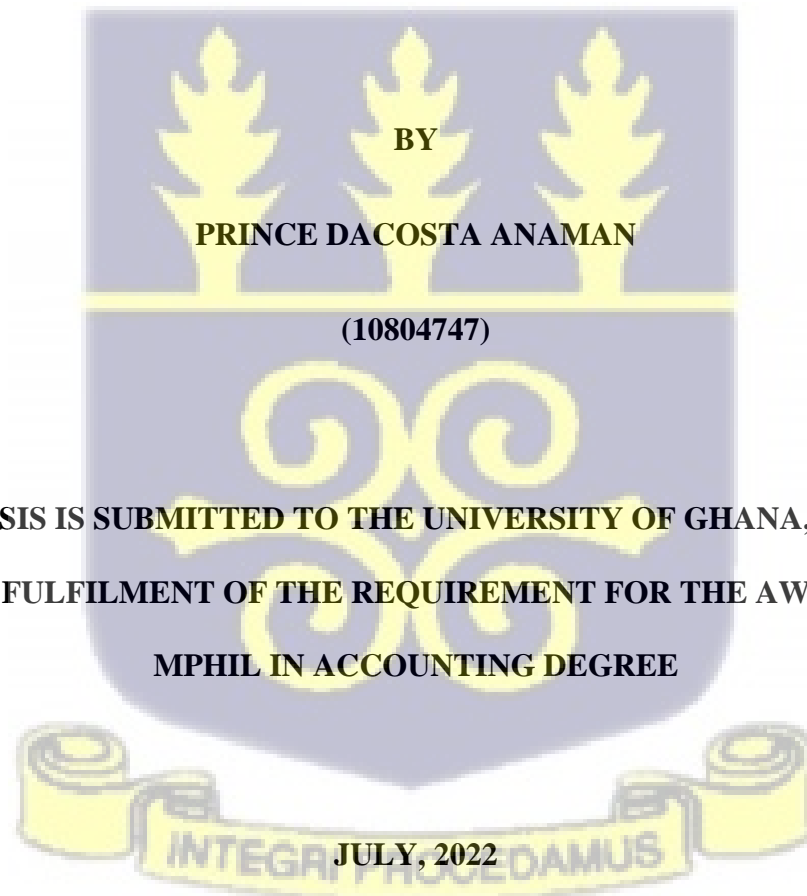


UNIVERSITY OF GHANA

COLLEGE OF HUMANITIES

EQUITY-BASED EXECUTIVE COMPENSATION, AUDIT COMMITTEE


CHARACTERISTICS AND FIRM FINANCIAL PERFORMANCE



**THIS THESIS IS SUBMITTED TO THE UNIVERSITY OF GHANA, LEGON, IN
PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF AN
MPHIL IN ACCOUNTING DEGREE**

DECLARATION

I hereby declare that this thesis is the result of my original research and that no part of it has been presented for another Degree at any University. However, all sources of borrowed material have been duly acknowledged.



8th December, 2023

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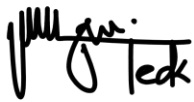
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CERTIFICATION

I hereby certify that this long essay was supervised and coordinated in conformity with the duly laid down procedures of the University of Ghana.



10-12-2023

DR. TEDDY OSSEI KWAKYE

DATE



14/12/2023

DR. EDWARD NARTEY

DATE



DEDICATION

I dedicate this work to my parents John Anaman and Mary Silvah and my Uncle, Mr James Silvah for their massive support of my MPhil program.

