

CAPITAL STRUCTURE AND FINANCIAL PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA: MODERATING ROLE OF CORPORATE GOVERNANCE

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Abstract

Nigerian deposit money banks continue to struggle with achieving optimal financial performance, partly due to ineffective capital structure decisions and weak corporate governance mechanisms. This study investigates the effect of capital structure and corporate governance on the financial performance of listed deposit money banks in Nigeria. Specifically, it examines whether board size moderates the relationship between debt-to-equity ratio and financial performance, measured by Return on Assets (ROA). The study adopts an ex-post facto research design using secondary data from 12 banks with complete financial records between 2015 and 2024. Descriptive statistics, correlation analysis, diagnostic tests, and multiple regression models, estimated through Ordinary Least Squares (OLS) after validating assumptions via the Hausman test, were employed for data analysis. Findings reveal that the debt-to-equity ratio negatively and significantly affects financial performance, while corporate governance, proxied by board size, has a positive and significant effect. Moreover, board size significantly moderates the relationship between capital structure and performance, improving the model's explanatory power. These results support the Trade-Off Theory, suggesting that while high leverage may reduce performance, strong governance can mitigate its negative effects. The study concludes that maintaining a balanced capital structure and enhancing corporate governance structures are essential for improved bank performance. It recommends that banks minimize over-reliance on debt, optimize board composition, and strategically design governance practices to complement financial decisions.

Keywords: Board size, capital structure, corporate governance, financial performance, Nigerian banks, trade-off theory.

1.0 Introduction

Financial health is the cornerstone of any economy. Around the world, robust financial performance underpins investment, innovation, and stability not just in banking, but across industries. Institutions that consistently deliver strong returns boost market confidence, catalyze job creation, and give policymakers room to maneuver during downturns. In emerging economies, where shocks often test resilience, the quality of financial outcomes becomes even more critical (Khan 2022).

Zooming in on Nigeria, the stakes are particularly high. As Africa's largest economy by GDP, the performance of its financial system influences livelihoods nationwide. Nigerian companies, and particularly banks, play a vital role in financing commerce and public projects. But in a landscape marked by currency fluctuations, inflation, and regulatory shifts, maintaining strong performance is a constant challenge (Otegunrin et al. 2024).

Within that setting, the banking sector emerges as both a source of systemic strength and vulnerability. Nigerian banks have been called upon to raise capital, shore up reserves, and sustain lending amid economic headwinds. Their ability to deliver healthy returns matters not only to shareholders, but to the economy at large (Muktar et al. 2025). Performance here isn't an academic concern, it's a practical imperative.

One dimension increasingly under scrutiny is the composition of financing, how much comes from debt versus equity. The balance between these financing sources shapes cost structure, pressure on earnings, and risk exposure. In global and regional studies, banks that manage this balance effectively tend to deliver more stable and higher returns (Khan 2022). Yet overleverage can quickly erode profitability, especially in volatile markets.

Equally important is corporate governance. In particular, the size of a bank's board influences how strategic decisions are made, risks are overseen, and performance expectations are aligned. In Nigeria, the evidence is mixed: some studies suggest that an appropriately sized board supports better outcomes through stronger oversight, while others point to inefficiencies and slower decision-making in boards that are too large (Chukwu 2021; Muktar et al. 2025).

This raises a compelling question: does board composition alter the effectiveness of financing choices on performance outcomes? In other words, might governance dynamics amplify, or dampen, the impact of how a bank is financed? Understanding this interplay could shed light on why some banks outperform peers under similar capital structures.

That insight has clear practical value. For regulators and bank leaders facing tightening capital requirements, knowing whether governance strengthens or weakens the link between financing structure and outcomes can inform policies and board design. Aligning capital strategy with board effectiveness might be the key to sustaining returns under pressure.

Yet a clear gap remains: despite much work on capital structure and governance separately, little is known about how board size interacts with financing mix to shape performance in Nigerian listed banks. This study seeks to fill that gap by exploring whether board composition changes how financing decisions translate into returns, offering timely and actionable insights for both policy and practice. Against this backdrop, the study tests the following:

H₀₁: Debt to Equity Ratio has no significant effect on financial performance of listed deposit money banks in Nigeria

H₀₂: Corporate Governance has no significant effect on financial performance of listed deposit money banks in Nigeria.

H₀₃: Corporate Governance has no significant moderating effect on the relationship between debt to equity ratio and Financial Performance of listed deposit money banks in Nigeria.

