FINANCIAL MANAGEMENT PRACTICES, WEALTH MAXIMIZATION CRITERION AND
FIRM VALUE: AN EMPIRICAL ANALYSIS

Peter O. Eriki, Eseoghene J. Idolor and Igbinovia L. Eghosa
Department of Banking and Finance, University of Benin, Benin City, Nigeria

Abstract
In the field of financial management, shareholders wealth maximization is often seen as the desirable
goal not only from the shareholders perspective but for the society at large; with the firm’s primary goal
aimed mainly at maximizing the wealth of its shareholders. This study thus aimed at determining the
impact of the core financial management decisions or functions on firm value or shareholders wealth.
The study adopted the use of the Ordinary Least Squares (OLS) multiple regression and correlation
matrix to ascertain the relationship between shareholders value and the core financial management
decisions/functions. The results of our findings in the correlation matrix revealed that all the financial
management practices were negatively correlated with shareholders wealth or firm value while the OLS
multiple regression revealed that dividend decisions and investment decisions were the two variables that
exert significant influences on shareholders wealth or firm value.

Keywords: Financial, management, shareholders, firm, value

Introduction
Financial management is the managerial planning and control of financial resources of a business to
achieve the objectives of the business (Olowe, 1999). Financial management is a managerial
activity that is concerned with the planning and controlling of the firm’s financial resources
(Pandey, 2005). The field of financial management is of immense interest to academics and
practitioners because it is an emerging discipline with many areas where common grounds have not
been reached. Financial management focuses on the acquisition of funds which concerns the
financing decision of the firm (choice of the sources of funds for which projects); and utilization
of funds which concerns the investment decisions (determination of the firm’s choice criteria as well
as the selection of investment project that pass the firm’s test of acceptance using the company’s
choice criteria) and dividend decision which concerns whether or not to pay dividends; if yes,
whether to pay cash or scrips, bonus shares in lieu of dividends or a combination of both i.e. cash and
shares and liquidity decision which concerns the management of current assets (Pandey, 2005).

Financial management is based on the assumption of shareholder’s wealth maximization objective
(Olowe, 1999). Shareholders’ wealth maximization cannot be achieved without a recourse to the
functions – financing, investment, dividend and liquidity decisions. Financing decisions have
implication for the cost of capital and the consequent optimisation of returns; the way the
finance of a firm is managed determines to a large extent its survival and growth (Idolor, 2010);
investment decisions have implication for the company’s profitability and hence its
competitiveness and survival in the market place; dividend decision have implication for the
shareholders’ continued loyalty as well as the organization’s well being in the sight of the
investing public (present and potential) and the capital market and liquidity decisions have
implication for the current asset of the firm.

A careful juxtaposition of financing, investing, and dividend and liquidity decision indicates that they
are all crucial to the optimization of corporate returns. This underscores the importance of
financial management to the success of business organizations. While most researchers agree on the
importance of sound financial management and its functions in achieving shareholders wealth
maximization objective, the point of departure tends to remain with the hierarchy of prepotency of
each of the functions. The essence of this study is to wade into the controversy and see which of the
oft reported functions is significantly predominant in this very important area of finance. Essentially the study is exploratory and the case studies are confined to Nigerian commercial banks.

**The research problem**

Little attention has been given to the empirical evaluation of financial management practices in Nigerian banking institutions. Non-adherence to financial management practices has been identified as the cause of illiquidity, poor investment strategy, poor dividend decision and non-optimal capital structure in Nigerian banking institutions.

It is against this background that the study seeks to provide answers to the following questions:

(a) Does Nigerian commercial banks dividend decisions affect their desire to maximize shareholder’s wealth?

(b) To what extent do Nigerian commercial banks financing decision affect their desire to maximize shareholders’ wealth?

(c) Is the maximization of shareholders’ wealth in Nigerian commercial banks influenced by their investment decisions?

Is there a relationship between Nigerian commercial banks liquidity decisions and the maximization of shareholders’ return or wealth?

**Research methodology**

In this study the impact of the four core financial management functions/decisions on firm value or shareholders wealth was analysed and measured, so that the relationship between them can be established. The Ordinary Least Square (OLS) method of regression and the correlation matrix was used to ascertain the relationship between shareholders value and the core financial management functions/decisions. Our choice of the Ordinary Least Square estimation technique is based on the fact that it possesses some desirable properties which makes it unique. This is because among a class of linear unbiased estimators, the ordinary least square estimator is “blue” (best linear unbiased estimator).