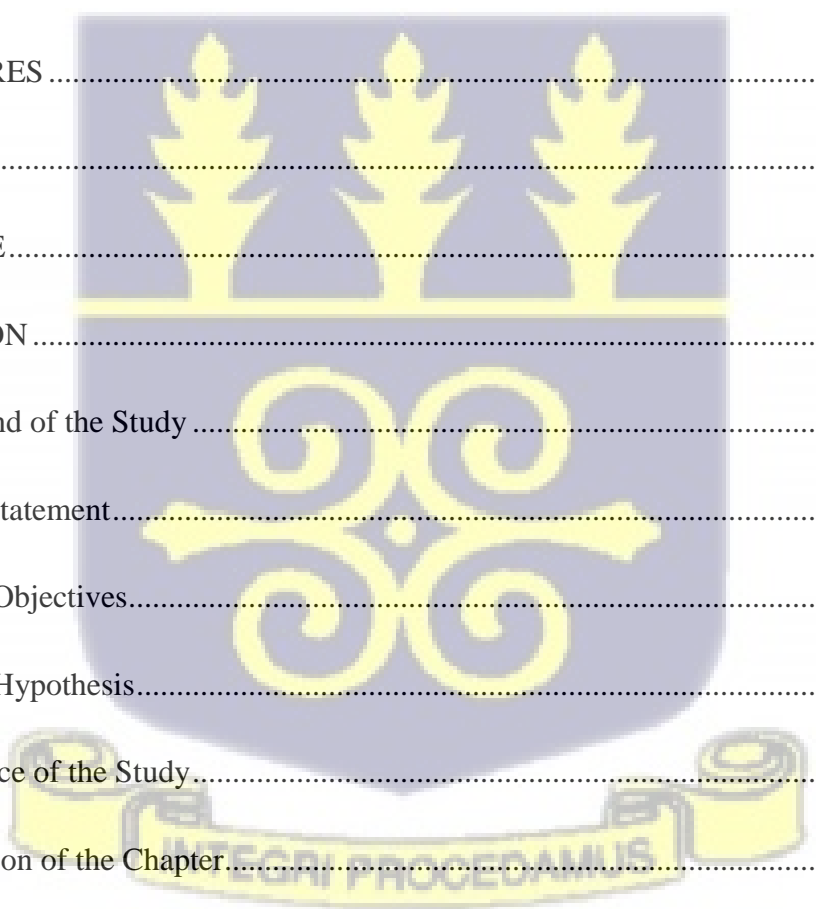


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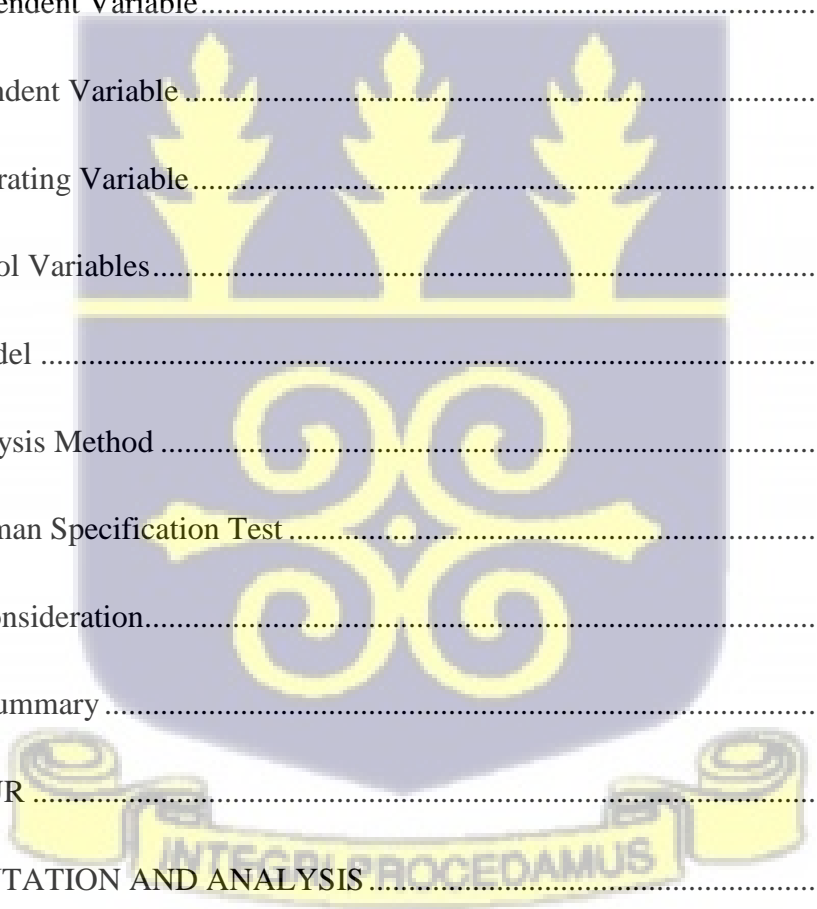
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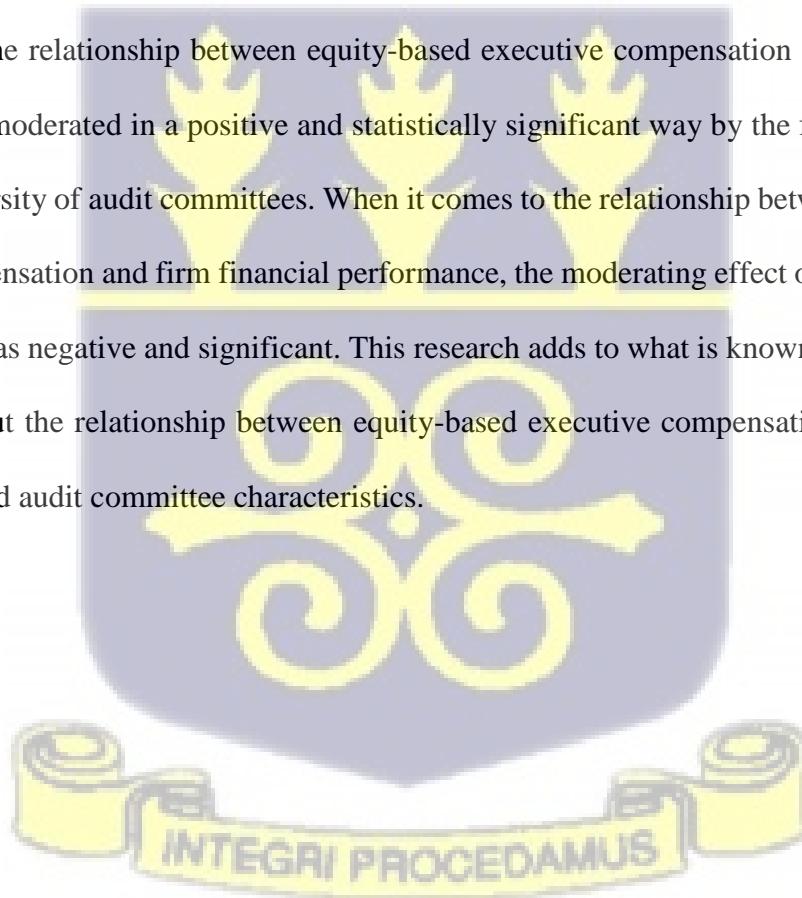
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Figure 1: Conceptual framework of equity-based compensation, firm financial performance and audit committee characteristics. 32



ABSTRACT

This study, guided by agency theory and resource-based theory, analyses the impact of audit committee characteristics on the relationship between equity-based executive compensation and the financial performance of listed non-financial firms in Sub-Saharan African countries. This analysis relies on the financial expertise, gender diversity, and independence of audit committees. Over the research period of 2010-2019, 620 firm-year data were used in a panel regression analysis. According to the results, compensation for executives based on shareholding has a significant and negative impact on the company's profitability. In addition, the qualities of the audit committee employed in this research show a positive correlation to firm financial performance. Another key finding is that the relationship between equity-based executive compensation and firm financial performance is moderated in a positive and statistically significant way by the financial expertise and gender diversity of audit committees. When it comes to the relationship between equity-based executive compensation and firm financial performance, the moderating effect of audit committee independence was negative and significant. This research adds to what is known theoretically and empirically about the relationship between equity-based executive compensation, firm financial performance, and audit committee characteristics.



CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Employee compensation refers to the benefits offered to workers by their employers in exchange for their efforts (Kim & Jang, 2020). Employees are compensated in various ways, including guaranteed salary, variable pay, incentives, and equity-based compensation. Base salary, which includes financial allowances, is the most prevalent type of guaranteed income. Guaranteed income is a set monetary reward paid by an employer, and variable pay is a non-fixed monetary reward provided to an employee based on the employer's discretion (Knepper, 2020). It can also be based on the performance or outcomes achieved by the employee. Khalid and Nawab (2018) assert that employers have instituted all these for employees to be satisfied and work effectively and efficiently.

The term "executive compensation" refers to the cash remuneration and other non-financial incentives that an executive receives from a company in exchange for the services that they offer (Khalid & Nawab, 2018; Knepper, 2020). It is usually a mix of a set remuneration, carefully tailored to the organization's and executive's preferences. Executive compensation is significantly higher than that of hourly workers or salaried managers and professionals (Barde & Zik-Rullahi, 2020). This is because executive compensation is significantly skewed toward rewards for real performance. Consequently, executives' compensation is generally lowered to a proportion of their performance if the company underperforms. Executive compensation is set up in such a way that it rewards firm financial performance while also aligning it with shareholder value (Barde & Zik-

Rullahi, 2020). Thus, in recent times, an executive's compensation is normally tied to the firm's long-term performance through equity-based compensation. This is either a stock or a pseudo stock programme used by employers to grant actual or perceived ownership in the company. Equity-based compensation aims to align executive interests with those of shareholders, ultimately impacting firm financial performance. However, when improperly calibrated, this form of compensation can lead to risky behaviours, which, in turn, can negatively affect the firm's performance (Jensen & Meckling, 1976; John & John, 1993).

Equity-based executive compensation, commonly provided in the form of stock options, restricted stock units (RSUs), and performance shares, plays a crucial role in aligning executives' interests with those of shareholders and the company's overall performance (Beck et al., 2020; Dias et al., 2020). Stock options allow executives to purchase company stock at a set price, incentivizing them to boost the stock's value (Dias et al., 2020). RSUs are company shares with a vesting period, requiring executives to meet certain criteria before gaining full ownership (Beck et al., 2020). Performance shares are awarded based on achieving specific targets, directly tying compensation to company success (Dias et al., 2020). While offering significant rewards and aiding in talent retention, this compensation model can also encourage short-term strategies and is susceptible to market downturns, affecting its value and potentially impacting executive motivation (Abudy et al., 2020; Murphy, 2013).

All employees, including executives and non-executive staff, are working for the same goal. Due to the agency dilemma that exists between CEOs and shareholders, alternative forms of compensation have become required (Jensen & Meckling, 2019). According to Chams and GarcíaBlandó (2019), executives are employed by a company's Board of Directors (BODs) to increase shareholder wealth. However, because of the agency problems that exist in organizations,

Boateng et al. (2017) indicate that executives may behave in their interests rather than that of the investors.

As a result, in an attempt to tackle such challenges, shareholders have devised a variety of strategies to align managers' interests with their own. Some of these strategies include practising full transparency, restricting the agent's capabilities, and providing equity-based executive compensation (Abudy et al., 2020; Shilon, 2018, 2021). Making executives practise full transparency solves the transfer of ownership problem where shareholders do not get to participate in the day-to-day activities of the firm. Thus, if full transparency is practised, shareholders get to know the activities that management engages in and the returns of such activities (Shilon, 2018). Shilon (2018, 2021) further indicates that when the agent (executive) activities are restricted, they will be able to engage in activities that are in the best interest of the shareholders. Executives are incentivized to make choices that will boost the value of the company for the shareholders (Armstrong & Vashishtha, 2012; Chen et al., 2019; Jensen & Meckling, 1976). The granting of equity-based executive compensation has proven to be the most effective solution to the agency problem that has been presented (Abudy et al., 2020; Murphy, 2013).

Shilon (2018, 2021) also asserts that the introduction of equity-based executive compensation has proven to be a successful technique for decreasing the existing agency problem. Since the interests of the management are now more closely aligned with those of the shareholders, this has also brought some relief to the shareholders. According to Murphy (2013), from the mid-1970s until the early 2000s, compensation levels increased and equity incentives tied to management performance also broadened. This indicates the acceptance of equity-based executive compensation as the most practical strategy to solve the agency problem. In addition, Kabir et al. (2013) urged an even more formalised contract which assesses the incentives of the different

parties to address the agency problem. This will help attract managers and motivate and retain them. Moreover, to inspire executives to take action to benefit shareholders, the board must design contracts that link the executive's pay to measurable performance results (Boakye et al., 2020; Pepper, 2019).

