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BANKS' CHARACTERISTICS AND EARNINGS OF DEPOSITS MONEY BANKS IN NIGERIA

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ABSTRACT: *The relevance of banking sector in an economy is defensible for the fact that it is the foremost channel of savings and its allocations to various economic units. Banks are characterized by some unavoidable variables, for this study, they are capital, loans and advances and liquidity. It is therefore assumed that banking business, especially the deposit money banks in Nigeria cannot financially perform satisfactory without these variables in place. The objective of this study is to examine the impact of these characteristics on profitability. The study adopts ex-post facto research design and secondary source data drawn from the financial statements of the selected banks were used. Regression analysis was adopted in analyzing the data. The findings of the study show that bank capital, loan and advance have a significant relationship with earnings but liquidity is not during the period of study. The study recommends that the Nigerian banks' regulatory authorities should focus and continue to regulate banks' capitals as necessary with a view to improving the profitability of deposit money banks in Nigeria, the management of deposit money banks, should develop credits policies that will always be in agreement with the CBN's policies on credits and CBN should review the liquidity requirements with a view to investing idle liquidity to encourage earnings.*

KEYWORDS: Bank capital, earnings, liquidity, loans and advances

INTRODUCTION

The relevance of banking sector in an economy is defensible for the fact that it is the foremost channel of savings and its allocations to various economic units. The banking sector facilitates a vital financial intermediation function by transferring deposits into productive investments. It is also the injection of cash which stimulates economic competence by mobilizing savings to investment channels. It serves as a bridge between savers and borrowers and executes all tasks concerned with the profitable and secure channeling of funds (Ariccia & Marquez, 2004). According to Abu and Okpe (2016), bank characteristics' review are particularly necessary in the Nigerian banking because of the number of financial failures, frauds and questionable business practices which had adversely affected and still affecting investors' confidence. Bank characteristic in this study will focus on bank capital, loans and advances, and liquidity (representing cash and cash equivalents) of deposit money banks as these form the basic elements of banking operations.

Capital of a bank is highly regulated by the nation's apex body, the Central Bank of Nigeria (CBN). Therefore any bank operating in Nigeria must meet the minimum required capital as specified by the CBN. To deposit money banks, capital in place that determines their classification status that is, whether the bank should be regional, national or international. According to the Capital Adequacy Standard set by Bank for International Settlements (BIS, 2010), banks must have a primary capital base equal to at least 8 percent of their assets capitals (first and second tiers) to total risk assets. However, due to

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differences in banks' specific characteristics, the CBN came up with N25 billion minimum capital base after considering all the capital adequacy variables (Jallol, 2017) in the year 2004 but effective 2005. Susan and Nasieku (2016) believe that high capital levels can enable a bank to increase scope of its profitable projects while low capital levels will force a bank to control its investment appetite. In the same vein, Agbeja, Adelakun and Olufemi (2015) state that, banks with high capital levels are profitable and are perceived to be saved by depositors and create more businesses for them. Ozgur and Gorus (2016) indicate that banks with higher capitalization, low level of non-interest earning assets, less dependent to deposits as a fund have higher level of profit than others. Following these views, will the increase in capital base has any positive impact on the profitability of these banks, if one function of capital is to absorb looses arises from banks operations (Mgbodile, 2014). Loans and advances form the largest asset in a any deposit money bank's statement of financial position hence the justification for one major determinant of a bank's profitability. This is because almost all deposit money banks' earnings come from interest generated from loans and advances granted to desired customers of the bank. Profitability in this study shall be used interchangeably with earnings. The entire process of credit facilities or loans and advances up to disbursement level must be in line with the CBN's guidelines.

The power of banking system to create loans and advances is of great economic significance both to the bank/owners and the economy because it will result in the elastic credit system that is necessary for economic progress at a relatively steady rate of growth. Banks can directly affect the level of economic growth of a country through granting of credit facilities, it therefore follows that the greater the percentage of a bank's total resources placed in loans, the better the bank's performance (Bruker, 1970).The loans and advances to deposits ratio gives an impression of the extent to which banks used the resources available to them and thus consider a positive index of performance (Jat, 2006). Therefore, to what extent will the loans and advances have impact on the profitability of these banks?

