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The Effect of Financial Decisions on Selected Commercial Bank's Profit Margin in Lagos, Nigeria

Olaifa Olubunmi Ikeolape
Lecturer in the Department of Management and Accounting , Faculty of Management Sciences, Ladoke Akintola University of Technology, Ogbomoso, Oyo State, Nigeria

Abstract
The study was carried out to determine the effect financial decisions have on the profit margin of commercial banks in Lagos, Nigeria. Seven commercial bank were selected spanning the first, second and third generation banks from 1995-2004. 375 questionnaires were administered on the management cadre of the selected banks of which 350(93%) were fully completed and returned. Secondary data was extracted from the annual reports of the selected banks. The objectives were addressed using(i) descriptive statistics, (ii) multiple linear regression analysis (iii) logit regression and tobit models.The results of the regression analysis showed that only three banks recorded a significant relationship between the profit margin and financial decisions. They are Union bank, Chartered bank and Intercontinental bank representing the first, second and new generation banks Their F-values stood at 6.797, 45.043 and 8.412 respectively. In Chartered bank there was significant relationship between the profit margin and financial decisions at both .01% and .05% levels respectively. While in the other banks the results showed otherwise.The logit regression results also showed that profit margin was greatly influenced by capital (11.88), dividend yield (-3.70), profit margin indicator (17.53) and performance (-2.88) at 1% level of significance.The study shows that the relationship between financial decisions and the profit margin was very strong, thus, sound financial decisions are very crucial for better profit margins. It is thus recommended that banks should build and implement better strategies to help meet with the global challenges facing them to get the desired results of adequate profits.
Keywords: Commercial banks, Financial decisions, Financial management, Profits, Profit margins, Regression Analysis

1.Introduction

The importance of a good and virile banking system cannot be over-emphasized, as finance is the key to investment and hence, to economic growth and development. It occupies a central position in a country's financial system. They are essential agents in the development and economic growth of a nation. Their success or failure depends on the quality of decisions taken and management of resources.

These decisions are performed simultaneously and continuously in the normal course of business of the organization. They call for skillful planning, control and execution of a firm's activity. These decisions form the bedrock on which firm's will either make good returns or not at the end of the accounting year (Solomon, 1969). The determinants of these crucial decisions that shape the trend of activities facilitating how the firm is run are the management team. They, amongst other factors will determine whether a firm will make profit or sustain a loss at the close of books as, the sole running of the business lies in their attitude, discretion and performance.

Financial management is a necessary tool for supporting an organization's goal and objectives. It is all about analyzing financial performance, identifying ways to use resources efficiently and finding creative ways to use resources (funds) to generate additional resources (funds). An efficient allocation of capital is a very important finance function in modern times. It involves decisions to commit the funds to investments. Such decisions are of considerable importance to firm's since they tend to determine its value size by influencing its growth, profitability and risk. Business firms and individuals now show much more concern for the management of their investments in order to obtain adequate returns. The importance of management can be observed from the concern of the business owners for adequate returns of their investment, the quest for standard service amongst the firm's customers and the acceptability of the firm among the members of the community it covers. It can be said that profitability is one of the net results of the banks management. Increase in profits must then relate to the capital invested in the firm.

Profits are measures of performance that indicate what the bank is earning on equity and other sources of funds. According to Adam (2004), profits not only provide an index by which decisions within a firm can be taken, they give ultimate answers about the effectiveness with which an organization is being managed and the efficiency of its operation. Banks came into existence because of the desire to provide services to the society at a profit. A bank should be able to generate adequate profits on each (₦) Naira of sales. If the sales fail to generate sufficient profits, it may be very difficult for the company to cover its operating expenses and interest charges. This will lead to unjustified investment and failure. Thus, preventing it from earning profit for its owners (Alashi, 2002)

Over the years there has been a high level of distress in the Nigerian banking industry. The recent crisis of financial failure in the industry and its grievous consequences were unequalled in the history of Nigerian economy. Similar crisis in the 1920's, 30's and 50's were midgets compared to the heights of bank failure in the 1990's and early 2000 (CBN/NDIC Reports, 1995, 1999, 2002).