However, researchers have indicated that equity-based executive compensation can result in a range of unintended outcomes. For example, equity-based executive compensation may encourage managers to take risky policy decisions (Edmans et al., 2017; Jensen & Meckling, 1976; John & John, 1993). Thus, one problem that arises in the payment of equity-based executive compensation is the riskiness level of the firm. This is because executive compensation in the form of equity is more affected by stock price fluctuations. This helps executives overcome their risk aversion. Studies have shown that executive and executive risk behaviour have a positive relationship (Baixauli-Soler et al., 2015; Chen & Ma, 2011; Gray & Cannella Jr, 1997; Martin et al., 2013; Sanders, 2001). These studies support the assertion that executives' risk-taking behaviour is aroused when equity-based executive compensation is used in aligning the interests of executives and shareholders.

Also, Aman and Nguyen (2013) add that the overarching literature on the reward of executives is that salaries are designed to provide executives with the right incentives to increase shareholder wealth. Jensen and Meckling (1976) suggest that executives are strongly motivated to take on risky investments if their interests (compensation) coincide with the interests of shareholders. They do this because the value of the stock incentives that executives receive grows along with the riskiness of the assets held by the firm (Feng & Rao, 2018). If these risky investments pay off, shareholders and executives will enjoy all of the value gains. However, the firm's performance suffers as a result of these risky endeavours (Ghouma et al., 2018). Therefore, as shareholders are looking to solve

the agency problem, another problem arises, which is the negative effect of the equity-based executive compensation package on the financial performance of firms. The role of corporate governance, specifically the audit committee, is crucial in monitoring and ensuring the financial performance of firms.

Corporate governance mechanisms have been put in place by various firms to check the activities of management and improve the performance of executives. One mechanism is the audit committee. There are many people whose interests need to be protected in a business, and the audit committee is one mechanism for doing so within the corporate governance structure (Al-Amarneh & Yaseen, 2014). Good corporate governance requires the establishment of an audit committee charged with protecting the financial interests of shareholders and other important stakeholders (Abdullatif & Al-Khadash, 2010; Kallamu & Saat, 2015; Yatim, 2009). The primary responsibility of the audit committee is to monitor the company's financial results and check the reliability of the company's financial statements (Abdullatif & Al-Khadash, 2010). An audit committee is in charge of making sure that a company's financial reporting is accurate and of high quality.

In addition to this duty, the audit committee is accountable for the evaluation of the financial reporting and disclosures, keeping tabs on the adoption of new accounting standards, and keeping an eye on the qualifications of the company's external auditors (Al-Shaer & Zaman, 2018). Also, Gebrayel et al. (2018) indicate that, in addition to regulating regulatory compliance, ethics, and whistleblower helplines, the internal control procedure is another area of responsibility for the audit committee. In addition to this, the committee is responsible for monitoring the performance of the internal audit function and holding meetings with management to go through risk management policies and procedures (Ashfaq & Rui, 2019). There are a diversity of roles inside

an organisation that is responsible for identifying and addressing risks that might endanger the business's objectives.

The firm's policies and processes for recognising risks (or opportunities), ranking them in importance, and responding to them are often presented to the audit committee of the corporation. The effectiveness of the internal control system is enhanced by the audit committee's monitoring of risk management operations. Therefore, the oversight of risk management should have a positive connection to the factors that contribute to the effective operation of the audit committee within the context of a well-run company (Kallamu & Saat, 2015; Yatim, 2009). Given that equity-based compensation can drive executives towards riskier decisions, there's a pertinent need to investigate how the characteristics of an audit committee can potentially moderate the relationship between equity-based executive compensation and firm financial performance. In essence, how does a robust audit committee ensure that equity-based compensations are well-balanced and do not lead to undesired corporate behaviors?

1.2 Problem Statement

Executive compensation has long been a focal point in corporate governance studies (Barde & Zik-Rullahi, 2020; Kabir, Li, & Veld-merkoulova, 2013; Khalid & Nawab, 2018). Over the years, these compensation schemes have been strategically crafted to motivate managers and align their interests with the overarching goal of enhancing firm value (Grivas, 2013). Among the diverse components of executive compensation, equity-based compensation have emerged as a prominent mechanism aimed at ensuring this alignment. However, the actual impact of equity-based compensation on firm financial performance remains contested, with researchers presenting a spectrum of findings ranging from strong positive correlations to negligible or even negative associations (Anyigbah et al., 2021; Ozkan, 2011; Villagrasa et al., 2018).

Conversely, there is a segment of research that highlights either a neutral or negative relationship between equity-based compensation and firm financial performance (Anyigbah et al., 2021; Ozkan, 2011; Villagrasa et al., 2018). This is because the shareholders' and managers' interests are aligned and, as such, managers will like to take on investments that will help grow the value of the firm. The risk level of such investments is normally very high. Thus, when these high investments succeed, the shareholders, as well as the executives of the firm, enjoy the benefits. In a similar vein, if these high-risk investments are unsuccessful, the value of the company will suffer and fall over time (Edmans et al., 2017).

Several academics in a variety of settings have looked at the connection that exists between the equity-based executive compensation and firm financial performance. The relationship has shown mixed outcomes, with various patterns appearing in different industries and cultures. For example, the studies of Basu et al. (2007) and Raithatha and Komera (2016) show a positive and significant relationship between equity-based executive compensation and the financial performance of firms. Chen and Jermias (2014) also discovered an unfavourable and statistically significant relationship between CEO pay in equity and company output, whilst Sheikh et al. (2018) and Ozkan (2011) revealed a negative but insignificant link between the equity-based executive compensation and the financial performance of firms.

While studies globally have traversed the landscape of equity-based compensation, research specifically within the African context exhibits inconclusive results. According to the findings of a study conducted by Kurawa and Kabiru (2014) in Nigerian banks, there is a positive correlation between equity-based executive compensation and firm financial performance. Additionally, Anyigbah et al. (2021) investigated the Ghanaian banking industry and discovered that there is a negative relationship between equity-based executive compensation and firm financial

performance. Rasoava (2019) conducted research in South Africa and found that there was no significant correlation between the pay of executives in equity and the financial performance of their companies. According to the findings of Amewu and Alagidede's (2020) research, there is an inverse connection between equity-based executive compensation and the financial performance of the company. Since the conclusions drawn from the previous research are not entirely clear, it would be beneficial to conduct additional studies on the topic of the connection between equity-based executive compensation and the financial performance of businesses in Africa.

While the existing literature extensively explores the impact of equity-based executive compensation on firm financial performance, there is a notable gap in understanding how the characteristics of audit committees might influence this relationship. The audit committee plays a pivotal role in overseeing financial reporting and risk management, which are essential elements in the execution and outcomes of equity-based compensation strategies. Their oversight is particularly critical in ensuring that the incentives provided by such compensation align with the long-term interests of the company and its stakeholders. The characteristics of audit committees, such as financial expertise, gender diversity, and independence, are hypothesized to have a significant moderating effect on the relationship between equity-based executive compensation and firm financial performance. Financial expertise within the committee can provide more effective oversight of the risks associated with equity-based compensation plans, potentially influencing executive decision-making towards sustainable firm growth. Similarly, gender diversity in the audit committee may bring diverse perspectives that could shape more balanced and effective compensation strategies. The independence of the committee ensures unbiased governance, crucial for aligning equity-based executive compensation with the company's long-term performance goals.

Given that most existing literature targets financial firms, it becomes imperative to explore equity-based compensation in non-financial firms (Anyigbah et al., 2021; Kurawa & Kabiru, 2014; Omoregie & Kelikume, 2017). A study on non-financial firms is done because the nature and activities of financial and non-financial firms are different (Omoregie & Kelikume, 2017). According to Kurawa and Kabiru (2014), financial institutions are highly leveraged firms that conduct business mainly by facilitating leverage for others. This is because these financial institutions operate by taking loans (from depositors) and give them out to others at a higher interest rate. As a result, an equity-based executive compensation structure that is optimally designed in a financial institution will not only align the interests of managers to that of shareholders but will also signal to other stakeholders (depositors) the incentive structures that are underlying the risk choices that are being made by executives of the firm (Kose & Yiming, 2003). Therefore, the ideal equity-based executive compensation structure in financial organisations will have lower equity-based executive compensation than in non-financial firms to match the interests of executives with those of shareholders and depositors (Kose & Yiming, 2003; Kurawa & Kabiru, 2014).

