Research Article

Moderating Impact of Audit Committee Financial Expertise on Capital Structure and Financial Performance of Listed Deposit Money Banks in Nigeria

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Abstract

This study examined the moderating impact of audit committee financial expertise on capital structure and performance of listed deposit money banks in Nigeria. Ex-post facto research design was adopted to define the structure and strategy of the study, while the target population was all the listed deposit money banks in Nigeria as at 31st December, 2022 which were 14 in number. Out of the 14 banks 11 were purposively chosen based on their complete annual reports and accounts over the period of the study (2012-2022). Panel regression analysis was adopted to analyze the collected data. Thus, the study found a positive but insignificant impact of debt financing on the performance of the bank. However, equity financing was found to have positive and significant impact on the performance of the selected banks. Furthermore, audit committee financial expertise was found to have positive and significant moderating impact on debt financing, equity financing and net interest margin of the banks. Therefore, the study concluded that audit committee financial expertise has positive and significant moderating impact on capital structure and performance of listed deposit money banks in Nigeria. This signifies that, the higher the number of audit committee members with expertise in finance and accounting, the optimal capital mix decision making of the banks and the higher the performance. Therefore, this study recommends that; in order for listed deposit money banks in Nigeria to have optimal capital structure decision making that would result to higher performance; the composition of audit committee members should reflect high number of members with finance and accounting knowledge.

Keywords: Audit committee financial expertise; Capital structure; Listed deposit money banks; Nigeria; Performance

Introduction

Financial performance is very crucial element as it indicates the business health and its survival. The ability of any business management to effectively and efficiently utilized firm's resources is highly revealed in financial performance, hence contributes to national economy growth (Sathyamoorthi *et al.,* 2020). Therefore, El-Maude *et al.* (2022) described financial performance as the ability of business to generate revenue above its expenses. Banking industry is one of the most important sector in any national economic growth. Therefore, the importance of financial performance of Deposit Money Banks (DMBs) cannot be over emphasized. However, given the current economic challenges, DMBs in Nigeria are left vulnerable to existential threat due to poor performance [33]. Hence, the need to improve banks performance through effective and adequate monitoring of the driving factors. To maximize firms' performance, previous

studies such as Ali and Faisal and Hussain *et al.* [4,21] identified factors such as capital base, environmental factor, political and socio-economic factors as major drivers of corporate performance. Hence, to empirically determined the extent and significant of these factors on financial performance, several studies such as Rahman et al., and Alawagleh and Almasria [3,31] were conducted, particular on the influence of capital structure on financial performance. An appropriate capital structure is believed to be a critical decision factor for any business organization. The decision is important not only because of the need to maximize returns to various organizational constituencies, but also because of the impact such a decision have on an organizations ability to deal with its competitive environment [1]. Following the work of Modigliani and Miller [24], several studies were conducted on the impact of capital structure on financial

performance. However, the studies reported different results in different contexts [2,33]. Studies such as Ngaji *et al.* [28], Ramli *et al.* [32], Kashiramka and Singh (2020) reported positive and significant effect of capital structure on financial performance. However, in their studies, Bhattarai [9] found an insignificantly negative correlation between capital structure and financial performance. Hence, in their study, Rahman *et al.* [31] concluded that, studies on capital structure is inconclusive. Therefore, there is a need for the use of mediating or moderating variable to observe its interactive effect. Furthermore, most of the prior studies on capital structure and financial performance were mainly cross-sectional in nature investigating the relationship over few years. Studies such as Umobong and Ibanichuka [37], Chaudhry *et al.* [11], and Omotoye *et al.* [29] used at most five years. However, studies such Farooque *et al.* [14] were of the view that, if such relationships exist, the results obtained cannot be realistic over time as the listed banks may prove to be unstable from year to year.

Given the limitations of the previous studies on capital structure and financial performance, this study used audit committee expertise to examine its moderating impact on the relationship between capital structure and financial performance of listed DMBs in Nigeria over a period of ten years from 2012 to 2022. This helped to resolve issues concerning causality and shed more light on the evolving pattern of the role of audit committee in determining the best capital structure combination that will lead to high financial performance.

Therefore, null hypotheses were formulated to guide the study.

