Board Composition, Audit Committee and Financial Performance of Deposit Money Banks in Nigeria

Igweagbara, Gladday[1] and Edori D. S.[2]
[1] Bursar, Benson Idahosa University, Benin, Edo State, Nigeria
[2] Business Department, C.S.S Mgbuoshimini, Port Harcourt, Rivers State, Nigeria
Corresponding Author: edssdern@yahoo.com

DOI: 10.56201/jafm.v9.no9.2023.pg153.167

Abstract

Efficient and effective board and audit committee in a company plays the role of ensuring the company performs very well in order to maximise the wealth of shareholders. This study therefore attempts to unearth the relationship between board composition, audit committee, and financial performance. ROA and EPS were used to proxy financial performance. The study used already existing (secondary) data from 2010 to 2019, hence the choice of the ex post facto design. Eight banks were selected and analysis was made on the data collected using correlation (Pearson). The study found insignificant relationship of 0.070 and 0.069 between board composition and ROA as well as EPS. While the correlation was negative and very weak between board composition and ROA, it was positive though still very weak with EPS. Also, the result unveils an insignificant relationship of 0.288 and 0.641 between audit committee and ROA as well as EPS with very week positive correlation with both. Recommendations made were that composition of the board should comprise of few members in order to increase effectiveness, efficiency and full participation that is sufficient to actualize the aim of wealth creation; board should wake up to their responsibility and strive to increase earnings by pursuing objectives and taking decisions targeted at enhancing the earnings; audit committee should be embraced, strengthened, meet frequently to check compliance and also ensure they improve their monitoring capacity; and audit committee independence level should be increased, believing that this will ensure better objectivity, transparency and monitoring for better financial performance. The study came to a conclusion and agreed to the various scholars that found a mixed relationship and correlation between board composition, audit committee and financial performance.

Key words: *Board Composition, Audit Committee, Financial Performance, Deposit Money Banks in Nigeria*

1. Introduction

1.1 Background to the Study

Corporate governance problem remains a problem in Nigerian banks as fraudulent financial reporting as well as information disclosures have resulted to scandals in the cases that involved Afri Bank, Fin Bank, Intercontinental Bank, Oceanic Bank, et cetera. Joshua, et al (2019) asserts that the failures can be linked to board of directors' lack of watchfulness on its oversight roles. Banks needs number that is adequate and directors' composition that is appropriate and capable of independently exercising judgment, management, political interests, or inappropriate outside interests' views (Kiel & Nicholson, 2003). Likewise, a strong and efficient audit committee is needed in the banks due to past records of bank failures.

Financial performance (Saseela, 2017) is a subjective assessment of the appropriateness as it concerns a firm utilization of assets through her major business and revenues generation. A company's financial performance is key and crucial to all categories of stakeholders but to the shareholder specifically, its importance is enormous. Muller (2014) believes that the enormous importance of financial performance to the shareholders is because financial performance is a key source used in financing firms' current economic activities and making sure the firm's going concern is upheld and the business value increased and also serve as dividend distribution basis which attract investors (Muller, 2014). Financial performance has some implications on the health of a business entity and on its survival eventually. Effectively and efficiently managing a firm in making use of its resources is exceedingly reflected by financial performance that is high and this invariably contributes to the economy of a country at large (Naser & Mokhtar, 2004).

Corporate governance, according to Ogaluzor and Chukwu (2022), takes on various forms, therefore leaves no room for actions taken in a unified view. Board composition is seen as a corporate governance element that is critical in which the board is mandated with role of supervision and advisory on the management of a company. Cherotich and Obwogi (2018) argued that this assertion has formed the belief that the board of directors have the ability to influence a company's strategic decision making and then its performance. Zhang et al (2013) asserts that board composition has implications that are important for diverse areas of firm performance. The board has the role of formulating policies which will ensure better performance financially or worse. However, existing empirical studies provide conflicting results regarding the effect of board composition on firm financial performance

Audit Committee is responsible in inspecting and managing of the process of determining the financial outcome. This is done by analyzing the reporting entity's financial statements and carrying out the procedures for internal audit as well as significant audit (Klein, 2002). Koutoupis and Bekiaris (2019) argued that an audit committee that is effective must possess an audit team that is qualified and experienced and having sufficient resources, supervisory efforts and power to confirm financial statement's reliability, management of risk, management of internal control and stakeholders' interest protection. Also, it is expected that audit committee that is effective should focus on shareholders' wealth optimization and stop personal interest maximization by top management.

