CAPITAL STRUCTURE AND FINANCIAL PERFORMANCE OF MONEY DEPOSIT BANKS IN NIGERIA

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ABSTRACT

The study's main objective was to investigate how capital structure affected deposit banks in Nigeria's financial performance. The study specifically looked at the effects of the ratio of total capital to total assets on the asset return of chosen DMBs in Nigeria, as well as the effects of the ratio of total debt to total assets and the ratio of total debt to total debt. For the ex post facto study project, five (5) money depository institutions were selected as a population sample of all money depository banks in Nigeria. The independent variable was represented by TETA, TDTE, and TDTA, while the dependent variable was represented by return on assets (ROA) and current ratio. The data sources were the overall annual income and financial standing of the selected institutions, and panel fixed effects regression was utilized as the main estimation method. The findings demonstrated that the capital structure had very little positive influence on investment returns from assets. Debt-to-equity ratio, however, has little effect on Nigerian depository banks' return on assets. The study came to the conclusion that the assets' profitability is not significantly positively impacted by the capital structure (TDTE, TETA, and TDTA). As a result, the report advised depository banks to take on more debt in order to boost their return on assets and earnings per share.

Keywords: Capital, Performance, Equity, Debt, Assets

1.0 INTRODUCTION

Undoubtedly, the function that banks play in the financial system is becoming more and more significant, which is why many bank managers and regulators place a strong emphasis on enhancing bank performance. Capital structure has been the subject of recent financial study, which has taken into account a number of factors that affect bank performance as well as the spread of panic throughout the world banking system. Corporate and modern finance have long argued over the best capital structure to reduce a company's cost of capital and raise its value. On this, several researchers have various viewpoints and theories. Banks might be compared

to this, although with a somewhat different strategy. Receiving capital from investors and then lending it to the corporate sector when necessary is the fundamental role of banks (Serwadda, 2019). For the expansion of any economy, banks are a must.

The bank's funding sources show that it has the capacity to make stronger investments and draw in more customers. The organization's profitability and resource management are both demonstrated by the financial outcomes. It is an important truth for everyone involved, including the government, managers, shareholders, and creditors. It serves as proof to the depositor that the money they deposited was profitable. It proves to creditors that the bank can fulfill its promises to them. The state can determine whether a bank can afford to pay taxes based on financial performance. Shareholder financial statistics demonstrate the return on their capital investments. The financial success of managers serves as a gauge of the worth of their labor and resources (Aymen, 2018).

Banks can use the appropriate capital structure as a helpful buffer during a crisis to prevent financial exhaustion. The Basel Committee has changed the Basel criteria to govern the minimum financial leverage ratio while taking into account financial institutions' on- and off-balance sheet activities. Financial institutions also need to raise more capital to safeguard depositors and lessen unforeseen losses when risks materialize. Determining how capital structure affects bank performance can benefit policymakers, managers, and shareholders by identifying and minimizing potential risks related to financial decisions in banking operations. This will enhance bank performance, increase bank value, and maximize asset value for shareholders (Ahmed et al., 2018).

A crucial metric for assessing a bank's success is return on assets (ROA). By dividing net income by total assets, it is calculated. Return on assets (ROA), according to Anarfo and Appiahene (2017), is a gauge of how much profit each asset produces. One of the primary goals of the majority of publicly traded banks is to ensure the satisfaction of all business stakeholders. These frequently lead bank executives to develop a range of strategies that enable them to select the optimal financing and investment solutions to support the company's objective. When making financial decisions, one of the manager's main goals is to make sure the company has a sound financial mix or capital structure (Ogebe et al., 2013).

As a result, "capital" might refer to a company's funding options. Internal and external sources are the two main types of capital. "Internal source" refers to funds that a business raises on its own, typically through retained earnings. Companies can search outside for the funding they require to increase their activities, just like individuals can. Any money raised outside of the organization's regular budget is referred to as external funding. Two options to obtain outside funding are to increase the number of co-owners of a business or to borrow directly in the form of a loan, either short- or long-term, or both (Eniola et al., 2017).