H_{o1}: Debt financing has no significant impact on the financial performance of listed DBMs in Nigeria

H_{o2}: Equity financing has no significant impact on the financial performance of listed DMBs in Nigeria

H_{o3}: Audit committee expertise has no significant moderating impact on the relationship between debt financing and financial performance of listed DMBs in Nigeria

H_{o4}: Audit committee expertise has no sig infant moderating impact on the relationship between equity financing and financial performance of listed DMBs in Nigeria

The novelty of this study is in its contributions to knowledge in the area of corporate governance, capital structure, and financial performance. Therefore, the study would benefit management and investors of listed deposit money banks. It would enlighten the management of the banks on the influence of good corporate governance on effective and efficient capital structure decision making and its impact on financial performance. Therefore, the remaining part of this study is structured into four sections given that section one is introduction. The review of relevant literatures is presented in Section 2, while Section 3 described the methodology adopted for the study. Then, Section 4 discusses the results of the empirical analyses, while Section 5 presents conclusions and recommendations.

Literature Review

Firms Performance

Performance or firm's performance is the result of management process in relation to corporate goals. It is a product of the activities and return on investment in a given period [30]. Firm performance helps to indicate the result of investment activities of the business, thus create signals to the public in relation to business value to enhance investors' economic decisions making (Eitokpa, 2015). This firm value is mostly measured using financial performance [28]. Thus, financial performance is described by Hassan *et al.* (2020) as the ability of a firm to operate efficiently, generate effective income, survive, and expand by observing environmental opportunities and threats. Financial performance gauges the proper use of enterprises' resources to maximize profit and wealth [3].

Hence, the concept of financial performance is mostly measured using return on equity, return on capital employed, return on assets, return on investment, and net interest margin [36]. The analysis of financial performance helps to identify the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the statement of financial position and statement of comprehensive income [27]. Therefore, for the purpose of this study, net interest margin is used to measure financial performance of listed DMBs in Nigeria.

Capital Structure

The concept of capital structure was described by Ekegbe *et al.* (2019) as the firm's financial framework which consists of debt and equity used to finance firm. While Mbonu and Amahalu [23] described capital structure as the particular combination of debt and equity used by company to finance its operations and growth. Capital structure means the source of capital of a firm which come from either debt or equity, or the combination of both debt and equity. The proportion in which a firm finance its activities in described in the form of debt-to-equity ratio. It indicates the proportion of the ownership of company in the capital [23]. Debt is the proportion of firms' capital that did not come from the owners, thus, is an obligation to be paid with interest. It can either be long-term debt or short-term debt. While equity described the proportion of firm's capital that is invested by the owners of the business. Therefore, capital structure increases the ability of the company to find new wealth thereby creating investment opportunities [22].

Debt to equity ratio is used to measure capital structure and it determine firm's financial leverage. It is calculated total debts divide by total equity shares. It is a gearing ratio that measure the degree to which firm finance its operations through debt versus owned funds. More specifically, it reflects the ability of equity share to cover outstanding debts in the event of business liquidation.

Audit Committee Expertise

Ashari and Krismiaji [7] defined audit committee as a sub-committee of corporate board that is charged with the responsibility for oversight of auditing activities. The committee acts as liaison between external auditor and the board of directors, and also review nomination of the auditor, overall scope of the audit work, consideration of audit report, internal financial controls, and financial information for publication. In the Nigerian context, every public company is mandated under Section 359 (3) and (4) of CAMA to establish an audit committee. It is the responsibility of the Board to make sure that audit committee is constituted according to the laid down policies which would improve its effectiveness and efficiency. Hence, Sec. 359 (3) and (4) of CAMA 2004 as amended provides that, in constituting audit committee, at least one member should have knowledge in accounting and finance. This was also emphasized

by SEC Code 2011 which states that, at least one of the audit committee members should have sound knowledge in financial and accounting matters. Financial reporting and its related internal control processes is complex, and only those members that have the relevant competency or expertise in accounting, finance, or business are capable of understanding them [5,6]. Audit committee members with financial or accounting expertise are believed to be able to unveil any opportunistic behavior by management more effectively, and have effective interaction with internal auditors and are less likely to witness internal control problems [11]. They are more likely to understand external auditors and support the auditors in conflict situations with management [11].