Our model was specified using shareholders wealth or returns (SHAV) as the dependent variable; while dividend payout (DIV), liquidity ratio (LIQ), debt-equity ratio (FIN) and total fixed asset (INVT) was used as independent variables (explanatory variables). Specifically, the model is specified in functional form as follows:

$$SHAV = F(DIV, LIQ, FIN, INVT)$$

The model is further specified in linear form as follows:

$$SHAV = \alpha_0 + \beta_1 DIV + \beta_2 LIQ + \beta_3 FIN + \beta_4 INVT + \Sigma$$

Where:

- \(\alpha_0\) = Intercept of the entire regression model
- \(\beta_1\) = Slope of DIV
- \(\beta_2\) = Slope of LIQ
- \(\beta_3\) = Slope of FIN
- \(\beta_4\) = Slope of INVT
- \(\Sigma\) = Stochastic error term or white noise.

The definition of our model variables as well as their apriori signs or expectations are shown in Table 1.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Apriori Sign</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>SHAV</td>
<td>-</td>
<td>Returns on capital employed (shareholders wealth or returns – which is the goal of financial management practice)</td>
</tr>
<tr>
<td>DIV</td>
<td>+</td>
<td>Dividend payout (proxy for dividend decisions)</td>
</tr>
<tr>
<td>LIQ</td>
<td>+</td>
<td>Liquidity ratios (proxy for liquidity management decision)</td>
</tr>
<tr>
<td>FIN</td>
<td>+/-</td>
<td>Debt-equity ratios (proxy for financing decisions)</td>
</tr>
<tr>
<td>INVT</td>
<td>-</td>
<td>Total fixed asset (proxy for long term investment decisions)</td>
</tr>
</tbody>
</table>

Furthermore, the nature of the study necessitated the use of secondary data. These data include the selected banks’ dividend payout (proxy for dividend decisions), liquidity ratios (proxy for liquidity management decisions), debt-equity ratios (proxy for financing decisions), total fixed asset (proxy for long term investment decisions) and returns on capital employed (shareholders wealth or returns – which is the goal of financial management practice). Also constraints of data availability necessitated the use of ten (10) publicly
quoted deposit money banks in Nigeria for our analysis which covered a five (5) year period from 2004-2008. The sampled banks were Skye Bank, Eco Bank, Standard Chartered Bank, Zenith Bank, Afribank, Bank PHB, Fin Bank, Oceanic Bank, Union Bank and Stanbic IBTC Bank. The choice of the sampled banks as previously noted was based on the use of judgemental sampling techniques due to constraints of data availability. The data was sourced from BGL research reports, Nigerian Stock Exchange (NSE) fact books and the respective banks annual financial reports. It must however be noted that due to recent changes in the Nigerian banking industry, some of the banks used as case study have either changed their names or merged with other banks. This however does not in any way dampen the flavour of our current research endeavour.

**Data analysis and interpretation of results**

The empirical relationships between the core financial management functions/decisions and shareholders’ value was examined. The dependent variables used were shareholders return on capital (SHAV) while the independent variable were dividend payout, liquidity ratio, debt equity ratio, and total assets. In evaluating the influence of banks financial management practices on their shareholders value, we employed both the Pearson correlation matrix and Ordinary Least Square (OLS) multiple regression technique. This is especially important for a better understanding of how shareholders value can be maximized by adjustments in the bank’s financial management practices. Table 2 shows the correlation matrix as well as the regression results obtained before and after correction for autocorrelation and heteroskedasticity.
The correlation matrix table in table 2 reveals that the selected banks dividend (-0.05), financing (-0.26), investment (-0.15) and liquidity (-0.08) practices are negatively correlated with shareholders wealth (firm value). This implies that most banks in Nigeria are adopting financial management practices that are associated with reducing shareholders returns or firm value. The results also indicates that the reduction in shareholders wealth or firm value is not strongly associated with increases in dividend payout, total asset, debt-equity ratio and liquidity ratio.

In evaluating the causal-effect relationship among the variables, we used the Ordinary Least Squares (OLS) regression analysis. The result is shown in table 3.

