Impact of Internal Financing on Firms Value among Deposit Money Banks in Nigeria

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Abstract
This paper is focused on the impact of internal financing on firm`s value among deposit money banks in Nigeria. The identifies internal sources of funds and their effect on firm`s value. The sources include retained profit, sale of assets and reduction or controlling of working capital. Advantages of these sources were also looked into. The study was based on financial report of some selected banks, it was found out that the retained earnings has significant impact on value of DMBs in Nigeria, because it add to the value of the firm and therefore the firms are recommended to finance business internally as it is healthier than external financing which attracts rate of return sometimes at high rate. Retain profit, sale of assets and reduction of working capital improve financial value of firms.

Keywords: Internal financing, retained profit, sale of assets, reduction or controlling of working capital

Introduction
The term internal source of finance itself suggests the very nature of finance. This is the finance which is generated internally by the business unlike finances such as loan which is externally source by banks or financial institutions. The internal sources of finance are retained profits, the sale of assets and reduction of working capital (Zhenkung & Yanping 2019).
Finance is a constant requirement for every growing business. There are several sources of finance from where a business can finance its activities. However, the finance manager cannot just choose any of them indifferently. Every type of finance has different pros and cons in terms of its cost, availability, eligibility, legal boundaries etc. We need to have an in-depth understanding of the characteristics of the source of finance. Let us focus first on the internal source of finance (Mand, Meenakshi, Amarjit & Amiraslany, 2018).
Internal sources of finance are the sources of finance for businesses which are generated by the business itself in its normal course of operations. The study of internal financing is an important reference study in enterprise's financing policy. How an organization is financed is of paramount importance to both the manager of the firms and provider of funds. This is because if finance cannot be source internally; the value of the business enterprise may be seriously affected. This study is to find out the impact of internal financing on firm's value. Hence, the paper seeks to fill the gap in the literature as a result of limited studies that have been conducted so far in this area using Nigerian context. The paper contributes significantly to the literature, as we demonstrate that firms should source their financing internally in other to increase their values.

Objective of the Study
The general objective of the study is to determine the impact of internal financing on the value of banks in Nigeria.
The specific objectives are:
i. To investigate the impact of retained earnings on firms' value.
ii. To investigate the impact of Sales of assets on firms' value.

Statement of Hypotheses
The following hypotheses are formulated below:
H1: Retained earnings have significant impact on firms' value.
H2: Sales of assets has significant impact on firms' value.

Literature Review

Internal Source of financing

Corporate bodies like other entities are always in constant need of funds to finance their operations. These funds which are either internally or externally generated have their various implications on the overall performance of the corporation. Essentially, an entrepreneur or a manager considering raising external funds must realize that the lender will place considerable demands on him. The high cost of raising external finance such as interest payment on loans, debentures and leases, dividends payment on shares, rent and royalty payment, repayment of loan sums, redemption of redeemable debentures, redemption of redeemable preference shares, etc. serves as a bane for raising funds through this medium. Also, the additional disclosure requirements conferred on the corporation equally militates against raising external funds (Scott, 2003).

It is on the above background that the researchers intend to critically examine and appraise the impact of retained profit as an alternative method of financing a firm. Internal financing which involves a firm using its retained profit does not confer any obligation on the firm as the firm does not have to pay transactional cost and other cost associated with raising external funds, however, assuming the corporation has no profit during the year of operations, then it has to source for funds (short term capital) by way of overdraft, commercial papers, credits, debt factoring, etc.

In the theory of capital structure, internal financing is a situation where firm uses its fund as a source of capital for new investments rather than distribute it to the firm's owners or other investors and obtain capital elsewhere. Internal financing is generally seen as less expensive for the firm than external financing because the firm does not have to incur any expenses in the process of carrying out transactions, it (firm) does not have to also pay the taxes associated with paying dividends. Most economists debate that neither the availability of internal finance is an important determinant of a firm's performance or not a related controversy is neither the fact that internal financing (using retained profit) is empirically correlated with investment implies that firms are credit constraint and therefore depends on internal funding through retained profit for investment. Net income retained in the business can be used to acquire additional income earning assets that result in increased income in future years. The size of this income indicates to the public how big a company's war-chest is. Also known as statement of stakeholders' equity, a report on retained earnings indicates whether the firm has 'adopted resources (Scott, 2003). Smaller and faster growing companies tend to have a high earned surplus ratio to fuel research and development; it also fuels new products expansion. Mature firms on the other hand, tend to pay out a high percentage of their profits as dividends

Retained Earnings

Retained earnings are called the internal source of finance for a business for the simple reason that they are the end product of running a business. The phenomenon is also known as ‘Ploughing Back of Profits’. Retained profits can be defined as the profit left after paying a dividend to the shareholders or drawings by the capital owners.

Retained earnings are a long-term source of finance for a company because there is no compulsory maturity like term loans and debentures. Retained profits are also not characterized by fixed burden of interest or instalment payments like borrowed capital (Christian & Antonio, 2018).

The advantage of having retained profits is clearly seen in its characteristics. They are long-term finance and nobody can ask for their payments, since there is no additional equity to be issued, there is no dilution of control and ownership in the business, there is no fixed obligation of interest or instalment payments. Retained earnings as an internal source of finance are cost effective considering the fact that there is no issue cost attached to it which ranges between 2 – 3 %. Investing retained earnings in the projects, with IRR better than ROI of the business, will directly have a positive impact the shareholder’s wealth and thereby the core objective of management will be served (Christian & Antonio, 2018).