2.0 Literature Review

Concept of Financial Performance

Financial performance, broadly understood as how well an entity generates value from its resources, is often operationalized in banking through Return on Assets—a metric that gauges how effectively a firm turns its asset base into net earnings. Studies in banking and finance consistently rely on ROA because it encapsulates operational efficiency and profitability in one ratio (Singh 2024).

In contexts like Bangladesh, ROA is widely used alongside ROE and net interest margin to assess profitability across bank-specific and macroeconomic dimensions (Hossain & Ahamed 2021). In Vietnam, analyses show that ROA reflects credit risk effects and persists over time in its predictive power (Nguyen 2023). African banking studies also center on ROA to evaluate how governance mechanisms enhance performance (Chukwu 2021). Research in Southeast Asia finds

ROA responsive to ESG practices and growth dynamics (Yusop et al. 2024). Comparative efficiency studies highlight ROA's stability relative to more complex metrics like DEA-based super-efficiency (Liao 2024). Furthermore, cross-industry analyses validate ROA's role in capturing asset-usage effectiveness (Boyte-White 2021). Collectively, these sources confirm that ROA remains a robust, interpretable, and widely adopted indicator of financial performance. For this study, ROA, which is net income divided by average total assets, is adopted as the operational definition of financial performance, aligning with global practice and empirical precedent.

Concept of Debt to Equity Ratio

Debt-to-equity ratio, a fundamental measure of financial leverage, reflects the extent to which a firm relies on debt compared to equity financing in its capital structure. In banking, it signals both the risk appetite and funding strategy of management, influencing profitability and stability outcomes (Alarussi & Alhaderi 2021). Evidence from Nigerian banks shows that optimal debt-to-equity levels can support growth, but excessive leverage increases vulnerability to liquidity shocks and credit risk (Okafor & Eze 2022). Studies in Pakistan and Malaysia report a negative relationship between debt-to-equity ratio and bank performance, suggesting that overreliance on debt undermines efficiency and investor confidence (Ali & Puah 2020; Yusuf & Awang 2023). Conversely, moderate leverage can enhance return potential through tax advantages and expanded lending capacity, as seen in Ghanaian and Kenyan banking analyses (Mensah & Abor 2021; Mwangi 2024). In emerging economies, the ratio also reflects regulatory constraints, especially under Basel III frameworks, which limit excessive debt usage (Rahman & Akhter 2022). Comparative multi-country studies affirm that the ratio remains a consistent, interpretable proxy for leverage decisions across contexts (Afolabi & Adebayo 2022). For this study, debt-to-equity ratio is defined as total liabilities divided by total shareholders' equity, representing the bank's leverage position and its potential effect on financial performance.

Concept of Corporate Governance

Corporate governance matters because it shapes how decisions get made, how risks are overseen, and how strategic tradeoffs between growth and safety are resolved. Empirical reviews and meta analyses show that board characteristics, including size, consistently influence bank outcomes across jurisdictions (van Essen, Engelen, & Carney 2021). Cross country and regional studies find that larger boards can bring diverse expertise and stronger monitoring, which supports performance in many banking contexts (Abiad, Abraham, El-Chaarani, & Binsaddig 2025). At the same time, several country level studies caution that oversized boards may slow decision making and dilute accountability, creating an inverse effect on returns (Revisiting Board Structure Study 2023). Evidence from East and West Africa confirms mixed results, where board size interacts with regulatory quality and market structure to determine whether governance improves or impairs financial outcomes (Board Characteristics Study 2024; Board Governance and Bank Stability 2023). Sectoral analyses in emerging markets show that alongside independence and expertise, the sheer number of directors meaningfully affects supervisory effectiveness and strategic agility (Olowofela, Donfack, & Soh 2025). Meta evidence further highlights that heterogeneity in effects arises from measurement differences and institutional setting, calling for context specific operationalization (Board Governance Meta-analysis 2021). Taken together, the literature supports viewing board size as a governance attribute that can either strengthen or weaken bank performance depending on how it influences oversight, coordination, and strategic capacity. For this study, corporate governance is conceptualized with emphasis on board size, defined as the total number of directors formally serving on the bank board during a

fiscal year, and treated as a moderator of the relationship between capital structure and financial performance.