Table 3: OLS Multiple Regression Results

<table>
<thead>
<tr>
<th></th>
<th>Result 1</th>
<th>Result 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>48.54</td>
<td>52.5</td>
</tr>
<tr>
<td></td>
<td>(3.29)</td>
<td>(1.85)</td>
</tr>
<tr>
<td>DIV</td>
<td>0.001</td>
<td>0.002</td>
</tr>
<tr>
<td></td>
<td>(0.68)</td>
<td>(3.76)</td>
</tr>
<tr>
<td>INVT</td>
<td>-2.04</td>
<td>-2.83</td>
</tr>
<tr>
<td></td>
<td>(-1.10)</td>
<td>(-3.21)</td>
</tr>
<tr>
<td>LIQ</td>
<td>-0.20</td>
<td>-0.27</td>
</tr>
<tr>
<td></td>
<td>(-1.23)</td>
<td>(-1.25)</td>
</tr>
<tr>
<td>FIN</td>
<td>-1.23</td>
<td>0.94</td>
</tr>
<tr>
<td></td>
<td>(-1.75)</td>
<td>(-0.72)</td>
</tr>
<tr>
<td>R²</td>
<td>0.12</td>
<td>0.28</td>
</tr>
<tr>
<td>Adj. R²</td>
<td>0.04</td>
<td>0.20</td>
</tr>
<tr>
<td>F-statistics</td>
<td>1.5(0.22)</td>
<td>3.4(0.01)</td>
</tr>
<tr>
<td>DW</td>
<td>2.8</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Note: The values in parentheses are the t-ratios

Table 3 shows the regression results obtained before and after correction for autocorrelation and heteroskedasticity, which we depicted as result 1 and result 2. For result 1, the adjusted $R^2$ value of 0.04, Durbin-Watson (DW) statistics of 2.8 and F-statistics of 1.5 (the initial result from our model) is very poor and sends signal that it might be subject to the problem of autocorrelation and heteroskedasticity. This findings necessitated the adoption of AR (1) autocorrelation correction method. This aided in arriving at a more valid result for this study.

As shown in result 2, the $R^2$ value of 0.28 shows that about 28% of the systematic variations in shareholders wealth or firm value is jointly explained by changes in the sampled banks financial management practices (i.e. financing, dividend, liquidity and investment practices). This is further complimented by the adjusted R-square of 20%. The low R-square value can be attributed to the exclusion of other important pertinent variables that can contribute to firm value. The F-statistics of 3.40 (0.01) is highly significant at 5% level of significance. This implies that the overall model is significant. Also, the Durbin-Watson (DW) statistics of 2.2 after post residual analysis suggests the absence of autocorrelation in the regression results; thus giving more credence to regression result 2.

Also, result 2 shows that dividend (0.002) and investment (-2.83) are the two most statistically significant variables influencing shareholders wealth or firm value at 5% level. The results also revealed that increasing dividend payout in the selected banks translate to increases in firm value while increases in asset investment decreases firm value from shareholders wealth maximization criterion (or view point). The decreasing effect of asset investment on firm value is logically acceptable since more funds will be ploughed back into the firm rather than being transferred to the shareholders. Furthermore, the results revealed that financing and liquidity financial management practices of the selected banks had a negative but insignificant influence on firm value or shareholders returns.
Conclusion and recommendation

The broad objective of this study was to empirically evaluate the effect of financial management practices of quoted firms in the Nigerian bourse; on firm value or value of shareholders. Based on the empirical findings, we discovered that dividend and investment financial management practices were the only two core functions or decisions that had a significant influence on firm value. The finding also revealed that dividend positively influenced shareholders wealth while investment negatively influenced shareholders wealth. It is therefore fair for us to generalize that increased dividend payout ultimately leads to increased shareholders value while increased investment in assets leads to decreased shareholders value. Also, liquidity and financing decisions are not good factors in determining shareholders wealth.

Flowing from our findings we recommend that more focus be placed on dividend and investment decisions as they both appear to have significant influence on shareholders wealth compared to liquidity and financing decisions. However, we note that serious improvements is needed in the financing and liquidity management decisions of Nigeria firms, as this help ensure their continued survival (as no firm can survive without funds); as well as ensure that they do not become illiquid and insolvent. While suggesting that this research work expresses a highly intelligent guide to the propellers of firm value and shareholders wealth maximization criterion in Nigeria, interested scholars and researchers are hereby advised to conduct more research on this very topical area of financial management, as improvement will be highly appreciated.

Reference