This study aims to fill the existing research gap by examining the moderating role of audit committee characteristics in the specific context of equity-based executive compensation in nonfinancial firms. Given the distinct nature and operational dynamics of non-financial firms compared to financial institutions, understanding how audit committee features influence the efficacy of equity-based compensation strategies becomes imperative. This is particularly relevant in the African context, where corporate governance structures and their impacts might exhibit unique patterns and implications.

Firm financial performance is intrinsically linked with corporate governance. Central to this discussion is the role of the audit committee (Basu et al., 2007; Kurawa & Kabiru, 2014). In the context of corporate governance, the major responsibility of the audit committee is to oversee and monitor the process of financial reporting. This duty includes the examination of financial statements, as well as internal audit procedures and risk management policies (Chaudhry et al., 2020). The functions performed by the audit committee, directly and indirectly, affect the performance of firms. Basu et al. (2007) argue that agency problems become greater when an organization has weak corporate governance structures. Firms with greater agency problems have also been found to have worse firm financial performance (Fuji et al., 2016; Gaur et al., 2015). In addition, Gebrayel et al. (2018) state that the primary objective of an audit committee is to improve a company's performance and competitiveness by supervising the company's financial reporting, report review, internal accounting controls, audit process, and risk management systems. Therefore, one may make the case that the features of the audit committee have a direct impact on the performance of companies (Basu et al., 2007; Gebrayel et al., 2018; Ghafran & O'Sullivan, 2013; Rupley et al., 2017). As a result, the purpose of this research is to investigate the connection that exists between the composition of a company's audit committee and its performance in the different stock markets that are located in Ghana, Nigeria, and South Africa.

To address the gap in the existing body of literature and in response to the inconclusive nature of previous studies, this research endeavours to examine a connection that, as far as the existing research is concerned, is inconclusive. This study provides more evidence that there is a correlation between the features of audit committees and the performance of companies, which the existing research indicates to have a positive influence. Therefore, the existence of audit committees in businesses contributes to increases in company performance as well as an increase in

competitiveness (Gebrayel et al. 2018). Equity-based compensation available to executives of an organization increases their risk-taking activities. Alzharani and Aljaaidi (2015) indicate that an audit committee in an organisation regulates managers' risk-taking behaviours. Even though this function is not the audit committee's major responsibility in some companies (with the introduction of risk committees in some companies), they help regulate the risk in businesses (Jiang & Kim, 2020; Kolev et al., 2019). Therefore, it can be argued that equity-based executive compensation has an impact on the performance of firms but this impact depends on the audit committee in an organization. Thus, this study examines the moderating role of audit committee characteristics on the relationship between equity-based executive compensation and the firm financial performance.

1.3 Research Objectives

The primary purpose of the research is to investigate the role of audit committees in the relationship between equity-based executive compensation and the financial performance of non-financial firms.

Specifically, this study seeks to;

1. Examine the relationship between equity-based executive compensation and firm financial performance
2. Examine the moderating role of audit committee characteristics on the relationship between equity-based executive compensation and firm financial performance

1.4 Research Hypothesis

The following hypothesis has been formulated.



H1: There exists a negative relationship between equity-based executive compensation and firm financial performance

H2a: Financial expertise of audit committees positively moderates the negative relationship between equity-based executive compensation and firm financial performance

H2b: Gender diversity of audit committees positively moderates the negative relationship between equity-based executive compensation and firm financial performance

H2c: Independence of audit committees positively moderates the negative relationship between equity-based executive compensation and firm financial performance

1.5 Significance of the Study

Relevance to policy, practice, and the academic community is demonstrated by the study. First, this research will help clarify the factors that influence managers' remuneration, which is useful information for formulating efficient rules and policies. Therefore, shareholders will be able to find the best way to make the management of their company work in their interest to improve the performance of the firm. Also, policymakers will be able to take insights from this study and put out policies that will help reduce the risk-taking behaviours of managers in an organization. For example, policies on the number and group of people in an audit committee, the required experts and gender diversity to enable a balanced committee. This study will also help shed light on the connection between pay for executives, business performance, and the structure of the audit committee. This study will provide insight into the importance of corporate governance mechanisms like audit committees. Since this study is one of the first studies to be on the relationship between the three variables, future researchers will be able to use it as a reference to conduct other studies on this topic under study.

1.6 Organization of the Chapter

The content of this study consists of the following five chapters: The research will be covered in the first chapter, which will cover the background of the study, the problem statement, the objectives, and the hypotheses that are associated with the research. This chapter also contains information on the relevance of the study and its structure. The review of the relevant literature is discussed in chapter two. The many different theories, as well as an empirical and conceptual evaluation of the subject matter that is the focus of the current research, are all taken into consideration. The methodology that was used for the study is discussed in chapter three of the paper. In chapter four, the findings and discussion are provided, and in chapter five, a summary, conclusion, and recommendation for the study are made, along with suggestions for future research.

1.7 Chapter Summary

The purpose of this chapter was to provide an overview of the research activity. In this part of the report, we discussed the background of the study, the specifics of the issue, and the main goal of the research. In addition to this, the chapter emphasised how important the inquiry and the overall study concept were. This chapter argues that more investigation into the influence of audit committee features as a moderator of the link between equity-based executive compensation and firm financial performance is warranted and provides supporting evidence.



CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Introduction

In this section of the study, a wide variety of previous research on the subject is examined. This chapter presents some expositions on the research's keywords and also includes some empirical findings. It discusses the theoretical framework of the investigation. The chapter also brings to light knowledge of the keywords of the study, including compensation, firm financial performance, and audit committee characteristics.

2.2 Compensation

The term "compensation" refers to any payment that an employer makes to an employee while that employee is working for that employer (Madhani, 2019). This could include a base salary, commissions, and incentives dependent on meeting certain standards of achievement (Khalid & Nawab, 2018; Kim & Jang, 2020). According to Haralayya (2022), successful compensation plans consist of three elements which include; clearly stated goals, a well-defined relationship to company objectives and well-designed compensation and reward programmes. The compensation of employees may take the form of financial as well as non-financial benefits. Financial compensation an employee receives may be in the form of cash, such as hourly pay, salary, bonus, or commission (Barde & Zik-Rullahi, 2020). According to Mahathir et al. (2020), nonfinancial compensation may include fringe benefits; physically, socially, and intellectually healthy work environments, etc. In this thesis, the focus is on equity-based executive compensation. First, the study will take a look at what executive compensation is, the components, then move on to equity-based executive compensation.

2.2.2 Executive Compensation

Executive compensation, often known as executive pay, is a type of remuneration that is set aside for a company's top executives, managers, and other high-ranking personnel (Beck et al., 2020). Salary, bonus, incentive, and insurance coverage are just a few of the many components that make up an executive's total pay package. Since executives are the ones that formulate business plans, make significant choices, and so on, they play an essential part in the operation of the organisation. It is crucial to design the appropriate benefits package to maintain their motivation and ensure their satisfaction (Dias et al., 2020). This form of remuneration is negotiated between the prospective executive and the employer, and it may go against the organization's rules about the salary given to normal employees.

There are various forms of compensation that can be given to executives. Some of these forms of compensation given to executives of a firm include; basic salary, incentive bonus, stock option, deferred compensation and perquisites (Dias et al., 2020). The basic salary includes the taxable yearly wage given to executives of firms. Also, it is on top of this basic income that other kinds of financial incentives and supplements are offered to executives to motivate them. Incentive bonuses are cash bonuses that are awarded at the end of the year as a reward for short-term achievement and are often reserved for executives (Beck et al., 2020; Dias et al., 2020). The fund that is used to pay bonuses is a predefined portion of the company's overall profits. The amount that is given to each executive depends on his/her degree of performance in addition to his/her current compensation.