Like the loans and advances, liquidity is another key variable not only in banks but all other business enterprises. A business without liquid assets cannot always operate to succeed so bank without adequate or required cash and cash equivalents will be prone to liquidity crises, hence the CBN is always particular about the term liquidity in deposit money banks. Bank liquidity means the ability of the bank to maintain sufficient cash to meet customers' needs at all times without impairing the CBN guidelines on liquidity. Ibe (2013) describe bank's liquidity as the ability of banks to immediately meet cash, cheques, other withdrawals obligations and legitimate new loan demand while abiding by existing reserve requirements. The liquidity needs in the banking system are usually defined by the sum of reserve requirements imposed on banks by a monetary authority in Nigeria and other nations. Another question of this study is, does maintenance of statutory cash requirements have any significant impact on the profitability of the banks since the cash is idle, or put into use to generate income.

In this work, earnings, profit and Profitability will be used interchangeably, but in real term, profit is an absolute term, whereas, profitability is a relative concept. Profit refers to the total income earned by the enterprise during the specified period of time, while profitability refers to the operating efficiency or simply the ability of the enterprise to make profit on sales (Olalekan & Adeyinka, 2013). Profitability appear to be one major objective of banks as it is essential for the purpose of paying corporation tax like any other company, paying interest to depositors, wages to staff members, dividends to shareholders and meeting other expenses (Ezike & Oke, 2013).

Profitability is vital for a bank to maintain its operational activities and for its investors to obtain fair returns, which is the most reason why bank capital will have to comply with the CBN figure. Again,

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liquidity and loans and advances will have to be in line with the regulatory authority's requirement as a deviation will amount to violation of operational and prudential guidelines of the CBN.
Jallof (2017) states that profitability, measured by earnings, is the bank's first line of defense against unexpected losses as it strengthens its capital position and improves future profitability through investments of retained earnings, adding that an institution that persistently makes losses will ultimately deplete its capital base which in turn will put equity and debt holders at risk.

Earnings according to Akanni and Akanni (2018) refer to amount of money a company has earned during a given period, usually a quarter or year, as reported based on proper accounting standards. Earnings help to measure a company's profitability. They opined that earnings are important to investors because they give an indication of the company's expected future dividends and its potential for growth and capital appreciation. In summary, the profitability is the function of the banks' characteristics in this study.

The main objective of this study is to examine the impact of bank characteristics on profitability of deposit money banks in Nigeria while the specific objectives are to: i) examine the impact of capital on the profitability ii) assess the impact of liquidity on the profitability and iii) find out the impact of residual loans and advances on the profitability. The profitability in this content is measured by the return on asset (ROA) of deposit money banks in Nigeria.

The findings of this study would be significant to i) CBN and Deposit money banks' executives as the results will guide them in the choice of capital maintenance, liquidity ratio, loans and advances and their relationship with profitability and ii) academia, it is a contribution to the body of knowledge and a useful addition to existing literature in the area of accounting and finance. In addition, the public, the shareholders and other stakeholders will benefit as the findings will provide them with information for decision making.

LITERATURE REVIEW

Conceptual Framework

Capital is one of the key variables in financial management since sufficient capital level for financial institutions is considered to be the most effective way to sustain business activities. Bank capital is the fund attributed to the shareholders as published in the financial position of a bank. The fund performs a number of functions but a consensus exists that the fundamental and overriding function is to provide a cushion against losses not covered by current earnings and to protect depositors and other creditors against loss in the event of liquidation (Olalekan et al, 2013). Capital is the value of the net assets of the owners of the company, in this case the bank. Capital is initially a source of fund for the bank for buying all necessary fixed assets and to supplementing working capital.

Loans and Advances are those operational but risky assets of banks from which they generate largest portion of their income. Koch (1991) defines loan and advances or simply risk assets as earning assets; they are the potential variation in income of the bank and market value of equity, resulting from non-payment or delayed payment. Some of the risk assets disclosed in the statement of assets and liabilities of banks include loans, advances, accounts receivables, investments, equity participation and contingent liabilities.