Empirical Review

Debt to Equity Ratio and Financial Performance

Empirical studies across emerging markets consistently link the debt-to-equity ratio to bank performance, though findings vary by context. In Nigeria, Otekunrin, Nwanji, Eluyela, Olowookere, and Fagboro (2020) report that higher leverage correlates negatively with profitability, underscoring the perils of excessive debt. Contrarily, Chizuru and Ogoke (2024) find that debt-to-equity ratio exhibits a positive impact on return on assets, suggesting better managerial incentives under leverage. Madume (2023) supports this, showing a significant positive relationship between debt-equity ratio and return on equity in Nigerian deposit money banks. A broader Tanzanian study by Kabichi and Bwana (2024) reveals that a 1 % increase in the ratio yields an 18 % decline in ROA, yet debt capital itself may boost performance. In Ghana, leverage appears beneficial when deployed efficiently (Abiad, Abraham, El-Chaarani, & Binsaddig, 2025). In Pakistan and Malaysia, Ali and Puah (2020) observe that excessive leverage undermines bank efficiency. East African evidence from Mwangi (2024) similarly indicates diminishing returns to high leverage. Rahman and Akhter (2022) find that regulatory capital influences this relationship in South Asia.

Corporate Governance and Financial Performance

Across emerging markets, empirical work reveals a varied but revealing picture of how board size influences bank performance. In Nigeria, Okoye, Olokoyo, Okoh, Ezeji, and Uzohue (2020) find a positive and significant relationship between board size and financial performance, as captured by ROA and ROE. In a similar context, Oluwole (2021) reports that board size enhances earnings per share, reinforcing governance as a performance lever. Yet other studies in Nigeria deliver mixed results, Uwuigbe and Fakile (2020) show that board sizes above thirteen tend to reduce bank ROA, while Wokeh (2024) finds a negative but insignificant effect of board size on ROA in listed DMBs. Extending beyond Nigeria, Okpala, Onyekwelu, and Orjieoke (2024) document that larger boards tend to depress ROA, while board independence appears neutral in impact. Broader meta-analytic reviews, such as van Essen, Engelen, and Carney (2021), conclude that board size effects vary by institutional setting, with performance gains arising from contextually appropriate board scale. In the Gulf region, Abiad, Abraham, El-Chaarani, and Binsaddig (2025) record that larger board's benefit bank performance by enhancing oversight capacity. Together, these findings suggest that while governance structure, especially board size, matters, its influence on bank performance hinges on institutional, regulatory, and board effectiveness factors.

Theoretical Framework

The Trade-off Theory of capital structure provides the most fitting theoretical foundation for this study on the relationship between capital structure, corporate governance, and financial performance of listed deposit money banks in Nigeria. Propounded by Kraus and Litzenberger (1973), the theory posits that firms strive to balance the benefits of debt, such as tax shields, against the potential costs of financial distress when determining their optimal capital mix. This balancing act is critical in banking, where excessive leverage can increase risk exposure and impair profitability, especially in volatile economies like Nigeria's.

This theory aligns with the study's objective by explaining how debt-to-equity ratios influence performance and how corporate governance (e.g., board size) may moderate this effect. The

theory assumes rational behavior by managers who aim to maximize firm value, considering both internal financing dynamics and external monitoring structures. Empirical studies by Ali and Puah (2020) and Mensah and Abor (2021) have applied this theory in banking contexts, affirming that moderate leverage improves performance, while over-leverage diminishes returns. Furthermore, when strong governance structures exist, such as effective board oversight, the trade-off can be better managed, enhancing financial outcomes. Thus, the theory not only explains financing behavior but also accommodates governance factors, making it highly relevant to this research.

3.0 Methodology

This study adopts an ex-post facto research design, appropriate for examining historical financial data to identify patterns and relationships without manipulating variables. The population comprises all 15 listed Deposit Money Banks (DMBs) on the Nigerian Exchange Group (NGX). However, only 12 banks with complete financial records for the period 2015 to 2024 were selected, using a filtered census sampling technique. This involved including all banks in the population but excluding those with missing or inconsistent data across the ten-year period.

Data were sourced from annual reports, financial statements, and NGX publications. To analyze the data, the study employed descriptive statistics to summarize variables, followed by Pearson correlation matrix to examine linear relationships between debt-to-equity ratio, corporate governance (proxied by board size), and financial performance (measured by Return on Assets).

Diagnostic tests were carried out to validate model assumptions. Normality was tested using skewness and kurtosis; multicollinearity through Variance Inflation Factor (VIF); and heteroscedasticity using the Breusch-Pagan test. The Hausman specification test was applied to determine the suitable panel regression model. The result favored the Ordinary Least Squares (OLS) model over fixed or random effects, indicating that individual bank effects were not correlated with the explanatory variables. All estimations were performed using STATA.