Empirical Review

Given that the concept of capital structure and financial performance is not new in finance theory, various studies were conducted in this area. Therefore, some of the empirical studies conducted to examine the effect of capital structure and financial performance are presented under this sub-section.

Njagi *et al.* [28] examined the impact of capital structure on the financial performance of listed banks on Karachi Stock Exchange in Kenya for a period from 2007-2011. Using multiple regression analysis to analyze the data collected from annual reports and account of the banks, the result indicated that there is a positive relationship between capital structure and performance of the banking industry. This result was supported by the study of Ramli *et al.* [32] in Sri Lanka using manufacturing companies, they reported positive and significant relationship between capital structure and performance. Furthermore, in their study Kashiramka and Singh (2020) documented a positive relationship between capital structure and financial performance of 272 listed American firms in New York over a period from 2016-2019. Shoaib and Siddique [35] investigated capital structure and firm performance of 28 listed companies in Palestinian using panel data over a period from 2016-2019. The study showed that return on equity, return on assets, earnings per share, market value of equity to the book value of equity and Tobin's Q as a measure of firm performance was positively related to capital structure measured by short term debt, long term debt and total debt to total assets, and total debt to total equity at very significant level.

However, the study of Nwude *et al.* (2016) on the impact of debt structure on the performance of 43 Nigerian quoted firms over a period from 2001-2012. The study employed three regression estimations (Pooled OLS, Fixed Effects and Random Effects) and found debt structure had negative and significant impact on the performance of Nigerian quoted firms within the period under review. Also, Saif-Alyousfi *et al.* [34] conducted a study on capital structure and profitability of listed companies of Malaysia. Employed Ordinary leased square regression and correlation for data analysis, found an adverse relationship between equity size and profitability. Furthermore, Hussain *et al.* [21] studied the effect of capital structure on financial performance of 50 Small and Medium Enterprise in Pakistan over a period 2007 to 2015. Using Return on Assets (ROA) and Return on Equity (ROE) as proxy for financial performance and total debt to total assets and Total debt to total equity to proxy capital structure. The study found a significant negative relationship between capital structure and performance of the business.

Looking at the studies reviewed, it revealed that, the relationship between capital structure and financial performance are contradictory, hence inconclusive. However, the studies on the influence of audit committee financial expertise on capital structure and financial performance are limited. But the studies of the influence of audit committee expertise on capital structure, and audit committee financial expertise on financial performance were found to be positive and significant. Hanlon *et al.* (2020) found that audit committee financial expertise has a significant impact on returns on equity and return on asset. Amahalu [5,6] found that audit committee financial expertise has a significant impact on returns on equity and return on asset. Defond *et al.* [12] investigated how markets react to the appointment of an audit committee member with a different level of accounting and financial expertise and found a positive market reaction to appointing accounting and financial expert. Hence, Ashraf *et al.* [8] concluded that firms with higher financial performance are more associated with audit committee members who have financial expertise. Therefore, this study believed that audit committee financial expertise would positively and significantly moderate the relationship between capital structure and financial performance of listed DMBs in Nigeria

Theoretical Review

Since the concepts of capital structure and financial performance have received a lot of attention by both policy makers and researchers. Thus, several theories were used to explain the concepts as stated by Myers [26]. Such theories include Modigliani-Miler Theory, Neutral Mutation Hypothesis, Market Timing Theory, and Agency Theory. However, this study is anchored on Market Timing Theory.

According to the market timing theory, the fluctuations in the price of shares influence corporate financing decisions and finally the capital structure of firms. Issuing equity is influenced by the market performance. Firms usually issue new security when they believe their shares in the market are overrated and buy back shares when they feel that they are undervalued (Baker & Wurgler, 2002). Market timing theory argues that firms' issues equity when their market performance is high [19]. Therefore, during unfavorable market conditions, firms hardly go to the market, there is possibility to delay investments until favorable market condition is attain. This is supported by a body of knowledge that asserts that firm delay issuing securities due to expectation of growth opportunities. Apparently, firms that

Table 1: Variable identification and measurement.