According to Van Greuning and Brataonovic (2003), banks are characteristically exposed to a variety of risks in the course of their day-to-day operations. The risks are broadly defined as financial,

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operational, business and events risks. These risks can result in loss to the banks or affect their liquidity if they are not properly identified, assessed and managed. Carse (2000) opines that banking involves risks and no amount of care and prudence will prevent the occasional problem from arising. In the same opinion, Chemielewski (2005) asserts that the existence of risk is not necessarily a problem; even the existence of high risk is not necessarily a concern, so long as management effectively manages that level of risk.

Liquidity in banks represents physical cash, bank balances with CBN and other banks, treasury bills/certificates and any other assets of a bank that can easily be converted to cash with minimum risk of loss (Adah, 2012). Liquidity and bank performance are key factors in determining the survival, growth, sustainability and performance of a banking system. Mistakes in liquidity planning and implementation can affect banking operations and might exhibit long term effect on the economy (Edem, 2017).

Olarewaju and Adeyemi (2015) define liquidity as a measure of the extent to which a person or organization has cash to meet immediate and short-term obligations, or assets that can be quickly converted to cash. They explain that liquid assets are those that can be converted to cash quickly if needed to meet financial obligations, and for a financial institution to remain viable, it must have enough liquid assets to meet its short term obligations. Ejike and Oke (2013) view liquidity as the ability of the bank to meet periodic cash demand of customers and a measure of its strength and an assurance for depositors' confidence. Nwaezeaku (2006) defines liquidity as the degree of convertibility to cash or the ease with which any asset can be converted to cash that is, sold at a fair market price.

According to Akanni and Akani (2018), earnings is the amount of money a business has earned during a given period, usually a quarter or year, as reported based on proper accounting standards, and help to measure a company's profitability. Profitability is the ability of a business to earn a profit while a profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue. Khalid (2012) opines that earnings and profits are the initial safeguard against the risks of engaging in the banking business and represent the first line of defense against capital depletion resulting from shrinkage in the assets value. Earnings and profitability performance should also allow bank to remain competitive by providing the resources required to implement management's strategic initiative (Tsai, 2010).

Profit is said to be the bottom line since it determines the success of any bank, as no business will want to be identified or associated with failure or loss. Profit could be defined as the financial returns from the successful use of financial capital within a period of time or financial year without impairing the capital. It could also be seen at as the growth in financial capital resulting from usage between the beginning and end of a defined period of time taking into consideration any additional capital introduced within the year under review (Adah, 2012).

Theoretical Framework

Commercial loan theory: This theory postulates that for bank loan to be short-term, self-liquidating and productive, commercial paper maturity should be of less than one year. According to Soyibo (1994), the theory requires that banks should not grant long term loan such as estate loans and loans for financing the purchase of plants and equipment because they are considered too illiquid.

The shift-ability Theory: This theory posits that a bank's liquidity is maintained if it holds assets that could be shifted or sold to other lenders or investors for cash. This point of view contends that a bank's liquidity could be enhanced if it always has assets to sell and provide the Central Bank and the discount

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Market stands ready to purchase the asset offered for discount. Thus this theory recognizes and contends that shiftability, marketability or transferability of a bank's assets is a basis for ensuring liquidity. Thus the test of an acceptable bank asset becomes whether it can be shifted' to another owner at no financial loss (Elliot, 1984).

The anticipated income theory: This theory developed by Prochanov (1944) explains the theoretical underpinning as it relates to banks performance. The theory depends on the loan portfolio as a liquidity source. In essence, banks' liquidity can be planned if scheduled loan payments are based on future incomes of borrowers at a point in time. Thus, the theory recognizes the influence of the maturity structure of the loan and investment portfolio on the liquidity position of a bank.

The Relevant Theory: The Shift-ability Theory is the relevant in this study because it postulates that the ease with which bank assets can be shifted to another owner at no financial loss, the better for the bank's liquidity. From this study, it is discovered that liquidity plays the most significant role in profitability in deposit money banks.

Empirical Review

The relationship between bank characteristics and financial performance particularly earnings in this study has been widely studied with mixed findings using data from different countries (Genchev, 2012). Jalloh (2017) examines the impact of capital adequacy variables (total assets, owners' funds, customers' deposits and loans and advances) on bank performance in Nigeria using cross panel from nine deposit money banks with significant foreign operations. The results of the ordinary least square (OLS) regression show that 76 per cent of the variations in profit after tax were caused by independent variables, indicating too much emphasis should not be on the size of capital.