Sale of Assets

This is another example of internal source of finance. Business sells off all sorts of non-current assets to finance the immediate requirement of capital. Businesses which sell off useful assets put themselves at loss because once these useful assets are sold off; the business wouldn’t be able to receive any benefit

from them. There are three better options Business can sell off old assets which they can't use for very long time. Selling off old assets will help business in fulfilling the immediate requirement and the business will also not leave out a lot of benefits. The company can use the approach "sell and lease back". Under this approach, the company will get the cash for selling the assets but at the same time, they will be able to use the assets on a lease. If selling off old assets doesn't serve the company, going for an external source of finance is a better option (if there are no other internal sources of finance the company can use) (Christian & Antonio, 2018).

Reduction of working capital

This is also another example of internal sources of finance. Though it's not used much, it can be valid if the company needs a small amount of money immediately.

A company can reduce its working capital by speeding up the cycle of accounts receivables and stock and/or lengthen the cycle of accounts payable.

Speeding up the stock/accounts receivable will help them get the cash quickly. And lengthen the accounts payable cycle will keep the cash in the company for some time. AS a result, a business can use this cash for its immediate requirement (Mand, Meenakshi, Amarjit & Amiraslany, 2018).

Review of Relevant Theories

The pecking order hypothesis (POH) suggests that costs associated with information asymmetries between stockholders and company management have a significant impact on the firm's choice of funding. Managers are privy to 'inside' information that is not available to actual and potential investors. Investors understand this asymmetry, and they assume that managers will issue stock only when they perceive it to be overvalued. The POH predicts that in order to avoid this adverse signaling problem, firms prefer to finance projects from retained earnings. When the internal sources are exhausted, managers will opt for 'safer' securities, which Myers (1984) in Abdul, Edil and Ismath (2019) defines as securities whose future value changes least when the manager's inside information is revealed to the market? Thus debt will be preferred to outside equity, and new equity will be issued only as a last resort. The POH has received considerable empirical support at the level of the corporation (Lisana, Scherger & Belén, 2019), although some recent studies have found that new equity is becoming a more popular source of finance amongst listed firms (Zeeshan & Daw (2018)).

Internal Financing and Profitability of Firms

The pecking order theory of capital structure shows that if a firm is profitable, then it is more likely that financing would be from internal sources rather than external sources. In other words, firms tend to use internally generated funds first and then resort to external financing. This implies that profitable firms will have less amount of leverage (Myers and Majluf, 1984). By this, profitable firms that have access to retained profits can rely on them as opposed to depending on outside sources (debt) (Mand, Meenakshi, Amarjit & Amiraslany, 2018).

Methodology

Research design is the framework for collecting and analyzing data. The researchers adopted an empirical design for the study. Here, the researchers want to know the impact of internal financing on the performance of deposit money banks operating in Nigeria.

Twenty-one (21) deposit money banks operating in the country constitute the population of the study. Fifteen (15) banks were sampled through purposive sampling method for the study, based on the availability of data within the study period of 10 years from 2008 to 2017. The data was sourced from annual report of the selected banks under study.

The variable consists of independent and dependent variables. The independent variables are retained earnings and sales of assets as proxy to internal financing. The dependent variable is firm's value. The regression model is presented below:

$FV = \alpha + \beta RE_{it} + \beta FA_{it} + e_{it}$

Where:

FV = Firm value measured by Tobin's Q

RE = Retained profit for the year
FA = Earnings from sales of fixed assets
α = Constant
β = Coefficient
e = error term

Results and Discussion

Diagnostic checks were performed on the data set, and the result of Breusch-Pagan/Cook-Weisberg test for heteroskedasticity revealed a significant p-value at 0.05 level of significance which is an indication that heteroskedasticity exists. The data was later corrected by running a robust OLS-Regression model. The test for collinearity indicated that independent variables in the model are not collinear evidence with vif of less than 5.

Table 1: Correlation between FV, RE and FA

	FV	RE	FA	VIF
FV	1.00			-
RE	0.5549	1.00		1.02
FA	0.1729	-0.1329	1.00	1.02

Source: Author's computation

From the correlation matrix above, it can be deduced that firm value is positively related with all the independent variables (RE and FA). Retained Earnings is related with FV by about 55% while FA explained FV by only 17%. From the table a negative low relation is experience between the independent variables by about 13%. This is also an indication of absence of collinearity in the model.

Regression result

Table 2: Impact of Internal Financing on Firm's Value

ROA	Coef.	Std. Err.	T	P>t
RE	.5294	.2485	2.13	0.035
FA	.0787	.0189	4.17	0.000
Cons	-1.1209	.6233	-1.80	0.074
R^2	0.3699			
F stats	10.62			
P-value	0.000			

Source: Author's computation

The robust OLS-regression result shows that parameter estimate for retained Earnigs (RE) and Earnings from sales of fixed assets (FA) were found to have significant positive impact on value of Nigerian Deposit money banks at 5% level of significance. R-squared of 0.3699 is an indication that about 37% variation in the value DMBs in Nigeria is explained by join influence of RE and FA. Significant F-value (10.62) at 1% level of significance is an evidence that the model is very much adequate to explain the relationship between the variables.

The model read thus:

$FV = \alpha + \beta 0.53 + \beta 0.08 - 1.12 + e$

Conclusion

This study examines the impact of internal financing on value of Nigerian Deposit money banks for the period of ten (10) years (2008 – 2017). Based on the results presented above, the study concludes that internal financing (measure by Retained earnings and earnings from sales of fixed assets) has positive influence of financial value of DMBs in Nigeria. Therefore, financing business activities internally is healthier than external financing which attracts rate of return sometimes at high rate. Sourcing income via retained profit, reserves and sales of redundant assets improve financial value of businesses.

Taking the above findings into consideration, companies are therefore recommended to source financing internally than looking outward for finances, as evidence has it that value is improved when finances are sourced internally.

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