

INCOME-EARNING ASSETS AND PROFITABILITY OF DEPOSIT MONEY BANKS IN NIGERIA

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ABSTRACT

This study examined the income earning asset structure and its implications on the profitability of deposit money banks in Nigeria. It was motivated by the observed gap in the existing literature on the relationship between income generating assets and the profitability of Deposit money banks in the country. The study adopted the Ex post Facto Research Design. The sample size comprised 10 Deposit Money Banks covering the period 2002 to 2018 financial years. The data relating to income-earning assets and profits were obtained from select listed Deposit Money Banks in Nigeria, and analyzed using Descriptive Statistics and Simple Linear Regression Model. Results reveal a significant relationship between the income earning assets and profitability of the deposit money banks in Nigeria. Based on the findings, the study recommends among others that banks should increase their investments in securities, loans and advances as well as treasury bills as this will improve their profitability. Thus profitability of banks is directly affected by management of their assets and liability. Their study examined how assets and liability management together with external variable such as degree of market concentration and inflation rate impact the profitability of selected commercial banks in Bangladesh. The study is limited to only the banking sector as other sectors are excluded. Nonetheless the sample size, number of variables, concentration on a single sector would not invalidate the outcome of the study.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Deposit money banks play an important role in the economic development and growth, due to their contribution to the financial system through providing financial facilities to all economic enterprises and individuals. In addition, the Deposit money banks provide comprehensive financial services as compared to any other financial institutions e.g., they receive and collect the money from individuals who want to make saving and provide these collected amounts to those who are in need to set up their enterprises. As a result of economic development in various countries, banks have become an essential element in the financial system and its development, for example the financing of trade activities, services, industrial and agricultural sectors, as well as individuals through long and short-term loans and other banking services (Alhadab & Alsahaweh, 2022).

In every system, there are major components that are paramount to its survival. This is also applicable to the financial system where deposit money banks contribute significantly to the effectiveness of the entire system. They do this by providing an efficient mechanism for the mobilization of resources and efficiently channeling them for productive investment (Wilner, 2000). Therefore, the two major functions of deposit money banks, deposit mobilization and credit extension define their financial intermediation role in the economy. However, efficient financial intermediation by a deposit money bank demands the purposeful attention of the bank's management to the income generating assets and their impact on profitability. There are two kinds of assets in the deposit money banks, such as current assets and non-current assets. The

examples of no-current assets are building and land, furniture and fittings, motor vehicles, etc. while current assets include cash and cash equivalents, loans and advances, investment in securities, treasury bills, etc. Current assets are otherwise called income generating assets while the non-current assets enhances the generation of income.

Assets have significant role in determining the profitability of a firm (Smith, 1980). Bank profitability is an important ingredient of financial development, its relevance spans through banking firm performance to macroeconomic stability. At the firm level, a higher return to a large extent reduces bank fragility. At the macro level, increased profitability makes for a sustainable banking sector that can finance economic growth and development. However, due to the intermediation role of the banking system, higher returns may imply higher interest rates on loans. This informs a reason why monetary authorities are always poised to regulating the banking system. Increased regulations and counter deregulations have encouraged competition in the banking sector, and hence exposed banks to increased fragility. For example between 1990 and 2013, bank regulators have increased the minimum share capital of banks operating in Nigeria five times (Aburime and Uche, 2008). These reforms were all aimed at improving the financial position , profitability and stability of banks in Nigeria, even though the outcomes sometime differ from expectations.

1.2 Statement of the Problem

It is the primary concern of business organizations to give adequate attention to return on assets because of its implications to business survival. High Performance reflects management effectiveness and efficiency in making use of company's resources and thus in turn contributes to the country's economy at large.

Poor mix and management of income earning assets causes low return on investment. And low return on investment is an attribute of ineffectiveness and inefficiency in the utilization of assets. Income earning assets are like flesh while the non-current assets are like structures or bones and without the structure the flesh cannot stand. The productive engine is the income earning assets in banks.

The problem of appropriate level of investment in current assets or income earning assets in banks in Nigeria is vital because more current assets can create high liquidity, surplus cash and high liquidity impairs profitability. The problem of proper evaluation of investment on income earning assets is necessary because investment cannot be taken on the hunch. Despite the strategic importance of income earning assets in banks, there are no comprehensive studies in Nigeria yet on this subject matter. It is against this background that this study is articulated.

1.3 Aim and Objectives of the Study

The main objective of this research is to examine the income earning asset structure and its implications for the profitability of deposit money banks in Nigeria. The specific objectives are to:

- i. Examine the relationship between the structure of income earning assets and the profitability of deposit money banks in Nigeria.
- ii. Evaluate the effects of loans and advances on the profitability of deposit money banks in Nigeria.
- iii. Examine the effects of investment in securities on the profitability of deposit money banks in Nigeria.

- iv. Examine the effects of investment in treasury bills on the profitability of deposit money banks in Nigeria.

1.4 Research Questions

The following research questions were formulated for the study;

- i. What is the relationship between the structure of income earning assets and the profitability of deposit money banks in Nigeria?
- ii. How does investment in loans and advances affect the profitability of deposit money banks in Nigeria?
- iii. What is the effect of investment in securities on the profitability of deposit money banks in Nigeria?
- iv. To what extent does investment in treasury bills affect the profitability of deposit money banks in Nigeria?

1.5 Hypotheses

The following research hypotheses were formulated for this study;

- Ho1: There is no significant relationship between the structure of income generating assets and the profitability of Deposit Money Banks in Nigeria.
- Ho2: There is no significant effect of loans and advances on the profitability of Deposit Money Banks in Nigeria.
- Ho3 : There is no significant effect of investment in securities on the profitability of Deposit money banks in Nigeria.
- Ho4 : There is no significant effect of investment in treasury bills on the profitability of deposit money banks in Nigeria.

1.6 Scope of the Study

The study is limited to Deposit Money Banks listed on Nigeria stock Exchange. The study period is 2011 to 2022 financial year. The subject matter of the study is bank profitability and investment income earning assets. Moreover, the study concentrates on income-earning assets (loans and advances, securities and treasury bills).

1.7 Significance of the Study

The management of Deposit Money Banks would be informed and equipped with appropriate information regarding the influence of non-current assets on its financial performance, thus aiding them in planning, controlling and decision-making. It would help the investors (existing and prospective) in assessing the viability of their investments in banks via the assessment of the bank profitability.

Business practitioners such as stock brokers, bankers, insurance brokers and chartered accountant would benefit from the findings as it would serve as a source of information for them in the discharge of their professional duties to their clients.

This study would add to the existing stock of empirical literature on non-current assets of banks in Nigeria. It would serve as a reference for scholars researching in this area. The study would provide informed basis for policy makers and managers to profitably guide the operations of these institutions.

1.8 Justification of the Study

The justification for this study is the need to bridge the gap in existing literature on the influence of income generating assets on the profitability of Deposit money banks in Nigeria.

1.9 Definition of terms

Financial Performance: This refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives are being or has been accomplished.

Income Earning Assets: An asset of a business intended for continuing used to generate profit in the short-term. Examples include; loans and advance, treasury bills, investment among others.

Profitability: Profitability connotes a situation where the income generated during a given period exceeds the expenses incurred over the same length of time for the sole purpose of generating income