SN	Label	Variables	Description	Sources
1	NIM	Net interest margin	Investment returns less interest paid divide by average earning assets	Busch & Memmel (2021)
2	DAR	Debt to total assets ratio	Total debt divide by total assets	Geressem & Michael (2019)
3	EAR	Equity capital to total assets ratio	Total equity capital divide by total assets	Ali & Faisal (2020)
4	ACF	Audit committee expertise	Audit committee members with accounting and finance knowledge to total number of committee members	Hayat *et al.* (2016)
5	FMS	Firm's size	Natural logarithms of total assets	Bala *et al.* (2018)
6	FMA	Firm's age	Years of operation since incorporation	Ali (2021)

mostly issue securities at peak (growth) period expected to obtain this fund at low price resulting to high expected rate of return. Hence, financial structure only depends on equity market returns and conditions on the bond markets and a target financial structure does not exist (Getzmann *et al.,* 2010).

Afrasiabi and Ahmadinia (2011) contend that financial structure market timing theory argues that issuance of equity by the firm are timed, in such a way that market is the ultimate. They further stressed that fluctuations in stock prices affect firm's capital structure. The theory assumes economic agents (managers) to be rational. Managers issue equity when they believe their cost is irrationally low and repurchase equity when they believe their cost is irrationally high. Thus, manager does not predict stock returns but they believe they can time the market. Market is regarded by managers as the most important factor in their decision of whether to issues new stocks or not (Graham & Harvey, 2002).

Huang and Ritter (2004) supported the view of rational and irrational manager with argument that firms prefer external equity when the cost of equity is low, and prefer debt otherwise. The theory believes that windows of opportunity exists as long as the relative cost of equity varies over time for either rational or irrational reasons, and has important implications for financial structures choices. Therefore, the condition in the market determines the position of the firm to be either equity finance or debt finance, which invariably influences the value of the firm. Empirical work of Baker and Wurgler (2002) suggests a positive relation between equity issues and the business cycle and suggest that equity should be issued only when the economy is booming and not the other way around.

Methodology

This study adopted ex-post facto research design to define the structure and strategy of the study. While the target population consisted of all the listed deposit money banks in Nigeria as at 31st December, 2022 and were fourteen (14) in number. Out of the 14 banks, 11 were selected as sample based on the availability and the complete required annual reports and accounts of the banks over the period of ten years from 2012 to 2022. The data collected were analyzed using both descriptive and inferential analysis.

Two panel regression models were developed in line with the model of Mwau *et al.* [25]. Model 1 was to evaluate the direct effect of capital structure on performance, while model 2 was to evaluate the moderating effect of Audit Committee Financial expertise (ACF) on capital structure (DAR, EAR) and financial performance (NIM) of the quoted DMBs in Nigeria, while controlling firms' characteristics (FMS, FMA).

$Y = F (DAR, EAR, ACF, FMS, FMA)$ ……....................................
……...............equation

$NIM_{it} = \beta_0 + \beta_1 DAR_{it} + \beta_2 EAR_{it} + \beta_3 ACF_{it} + \beta_6 FMS_{it} + \beta_7 FMA_{it} + \mu_{it}$… …….…………model 1

$NIM_{it} = \beta_0 + \beta_1 DAR_{it} + \beta_2 EAR_{it} + \beta_3 ACF_{it} + \beta_4 DER*ACF_{it} + \beta_5 EAR*ACF_{it} + \beta_6 FMS_{it}$

$+\beta_7 FMA_{it} + \mu_{it}$… ……...
model 2

Results and Discussions

The results of descriptive statistics are presented in Table 2.

Table 2: Descriptive Statistics.