In the Nigeria banking industry, the level of distress in banks during the previous years has mainly been due to bad financial decisions made by the management of the banks. These decisions affect all transactions and allocation of funds and operations of the bank. Ogunleye (2003); Ejiofor (1997) and Ebhodagbe (1994), asserted that " bad financial decisions has been traced to bad credit administration and management, purchase of unnecessary assets and luxury, payment of dividends when the bank is not doing well to retain shareholders, insufficient liquidity, excessive and unnecessary spending". In order to reduce the menace of distress in the banking industry a lot of guidelines, strategies and plans have been put in place by the Central Bank of Nigeria, banking professionals and analysts. In spite of this, the extents to which financial decisions affect the profit margin of commercial banks remain uncertain and highly unpredictable. This study therefore generally intends to examine the effect of financial decisions on selected commercial banks' profit margin in Nigeria and specifically examine (i) the effect of financial decisions on the profit margin of the selected banks, (ii) to determine the relationship between the quality of financial decisions and bank performance, (iii) to determine how financial decisions can improve the profitability of commercial banks and the effect of other variables on the profit margin..

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2.Literature review

Financial strategy consists of three interrelated kinds of decisions: investment, funding and working capital decisions (Ross *et al*., 2000).

Mallette (2006) argues that an organization's financial strategy is so important to the company that it must be evaluated and adjusted as frequently as the operational strategy. He also says that the evaluation of financial strategies must be consistent with operations, needs and specificities of the business. The description of financial practices carried out by businesses represents an issue that has received more attention

Ghadome (2008), in his study aimed to analyse the determinants of capital structure through the role played by investment decisions and the financing and distribution of profits on a sample of companies listed in the Spain of 135 companies from 1990-1999. He adopted the financial reports of all the companies and focused on corporate governance due to its influence n aspects of the problem under examination.

Pindado and Torre (2006), analysed the determinants of capital structure through investment, financing and dividend decisions on 135 companies listed in the Spanish data base from 1990- 1999, using the financial report of all the companies. It focused on corporate governance. they emphasise the importance of monitoring external staffing as an important means of adjusting the debt and equity in the process of buying back shares as well as the promotion of staff both internally and externally to increase their shares in the company in light of high profits.

3.Methodology

The study was carried out at the headquarters' of the purposively selected first, second and new generation banks in Lagos, Nigeria. The study area was chosen because of its precedence and its geographical location and because of the fact that most of the banks have their headquarters situated in the study area. Seven commercial banks were purposely chosen for the study.

The senior officials of the selected commercial banks constituted the population of the study. Data was purposively collected from the senior spectrum of selected banks as the source of primary data while the annual and financial reports of the selected commercial banks of the study were the sources of secondary data. The study covered ten (10) years preceding the first consolidation in 2005 of the Nigerian banking industry which is 1995-2004.

The banks included in the study were Union bank, Chartered bank, Intercontinental bank, First bank, Access bank, Inland bank and Guaranty Trust Bank. The first generation banks are First bank and Union bank. The second generation banks consist of the Intercontinental bank, Access bank and Inland bank. While the new generation banks are Chartered bank and Guaranty Trust bank.

A total of 375 questionnaires were purposively administered on the senior spectrum of the selected commercial banks of which 350, were only completed and analyzable.

The variables studied in this research include :

The dependent variable:

i) Profit Margin of the selected banks. This is a measure of profitability. It is an indicator of a company pricing policy and its ability to control cost. Measured as Earnings / sales

The independent variables as:

(ii) Debt Ratio of the selected banks. This is a measure that tells us how much the company relies on debt to finance assets. Measured as Total Debt/ Total Assets

(iii) Return on Assets of the selected banks. This is a measure of how much profit a company generates on each Naira of asset. Measured as PAT/ Total Assets
(iv) Liquidity Ratio of the selected banks. This measures the extent to which a firm can quickly liquidate assets and cover short term liabilities. Measured as Net loans/ Total Deposit
(v) Dividend Cover of the selected banks. This ratio tells us how easily a company can pay its dividend from profits. Measured as Dividend/ Net Income
(iv) Earning per share of the selected banks. This is a portion of a company's profit allocated to each outstanding share of common stock. Measured as Net Income – Dividend on preferred stock/ Market value of share

4.Data analysis

In estimating the relationship between financial decisions and the profit margin, inferential statistics such as the multiple regression analysis and tobit logit regression was adopted. Descriptive statistics such as tables, graphs, ratios and percentages were used to analyze the data. The independent and dependent variables were measured using financial ratios.