Another form of compensation that can be given to executives is the stock option. The availability of stock options is one of the most critical components of executive compensation (Lovett et al.,

2022; Murphy, 2013). Executives who engage in stock option programmes are provided with the chance to purchase shares of a company's stock at a defined price and period. The executive might exercise the option, which would include purchasing shares at the option's set price. This would result in a big profit for the executive (Lovett et al., 2022). If the shares' actual market value increases significantly beyond the option price, the executive may decide to execute the option. Deferred compensation can be given to executives to also motivate them (Scheetz, 2021). A pension supplement or a bonus, which may be paid out in cash or shares, is one of the forms that deferred compensation can take. It is paid after retirement when the recipient's income would be smaller. Perquisites are benefits that are offered to executives and form part of the components of executive compensation. Free medical care, access to educational institutions, corporate vehicles and drivers, and other luxuries are some examples of the perquisites or fringe benefits that executives often receive in their positions (Lovett et al., 2022). In most businesses, the value of benefits and perks represents a sizeable portion of total personnel expenses.

2.2.4 Equity-Based Executive Compensation

The majority of the remuneration included in most executive pay packages takes the form of equity (Benischke et al., 2019; Lovett et al., 2022). This equity often takes the form of company stock or a type of business stock that is derived from company stock. The value of a stock reward is directly related to how well a company's stock price performs, making equity compensation a powerful incentive for employees. This is because the value of the reward is directly tied to the success of the share price (Dias et al., 2020). The value of the executive's stock will increase in proportion to the growth in the overall worth of the firm. This will serve as an incentive for the executive to work toward the growth of the company's success and market value. There are four basic varieties of equity that are employed in the compensation of executive staff members.

2.2.4.1 Stock Options

The holder of a stock option has the privilege of, for a predetermined amount of time (often ten years), purchasing one share of the company's stock at a predetermined price (Lovett et al., 2022; Murphy, 2013). The share price of the firm on the day the options are granted is frequently used to determine the exercise price. The executive will be rewarded for his contribution to the firm's success, and the value of the options will increase if the stock price rises above the price at which they may be exercised if the company is successful (Murphy, 2013). Before such options vest, or become eligible to be exercised, there is often a waiting period during which they cannot be put to use. This period typically ranges from one to five years.

2.2.4.2 Restricted Stock

Shares of a company's stock that have been issued as a form of compensation but which the recipient is not permitted to sell until a predetermined vesting schedule has been fulfilled are referred to as restricted stock (Lovett et al., 2022). Even though owners of restricted stock cannot sell their shares until the vesting schedule has been fully completed, they are still entitled to all of the other benefits that come along with stock ownership, such as voting rights and dividends. The stock is deemed forfeited if the executive leaves the firm before it vests (Johannesson & Kim, 2021). On the day of vesting, any amount of restricted stock that was received is subject to taxation based on the closing market value of the stock price.

2.2.4.3 Restricted Stock Units (RSUs)

Restricted stock units are a kind of remuneration that operates in a manner analogous to that of restricted stock. When compared with restricted stock, Restricted Stock Units (RSUs) represent an employer's promise to pay an employee a predetermined number of company shares upon completion of a vesting schedule (Scheetz, 2021). RSUs also provide several significant benefits

over restricted stocks. To begin with, executives can issue RSUs without having a negative impact on the share base. Second, there are no real shares that need to be issued, held, recorded, or tracked, which means that the administrative expenses of the corporation that is granting the RSUs are often reduced (Lovett et al., 2022). And finally, RSUs can make tax deferrals simpler by simply deferring the issuing of actual shares over a period. Owners of RSUs do not have any of the rights that come along with stock ownership because RSUs only reflect a promise of future shares.

2.2.4.4 Performance Shares

These are shares of the company's stock that are granted throughout a performance term if certain performance metrics are met. Performance conditions and market circumstances are the two categories of measurements that may be used to assess performance (Xie et al., 2022). The term "performance conditions" refers to monetary objectives such as earnings-per-share or return-on equity ratios. In contrast, market conditions compare the firm's performance to that of the market or a portion of the market (Scheetz, 2021). The normal length of a performance period is three years. However, grants are frequently awarded on an almost yearly basis, which might result in performance periods that overlap. Different accounting treatments are applied to performance shares depending on whether or not they are settled in cash or stock, as well as whether or not they are tied to a market condition or a performance requirement (Lovett et al., 2022).

2.2.5 Executive Compensation and Risk-Taking

In the years that led up to the global financial crisis, there was a meteoric rise in the number of companies that compensated their executives with equity in the form of shares of the company's stock and options to purchase shares of that stock (Hilscher et al., 2021; Kabir, Li, & VeldMerkoulova, 2013). This was due to the fact that Jensen and Meckling (1976) said that the interaction between shareholders and executives is one of the agencies. Executives of companies

are hired to oversee the operations of the company on behalf of their owners. Yet, the activities of executives are not always completely transparent. As a result of this conflict of interest, compensation packages have been put in place to resolve the agency issue. As a result of these pay packages, shareholders' and executives' interests are more closely linked (Kabir et al., 2013). However, Bebchuk et al. (2010) argue that executives whose compensation is aligned with shareholders through equity-based arrangements have an incentive to engage in risky activities that go beyond what is considered efficient. This is because these executives do not suffer the losses that this risk-taking behaviour has on the firm. Therefore, executive remuneration could encourage an unhealthy level of risk-taking.

According to Bhagat et al. (2014), there is a positive correlation between CEO equity-based remuneration and risk, which lends credence to what they refer to as managerial incentives. The assumption contends that executives would engage in unreasonably high levels of risk-taking if they were incentivized to do so by a managerial pay programme. Management of companies would stand to gain from this excessive risk-taking, but long-term shareholders would suffer as a result. The net present value of the projects that resulted in an unacceptable level of risk-taking was negative. According to Bolton et al. (2015), excessive risk-taking has resulted from executive compensation plans that give incentives to maximise shareholders' wealth. This phenomenon is especially prevalent in organisations that use leverage. Because banks are heavily leveraged and pay in banks does not represent the interests of all of the various parties involved, the problem of risk-taking is especially pressing in the banking industry.

2.3 Firm Financial Performance

In the vast majority of accounting studies, the performance of the company has been used in the role of the dependent variable. These studies have been conducted to determine the influence that

one variable has on the amount of revenue that is generated by companies. Even though it is a highly popular idea in academic literature, there is very little agreement over its definition of it or how it should be measured. However, because there isn't a single operational definition of company performance that the vast majority of academics can agree on, different people have different interpretations of what it means, and they suggest these interpretations based on their perceptions (Liu et al., 2015; Simionescu et al., 2021). The notion can be defined in a variety of ways, including being abstract, generic, less specific, or clearly defined.

In the 1950s, the performance of a company was often regarded as similar to an organization's efficiency (Simionescu et al., 2021). This shows how well a social structure with limited resources and procedures may achieve its goals without overworking its members. According to Georgopoulos and Tannenbaum (1957), the factors that are considered when evaluating an organization's level of performance are its levels of productivity, adaptability, and interorganizational conflicts. In the 1960s and 1970s, companies looked into developing innovative methods to assess employee performance. Performance was also defined as an organization's ability to take advantage of its surroundings by using the resources available to it (Yuchtman & Seashore, 1967). When compared to the work of other researchers working during the same period, Warmington et al. (1977) handled the concept of organisational performance most meticulously and understandably. According to Warmington et al. (1977), an efficient organisation has a high rate of production as well as high levels of motivation and satisfaction among its members, while also having low or non-existent rates of employee turnover, costs, and labour unrest.

In the decade that followed, Adam (1994) proposed that the performance of an organisation was heavily dependent on the quality of the performance of its people. According to him, to ensure a

high level of organisational performance, corporate employees must be regularly exposed to fresh and current information and skills. This, in turn, would enable them to stay up with the market's new developments, resulting in an improvement in the organization's overall performance.

Organizational performance in the first decade of the 21st century is mostly centred on an organization's skill and proficiency in making efficient use of its resources to produce results. These achievements were compatible with the goals that had been set for the firm, while also considering the relevance of such accomplishments to the users of the organisation (Peterson et al., 2003). According to Melville et al. (2004), an organization's overall competitiveness, efficiency, and effectiveness are enhanced by its performance because of the knowledge and skills gained in the fields of management, economics, and marketing. According to Stanciu et al. (2019), the definition of performance ought to be accomplished using things like piloting, assessment, efficiency, effectiveness, and quality.