Variables	Obs.	Mean	Std. Dev.	Min.	Max.
NIM	121	0.7692	0.1033	0.6	0.98
DAR	121	0.4506	0.0727	0.31	0.56
EAR	121	0.5538	0.0953	0.37	0.88
ACF	121	0.6242	0.1765	0.22	0.99
FMS	121	15.1472	1.5780	11.13	18.68
FMA	121	40.27	16.4057	13	77

Source: STATA 14 Output (2023)

Table 2 indicated the mean value for Net Interest Margin (NIM) of 0.7692 with a minimum value of 0.6, maximum value of 0.98 and a standard deviation of 0.1033. This implies that the listed DMBs performed moderately given the standard deviation is less than the mean value. Moreover, the mean value for debt financing (DAR) is 0.4506, minimum of 0.31, maximum of 0.56, and a standard deviation of 0.0727. With respect to equity financing (EAR), the mean value is 0.5538, minimum is 0.37, maximum is 0.88, and standard deviation stood at 0.0953. Likewise, the average value for Audit Committee Financial expertise (ACF) is 0.6242, minimum and maximum values are 0.22 and 0.99 respectively, while standard deviation is 0.1765 indicating that there is no variation between listed DMBs in regards to ACF, because the standard deviation is less than the mean value. In regards to firms' characteristics as control variables, the descriptive statistics shows that firm size (FMS) has a mean value of 15.14, a minimum of 11.13, a maximum of 18.68, and a standard deviation of 1.5780. For firm age (FMA), the average is 40.27 years, minimum of 13years, maximum of 77 years and a standard deviation of 16.4057.

Furthermore, correlation analysis was carried using Pearson moment correlation statistics and the results presents in Table 3.

Table 3 shows that, Debt to total Assets Ratio (DAR) has a negative correlation (-0.0066) with Net Interest Margin (NIM), while equity to total assets ratio has positive correlation (0.5085) with net interest margin at 10% level of significant. However, Audit Committee Financial expertise (ACF) has negative correlation (-0.1649) with net interest margin.

Although there was mixed result in the direction of the relationship of debt to total assets, equity to total assets, audit committee financial expertise and the firm's characteristics, most of the correlation values ranges from very low to moderate correlation. The minimum absolute value of correlation is

Table 3: Correlation Results.

Variables	NIM	DAR	EAR	ACF	FMS	FMA
NIM	1					
DAR	-0.0066	1				
EAR	0.5085*	-0.1804*	1			
ACF	-0.1649	0.0913	-0.1844*	1		
FMS	0.4421	-0.0693	0.2689*	-0.0144	1	
FMA	0.3521*	-0.0203	0.0767	-0.0050	0.0695	1

Sources: STATA 14 Output (2023) @ 5% & *10%

Table 4: Diagnostic test results.

Variables	VIF	1/VIF	Skewness	Kurtosis
DAR	1.04	0.9615	-0.2363	4.7993
EAR	1.15	0.8696	0.6641	4.3788
ACF	1.04	0.9615	0.2472	3.6577
FMS	1.08	0.9259	-0.2569	3.0152
FMA	1.01	0.9901	0.4621	4.1411
Hausman		0		

Source: STATA 14 Output (2023)

Table 5: Regression results.

Models	Model 1			Model 2		
Variables	Coeff.	t-value	p-value	Coeff.	t-value	p-value
Constant	0.1050	1.16	0.248	0.4101	5.42	0.000
DAR	0.1257	1.29	0.199	0.1208	1.38	0.167
EAR	0.4775	6.15	0.000	0.4007	5.36	0.000
ACF	-0.1308	-2.27	0.025	-0.5314	-4.80	0.000
FMS	0.0221	4.80	0.000	0.0209	4.49	0.000
FMA	0.0020	4.82	0.073	0.0019	4.50	0.000
DAR*ACF				0.2698	1.72	0.088
EAR*ACF				0.6402	5.37	0.000
R^2		0.4656			0.4548	
Wald chi2 (5)		68.07			65.06	
Prob>chi2		0.0000			0.0000	

Source: STATA 14 Output (2023)

0.0050 and the maximum absolute value is 0.5085. This implies that, the variables of the study were moderately correlated, thus, no multi-collinearity problem among the variables.

The diagnostic results in Table 4 shows that, the absolute skewness values were all less than 1.96, and kurtosis more than 3. Hence, the data is considered to be moderately skewed and platy Kurtic in accordance to the rule of thumb [16]. Furthermore, VIF shows the maximum value of 1.15 with a minimum value of 1.01, while the maximum tolerance coefficient of 0.9901 with a minimum value of 0.8696. This means that, the data collected are normally distributed and has no multicollinearity problem [17]. The value of Hausman model specification test of 0.000 is significant, thus, the null hypothesis was rejected (random effect) in favor of fixed effect.