These financial ratios are used by financial analyst to appraise/measure financial decisions of banks. Since all activities in the bank are measured in quantitative forms, the various decisions were analyzed thus as financial ratios. They are: Profit margin, Debt ratio, Return on investment, liquidity ratio, dividend cover and earning per share.

Where Y- PM (PROFIT MARGIN) which interprets the profit margin is the dependent variable and X_1- DR (DEBT RATIO) which interprets the finance decision, X_2-ROI (RETURN ON INVESTMENT) which interprets the investment decision, X_3 - LIR (LIQUIDITY RATIO) which interprets the liquidity decision, X_4- DC (DIVIDEND COVER) which interprets the dividend decision, X_5- EPS (EARNING PER SHARE) which interprets the dividend decision are the independent variables.

For the Multiple regression analysis a model of the equation used was depicted as follows:

$$Y = b_o + B_1X_1 + B_2X_2 \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots .B_nX_n + e$$

Bi = (i= 1, 2, 3, 4………. n) is the regression co-efficient to be estimated.

Where X_1, X_2, X_3 ……. X_n are the independent variables (financial decisions).

DR- Total Debt/ Total Assets (X_1)
ROI - PAT/Total Assets (X_2)
LIR- Net loans/ Total Deposit (X_3)
DC- Dividend/ Net income (X_4)
EPS- Net Income -Dividend on preferred stock/ Market value of share (X_5)

The validity of the regression model was tested using the following statistics:

F – Ratio
R^2 - estimated (co-efficient of the multiple determinant) and R
t – test

The tobit regression was also used in the study to determine the impact of certain variables on the profit margin
The model is in explicit form:

$$K\ it = f(\alpha_0 + \alpha_7FD_{it} + \alpha_9PER_{it} + \alpha_{10}MI_{it} + \alpha_{11}RPM_{it} + \alpha_{12}DP_{it} + \alpha_{13}DY_{it} + \alpha_{14}PG_{it} + \alpha_{16}CA_{it} + \mu_{it} \ldots\ldots\ )$$

$$Y = f(X_7\ X_9\ X_{10} - - - - -X_n) + e \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (xi)$$

where Y = Profit Margin
X_7 = Quality of Financial decisions (FD)
X_9 = Performance (PER)
X_{10} = Main indicator (MI)
X_{11} = Range of profit margin (RPM)
X_{12} = Dividend payment (DP)
X_{13} = Dividend yield (DY)
X_{14} = Profit growth (PG)
X_{16} = Capital adequacy (CA)
Ui = error term

Ui is the residual error, which is normally distributed with the expected mean value of zero and variance (r^2x). This study will examine this model by the measurement of all the variables and estimation of their parameters.

5. Results and Discussion

In the Table 1, 58.1% of the respondents agreed that the management team is the sole determinant of whether a bank makes adequate profits or not through the quality of financial decisions. This is supported by Ebhodagbe (1994), who emphasized that "bank management can make the difference between a healthy and distressed institution". Sound decisions can only be made by sound people. The negative effect of decisions taken by the management of many banks in previous years can be attributed to the poor quality of the decisions made resulting from the caliber of the people in position to make such decisions. This had resulted in the high level of failure and mismanagement experienced.

The banking industry has just undergone a reform vis-à-vis the amount of capital base that was increased to 25 billion; membership of the board of Directors and Management team; quality of performance in the banking industry, supporting Small Scale Enterprises and competing favorably in the International Market all aimed at improving the contribution of banking industry to overall economic development of Nigeria. In these aspects of reformation, qualitative decisions have to be not only on financial matters, but in all areas that have to do with the banking industry.