2.3.1 Using Accounting Measures to Evaluate Firm Financial Performance

When evaluating a company's performance, the use of accounting income indicators is justified because these metrics provide the most accurate information that is currently available (Huang, 2021). Accounting measures were regarded to be apparent metrics that produce a stronger predictor of business performance (Van Beurden & Gössling, 2008), which also indicates that accounting measures were examined. Investors can easily evaluate potential investment possibilities when accounting information detailing a company's profitability is made regularly available (Gentry & Shen, 2010). Two different accounting methods have been extensively used for evaluating the success of businesses. They include return on assets (RoA) and return on equity (RoE).

2.3.1.1 Return on Assets (RoA)

The return on assets (RoA) ratio is a form of statistic that may be used to quantify the profitability of a company in relation to the total assets that it possesses. This ratio compares a company's profit before interest and taxes (which is also known as net income) to the amount of capital that the company has invested in its assets, and the result indicates how well the company is doing overall (Gentry & Shen, 2010; Heikal et al., 2014). Financial analysts use ROA to analyse a company's operating performance relative to its investments without considering how the investments were financed. The greater the return, the greater the management's productivity and effectiveness in utilising existing financial resources. The ROA formula is:

$$ROA = \frac{\text{Net Income}}{\text{Average Assets}} * 100\%$$

2.3.1.2 Return on Equity (ROE)

Return on equity is the amount of profit that a company is able to make for its shareholders by utilising the money that the shareholders have contributed to the firm. This profit is generated using the money that the shareholders have invested in the company. To put it another way, it is the ratio of a company's annual return (net income), expressed as a percentage, to the value of the company's total shareholders' equity (Gentry & Shen, 2010). To put it another way, it determines how much of a return on investment was achieved for each dollar contributed by shareholders. It reveals whether the management was successful or unsuccessful in maximising the return on investment for the company's owners depending on the investments they made in the company (Heikal et al., 2014). The formula for ROE is:

$$ROE = \frac{\text{Net Income (annual)}}{\text{Shareholders' Equity}} * 100\%$$

When compared to the norm for the industry, a company's return on equity (ROE) can provide insight into the nature of the company's competitive edge (Pointer & Khoi, 2019). A return on equity (ROE) that has been steadily growing over time is one indicator that a company is good at producing shareholder value. This is because the company understands how to intelligently reinvest its earnings to boost both its productivity and its profitability. On the other hand, a consistent decrease in ROE may imply that management made bad choices about the reinvestment of money in initiatives that did not produce a return on investment (Heikal et al., 2014). However, ROE does not indicate to the owners whether the business is increasing the wealth of its shareholders or decreasing it.

2.3.2 Using a Market-Based Approach to Evaluate Firm Financial Performance

In a practical sense, since there is a growing lack of faith in the accounting data provided by companies, it has been advised that investors use market indications as a basis for their decision making (Al-matari et al., 2014; Gentry & Shen, 2010). More and more businesses in the modern day tend to base the salaries of their managers on market indicators that maximise the value of the shareholders. The fact that the market value-base includes information from the market about the company's prospects and that this information can be analysed right now is a significant advantage of using a market value-base (Gentry & Shen, 2010). In addition, the information derived from market value offers compelling evidence and important viewpoints on the factors that contribute to profitability. The Q ratio, often known as Tobin's Q ratio, is the most generally used and accepted market value measure of profit. Tobin's Q ratio measures the relationship between the market value of a physical item and its replacement value. James Tobin, the winner of the Nobel

Prize in Economics, was the one who came up with the ratio (Tobin, 1978). Tobin proposed that the overall market value of all enterprises trading on a stock exchange should roughly match their total replacement costs. The formula for the Q Ratio is:

$$\text{Tobin's } Q = \frac{\text{Total market value of firm}}{\text{Total asset value of firm}}$$

2.4 Audit Committees

The board of directors of a company will often delegate important operational tasks to a number of committees, one of which is the audit committee. The primary responsibility of the audit committee is to verify the accuracy of the reported financial data and maintain transparency (Al Amarneh & Yaseen, 2014). When it is decided that accounting practices are problematic or doubtful, or when major staff difficulties occur, the committee can launch special investigations. This authority also extends to cases in which it is determined that accounting practices should be investigated. Financial reporting, accounting processes, external auditors, compliance with regulations, and risk management policy discussion with management are all under the purview of the audit committee (Abdullatif & Al-Khadash, 2010; Kallamu & Saat, 2015). Stakeholders place a high value on the job of the audit committee because of the potential for improved market performance brought about by higher quality disclosed financial reporting (Yatim, 2009).

The role of the audit committee has evolved from that of a temporary monitoring mechanism used in high-agency-cost situations to that of a permanent member of the board to improve the quality of the information that is disseminated to shareholders. This was done to make the audit committee a permanent member of the board. This procedure started with the establishment of the audit committee's function (Kallamu & Saat, 2015). It is now an essential part of the duty of supervision and the subject of rising interest from both the public and the regulatory bodies. In addition,

Poznanić (2011) says that in addition to its supervision responsibilities, the monitoring and evaluation of the disclosure of different risks often falls within the purview of an audit committee. This responsibility falls under the category of oversight responsibilities.

2.4.1 Characteristics of Audit Committees

The characteristics of audit committees used in this research are discussed in this section.

2.4.1.1 Financial Expertise

The success of the company might be affected by the audit committee's financial skills. Education and practical experience are both necessary components of financial knowledge. According to the UK Corporate Governance Code, "the board should satisfy itself that at least one member of the AC has recent and appropriate financial experience." According to Krishnan and Visvanathan (2008), the presence of accounting knowledge inside boards is indicative of sound governance and contributes to a better degree of monitoring by the audit committee. In addition, Giacomino et al. (2009) suggest that merely having experience in the field is not necessarily enough to qualify as having financial knowledge. Becoming an expert in finances requires a combination of practical experience and academic study. According to the research that has already been conducted, there is a strong correlation between the background of the head of the audit committee and the quality of the working relationship that exists between that chair and the chief financial officer of the organisation.

2.4.1.2 Gender Diversity

The presence of a female member of the Audit Committee and the gender diversity of the committee as a whole affects the variety of business choices that are considered and pursued by organisations (Thiruvadi & Huang, 2011). Women, by their nature, tend to avoid taking

unnecessary risks due to innate characteristics that make them more conservative in financial matters (Velte, 2018). In addition to this, it is more likely to be impartial in terms of judgements and behaviour (Thiruvadi, 2012). Several studies have been undertaken to evaluate the influence that having a diverse set of persons serving on the Audit Committee has on the overall quality of the financial reports. According to the findings of this research, the presence of women is favourably connected with the quality of financial reports (Kamarudin et al., 2014; Pucheta Martínez & De Fuentes, 2007).

Other research has looked into whether or not there is a correlation between the number of women who serve on a board of directors or an audit committee and the level of professionalism exhibited by the auditor in the report that is prepared. The findings of the study lead the researchers to the conclusion that there is a favourable correlation between gender diversity and the quality of the auditor's report (Aldamen et al., 2016; Ittonen et al., 2010; Velte, 2018). In addition, Thiruvadi and Huang (2011) evaluated the impact of having a woman serve as the chairperson of the Audit Committee and found that it had a positive influence on profits management. The findings of the study indicate that the presence of a woman in the capacity of the chairperson of the audit committee would set constraints on the practices of earnings management techniques.

2.4.1.3 Independence

The independence of audit committees is also another characteristic of the audit board that can affect its decision-making. An audit committee made up of more non-executives leads to the independence of the committee (Khudhair et al., 2019). Therefore, it is expected that an audit committee will have more non-executive members than executive members. If there are a greater number of executive members on an audit committee than there are non-executive members, the committee is more likely to make decisions or take measures that will be to the management's

advantage (Rahman & Ali, 2006). As a result of the audit committee's role as an oversight body for the company, its membership should consist of a greater proportion of individuals who are not executive members.

2.5 Theoretical Review

This study will rely on the agency theory and the resource dependency theory. Thus, these theories are discussed under this subheading in this section of the study.