Studies of Kalsie and Shrivastav (2016) and Oludele et al (2016) showed board composition relates with financial performance positively, while Nhung and Nguyen (2017) and Bublykova (2014) showed negative relationship. Fernandez (2015) study showed absence of association. This means a mixed and inconclusive result. Amer et al (2014) empirical study found audit committee and performance (ROE) have positive relationship.

In order to affirm or disprove the various findings, this study aimed at finding the relationship between the study variables

1.2 Research Hypotheses

Ho_1: There is the absence of significant relationship between board composition and Return on Assets (ROA) of listed deposit money banks in Nigeria.

Ho_2: There is the absence of significant relationship between board composition and Earnings per Share (EPS) of listed deposit money banks in Nigeria.

Ho_3: There is the absence of significant relationship between audit committee and Return on Assets (ROA) of listed deposit money banks in Nigeria.

Ho_4: There is the absence of significant relationship between audit committee and Earnings per Share (EPS) of listed deposit money banks in Nigeria.

1.3 Scope of the Study

This study is limited to the variables of the study. Geographically, it covers listed deposit money banks in Nigeria. The time scope covers ten (10) years from 2010 to 2019. The unit of analysis consists of eight (8) sampled deposit money banks in Nigeria as follows: Access Bank Plc; Ecobank Plc; Fidelity Bank Plc; First Bank Plc; First City Monument Bank (FCMB) Plc; Guaranty Trust Bank (GTB) Plc; Stanbic IBTC Plc; and Zenith Bank Plc

2. Literature Review

2.1 Theoretical Review

Agency Theory

This theory was entrenched in economic theory by Alchian and Demsetz in 1972, in 1976 it was developed by Jensen and Meckling. It can be said that the theory was propounded by Jensen and Meckling (1976). The theory revolves around the principals (mainly shareholders) and the agent (mainly company managers and executives). The theory's tenet is based on the principle that inherent conflict exists between firm's owners' interest and the firm's management (Kiel & Nicholson, 2003). Therefore, the theory focuses on ownership and control separation of the company.

Antonelli et al (2016) declared that the theory gives an explanation on corporate governance concept. The separation of control and management will positively impact on firm performance, which will enhance performance, thereby maximizing shareholders fund/wealth which is the shareholders' major interest. It is believed that the separation will improve firm performance.

Stewardship Theory

In 1997, Davis, Schoorman and Donaldson developed the theory. Their argument was that the steward, through firm performance, shareholders wealth is protected and maximized, since by so doing, functions of steward's utility are maximized (Cherotich & Obwogi, 2018). The theory emphasizes on the executives and managers using their position to do things by themselves to ensure that returns of shareholders are maximized. The stewards are company's managers and executives that work for the shareholders, and seeking to protect and enhance profitability of the firm for the shareholders (Ahmed & Hamdan, 2015). It stresses on the position of executives to act more for better performance.

Resource Dependency Theory

Pfeffer and Salancik in 1978 postulated this theory in their publication. They elucidated that when an individual is appointed to an organisation's board, such individual is expected to give his/her support to the organisation, show concern with the organisation's problems, have to always present the problems to others, and try to help the organization. In doing this, the company performance is expected to improve and the purpose of corporate governance will be achieved. Provision of resources by the board relates directly to firm performance since provision of resources is board's important function.