Academics have long focused on and debated the ongoing issue of Nigerian commercial bank management's inability to select the appropriate financial mix capable of generating the required return. The majority of studies on the topic of capital structure in Nigeria have primarily focused on the study of the determinants of capital structure (Nwude & Anyalechi, 2018), while few studies examining the impact of capital structure on the performance of Nigerian deposit banks have covered a period of more than ten years with panel data. Sadiq et al. (2017) conducted similar research, but with fewer banks. The capacity to employ a single

financial performance indicator (ROA) to assess the effectiveness of money custody institutions in Nigeria over a brief period of time, let's say five years, has continuously been disregarded in prior empirical studies. In light of this, the purpose of this study is to close the knowledge gap in the area of capital structure in relation to the performance of the Nigerian banking sector by focusing solely on return on capital and return on capital precisely to assess the performance of the sector. Five banks were chosen for this study, and their return on capital was the only variable that was examined.

1.1 Objectives of the Study

The main goal of this research is to ascertain how Nigeria's banking sector's performance is impacted by its capital structure. The particular goals are to determine how selected Nigerian deposit-taking banks' investment performance is impacted by their total debt to total equity ratio; Determine the impact of the total debt to total assets ratio on the investment performance of a select group of Nigerian deposit-taking banks as well as the influence of the ratio of total capital to total assets on those banks' ability to make investments. The introduction, which comprises the background of the study, the definition of the topic, and the goals, is the first of the study's five major sections. Section two of the literature review discusses concepts, hypotheses, and empirical studies. The third section covers the study methods, while the fourth section deals with the data, data analysis, and results. Section five contains the conclusions and recommendations.

2.0 LITERATURE REVIEW

2.1 Capital Structure

Capital structure, in terms of finance, is the method a corporation employs to finance its operations through a combination of debt and equity. Furthermore, the publication of a seminar by two American economists, Modigliani and Miller (1958), marked the start of study on the structure of capital more than 60 years ago. They demonstrated that capital expenses have no impact on the capital structure under certain circumstances (perfect market, lack of taxes and transaction fees). In other words, a company's capital structure's debt does not affect the company's worth. This concept is usually referred to as "irrelevant theory". Later, though, they abandoned the pointless hypothesis. By giving evidence that the cost of capital influences the capital structure and, ultimately, the value of the enterprise when the assumptions of no tax or transaction costs are removed, Modigliani and Miller (1963) updated the irrelevant theory. Later, they asserted that borrowing had a tax benefit since taxing interest created tax havens, which decreased borrowing costs and enhanced corporate performance (Miller, 1977). The corporation must therefore decide between the advantages of employing debt and the associated expenditures.

The capital structure of a firm refers to the allocation of debt and equity for financing. Additionally, they contended that a company's capital structure is made up of a mix of hybrid securities, debt, and equity that is utilized to finance its operations. The various securities that a firm has issued to finance its operations make up its capital structure. It refers to the use of debt as leverage in a company's capital structure and has to do with the debt-to-equity ratio on the equity side of the liability holders on a company's balance sheet (Awunyo & Bandu, 2012).

2.2 Banks Performance

Performance is the act of carrying out, achieving, and finishing the tasks that have been allocated to you. It is evaluated in accordance with established, precise, financial, all-inclusive, and time standards. It is a method of evaluating a business's financial policies, practices, and operational outcomes. It is employed to assess a company's productivity, compliance, and financial stability. These outcomes are all represented by the company's return on investment, assets, capital, capital employed, and profitability. Performance refers to how well a bank's financial standing has held up over time. In order to boost sales, profitability, and the value of the company for its shareholders, it is a financial operation to manage a company's current and non-current assets, financing, equity, income, and expenses. Its main goal is to give shareholders and interest groups up-to-date information so they may make informed decisions (Nguyen et al., 2021).