2.5.1 Agency Theory

This is a theory that explains how owners and management interact. The theory aims at explaining organisational behaviour worldwide by emphasising the relationship between the manager as the "agent" and the shareholder as the "principal." To analyse leadership behaviour in large private and public firms, researchers have increasingly used this theoretical perspective (Roberts, 2005). The Agency Theory focuses on employees and their behaviour in their work environment, as is the case for most organizations. Given its economic roots, the theory suggests that actors that function in an organisation have a logic of utility maximisation and are looking for the best interest, even if it may not be in the organization's best interest (Lan & Heracleous, 2010).

According to Jensen and Meckling (1976), an agency relationship is an agreement in which one or more people (the principal) hire a third person (the agent) to supply the agent with some of the principal's decision-making skills. The agent then supplies the principal with some of the principal's decision-making skills. In a situation in which the agent's interests and those of the principal do not align, the relationship between the agent and the principal might become difficult. Two behavioural assumptions underlie the agency theory. The first assumes that people are trying to maximise their utility, and the second assumes that the incompleteness of contracts will probably

benefit people (Bosse & Phillips, 2016; Cohen & Holder-Webb, 2006). Sappington (1991) agrees that agency ties are generally more complex than contractual, in particular in the field of ethics.

To be more specific, in the sense that the agent is obligated to look out for the principal's best interests at all times.

An overwhelming majority of people who considered the management of new businesses agreed that enterprises should be managed by expert managers (Zogning, 2017). The shareholder must function as a required counterweight to prevent managerial discretion from being limitless. The principal does not take any action to control or define the agent's strategy but instead intervenes to ensure that the agent is acting by the contract (Zogning, 2017). The principle is unable to ensure that the agent will make the most advantageous decisions for him without incurring additional expenses. Both supervision and obligation costs must be borne by the principal and agent. The costs of the agency occur when there is suspicion between the two parties. The costs include the cost of monitoring borne by the principal to limit the agent's opportunist attitudes and behaviour and incentive costs incurred by the principal to direct the agent's conduct (Bosse & Phillips, 2016; Jensen & Meckling, 1976; Zogning, 2017). In addition, the expenses that the agent must bear in the form of responsibilities or obligations to gain the principal's confidence. Then there is another cost which involves the usefulness loss suffered by the principal after the divergence of interest with the agency. This is like the costs borne by the principal following the disadvantageous management by the agent of the principal's interests. This cost is known as the residual cost. It is therefore essential to create leverage at the level of corporate governance to align parties' interests.

This theory is not devoid of any limitations. The idea presupposes that actors are indifferent to one another and motivated solely by their self-interest, and that the market has no impact on the

strength of social bonds (Panda & Leepsa, 2017). Furthermore, it assumes the conduct of individual financial interests is solely motivated and that cooperation refers to a contract between the parties. The manager's action, like all social actions, is not fully determined by economic incentives and asymmetries as it is based on progressive social structures (Nyberg et al., 2010). The depiction of people and organisations mainly driven by financial gains in the agency's theory, therefore, appears unlikely (Lawter et al., 2015). Individuals, according to their behavioural studies, are motivated by their position, community, and self-fulfilment needs.

The agency theory presupposes in actual life that conduct and consequences are generally consistent and straightforward to manage. Lan and Heracleous (2010) state that being alert for opportunistic conduct can impede company initiatives, creativity, entrepreneurship, and innovation. Workers can be co-opted and work unintentionally to promote the goals of the organization. The connection between managers and owners may be based on a similar premise (Lan & Heracleous, 2010). This study uses Agency Theory to examine the association between the compensation of executives that is based on equity and business financial performance, while also considering the moderating influence of audit committee characteristics. It examines the principal-agent dilemma and emphasises the role of stock compensation in aligning the interests of executives with those of shareholders. Audit committees play a crucial role in corporate governance as they are responsible for overseeing financial reporting and risk management. These areas are particularly susceptible to agency conflicts. The efficacy of individuals is substantially influenced by their attributes, including financial knowledge, gender diversity, and independence. Financially informed members better comprehend and oversee equity-based compensation, eliminating information asymmetry. The inclusion of individuals with diverse gender identities in committees contribute to the enhancement of supervision over equity-

based executive compensation by including a wide range of opinions. Independent members of a board of directors offer impartial oversight, ensuring that compensation is in line with the interests of shareholders. By incorporating these elements of Agency Theory, it becomes possible to examine the direct influence of equity-based compensation on the performance of firms, as well as the manner in which audit committee characteristics moderate this association. This aligns with the theory's emphasis on governance structures as a means of reducing agency conflicts and enhance firm financial performance.

2.5.2 Resource-Based Theory

The concept of the "Resource Dependence Perspective" became extensively recognised in the Anglo-American conversation after Jeffrey Pfeffer and Gerald Salancik's (1978) book "The External Control of Organizations" (Salancik & Pfeffer, 1978). According to Ingley and Van der Walt (2001), the term "resource" refers to a connection to a nation's elite, industrial intelligence, rivals, market, or money. The Resource Dependence Theory is founded on the supposition that the functioning of organisations is dependent on "essential" and "crucial" resources, and that the decisions and actions of organisations may be described based on the specific situation of being dependent (Pfeffer & Salancik, 2003). According to Pettigrew (1992), the resource dependency theory is created by merging sociological and management ideas. This theory centres on the efforts of the Board of Directors to develop acceptable external links to expand the company, and it is predicated on the idea of co-optation, which serves as its foundation. The organisation expects that when it nominates a person to its board of directors, they will support it, be concerned about its problems, favourably support other people, and seek to assist them (Salancik & Pfeffer, 1978). The Board of Directors is the major cooperation mechanism used by the organisation to connect to the

outside world. This is done so that the organisation may have access to significant resources and defend itself against changes in the environment that could be harmful (Goodstein et al., 1994; Salancik & Pfeffer, 1978).

The board of directors is regarded as a supporting organisation being influenced by various stakeholders on behalf of the primary organization. In general, board resource relationships are designed to improve the performance of the board (Davis & Cobb, 2010b, 2010a; Salancik & Pfeffer, 1978). The Audit Committee is a subcommittee that is under the oversight of the Board of Directors. According to the resource dependence theory, the purpose of the board in an organisation is to expand the outward-looking frontiers to make the firm better. The Resource Dependence Theory investigates how an organization's external resources influence its behaviour, emphasising the interdependence of organisations and their surroundings (Biermann & Harsch, 2017; Celtekligil, 2020). According to this conception, the role of the audit committee is to provide the board of directors with direction and advice so that the firms can benefit from the valuable resources that are brought to them.

The use of Resource-based Theory in this study provides insights into the influence of audit committee characteristics on the relationship between equity-based executive compensation and firm financial performance. This theory emphasises the crucial significance of governance bodies, such as the audit committee, in the management and direction of a company's strategic resources. It highlights how important audit committees are to the board of directors' external interactions and resource acquisition, which are essential to efficient corporate administration. These committees play a crucial role in providing guidance to the board of directors, namely in terms of matching the pay schemes of the executives with the resource-based objectives of the organisation. The Resource-based Theory offers a significant framework for understanding the influence of audit

committees on strategic decisions pertaining to equity-based executive compensation and the subsequent impact of these decisions on firm financial performance.

2.6 Conceptual Framework of the Study

Framework building for this research was guided by the agency cost hypothesis. The conceptual framework delineates the interconnections between the study's research variables. The methodology initially demonstrates the causal relationship between equity-based compensation and company performance. Evidence from the academic literature shows that executive compensation in the form of equity does impact the performance of enterprises across industries. Therefore, there is a causal link between equity-based executive compensation and the performance of the organisation. The association between equity-based executive compensation and business financial performance is moderated by the characteristics of audit committees. Previous research has shown that audit committees may significantly affect a company's bottom line. Therefore, the purpose of this research is to examine how the composition of the audit committee might impact the link between equity-based executive compensation and business performance.