2.2 Conceptual Review

2.2.1 Board Composition

According to Ahern and Dittmar (2010), board is an organization's highest managerial body that make strategic decisions on how the organization projected to exploit her market value. Bhagat and Black (2002) said that board composition can reflect several degrees of heterogeneity. That is, it is measured in relations to various degrees of conglomeration. It has to do with the board size, directors (executive and non-executive) mix. Including other attributes that are desirable, such as gender (male and female) diversity. Atty et al (2018) put it that apart from been effective and efficient, the board have to look into areas like the size of the board, its independence, gender diversity, and non-executive and executive directors. Board composition denotes board size, independence as well as the structure of leadership of an institution. Basically, an organization's board composition significantly contributes to the practice of governance, process of strategic decision-making and achievement of hers aims (Behl, 2018; Agyemang & Castellini 2015). Khan et al, (2019) opined that, academicians and scholars, in the setting of board composition, have designed frameworks that relates to corporate governance in order to stabilise performance of entities and their total financial markets. Accordingly, having an understanding that directors of the board are the ultimate authority as it concerns the control and management of organisations, it is very central for organisations to understand her related dynamics as well as the role so that it can assess sufficiently its contributions to the financial performance. Njoka (2010) affirms that all board has sufficient need for knowledge that is collective of each type of financial activities intended by the bank to pursue.

The Central Bank of Nigeria (2006) listed corporate governance weaknesses in Nigerian banks as:

i. board ineffectiveness to oversight functions;
ii. board and management disagreements leading to board squabbles;
iii. practices that are fraudulent and self-serving amongst board members, management and staff;
iv. chairman or MD/CEO overbearing influence, especially when the bank is family-controlled.

2.2.2 Audit Committee

The audit committee idea was first introduced globally in 1939 while the McKesson and Robbins case celebrated was still under investigation. As a result, Owolabi and Dada (2011) saw no surprises when the report of the investigation made the recommendation that public companies should establish audit committee in order to strengthen corporate governance and the structure by improving the auditor status and also offer shareholders more protection. This idea was supported 1967 by American Institute of Certified Public Accountants (AICPA)

Audit committee plays the roles of an indispensable mechanism by communicating effectively between internal auditors and external auditors. It is the full board sub-group. Owolabi and Dada (2011) defined audit committee as members of companies selected, who take role that is active in supervision as it relates to companies accounting, their financial reporting policies, and their practices. It plays a correspondent function between the executive officers, full board, internal and external auditors, and fund executives (Kasthury & Anandasayanan, 2020). Audit committees must include directors that are independent for the purpose of sufficient and effective internal controls system that properly monitors possible problems, and ensure the preservation of financial reports integrity (Ness et al, 2010). The audit committees are to superintend the process of financial reporting, confirm the independent auditing firm appointment and additionally, when appropriate, plays the role of discharging independent auditors.

Okaro (2001) elucidates that an audit committee that is effective will provide the following as advantages:

i. Strengthening the independence of the external auditor;
ii. adding credibility of the audited financial statements;
iii. additional assurance that corporate policies are in shareholders and society's best interest;
iv. enhancement of the position of internal audit;
v. performance improvement of senior management by making them conscious;
vi. advance of conflicts that arises between the management and the auditors; and
vii. improved communication between director and the external auditors as well as the management.

2.2.3 Financial Performance

Financial performance measures firm's total financial health over specified duration of time. It gauges proper use of enterprises' resources in order to maximize profit as well as wealth. As such financial performance is a subjective measure of how well a firm can use or uses its assets from its primary mode of business to generate revenues (Kellen & Wolf, 2013). To Marr and Schiuma (2013), financial performance, as an organizational performance measure, has to do with the overall organizational productivity as it concerns its profitability and other related financial objectives, for example gearing, liquidity and efficiency. A firm with higher financial performance is likely to attract more investors that the one with lower financial performance (Ohaka et al, 2020). Major and Edori (2020) opined that financial performance can be seen as a pointer that relates the soundness of finance and performance of a firm.

Considering financial performance measurement significance, Verma (2021) opined that the interest of various related groups that are affected by a firm's financial performance and the kind of analysis differs according to the party that is involved specific interest:

i. Trade creditors: They are interested in the firm's liquidity (firm's liquidity appraisal)
ii. Bond holders: They are interested in the firm's cash-flow ability (appraisal of capital structure of the firm, main sources funds and its uses, profitability over time, and future profitability projection)
iii. Investors: They are interested in the present and the expected future earnings and earnings stability (appraisal of profitability of firms and the firms' financial condition)
iv. Management: They are interested in the firm's internal control, financial condition that is better and better performance (appraisal of present financial condition of the firm, evaluation of opportunities as it concerns current position, return on investment provided by the several company assets etc.)