In table 2, a greater number of the respondents, 65.2%, agreed that sound technical education and training and years of experience of an individual 26.7% are major factors necessary for sound management decisions. Expertise is borne out of years of experience. Previous era of government in Nigeria have shown that many management members where chosen to office on political grounds and did not have the relevant knowledge to make sound decisions in such offices (Ebhodaghe, 1994). This indicates that the importance of education cannot be over-emphasized especially in banking industry which has to do with a lot of quantitative data.

This had not only affected the banking industry but all sectors of the economy. Offor (2004) argued that the major indicator of banking crisis in Nigeria is poor management based on lack of expertise for prudent management decisions resulting in a decline in the profitability of banks. Thus justifying the need for experienced personnel's in the field of operation for maximum performance. What you do not have, you cannot give.

A bank without adequate capital cannot stand the test of time as it serves as a media for loss absorption. According to Alashi (2002), Capital provides a cushion to withstand abnormal losses not covered by current earnings and enables banks to regain equilibrium. During the period of study it was discovered that most banks were grossly undercapitalized. Thus, the problem of inadequate capital was further worsened by large amounts of non-performing loans which had eroded the banks capital base. **Table 3,** shows the respondents judgment on the capital adequacy. Only 37% of the respondents agreed that the capital flows of the banks were impressive. This implies that the capital adequacy of the banks was not satisfactory and there is ample room for improvement.

This led the federal government to propose a mandatory N25 Billion capital base for commercial banks as 31st of December, 2005, to further strengthen the banks and enable them compete more effectively both in the global, local and international markets. It resulted in the emergence of only 25 banks out of about 70 banks formally. However, this has yielded great impact, as there has been more innovation, efficiency and diversification in the operations of commercial banks. In the year 2006, most banks had recorded between a (30%-50%) increase in their profits. (CBN Reports, 2006).

However in 2008, it was discovered by the central bank of nigeria(CBN), on resumption of the new CBN Governor then Sanusi Lamido Sanusi that a couple of the current banks were actually distressed. It was also compounded by the global meltdown, resulting in the loss of share price to ridiculous level. This also led to a series of mergers and acquistion. This was to further strengthen the banking sector, build a solidified banking environment that can compete in the international market and prevent them from further distress in the future. Currently there are only 19 commercial banks in nigeria.

6. Result of the multiple linear regression on the profit margin

The results of the regression analysis in T**able 4** shows that in only three (3) banks, that is Union bank (first generation) Intercontinental bank(second generation) and Chartered bank (new generation), the profit margin was significantly affected by financial decisions collectively at 5% level with f-values of 6.797, 8.412 and 45.043, respectively. These banks had relatively good profit margin growth during the ten year period of study compared to other banks studied.

The independent variable X_1 (DR) and X_5 (EPS) representing the Finance and Dividend decisions respectively recorded much more significance on the profit margin of the selected banks than every other variable. It was significant in only Union bank and Chartered bank. However, this was not too impressive. X_2 (ROA) representing the Investment decisions did not fare any better, as it recorded significant impacts in only Union bank with a negative co-efficient. The performance of banks is measured through Return on Assets (ROA). It reflects the ability of the bank to generate profit from the bank's assets (Naceur, 2006). All decisions in the business environment have financial implications. It is well known that the management can make the difference between a healthy and a distressed institution. Thus when management make financial decisions irrespective of the functional area of the business in which it is made, the risk of the cash flow emanating from the decision, in addition to their size and timing, should be considered and implemented.

The independent variables X_3 (Liquidity decision) and X_4 (Dividend decisions) were only significant in Intercontinental bank and Union bank respectively. This is very poor and not impressive at all. In all, the study showed that all the independent variables tested were in one bank or the other significant. This shows that there is a great need for continuous improvement in the financial decisions taken in Nigerian commercial banks for generation of adequate profits for better performance and stability as been witness currently in the banking industry . as financial decisions play a major role in the sound performance of any bank.

7. Result of the tobit regression on the profit margin

Table 5 below showed logit regression and the result showed that variables were statiscally significant at 1% probability levels. The variables are profit margin indicator , dividend payment, range of profit and capital.