Ajibola (2016) studies the strategy to manage the composition of financial institutions' assets and liability by controlling the various types of business strategies to maximize profitability and increase performance. Time-series and cross sectional data were extracted from audited financial statements of selected Nigerian Deposit Money Banks a panel data regression analysis to explore the relationship between the variables. The result shows that loans and advances are positively related to return on equity especially when profitability is measured as proxy of financial performance.

Ejokor, Konboye and Nteegah (2016) examine how capitalization has affected banks profitability in Nigeria. Both panel and Partial Frontier efficiency analyses were utilized in the investigation, using gross profits of 18 DMBs as dependent variable while capital base of DMBs, real income (GDP), financial deepening, interest rate and inflation rate are independent variables. They found that capitalization has a significant impact on profitability of the banks. The study further revealed that impact of capitalization on profitability of banks is the same across the banks.
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Udo (2015), examine the impact of bank characteristics on the liquidity and profitability of select deposit money banks in Nigeria. Sample size of ten out of twenty two deposit money banks in Nigeria was used. Two hypotheses were formulated to guide the study and were analyzed using Pearson's correlation coefficients and Regression analysis. The findings show that there is significant positive relationship among the studying variables.

Abata (2014) evaluates banks asset quality and performance in Nigerian banks using secondary data extracted from the annual reports and accounts of six banks listed on the Nigerian Stock Exchange based on market capitalization with a sample interval of fifteen-year period from 1999 to 2013. The data were

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analyzed using Pearson correlation and regression. The study reveals that asset quality had a statistically relationship and influence on bank performance.
Makau and Memba (2014) evaluate the influence of asset and liability on financial performance of commercial banks in Kenya with specific interest in Diamond Trust Bank. The study used Secondary data extracted from the bank's annual audited financial statements from 2006-2013. The significance of the regression model was tested using the t-test. The result shows that customers' deposits have a significant influence on the bank's earnings for the period under the study.

Ibe (2013) investigates the impact of liquidity management on the profitability of banks in Nigeria. Three banks were randomly selected to represent the entire banking industry in Nigeria. Elliot Rothenberg Stock (ERS) stationary test model was used to test the run association of the variables under study while regression analysis was used in analyzing the data. The result of the study reveals that liquidity management is indeed a crucial problem in the Nigerian banking industry.

Asikhia and Sokefun (2013) examine the effect of capital adequacy on profitability of deposit-taking banks in Nigeria. Primary data were collected through questionnaires, involving a sample of 518 distributed to staff of banks with a response rate of 76%. Also published financial statement of banks were used from 2006 - 2010. The study reveal that revealed a non-significant relationship exist but the secondary data analysis showed a positive and significant relationship between capital adequacy and profitability of bank.

Adegbaju and Olokoyo (2008) investigate the impact of recapitalization in the banking system on the performance of the banks in Nigeria. The study employed secondary data obtained from NDIC annual reports. The data were analyzed using t-test and the test of equality of means. It was found that the mean of key profitability ratio such as the yield on earning asset (YEA), return on equity (ROE) and return on asset (ROA) were significant, meaning that there is statistical difference between the mean of the bank before recapitalization and after 2001 recapitalization.

METHODOLOGY

The study adopts ex-post facto research design and secondary source data drawn from the financial statements of the selected banks were used. Capital, loans and advances and cash and cash equivalent were extracted from the financial statements. The Population of this study comprised of all the 18 operating deposit money banks in Nigeria from which five were randomly selected but based on new and old generation banks to take care of the variables under study. The variables were examined over a period of five years commencing from 2013 to 2017. Regression analysis was adopted in analyzing the data, using Stata version 12.

Model Specification

Specifically, the linear regression is presented as follows:
ROA = F (BCAP + LADV + LQDTY) …………………………….. (1)
Restating the above equation in Econometric term, the equation becomes:
$ROAt = b_0 + b_{it}BCAP_{it} + b_2LADV_{it} + b_3LQDTY_{it} + U_{it}$…………… (2) [Model]

Where: ROA= an indicator for return on asset (Dependent Variable)
b_0 = Intercept term (a constant)
b_1 = Coefficient of bank capital
b_2 = Coefficient of loans and advances

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b_3 = Coefficient of liquidity
$BCAP_t$ = a predictor for bank capital
$LADV_t$ = a predictor representing loans and advances
LQDTYt = a predictor the third Independent variable is the liquidity ratio
u_t = Stochastic error term, representing the combined effect of omitted variables
it = panel series and; f = Functional relationship.