Earnings per share, return on assets (ROA), Tobin's Q, and return on equity (ROE) are seen as some ratios used more often as measures for financial performance evaluation of a firm. This view is in tandem with that of Ali and Shadrach (2023)

2.2.4 Return on Assets (ROA)

Major and Edori (2020) sees ROA as financial or accounting ratio that reveals the profit percentage earned by a business entity in relation to its overall resources. It provides answer to the question on what an organization do with the assets on her disposal. Return on assets measures both asset utilization and profitability and has been used in a number of recent studies (McDonald et al, 2008; Sanders & Hambrick, 2007). Scholars, such as Khan et al (2019), Cherotich and Obwogi (2018), Emeka and Alem (2016), Ahmed and Hamdan (2015),Ongore et al (2015), Uwuigbe (2011) and Ness et al (2010) have used ROA to measure financial performance.

2.2.5 Earnings Per Share (EPS)

The profitability of the shareholders' investment can also be measured in many other ways. One of such measure is to calculate the earnings per share. Adediran and Alade (2013) suggest that EPS signifies a financial performance measure that is sound from the shareholders view point. Owolabi et al (2020) defined it as a firm's portion of profit allocated to a common stock share. It is that part of the net profit of a company given to each share held by shareholders. It is the income amount earned for outstanding shares in a particular period. Nangih et al (2022) see it as total earnings that is attributable to a unit of a company's ordinary share. In terms of profitability, it serves as an indicator. EPS is a ratio that measure financial performance and it is considered not biased and measures the profit earned weight comparatively by outstanding ordinary shares.

When the EPS is high, it means that the company has created high wealth for its shareholders. Johannes (2014) argues that EPS is considered a strategic decision-making that is an essential undergirding as it concerns valuations of share, incentive schemes management performance, and negotiations for merger and acquisition. It is calculated by subtracting preference dividend from profit after tax then the result is divided by numbers of ordinary shares (Egbeonu et al, 2016). In calculating EPS, using the weighted ratio is advisable because over the time, outstanding number of shares may change, as the number of shares outstanding can change over time.

2.3 Empirical Review

Iliemena et al (2022) assessed corporate governance reporting effect on shareholders' wealth and measured shareholders' wealth with EPS between 2013 to 2020. Using 73 NGX Group listed manufacturing companies as the population, applied the judgmental sampling and selected 37 of them. The secondary data obtained were analysed using multiple regression and the results was a positive effect on earnings per share. Nangih et al (2022) used board size, and board diversity as proxies of corporate governance while EPS was used as proxy of earnings quality. Covering a period from 2015 – 2020, findings revealed an inverse and insignificant relationships between board size and EPS, positive and significant between board diversity and EPS. Owolabi et al (2020) study concentrated on deposit money banks to find corporate governance relationship with EPS in Nigeria covering 2006 to 2018. They selected the ex post facto and analysed data with the regression. The result showed that all dimensions of corporate governance were related with EPS positively. Khan et al (2019) used PSX listed firms in evaluating board composition nexus with financial performance. Considering KSE-30 index specifically and adopting 5 years data spanning from 2014 to 2018, used various dimensions of board composition against two metrics of financial performance. The analysis methods of regression and correlation were used. The result was a mixed significance of negative and positive influence. Dzingal and Fakoya (2017) assessment result from companies in the Johannesburg Stock Exchange (JSE) found weak negative, and weak positive correlation between ROE and corporate governance dimensions. The study covered 2010 – 2015. Emeka and Alem (2016) empirical investigation from 2004 – 2013 revealed significant effect of corporate governance on bank financial performance (using ROA as financial performance proxy). Ongore et al (2015) in their empirical study, surveyed listed 46 companies in 2011 of Nairobi Securities Exchange. Multivariate regression analysis was used on the panel data. Using ROA, ROE, and Dividend Yield (DY) as indicators of performance. Mixed results were found in their significance and insignificant relationship and both negative and positive correlation. Ahmed and Hamdan (2015) study evidenced from the Bahrain stock, sampled 42 out firms from 2007 – 2011. The empirical results using ROA and ROE as performance measures found positive influence. Uwuigbe (201 1) study also found mixed relationship and correlation between corporate governance dimensions and financial performance measures (ROE and ROA). Onakoya, et al. (2010) study from 2005 – 2009 on six sampled banks (First bank, UBA, Eco, Fidelity, FCMB, and GTB), used time series data and found corporate governance is low and impacts negatively on the performance of banks in Nigeria.