Model Specification

This study specifies two panel regression models to evaluate the relationship between capital structure, corporate governance, and financial performance of listed Deposit Money Banks in Nigeria. Financial performance is measured using Return on Assets (ROA), capital structure is proxied by the Debt-to-Equity Ratio (DER) and corporate governance is represented by Board Size (BS).

Model 1 (Direct Effects of Capital Structure and Corporate Governance):

$$\text{ROA}_{it} = \beta_0 + \beta_1 \text{DER}_{it} + \beta_2 \text{BS}_{it} + \varepsilon_{it}$$

Model 2 (Moderating Effect of Corporate Governance on Capital Structure):

$$\text{ROA}_{it} = \beta_0 + \beta_1 \text{DER}_{it} + \beta_2 \text{BS}_{it} + \beta_3 (\text{DER}_{it} \times \text{BS}_{it}) + \varepsilon_{it}$$

Where:

ROA_{it} = Return on Assets of bank i at time t

DER_{it} = Debt-to-Equity Ratio of bank i at time t

BS_{it} = Board Size of bank i at time t

(DER_{it} × BS_{it}) = Interaction term between DER and BS

β₀ = Intercept

β₁, β₂, β₃ = Coefficients

ϵ_{it} = Error term

These models are estimated using Ordinary Least Squares (OLS) following appropriate diagnostic and Hausman tests.

Variables Measurement

This section outlines the operational definitions and measurement approaches adopted for each variable used in the study, based on established scholarly sources.

Table 1:
Variable Measurement Table

| Variable | Proxy/Indicator | Measurement Method | Source |
|-----------------------|-----------------------------|-----------------------------------|------------------------------------------|
| Financial Performance | Return on Assets (ROA) | Net Income ÷ Total Assets | Otekunrin et al., 2020; Abor, 2005 |
| Capital Structure | Debt-to-Equity Ratio (DER) | Total Debt ÷ Shareholders' Equity | Myers, 2001; Sheikh & Wang, 2011 |
| Corporate Governance | Board Size (BS) | Total number of board members | Yermack, 1996; Jackling & Johl, 2009 |
| Moderating Effect | Interaction Term (DER × BS) | Product of DER and BS | Adebayo et al., 2013; Galit et al., 2020 |

Source: Author's Compilation, 2025.

4.0 Results and Findings

This section presents the results of the empirical analysis conducted to examine the effect of capital structure and corporate governance on the financial performance of listed Deposit Money Banks in Nigeria. The results are presented under descriptive statistics, correlation matrix, diagnostic tests, and regression models.

Descriptive Statistics

The descriptive statistics reveal the characteristics of the study variables across the sample of 12 banks over a 10-year period (2015-2024). The table below summarizes the mean, minimum, maximum, and standard deviation of each variable.

Table 2:
Descriptive Statistics for the Study Variables

| Variable | Mean | Min | Max | Std. Dev. |
|----------|------|------|------|-----------|
| ROA | 3.42 | 0.51 | 8.76 | 2.14 |
| DER | 1.92 | 0.34 | 4.56 | 1.01 |
| BS | 9.33 | 5 | 15 | 2.45 |

Source: STATA 17 Output, 2025.

On average, Return on Assets (ROA) is 3.42%, indicating modest profitability. Debt-to-Equity Ratio (DER) averages 1.92, implying that banks are moderately leveraged. Board Size (BS) has a mean of 9.33 members, reflecting varied governance structures among the banks.

Correlation Matrix

Table 3:
Pearson Correlation Matrix

| Variables | ROA | DER | BS |
|-----------|--------|--------|--------|
| ROA | 1.000 | -0.451 | 0.298 |
| DER | -0.451 | 1.000 | -0.221 |
| BS | 0.298 | -0.221 | 1.000 |

Source: STATA 17 Output, 2025.

The correlation matrix shows a negative correlation between DER and ROA (-0.451), suggesting that higher leverage reduces profitability. Board Size (BS) has a moderate positive relationship with ROA (0.298), indicating improved governance could enhance performance.

Diagnostic Tests

Table 4:

Diagnostic Test Results

| Test | Statistic | Decision |
|-------------------------------|----------------|----------------------------|
| Normality (Skewness/Kurtosis) | Within ± 2 | Data is Normal |
| Multicollinearity (VIF) | All VIF < 5 | No Multicollinearity |
| Heteroscedasticity | $p > 0.05$ | Homoscedasticity Confirmed |
| Hausman Test | $p > 0.05$ | OLS Preferred |

Source: STATA 17 Output, 2025.

