it is given as profit after tax (PAT) and preference dividends (PF) dividing the ordinary shares over a given period of time (preferably one year period).

$$ROE = \frac{PAT+PF}{\text{Ordinary Shares}} \times 100$$

If the ROE is high, then, it means higher value for the shareholders and if it is low, it means lower value for the shareholders. Shareholders is maximize when the ROE is high.

v. Deposit Mobilization - This is the major role of banks all over the world. It is the process of collecting cash through current account, savings account and fixed deposit account from the public by the financial institution. The funds mobilized are used by the banks for on-lending to the deficit economic unit and thereby maximize the wealth of shareholders and ultimately develop the economy.

vi. Shareholders' Funds - Shareholder funds is the same as the owner's equity. It represents the funds invested in the company through stock purchases or other private investments. It is given as total assets minus total liability. Shareholders' fund is the end result of the firm's worth after liability is completely deducted.

vii. Capital – capital comprises equity capital, ordinary share capital, intangible assets and audited revenue reserves. This is called Tier-1 capital. Tier-1 capital is used to soak up losses and does not require a bank to stop operations. Tier-2 capital is the one that cushions losses in case the bank is folding up, therefore, it provides a lower degree of safety to banks' customers. It comprises of unaudited retained earnings, unaudited reserves and general loss reserves. It is used to suck up losses if bank fall short of Tier-1 capital.

b) Theoretical Framework

i. Agency Theory - Agency theory was developed by Jensen & Mackling^[8]. The theory showed the connection between two parties known as the principal and the agent. The principal is the owner of the business and the agent is the manager of the business. In the case of bank, the shareholders are the owners of the banks and the managers are the agents. While shareholders want wealth maximization in form of dividends, the managers want business expansion by plowing back the profit. Agency relationship is always characterized by conflict of interest between the agent and the principal.

ii. Pecking Order Theory - The theory was first developed by Donaldson in^[9] and later modified by Stewart, Myers and Majluf in^[10]. The theory states that companies, here banks, should prioritize their sources of financing from internal financing to equity financing according to the principle of least effort or least resistance. According to

them, internal funds should first be used, follow by debt and finally equity if need be. The whole essence of this priority is to ensure that the shareholders' wealth is maximized and the company is not prone to danger.

iii. Baumol Model of Cash Management - The theory was developed by William J. in^[11]. He developed a model that showed that cash management helps to determine the firm's optimum cash balance with certainty. The theory is very useful and applicable extensively on cash management. The model sees cash and inventory management problems as the same.

They developed a model known as the transactions demand for cash: an inventory theoretic approach which is used in both inventory and cash management. His model affirms that managers can make an attempt to minimize the sum of the holding cash and the cost of changing marketable securities to cash.

iv. Behavioural Finance Theory - The theory of behavioural finance was developed by Shefrin and Statman in^[12] and Tversky and Kahneman in^[13]. The theory depicts the perception that the financial managers have over investor and the action put up by the financial manager to predict their behavior, aggregate market behavior and also price behavior. The theory gives an insight on how groups of investors were behaving differently to each other, but in ways common within their own market behavior's segment.

METHODOLOGY

The researcher employed ex post facto design. The fact that the data were original from National Deposit Insurance Corporation (NDIC) 2018 and adopted for the study necessitated the choice of the design. The data collected were return on equity, deposit mobilization, shareholders' fund and capital. Return on equity was the dependent variable whereas deposit mobilization, shareholders' fund and capital adequacy were the independent variables. The sample size is thirteen years (2006-2018). The researchers applied unit root test to stationaries the data and autoregressive distributed lag model was used to analyze the data. The model specification is given as:

$$ROE = f(TDM, SHF, CA)$$

This model can be Trans modified to econometric model as:

$$ROE_t = \alpha_0 + \sum_{i=1}^n \beta_{1i} ROE_{t-1} + \sum_{i=0}^n \beta_{2i} TDM_t + \beta_2 TDM_{t-1} + \sum_{i=0}^n \beta_{3i} SHF_t + \beta_3 SHF_{t-1} + \sum_{i=0}^n \beta_{4i} CA_t + \beta_4 CA_{t-1} + \mu$$

Where

ROE = Return On Equity

TDM = Total Deposit Mobilization

SHF = Shareholders' Fund

CA = Capital

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = Coefficient of independent variables (Slope)

μ = error term.

DATA PRESENTATION AND ANALYSIS

The data used for the work are presented below:

Table-1: Return on Equity (ROE), Total Deposit Mobilization (TDM), Shareholders' Funds (SHF) and Capital (CA)

Years	ROE	TDM	SHF	CA
2006	17.36	3412.3	1000.04	1000.03
2007	23.07	5357.2	1650	1000.07
2008	22.12	8702	5001	1059
2009	-64.72	9989.8	448.99	2201.84
2010	162.98	10837.14	312.36	429.6

2011	-0.2	12330	1934.93	1900.31
2012	22.2	14386	2150.32	2183.19
2013	19.14	16771.59	2418.75	2415.4
2014	20.34	18026	2440.2	2880.4
2015	19.78	17511	2780	3239.37
2016	12.56	18591	2650.15	3111.42
2017	4.7	19385	1757.96	2201.58
2018	9.73	21730.2	2825.99	3189.55

Source: NDIC Annual report and account

TDM, SHF and CA are in naira value whereas ROE in percentages. TDM, SHF and CA were logged in order to ensure the same unit of measurement.