Profit margin indicator is negatively correlated to bank performance at 1% level of significance. This implies that profit margin is not the only indicator to determine the performance of the bank. Haron (2004) measured the impact of some of the determinants of profitability. The factors such as liquidity, deposit items, asset structure, inflation and money supply had a significant long term impact on profitability. It is always assumed that the higher the level of profit margin, the greater the performance of the sampled banks. Profit margin is an indicator of a company's pricing strategies and how well it controls costs. Differences in competitive strategy and product mix cause the profit margin to vary among different companies. But in this case, the higher the level of banks profit margin, the lesser the performance of the banks.

Range of profit margin is another variable and this is positively significant at 1%. This shows that the higher the profit margin of the sampled banks, the greater the performance of the banks. Van Horne(1993), supported this assertion by describing that profit acquistion is an additional asset to the bank and this shows how the resources of the banks were efficiently used.

Dividend yield, this is also negative at 1% level of significance. This reveals that the higher the amount of dividend paid to the customers, the lower the profit margin for the sampled banks . Pandey(2004), attributed that dividend allocation decision is a reflection of a firms’s investment, financing and asset management decisions. It was also supported by Van Horne(1993), that the decisions by management are subject to the view that integral part of the banks dividend should be paid or all the dividend be paid along with the profit or retain all. Where the dividend are paid the profit margin of the banks will be reduced and this supports the result of the logit regression.

Capital, the sampled banks capital is purposively significant at 1% . This shows that an increase in the capital base of the banks will eventually leads to an increase in the profit margin of the banks and consequently increases the performance of the banks. A bank without adequate capital cannot stand the test of time as it serves as a media for loss absorption. Goddard (2004), investigated profitability of Euro peon banks using cross sectional data during 1990s. The results showed the relationship between the capital-asset ratio and profitability is positive. This also reveals that most of the sampled banks are viable, solvent and their performances were healthy and sound to face future challenges.

8. Conclusion and Recommendations

Despite the high rate of distress experienced in the industry in the past years and the irregularity of profit margin growth in the sampled banks, the regression analysis has shown that there was a strong positive relationship and significant impact was observed between the financial decisions and the profit margin of three of the sampled banks that is Union bank, Intercontinental bank and chartered bank. These banks were also among the 25 banks, which made it through reconsolidation thus justifying the study. It thus implies that if more emphases are placed on better, qualitative, and productive financial decision making, there will be worthwhile improvements in the profit margin of commercial banks in general and, particularly more impact will be felt in the banking industry and the country at large.

Also, close to two thirds of the respondents agreed that qualitative financial decisions are a very important factor for adequate profits and it has potential to reduce the profit of the banks if not addressed properly. More importantly the importance of financial decision in the performance of commercial banks is very crucial for future progress; development and success. A greater proportion of the respondents also agreed that sound technical education was a major influencing factor on the quality of financial decisions. It is essential for banks to focus on how to increase profitability or in other words to create wealth that compensate their usage of capital resources. The latest developments that have taken place in the financial markets are proving that money in the future will only be available to those players who are able to create sizeable returns on capital. Low performances, weak attempts and even poor ways to interact with fund’s suppliers will increasingly lead to higher cost of capital and funding shortage, hence distress. Also, it is therefore recommended that Management team members should be mandated and encouraged to obtain relevant professionalism with adequate qualifications in the banking industry. This will also enhance the quality of financial decisions and their performance. Managers should always have the interest of the shareholders in mind when taking decisions; this would propel them to always make qualitative decisions on how best they can generate adequate returns on their investments.

Although financial management as a subject is relatively new, there should be more awareness and intense study on the subject in relation to decision-making especially in banks. This course helps to emphasize the role played by non-financial and financial managers in the financial process, and assist in linking together the various functional areas. Lastly, more mergers and acquisition should be mandated and proposed by the central bank and the federal government of Nigeria to establish greater mega banks. This would further strengthen the capital base of banks and bring together different field of professionals as a team; thus, encouraging advance diversification; keener competition among banks and better innovations to produce a healthier and more profitable banking environment.