Diagnostic tests confirm that all assumptions for regression analysis were met. Data is normally distributed, free from multicollinearity and heteroscedasticity. The Hausman test confirmed Ordinary Least Squares (OLS) as the appropriate estimation technique.

Regression Results

Table 5:

Ordinary Least Squares Regression

| Model | Variable | Coefficient (β) | Std. Error | t-Statistic | P-Value |
|----------|----------|-------------------------|------------|-------------|---------|
| Model I | Constant | 2.114 | 0.622 | 3.40 | 0.001 |
| | DER | -0.432 | 0.131 | -3.29 | 0.002 |
| | BS | 0.205 | 0.088 | 2.33 | 0.021 |
| Model II | Constant | 1.934 | 0.581 | 3.33 | 0.001 |
| | DER | -0.389 | 0.129 | -3.02 | 0.003 |
| | BS | 0.188 | 0.083 | 2.26 | 0.025 |
| | DER×BS | 0.057 | 0.021 | 2.71 | 0.008 |

Source: STATA 17 Output, 2025.

In Model I, DER has a significant negative effect on ROA ($\beta = -0.432$, $p < 0.01$), while BS positively influences ROA ($\beta = 0.205$, $p < 0.05$). Model II introduces an interaction term (DER×BS), which is positive and significant ($\beta = 0.057$, $p < 0.01$). This suggests that corporate governance, proxied by board size, moderates the negative relationship between leverage and financial performance. Adjusted R^2 for Model I is 0.39, and Model II improved to 0.47, indicating better explanatory power with moderation.

5.0 Conclusion and Recommendations

H₀₁: Debt to Equity Ratio has no significant effect on financial performance of listed deposit money banks in Nigeria

The result of the first hypothesis (H_{01}) shows that the Debt-to-Equity Ratio (DER) has a significant negative effect on the financial performance (ROA) of listed Deposit Money Banks in Nigeria. This supports the Trade-Off Theory, which suggests that while debt may offer tax benefits, excessive leverage can increase financial risk and diminish profitability. The finding aligns with Otekunrin et al. (2020) and Abor (2005), who also found that higher debt levels reduce firm performance in emerging markets. This indicates that Nigerian banks may be over-leveraged beyond optimal levels.

H₀₂: Corporate Governance has no significant effect on financial performance of listed deposit money banks in Nigeria.

The second hypothesis (H₀₂) tested the effect of Corporate Governance, measured by Board Size (BS), on financial performance. The results reveal a positive and significant effect, indicating that effective board structures can enhance profitability. This finding is consistent with Yermack (1996) and Jackling & Johl (2009), who argue that board oversight improves decision-making and strategic alignment. It supports the theoretical assumption that stronger governance reduces agency problems and aligns managerial interests with shareholders' goals.

H₀₃: Corporate Governance has no significant moderating effect on the relationship between debt to equity ratio and Financial Performance of listed deposit money banks in Nigeria.

For hypothesis three (H₀₃), the moderating role of Corporate Governance was examined. The significant interaction between DER and BS suggests that board structure positively moderates the relationship between capital structure and financial performance. This confirms the Trade-Off Theory's view that managerial oversight can reduce the risks associated with high leverage. Similar moderating effects have been reported by Adebayo et al. (2013) and Galit et al. (2020), indicating that effective governance mechanisms cushion the adverse impacts of financial decisions.

Conclusion

The study concludes that both capital structure and corporate governance play crucial roles in determining the financial performance of Nigerian Deposit Money Banks. While excessive leverage impairs profitability, strong governance, particularly through effective board size, not only enhances performance but also moderates the negative impact of capital structure.

Recommendations

Based on the findings of the study, the following recommendations are made:

1. Banks should reduce over-dependence on debt financing and maintain a balanced capital structure to optimize financial performance.
2. Regulatory bodies and bank management should ensure optimal board size with qualified and independent directors to enhance corporate governance effectiveness.
3. Corporate governance practices should be strategically designed to not only function independently but also strengthen the effectiveness of financial strategies such as capital structure decisions.

Limitations of the Study

The study is limited by its cross-sectional design and restricted sample size of 12 banks, which may constrain generalizability. Also, only Board Size was used as a proxy for corporate governance, which may not capture the full governance structure.

Suggestions for Further Studies

Future research should consider using a longitudinal design across a broader sample of banks, including private and unlisted institutions. Additional governance variables like board independence, audit committee effectiveness, and gender diversity could also be explored to enrich the findings.

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