Table-2: Stationarity (Unit Root) Test Results

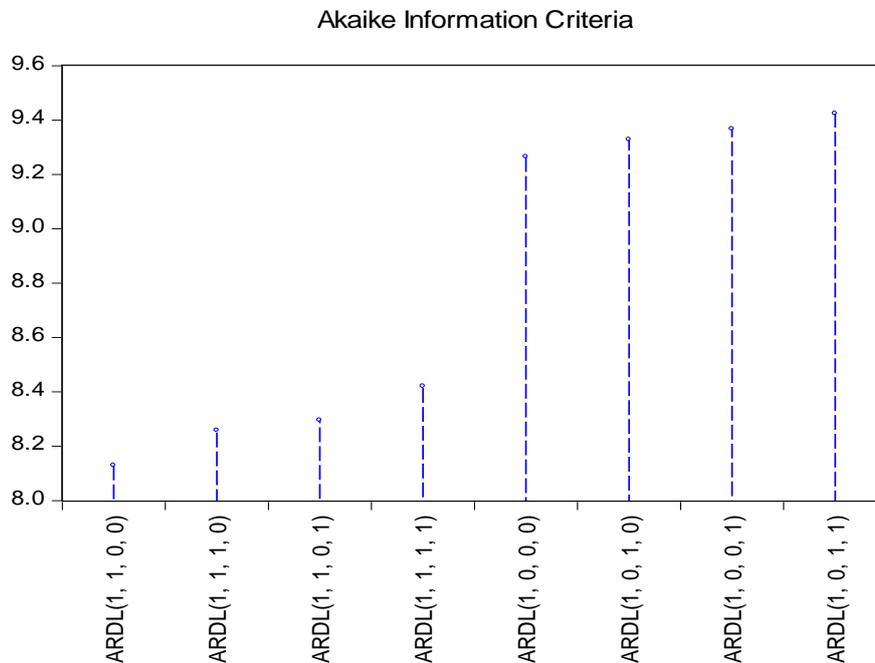
Variables	Level	1 st difference	Order of Integration	Remark
DROE	-5.477341	-	I(0)	Stationary
DTDM	-4.217581	-	I(0)	Stationary
DSHF	-3.274808	-4.638280	I(1)	Stationary
DCA	-4.218431	-	I(0)	Stationary

Significant at 5% level, ADF test > Critical Value, then the variable is stationary

Source: Extracts from E-Views 9 Output

The table above presents the unit root stationary test results with the outcomes for the utilized information of maximum of lags 2 with trend and intercept. The summary of the results are integrated in order I (0) and I (1). The ADF test statistic is higher when compared with all their critical values at 5%. As such, they are deemed fit for utilization and subsequent estimations and suggests the use of ARDL model for analysis^[14].

Figure-1: Auto-Regressive Distributed Lag (ADRL) Model selection test result



Source: Review version 9

The method is guided by the shortrun data span. The researcher chooses a maximum order of 1 for the provisional ARDL vector error correction model by using the Akaike information criteria (AIC). Number of models evaluated was 8 and the result showed that the best model is ARDL (1 1 0 0) which was summarized in graph above.

Table-3: Auto-Regressive Distributed Lag (ADRL) shortrun result

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
DROE(-1)	-0.593643	0.109929	-5.400267	0.0017
DTDM	-212.9012	67.42790	-3.157464	0.0196
DTDM(-1)	201.9832	46.76695	4.318930	0.0050
DSHF	32.94641	5.534976	5.952404	0.0010
DCA	-57.64582	11.09559	-5.195380	0.0020
C	600.7873	172.0962	3.490998	0.0130
R-squared	0.974085	Mean dependent var		20.97500
Adjusted R-squared	0.952489	S.D. dependent var		50.84019
S.E. of regression	11.08168	Akaike info criterion		7.955317
Sum squared resid	736.8221	Schwarz criterion		8.197770
Log likelihood	-41.73190	Hannan-Quinn criter.		7.865552
F-statistic	45.10475	Durbin-Watson stat		2.025337
Prob(F-statistic)	0.000111			
*Note: p-values and any subsequent tests do not account for model Selection.				

From the result, all the variables are significant at 5 percent level. This is their probabilities are less than 0.05. TDM of preceding year and SHF had positive significant where as TDM and CA showed negative significant. The result of the analysis is factual and confirms real life situation.

The deposit mobilization had negative significant in the present year but positive significant in the previous year. The negative significant in the present year could be as a result of the COVID 19 pandemic that ravaged the whole world. People at this period were not having food to eat let alone saving money in the bank, hence the negative significant. However, the preceding year had positive significant. At this period, normal economic activities were going on and the businesses were booming thus the positive significant.

Secondly, shareholders' fund had positive significant. This could be attributed to the risk taken by shareholders at this time to invest in the bank with the hope of getting better returns in future. Most shareholders are risk takers and are ready to pull all their resources for future returns hence the positive significant.

Finally, capital has negative significant. This is not unconnected with low capital available to the bank to transact business. As said earlier, this is the time of covid 19, therefore, there was no enough capital to transact business in the bank, hence negative significant.

The adjusted r^2 0.952489 implies that variation in all the explanatory variables account for 95% of the variation in return on equity. F – Statistic measures the overall significance of the model. The F-statistic is 45.10475 and the probability of F-statistic is 0.000111 is far less than 0.05 power of test. This means that fund management positively affects shareholders' wealth maximization of banks in Nigeria. 2.025337 Durbin Watson shows the absence of autocorrelation.

CONCLUSION AND RECOMMENDATIONS

From the result of the analysis, it is very clear that fund management in Nigeria's bank had positive effect on shareholders' wealth maximization. The individual variables had significant effect on return on equity within the period under consideration; therefore, we strongly recommend that bank management should sustain the strategy adopted in managing the deposit mobilized from the public, shareholders' funds and the capitals to maximize the wealth of the shareholders.

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