Performance can be used to assess similar businesses in the same sector or to combine sectors for comparison. Controlling risk and boosting a company's profitability while adhering to corporate governance requirements are necessary for making the right decisions. Making timely decisions necessitates accurate information and in-depth industry analysis (Farah & Farrukh, 2016). Given the foregoing, return on assets is a crucial factor to take into account when assessing bank performance indicators and is crucial to this study.

One of the primary issues with ROA's usage as a profitability indicator is the fact that it ignores the risk incurred to create a profit on assets. A bank may earn a lot of money by taking on greater risk. When risk is taken into account, the ROA in this scenario may be extremely high, but the implied return may be rather low. As a result, ROA is the anticipated rise in operating cycle cash flow brought on by capital investment; it serves as the compensation for skipping out on current spending. Net income is divided by total assets to arrive at ROA. This indicator is widely employed to evaluate banks' financial performance. The ROA demonstrates the profit generated per investment asset. Establish the effectiveness and performance of banking operations. Using ROA, management can see how to benefit from bank assets (Anarfo & Appiahene, 2017).

3.0 THEORETICAL FRAMEWORK

3.1 Agency Cost Theory

Agency cost theory has been one of the most important ideas in the world of finance ever since Jensen and Meckling's theory of the firm: managerial behavior, agency costs, and ownership structure was published in 1976. According to this theory, investment would suffer as the gap between major business ownership and control expanded. The argument was founded on the notion that shareholders' and managers' interests are not entirely congruent (Jensen and Meckling 1976). Conflicts between owners and bondholders, as well as between shareholders and management, will raise a company's operational, investment, and financing costs. As a result, agency theory predicts a positive relationship between company performance and leverage (capital structure). The idea contends that a number of stakeholders, including shareholders, lenders, and corporate decision-makers, have an impact on an organization's capital structure. The theory holds that as each stakeholder has unique preferences and expectations, selecting a funding source must take into account the needs of shareholders,

lenders, and borrowers alike. Decision-making for the company. By concluding that an organization can achieve its "optimal" capital structure by not only accommodating the incremental benefits and incremental costs of additional debt, but also the "agency cost" of additional debt and/or the "Agency costs" for additional equity, agency cost theory only supports the static compensation theory account. (Akingunola et al. 2017). Agency cost theory, however, has been used to connect the capital structure of banks with their financial performance. Because it is said that shareholders largely use debt to control the financial performance of banks, the agency theory was chosen.

3.2 Empirical Review

Numerous studies in the literature have looked into the connection between capital structure and bank performance. Nguyen et al. (2021) used the GMM estimate for the Vietnam instance to explore how capital structure affects bank performance. The study used information from 28 Vietnamese commercial banks from 2010 to 2019 to analyze how capital structure affects bank performance. The performance of certain commercial banks (as assessed by ROA and ROE) is negatively and considerably impacted by capital structure, as determined by total debt to assets and debt-to-equity ratio. Using the SYS-GMM approach, these results have been adjusted for several diagnostic issues and endogeneity phenomena. The majority of the control variables (bank size, non-performing loans, liquidity, and GDP growth rate) demonstrate substantial and positive connections with the performance of the bank, with the exception of the adverse effect of the incidence of operating costs.

During a ten-year period, from 2006 to 2015, another study by Serwadda (2019) looked at the effect of capital structure on bank performance. The effect of capital structure on bank performance is examined using panel regression models of banks. The findings indicate a significant relationship between capital structure features and bank performance. There are three options: total debt, net interest margin, and long-term debt. Return on capital and total debt have a positive correlation. Return on equity and total debt are both constant. Short-term debt and return on capital, however, have a poor relationship.

Uremadu and Onyekachi conducted research on the impact of capital structure on company performance in Nigeria in 2019. With a focus on the industrial consumer products sector of the economy, the study used return on assets, long-term debt-to-asset ratio, total debt-to-equity ratio, and multiple regression analysis. The study's conclusions indicate that the capital structure of Nigerian consumer goods companies had a negative and minimal impact on their financial performance.