2.4 Formulation of Hypotheses

2.4.1 Board Composition and Financial Performance

How a board is composed is extremely crucial, very key and central for the success, growth and survival of any profit-oriented entity, of which banks are not exonerated. Many factors are involved in the performance of business entities, yet the places and roles of board composition and audit committee cannot be ruled out completely or overemphasised. Studies have been carried out by various scholars and they are within the reach of the public.

The corruption and failure of so many boards cutting across the private and the public sectors are a thing of great concern. With board composition, as an integral part of corporate governance, financial performance of some business entities seems to fall below expectation. Scholars are increasingly studying and investigating its relationship with financial performance and there is yet no consensus. Kalsie and Shrivastav (2016); Oludele et al (2016) and Muller (2014) found positive relationship; Nhung and Nguyen (2017), Bublykova (2014), and Dogan et al (2013) found negative relationship; while Panasian et al (2015), Fernandez (2015) and Topak (2011) found no association. Yet, Karem et al (2021) elucidates that board composition is so vital in any institution as the organization performance can be affect by it, and it can pose enormous bearing on the organization financial performance.

The mixed and inconclusive result made this study to state the following hypotheses:

Ho_1: There is the absence of significant relationship between board composition and Return on Assets (ROA) of listed deposit money banks in Nigeria.

Ho_2: There is the absence of significant relationship between board composition and Earnings per Share (EPS) of listed deposit money banks in Nigeria.

2.4.2 Audit Committee and Financial Performance

Audit committee effectiveness depends largely on her ability to supervise the origination's financial results with individual members that are strong and strong audit committee characteristics (Kalbers & Fogarty, 1993). Again, an audit committee that is effective is expected to focus on shareholders' wealth optimization and also prevent personal interests' maximization by top management.

Ho_3: There is the absence of significant relationship between audit committee and Return on Assets (ROA) of listed deposit money banks in Nigeria.

Ho_4: There is the absence of significant relationship between audit committee and Earnings per Share (EPS) of listed deposit money banks in Nigeria.

3. Methodology

The study deals with time series data hence adopts the ex-post facto design method of research. A total of eight (8) money deposit banks was sampled using the purposive (a non-probability) technique of sampling. They are Access Bank Plc, Eco Bank Plc, Fidelity Bank Plc, First Bank Plc, First City Monument Bank (FCMB) Plc, Guaranty Trust Bank (GTB) Plc, Stanbic IBTC Plc and Zenith Bank Plc. They were selected because they are listed. Ten (10) years spanning from 2010 to 2019 are considered in this study. Data were collected from the financial statements of the sampled banks. The correlation analysis was considered appropriate for the study in testing the hypotheses.

4. Data Analyses and Discussion of Results

4.1 Data Analysis

Relationship between Board Composition (BC) and Return on Assets (ROA).

Correlations

		Board Composition	ROA
Board Composition	Pearson Correlation	1	-.204
	Sig. (2-tailed)		.070
	N	80	80
ROA	Pearson Correlation	-.204	1
	Sig. (2-tailed)	.070	
	N	80	80

The correlation results showed -0.204 correlation value (CV) and 0.070 P-value of. Meaning that 20.40% changes in ROA resulted from the predator variable board composition (BC) while the other 79.60% are caused by other factors. The negative sign on the correlation value reveals a relationship that is inverse. The P-value of 0.070 revealed by the result is higher than the 0.05 significant value. Therefore, the study found no significant relation. Meaning that null hypothesis stated in hypothesis one is upheld.

Relationship between Board Composition and Earnings per Share.

Correlations

		Board Composition	EPS
Board Composition	Pearson Correlation	1	.120
	Sig. (2-tailed)		.288
	N	80	80
EPS	Pearson Correlation	.120	1
	Sig. (2-tailed)	.288	
	N	80	80

The results found correlation value of 0.120 and P-value of 0.288. Based on the correlation value, 12% changes in EPS are influenced by board composition while the 88% remaining are not within the its influence. Also, variables are positively correlated, that is, the variables move in the same direction. The P-value of 0.288 suggests absence of significant relationship. Therefore, the study upheld hypothesis two (2).