RESULTS AND DISCUSSION

Descriptive statistics from the data are presented below covering mean, standard deviation, minimum and maximum values:

Table 1: Descriptive statistic

Variable	Obs	Mean	Std. Dev.	Min	Max
BCAP	25	26.036	10.1254	16.5	51.8
LADV	25	27.432	18.2984	9.7	60.6
LQDTY	25	25.396	11.2406	13.8	46
ROA	25	7.082	.6352	.3	2.9

As in table 1 above, the results state that the mean value of the dependent variable which is Return on Asset (ROA) for the selected bank is equal to (1.89) with a standard deviation of about (64%). This average implies that about (18.9%) on average of the bank capital attributed by the sampled bank are having a downward direction which means the capital perform a number of functions that the overriding function to provide a cushion against losses not covered by current earnings.On the other side, other results show higher value average for the Return on Asset compare to the study of Nwaezakku (2013) that uses a sample of 21 bank listed on the Nigerian stock exchange resulted in an average ROA level of 10% downward earnings as well. So there is a huge difference between the 4% gotten and the 7% on the result above, however this might be due to the small sample used for the study as only 10 banks constituted the sample.

The Table also indicates that loan and advance had a mean value of 27.4. This value indicates that 27.4% of the sampled banks issued loans and advances for a period of three years and above. This shows that more than 73.6% of the banks sector does not finance their bank with loan and advance which as they relies on other sources of earnings for their survival. The mean further implies that only 27.4% of the sampled banks relied mainly on return on loan and advance which has contributed immensely to the earnings of the above sample banks. The minimum and maximum values of loan and advance during the study period are 9.7 and 60.6 respectively. Similarly, the table shows that liquidity had a mean value of 25.4 during the period of study. This implies that about 25% of the banks measure on our sample size survival on availability of cash whether direct or indirect. The mean value of liquidity during the study period is slightly lower than both the mean values of capital and credit risks. The minimum and maximum values of liquidity stood at 13.8 and 46 respectively.

Correlation matrix

Correlation values between dependent and independent variables and the correlation among the independent variables themselves. The table below contains correlation matrix showing the Pearson correlation coefficients between the dependent and independent variables and among the independent variables of the study.

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Table 2: Correlation Matrix of Dependent and Independent Variables

VARIABLE	BCAP	LADV	LQDTY	ROA
BCAP	1.0000			
LADV	-0.3072	1.0000		
LQDTY	-0.4866	0.4474	1.0000	
ROA	-0.5273	0.3247	0.5972	1.0000

From table 2 above, it is observed that all variables that is, BCAP, LADV, LQDTY and ROA of the study are satisfactory correlated. For instance, there is no relationship among the variables that is large enough (greater than 0.80) to pose any problem of singularity of data (Hassan, 2011). The extent of relationship among all the independent variables is therefore acceptable to produce satisfactory results that can be relied upon.

Table 3: VIF/TV Test for Multicollinearity

Variable	VIF	1/VIF
BCAP	1.50	0.6652
LADV	1.23	0.6652
LQDTY	1.27	0.6652
Mean VIF	1.12	

From table 3 above, VIF values for all the independent variables were consistently below the benchmark of 10 which is considered adequate and satisfactory for regression analysis. Also, the tolerance value (TV or 1/VIF) for all the variables is above 0 and close to 1 which is recommended for regression analysis. The results of these two collinearity tests further confirmed the absence of multicollinearity problem.

Table 4: Regression analysis Result

ROA	Coef.	Std. Err.	T	P>/t/	[95% conf.	Interval]
BCAP	0.2103	.0118	1.61	0.002	-.0439	.0055
LADV	.1130	.0064	0.20	0.041	-.0120	.0146
LITQDTY	-.0843	.0114	2.14	0.241	.0006	.0481
-CONS	1.7319	.5205	3.33	0.013	.6493	2.8145
Prob > F				0.005		
R- Squared				0.811		
Adj R-squared				0.7837		

Source: Output from Stata 12

Table 4 reveals that adjusted R^2 of 78% shows that 22% of the variation in the dependent variable is explained by other factors not captured in the study model. This suggests that apart from bank capital, loan and advance and liquidity, there are other factors that affect the earnings of listed deposit money banks in Nigeria.