In their 2018 study, Nwude and Anyalechi explored how Nigerian commercial banks' capital structures affected their performance. The study looked at the impact of funding mix as well as the relationship between leverage and equity ratios and the performance of commercial banks. Ordinary least squares regression analysis, Granger causality analysis, fixed effects panel analysis, random effects panel analysis, and post-estimation tests such the restricted f-test for heterogeneity and Hausman's test were used to assess the data that had been gathered. The findings indicate that while debt financing has a sizable negative impact on return on capital, the debt to equity ratio has a sizable favorable influence on return on equity.

Akingunola et al. (2017) looked into the connection between an organization's financial performance between 2011 and 2015 in Nigeria while deciding on a capital structure. Regression analysis was used to calculate debt equity, short-term and long-term debt, asset tangibility, size, growth, ROE, and ROA. During the study period, debt, both short- and long-term, positively and significantly impacted ROE and ROA.

Muigai and Murithi (2017) used a workable generalized least squares regression model to identify the moderating role of firm size in the relationship between firm capital structure and financial distress of nonfinancial enterprises in Kenya from 2006 to 2015. The results of the study show that the link between the capital structures of nonfinancial enterprises and financial distress is greatly modified by firm size.

In order to assess the impact of capital structure on financial performance and determine the Istanbul Stock Exchange between 2005 and 2012, Nassar (2016) used multivariate regression analysis to measure return on assets, return on equity, and earnings per share as indicators of firm performance. Additionally, debt-to-GDP ratio was used as a proxy for capital structure. The outcomes show that there is a somewhat negative relationship between capital structure and firm performance.

4.0 METHODOLOGY

This study's methodology is known as ex-post-facto research since it made use of previously generated data to forecast a variable's behavior in the present. The research population includes all of Nigeria's operational and authorized deposit-taking institutions. However, the study made use of information from five (5) banks' online annual financial reports. These banks were picked based on a straightforward random sample technique and the availability of the required information over the course of an eleven-year period. The study lasted for eleven years, from 2012 to 2022. The banks selected at random are First Bank Nigeria Limited, Access Bank Plc, Guaranteed Trust Bank (GTB), and United Bank for Africa (UBA), and Zenith Bank Plc. These are the banks whose websites made their balance sheets clear and comprehensive. The study made use of panel regression coefficients, correlation matrices, and descriptive statistics to arrive at a particular conclusion.

4.1 Model Specification

The model of this study established the relationship that exists between return on asset (ROA) and total debt to total equity (TDTE), total equity to total asset (TETA), total debt to total asset (TDTA), long term debt (LTD) and liquidity (LIQ). To achieve this, the model adapted from study of Olagunju et al (2022) was used.

The model is mathematical presented as;

$$Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \beta_5 x_5 \mu_0 \dots\dots\dots\dots\dots Equ.(1)$$

Hence; $ROA = \beta_o + \beta_1 TDTE + \beta_2 TETA + \beta_3 TDTA + \beta_4 LTA + \beta_5 LIQ + \mu_0 \dots\dots\dots Equ.(2)$

Where:

ROA = return on asset

TDTE= total debt to total equity.