Since the data collected were normally distributed and there were no issues of multicollinearity, multi-regression analysis was carried out to examine the effect of capital structure and performance of the selected DMBs, and the moderating effect of audit committee financial expertise on capital structure and financial performance of the selected listed DMBs and results presents in Table 5.

Table 5 model 1 shows the R^2 value of 0.4656. This indicated that all the explanatory variables in model 1 accounted for 46.56% of variations in the dependent variable (NIM). Moreover, the model as a whole is also found to be significant (*Wald chis2 (5)* = 68.07, *p* < 0.01), indicating a goodness of fit and validity of the model.

More so, Table 5 model 1 shows that debt financing (DAR) has an insignificant positive effect on Net Interest Margin (NIM) at 10% level of significance (β = 0.1257; *p*>0.10). This implies that increase in debt financing (DAR) may result to an increase in the financial performance (net interest margin) of the MBs. Hence, the conclusion that, debt financing has no significant effect on the financial performance of the banks. This result corroborated studies such as Njagi *et al*. [28], but contradicts the studies such as Hussain *et al* [21]. However, Table 5 model 1 revealed that equity financing (EAR) has a significant positive effect on Net Interest Margin (NIM) at 5% level of significance (β = 0.4775; *p*<0.01). This implies that an increase in the rate of equity finance (EAR) may result to an increase in net interest margin (NIM). Hence, the equity financing has a significant positive impact on net interest margin. This result refutes studies such as Njagi *et al*. [28] who documented a significant negative effect equity financing on firm performance. Table 5 model 1 further shows that audit committee expertise (ACF) has an insignificant negative effect on net interest margin (β = -0.1308; *p*>0.10). This

implies that an increase in audit committee expertise by 1, may result to a decrease in net interest margin by 0.0474. Thus, contradicts the assumption of this study and studies such as Amahalu [5]. Table 5 model 1 shows that, FMS and FMA have positive but insignificant (FMS: β =0.0221; *p*<0.01; FMA: β =0.0020; *p*<0.01) effect on net interest margin.

Table 5 model 2 shows the regression results after the moderating variable was introduced. This result shows an R^2 value of 0.4548 indicating that all the explanatory variables in model 2 accounted for 45.48% of variations in the dependent variable (NIM). More so, model 2 as a whole is significant at 5% (Wald chis2 (5) = 65.06; p < 0.01), indicating a goodness of fit of the model.

Furthermore, Table 5 model 2, after inputting the moderating variable, the effect of debt financing (DAR) on performance (NIM) remained positive but insignificant, likewise the effect of equity financing (EAR) on performance (NIM) remained positively significant. The introduction of moderating variable has affected the value of R^2 from 0.4656 to 0.4548, and F-statistics decreased from 68.07 to 65.06 which signifies that audit committee has moderated the relationship between capital structure (DAR and EAR) and financial performance (NIM). The decrease in F-statistics from 68.07 to 65.06 implies the capability of Audit Committee Expertise (ACE) in moderating the relationship between capital structure and financial performance. Thus, the conclusion that, audit committee financial expertise has a significant positive effect on the relationship between capital structure and financial performance of listed DMBs in Nigeria over the period of the study.

Conclusion and Recommendations

Given the findings of this study, it reveals that, debt financing have positive but insignificant effect on the net interest margin of the banks, while equity financing shows a positive and significant effect on the net interest margin of the quoted DMBs in Nigeria over the period of the study. Furthermore, audit committee financial knowledge has significantly and positively moderated the relationship between debt financing, equity financing and net interest margin of the banks over the period of the study. Therefore, the conclusion that audit committee financial expertise has positive and significant moderating impact on the relationship between capital structure and performance of listed DMBs in Nigeria. This implies that audit committee financial expertise significantly influences investment decision making of both investors and creditors of listed deposit money banks.

Therefore, this study recommends that, in order for listed DMBs in Nigeria to maximize performance through effective and efficient capital structure, the management of the banks should pay more attention to the composition of audit committee and include at least one member with finance and accounting knowledge as provided by code of corporate governance. This, would help management to optimize capital mix that would improve firms' performance.

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