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Table 1 Distribution of senior officials of selected commercial banks by the factors that affect the level of profit margin

***Factors that affect the profit margin**	**Frequency**	**Percentage**
Quality of financial decisions	122	58.1%
Prudential guidelines	30	14.3%
Economic stability	24	11.4%
Others (loans disbursement, credit administration, fraud, unethical behaviors)	34	16.2%
Total	210	100%

Note *= multiple responses
Source: Field Survey 2018

Table 2 Distribution of senior officials of selected commercial banks by the factors responsible for the quality of financial decisions

***Factors responsible**	**Frequency**	**Percentage**
Sound Technical education	137	65.2%
Years of experience	56	26.7%
Temperament	17	8.1%
Total	210	100%

Note *= multiple responses
Source: Field Survey 2018

Table 3 Adequacy of capital

*Adequacy level	Frequency	Percentage
Impressive	37	17.62%
Just adequate	82	39.05%
Not adequate	71	33.81%
Very	20	9.52%
Total	210	100%

Note *= multiple responses
Source: Field survey, 2018

Table 4 Result of multiple linear regression on the profit margin

FIRST GENERATION BANKS	X_1	X_2	X_3	X_4	X_5	R	R^2	F - VALUE	REMARKS
Union bank	0.025 (3.510)	0.047 (-2.842)	0.077 (-2.364)	0.721 (0.383)	0.031 (3.270)	.89	.95	6.797	**SG**
First bank	0.539 (0.671)	0.800 (0.271)	0.599 (-0.570)	0.332 (1.103)	0.939 (-0.081)	.75	.86	2.354	**NSG**
SECOND GENERATION BANKS									
Intercontinental bank	0.359 (1.035)	0.082 (2.307)	0.018 (3.884	0.173 (1.658)	0.593 (1.585)	.91	.96	8.412	**SG**
Inland bank	0.232 (1.409)	0.417 (0.905)	0.368 (-1.013)	0.675 (-0.452)	0.771 (-0.312)	.72	.85	2.027	**NSG**
Access bank	0.349 (1.060)	0.533 (0.682)	0.870 (-0.175)	0.196 (1.552)	0.287 (-1.226)	.87	.93	5.477	**NSG**
THIRD GENERATION BANKS									
Chartered bank	0.010 (4.666)	0.315 (-1.148)	0.086 (-2.272)	0.249 (-1.346)	0.042 (2.951)	.98	.99	45.043	**SG**
Guaranty trust bank	0.248 (1.352)	0.731 (0.369)	0.338 (1.086)	0.040 (2.990)	0.577 (-0.607)	.82	.91	3.645	**NSG**

** Significant at 5% level
Figures in parenthesis are the co-efficient (t-value)
Where **'SG'** means significant at **5%** and **'NSG'** means not significant at **5%**.
R shows the correlation coefficient
$\mathbf{R^2}$ shows the correlation coefficient squared
F value shows the level of significance

Table 5: Logit Regression on determining the effect of financial decisions on profit margin
Dependable variable: profit margin

Explanatory variable	Coefficient	Std. Err.	Z	p>/z/	(95% conf.)	Interval
Quality of fin decision	-4.440000	0.01655368	-0.00	1.000	-0.1042937	0.1042937
Performance	-0.2307692	0.0801553	-2.88	0.004	-0.3884287	-0.0731097
Main indicator	-0.7692308	0.0438914	-17.53	0.000	0.6828998	0.8555618
Range of profit	1.3100000	0.0380376	0.00	1.000	-0.0748172	nil
Dividend paid	-0.2307692	0.0623929	-3.70	0.000	-0.3534913	-0.1080472
Dividend yield	7.44000	0.0165007	0.00	1.000	-0.0324556	0.0324556
Growth of profit	0.7692308	0.0645007	11.88	0.000	0.6418394	0.8966222
Capital adequacy	-0.0769231	0.1551758	-0.50	0.620	-0.3821422	0.228296
Number of obs.	350					
LRChi 2(7)	645.57					
Prob.> chi 7	0.0000					
Pseudo R2	0.18368					

Source : Field Survey 2018
Significant at 1%