TETA= total equity to total asset

TDTA= total debt to total asset

LTD= long term debt

LIQ=liquidity

μ_0 = error term β_0 = constant Y = dependent variable

5.0 ANALYSIS AND INTERPRETATION OF RESULTS

5.1 Descriptive Statistics

Table1 presents the summary of descriptive statistics of all variables used. The discussion comprised the mean, median, standard deviation, skewness, kurtosis and jargua-bera. The mean explained the average value of each variable in the model. A thorough analysis of the mean revealed that TETA, with a mean of 22.4753, has the highest mean, followed by LTD, with a mean of 14.0571, TDTA, with a mean of 7.8584, and ROA, with a mean of 0.020. Median is the middle value of the variables and it was found that, except median of ROA, LTD and LIQ, all other variables have median value that are higher which made them record positive skewness. That is, TDTE of 3.6568, TETA of 2.7919, TDTA of 0.1462 are all positively skewed. The standard deviation is meant to measure the degree of dispersion from the mean value, meaning, it measures how volatile a variable can be. The result revealed that, TETA of 26.6503 is the most volatile, followed by TDTE of 5.6960, the next is TDTA of 4.6351 while the least is ROA of 0.0218. With the exception of LTD and LIQ, the majority of the variables have kurtosis values larger than 3.0, indicating that the variables in the array are pointed, according to the kurtosis statistics, which compare the skewness and kurtosis of the series to those of the normal distribution. This implies that the series' variables have peaked and leveled off. In other words, the distribution is both leptokurtic and platykurtic in comparison to a normal distribution. The majority of the p-values for the series, as determined by Jarque-Bera statistics, are below 0.05, or the 5% level of significance. The fact that the series, with the exception of TETA and TDTA, are not widely accessible serves as a clue. There were a total of 55 observations.

Table 1: Summary of Descriptive Statistics

Variable	Mean	Median	Std Dev	Skewness	Kurtosis	Jarque-Bera	Obs
ROA	0.020492	0.020383	0.021867	-2.028467	13.66183	0.000000	55
TDTE	4.006634	2.026894	5.696012	3.656803	19.84790	0.000000	55
TETA	22.47530	14.66248	26.65053	2.791982	9.377623	0.000000	55
TDTA	7.858494	7.423040	4.635171	0.146249	1.963402	0.175496	55
LTD	14.05718	14.13659	0.659385	-0.14742	1.845939	0.119054	55
LIQ	1.107017	1.136110	0.217770	-0.740807	8.480105	0.000000	55

Source: Author's Computation using E-views 10, 2024

5.2 Correlation Matrix

Table 1 presents correlation relationship between the variables employed. Since the majority of the cross-correlation terms for the explanatory variables have been found to be fairly minor, there is no reason to worry about the issue of multicollinearity among the explanatory components. Additionally, it was discovered that all parameters had a favorable, albeit weak, connection with return on assets (ROA). As a result, it is anticipated that all explanatory factors will positively correlate with ROA.

Table 2. Summary of Correlation Matrix

	ROA	TDTE	TETA	TDTA	LTD	LIQ
ROA	1					
TDTE	0.096534	1				
TETA	0.199263	0.348730	1			
TDTA	0.149667	-0.42789	0.017127	1		
LTD	0.394911	0.097305	0.17746	0.154805	1	
LIQ	0.173951	0.132819	0.228575	0.112728	0.132714	1

Source: Author's Computation using E-views 10, 2024

5.3 Regression Result

The study employed panel regression to establish the effect of capital structure on financial performance of deposit money banks in Nigeria. To achieve this, both Fixed and Random effects were used and Hausman test was later used to test for the endogeneity of the model from which the study had to choose from fixed or Random effects. The result is presented in Table 2. The fixed effects revealed that, TDTE of -0.0001 and TDTA of -0.0007 have negative effects on the return on assets. The control variable that is, Total deposit (LTD) also exhibited a negative sign of -0.0164. On the other hand, TETA of 0.0009 and LIQ of 0.0051 have positive effects on return on assets. The probability of each variables also revealed that none of the variables is significant. This implies that, with the fixed effects, the ratio of total equity to total assets and total debt to total assets have insignificant negative effects on return on assets. On the other hand, the result from the Random effects showed that, all the explanatory variables have positive effects on return on assets. However, the probability of the capital structure such TDTE, TATE, and TDTA have an insignificant positive effect on return on assets except the control variables total deposit and liquidity that significantly impacted on return on assets. The implication of this is that, TDTE, TDTE and TDTA have an insignificant positive effect on return on assets.