Relationship between Audit Committee and ROA.

Correlations

		Audit Committee	ROA
Audit Committee	Pearson Correlation	1	.205
	Sig. (2-tailed)		.069
	N	80	80
ROA	Pearson Correlation	.205	1
	Sig. (2-tailed)	.069	
	N	80	80

0.205 and 0.069 were the results for correlation and significance respectively. The interpretation is that 20.50% changes in ROA could be traced to audit committee and 79.50% from other factors. A positive relationship was indicated, meaning their movement is in the same direction. The 0.069 P-value, which is higher than 0.05 means absence of significant relationship. Consequently, hypothesis three (3) is accepted and upheld.

Relationship between Audit Committee and EPS.

Correlations

		Audit Committee	EPS
Audit Committee	Pearson Correlation	1	.053
	Sig. (2-tailed)		.641
	N	80	80
EPS	Pearson Correlation	.053	1
	Sig. (2-tailed)	.641	
	N	80	80

The 0.053 correlation value and 0.641 P-value means that only 5.3% variation in EPS is traceable to audit committee while 94.7% are not traceable to audit committee but to other factors not captured. The correlation is positive hence both the predictor and criterion variables move in a common direction. Again, looking at the result, the value of the probability is higher than the 0.05 based rule of rejecting or accepting hypothesis. As a result, the study upheld the null hypothesis, that is, hypothesis four (4).

4.2 Discussion of Findings

Based on the result of the data analyses, there is the absence of significant relationship between the independent variables (board composition and audit committee) and the measures (ROA and EPS) of the dependent variable (financial performance). In terms of correlation, there is a very weak correlation between them, this is because the correlation values showed from the result of the analyses, were less than all 3.00. Also, they all have positive correlation, hence tend to move in the same direction except that of board composition and ROA that produce a negative correlation.

In terms of significance, the study results of insignificant relationship shown in the four hypotheses is in tandem with Nangih et al (2022) but disagrees with that of Owolabi et al (2020) and Emeka and Alem (2016). The result of hypothesis one, which showed a negative correlation agrees with the empirical results of Nhung and Nguyen (2017), Bublykova (2014) and Dogan et al (2013) while the result of positive correlation shown in the results of hypotheses 2, 3 and 4 are in tandem with the results of Kalsie and Shrivastav (2016), Oludele et al (2016) and Muller (2014).

In general, a mixed result in terms of correlation was find. This result agrees with Kahn et al (2019), Ongore et al (2015) and Uwuigbe (2011). But not in tandem with the result of Owolabi et al (2020) and Emeka and Alem (2016).

5. Summary, Conclusion and Recommendations

5.1 Summary of Findings

This study focused on board composition, audit committee and financial performance. The study sought to investigate their relationship. To actualize the study aim, the population of the study covered listed deposit money banks in Nigeria for period of ten (10) years from 2010 – 2019. Sampled eight and gathered data from their financial statement and analysed. The summary of findings are as follows:

i. Board composition showed absence of significant relationship and also a very weak negative correlation with ROA.
ii. Board composition showed absence of significant relationship with EPS and a very weak positive correlation.
iii. Audit committee showed absence of significant relationship and also a very weak positive correlation with ROA
iv. Audit committee showed absence of significant relationship with EPS and a very weak positive correlation.

5.2 Conclusion

Using ROA and EPS as measures of financial performance, the study investigated board composition and audit committee relationship with financial performance. Basing the study’s conclusion on the results, it concludes that board composition and audit committee have no significant relationship with financial performance.

5.3 Recommendations

Recommendations made after the findings are:

i. The composition of the board should comprise of few members in order to increase effectiveness, efficiency and full participation that is sufficient to actualize the aim of wealth creation.

ii. The board should wake up to their responsibility and strive to increase earnings by pursuing objectives and taking decisions targeted at enhancing the earnings.

iii. Audit committee should be embraced, strengthened, meet frequently to check compliance and also ensure they improve their monitoring capacity.

iv. The audit committee independence level should be increased, believing that this will ensure better objectivity, transparency and monitoring for better financial performance.

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