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Bank capital is statistically significant and has a positive contribution to ROA. The coefficient of 0.21 indicates that in every ₦1 increase in bank capital, ROA will increase by about 21%. This appears to be obvious as capital is the source of any business (not only in banking) and from which profit is expected. Ejokor, Konboye and Nteegah (2016)'s study found that, bank capital has a significant impact on profitability of banks. The study further revealed that, impact of capitalization on profitability of banks is the same across banks.

This result also indicates that capital is unavoidable and important for a bank business. In addition, capital also acts as a cushion to protect depositors and other creditors against losses. Graham (1989) affirmed that management discipline has an effect on capital. Graham (2008) is of the view that prudent guideline of bank capital system has an important impact on bank profitability and costs. The positive effect of bank capital is consistent with our a priori expectation.

Loan and advance result above shows a strong positive relationship with ROA, with the coefficient of correlation of 0.1130. This shows that, any ₦1 given out as loan and advance will lead to a return on asset of above 11%. Loan and advance is statistically significant to return on asset at 5% level. Meaning, granting of loans and advance tend to be profitable than keep the money idle.

The finding agrees with the study of Olaoye and Olarewaju (2017), Davydenko (2017) and Ramadan, Kilani & Kaddunni (2011) who found a significant positive relationship between loans and advances and profitability of DMB but Abata (2016) reported an insignificant relationship between loans and profitability of banks.

As a result of asymmetric information that exists between banks and borrowers, banks must have a system in place to ensure that they can do analysis and evaluate default risk that is hidden from them. While it is expected that banks would bear some bad loans and losses in their lending activities, one of the key objectives of the bank is to minimize such losses (Casu 2016).

The other hypothesis shows that there is weak relationship between liquidity and earnings. The result reveals that liquidity has a p-value of 0.241, meaning that the liquidity has no influence on earnings of DMBs because it is not significant. The coefficient of -.08 also states that an attempt to increase liquidity by one naira will lead to a decrease in the earnings of about 8%. The finding is in line with the earlier expectation that liquidity has no significant effect on earnings because cash must be put into use before it can generate earning. The finding suggests that appropriate liquidity is an indication of efficient performance but not factor for potential earning.

This finding is in consonance with that of Ibe (2013) who states that liquidity management poses a crucial problem to profitability in Nigerian DMB. The negative impact of liquidity may be as a result of appropriate liquidity maintained by the banks even though is in accordance with the CBN's prudential guidelines. This result is congruent with the findings of Almajali, et al (2015), Brown, et al (2016) and Carson & Hoyt (1995). They all suggest that liquidity is negatively and weakly related to earnings. However, this finding contradicts the findings of Abate (2012), Yuvaraj & Abate (2013), Ahmed, et al (2011), Bilal & Tuful (2013) and Daniel & Tilahun (2013).

CONCLUSION

The main objective of this study is to examine the impact of bank characteristics on profitability of deposit money banks in Nigeria. The regression result shows that bank capital has a significant positive

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relationship with ROA. The loan and advance has a positive relationship with earnings such that a unit increase in load and advance leads to increase of about 11% value in earnings. However, the liquidity relationship with return on assets is not a good one as it cannot power profitability of deposit money banks in Nigeria. In conclusion, the result shows that bank capital, loan and advance have a significant relationship with earnings but liquidity is not during the period of study.

Based on these findings, the following recommendations are made:

i) The Nigerian banks' regulatory authorities should focus and continue to regulate banks' capitals as necessary with a view to improving the profitability of deposit money banks in Nigeria and ensure stability in the financial system.

ii) The management of deposit money banks, need to be cautious in developing efficient credits policies that will always be in agreement with the CBN's policies on credits. This is to ensure enhancement of earnings and continuity of banks' business and

iii) The apex body – CBN should review the liquidity requirements with a view to investing excess or idle liquidity within the banking system to encourage earnings.

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