With fixed effects, the coefficient of determination (R^2) revealed a substantial link between capital structure and financial performance, with the explanatory variables accounting for around 71.23% of the variation in the dependent variable. Only 33.25% of the variation was explained by the explanatory variables for the random effects, though. The findings, however, indicate that there is minimal connection between financial success and capital structure. The model is also significant and well-fitted, as shown by the F-statistic of 6.32 and corresponding

p-value of 0.0000. The F statistic of 2.222 and the accompanying probability of 0.01 for random effects, however, also demonstrated the model's good fit and thorough specification. The series are not serially correlated, according to the Durbin Watson value of 1.98 for fixed effects, but the value of 0.8157 for random effects revealed that there was a significant issue with serial correlation in the series.

Table 3: Summary of Fixed Effect Panel Regression

Dependent Variable: ROA

FIXED EFFECT			RANDOM EFFECT		
Variable	Coefficient	Prob.	Variable	Coefficient	Prob.
TDTE	-0.000135	0.8022	TDTE	0.000192	0.5963
TETA	0.000902	0.9170	TETA	0.000005	0.2440
TDTA	-0.000721	0.2330	TDTA	0.00095	0.0599
LTD	-0.016493	0.2035	LTD	0.011419	0.0002
LIQ	0.005119	0.5933	LIQ	0.017491	0.0424
C	0.25266	0.1713	C	-0.169488	0.0001
R^2		0.7123		0.3325	
Adj-R^2		0.6		0.1829	
F-stat		6.3268		2.2222	
Prob		0.0000		0.0100	
D.W		1.9895		0.8157	

Source: Author's Computation using E-views 10, 2024

Having used both fixed and random effects of panel regression, the study had to choose between these two results. To achieve this, the study employed the use of Haussmann. This test is designed to identify whether there is an endogeneity issue when endogenous variables have values that are influenced by other variables in the system. OLS estimation will not work if a model has this issue. The p-value for this test should have a significance level higher than 5% because choosing the null hypothesis suggests that random effects are suitable. On the other hand, the fixed effect is supported by the alternative hypothesis, hence the p-value must be lower than 5%. According to Table 4, a p-value of 0.000 indicates significance, which is less than the 5% level of significance. This means that the null hypothesis can be rejected. Regression with a fixed effect panel is therefore reasonable.

Table 4: Summary of Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	66.72388	5	0.0000

Source: Author's Computation using E-views 10, 2024

5.4 Test of Hypotheses

Ho1: The first hypothesis claims that there is no discernible relationship between total debt and total equity and performance (ROA). It can be seen from Table 3 that the p-value for the TDTE is greater than the 5% level of significance with a value of 0.8022. As a result, the study kept the null hypothesis, which states that the ratio of total debt to total equity has no discernible influence on the return on assets of the chosen Nigerian banks.

Ho2: The second hypothesis claims that there is no discernible relationship between total equity and total debt and performance (ROA). It can be seen from Table 3 that the p-value for the TDTE is greater than the 5% level of significance with a value of 0.9170. The null hypothesis, which states that the ratio of total equity to total debt has negligible influence on return on assets of the chosen Nigerian banks, was therefore kept in the analysis.

Ho3: According to hypothesis three, there is no discernible relationship between total debt and total assets and performance (ROA). It can be seen from Table 4 that the p-value for the TDTE is greater than the 5% level of significance with a value of 0.2330. The null hypothesis, according to which the ratio of total debt to total assets has negligible effects on the return on assets of the chosen banks in Nigeria, was retained in the study.

6.0 CONCLUSION AND RECOMMENDATIONS

6.1 Conclusion

The study found that capital structure (TDTE, TETA, and TDTA) had negligible beneficial effects on return on assets after thoroughly examining how it affects deposit money banks' financial performance in Nigeria. As a result of the study's findings, it was suggested that deposit money banks increase their debt-to-equity leverage in an effort to boost bank earnings per share and return on assets. Since it was found that deposit impacted more than other variables in the model, it is therefore recommended that more deposit should be sourced and used in such a way that it would stimulate performance of deposit money banks in Nigeria.

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