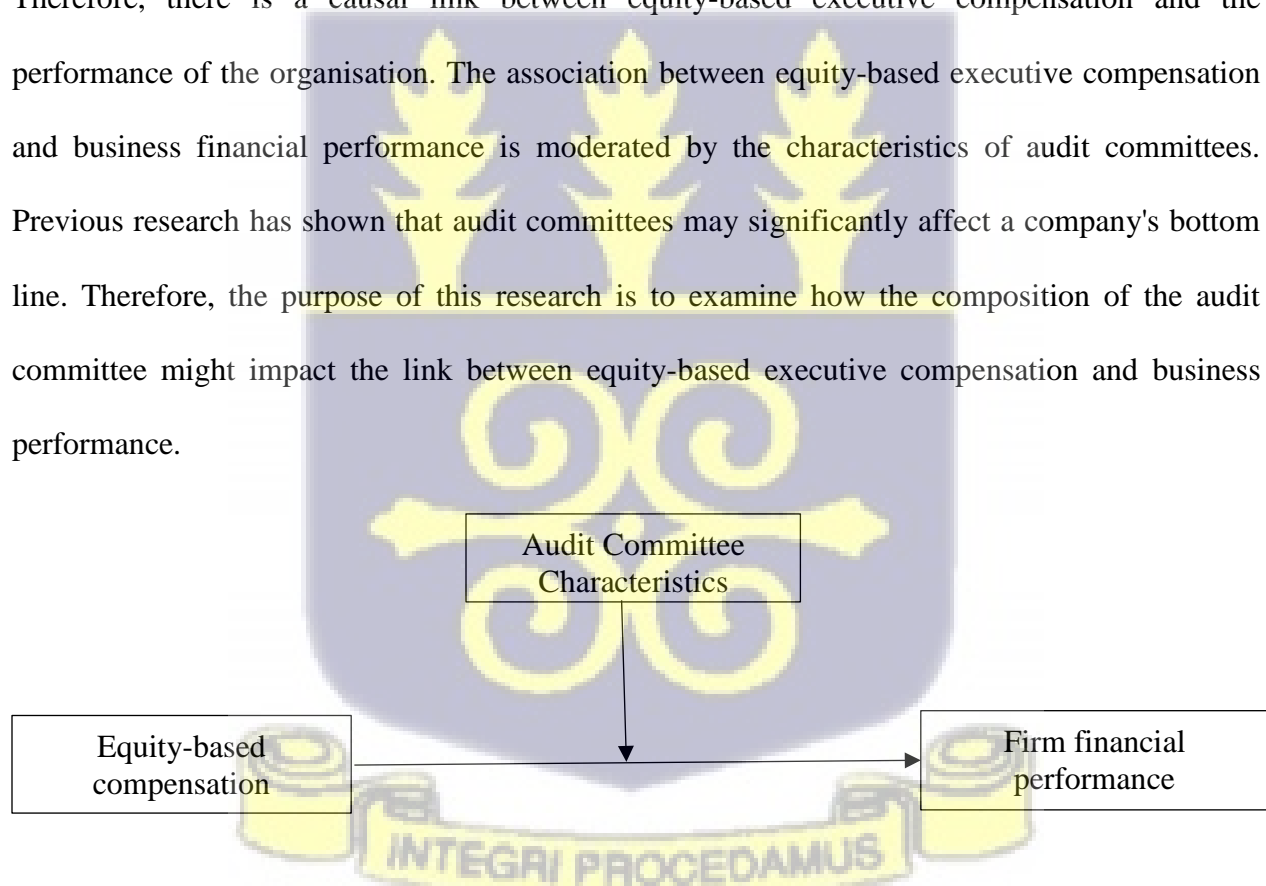


Figure 1: Conceptual framework of equity-based compensation, firm financial performance and audit committee characteristics.

2.7 Empirical Review and Hypothesis Development

This section of the study reviews the empirical literature on the three variables and also develops a hypothesis for the study.

2.7.1 Equity-Based Executive Compensation and Firm Financial Performance

The link between CEO pay and a company's performance has been the subject of a significant amount of empirical research, particularly in the past two decades, to produce findings that can be taken as definitively as possible. The findings of this research are not conclusive because a poor pay-performance association was found in the majority of the investigations. Numerous studies reveal a positive relationship between executive pay and company success, yet a small number of studies find a negative correlation between CEO pay and business performance.

Spoor (2020) conducted a study to investigate the association between short-term and long-term incentive pay and the performance of enterprises that were listed on the Amsterdam Euronext. They discovered a positive and statistically significant influence from this connection. The relationship between CEO pay and business performance was also studied by Buck et al. (2008) in the Chinese market. According to the findings of this research, there is a positive correlation between CEO pay and company success. Additionally, Namases (2019) discovered a positive and statistically significant influence of CEO salary on business performance when employing marketbased firm financial performance metrics as well as accounting-based firm financial performance measurements. On the other hand, Ozkan (2011) and Weenders (2019) did not discover any substantial connection between executive pay and business performance.

In contrast, Core et al. (1999) discovered that there is a link that is statistically significant between CEO salary and the operating and stock return performance of a company. The authors also imply

that chief executive officers at companies with larger agency difficulties earn higher remuneration and that companies with larger agency problems have lower levels of performance. In addition, Basu et al. (2007) discovered a negative association between executive salary and accounting-based business performance metrics. According to the findings of the research conducted by Anyigbah et al. (2021) in Ghana, executive remuneration packages were a contributing factor in the failure of banks that occurred between the years 2012 and 2018. They contend that the level of CEO remuneration has a substantial and potentially detrimental impact on the performance of companies.

The comprehensive body of empirical research provides insights into the complex connection between executive compensation that is tied to equity and the performance of firms, which precisely corresponds to the main objectives of this study. The existing body of research, encompassing investigations conducted by Spoor (2020), Buck et al. (2008), and Namases (2019), predominantly indicates a positive correlation. However, divergent conclusions put forth by Core et al. (1999), Basu et al. (2007), and Anyigbah et al. (2021) propose a negative relationship in relation to equity-based executive compensation. The contrasting outcomes highlight the importance and relevance of this study's aims to analyse and interpret these links within its particular research framework. Moreover, the hypothesis positing a negative relationship between equity-based executive compensation and firm performance is based on the theoretical framework of agency theory, which proposes that equity-based executive compensation may not consistently coincide with the objectives of shareholders. The difference in priorities between equity-based executives compensation and the long-term health of the organisation can result in lower financial performance. Therefore, this study takes the stand of the assertion that equity-based executive

compensation has a negative relationship with firm financial performance and, as such, hypothesis 1 below.

H1: There exists a negative relationship between equity-based executive compensation and the financial performance of a firm

2.7.2 Equity-Based Executive Compensation, Firm Financial Performance and Audit Committee Characteristics

In the prior sections, it was discovered that the remuneration given to executives has a significant influence on the overall success of the company. The findings of previous studies suggest conflicting conclusions on the connection between executive pay and the success of an organisation. Based on the factors that were utilised in the study, the results of some studies indicate a positive association, while the results of other studies indicate there is no significant relationship. This study takes the stance of the negative impact of equity-based executive compensation on firm financial performance and provides a moderating variable that has a positive relationship with firm financial performance. The study provides information on how corporate governance mechanisms in the form of audit committees help solve the agency problems that arise from the provision of compensation to executives of the firm. It has been discovered in the preceding paragraphs that features of the audit committee that have been determined to have a favourable influence on corporate performance include financial expertise, gender diversity, and independence.

The selection of financial expertise as a key indicator of audit committee effectiveness is grounded in the premise that financial literacy is crucial for overseeing complex accounting processes and ensuring accurate financial reporting. As per studies like those by Olayinka (2019) and Oussii and Klibi (2020), financial expertise within audit committees correlates with enhanced financial

transparency and better compliance with regulatory standards. This expertise facilitates more effective oversight of the company's financial practices, potentially leading to improved financial outcomes. The inclusion of gender diversity as an indicator is based on growing evidence that diverse boards contribute to more robust decision-making and risk assessment. Research by MensiKlarbach et al. (2021) demonstrates that gender-diverse boards are more likely to incorporate a wider range of perspectives and approaches, leading to more comprehensive governance. This diversity has been linked to improved company performance and governance, supporting the rationale for its inclusion as a key indicator (Morehead Dworkin & Schipani, 2018). The emphasis on independence within audit committees stems from the need to ensure unbiased financial oversight and reduce conflicts of interest. Independent audit committee members are more likely to provide objective judgment on financial matters (Baugh et al., 2022; Fuller et al., 2021). This independence is crucial for maintaining investor confidence and ensuring corporate decisions are made in the best interest of all stakeholders.

Also, according to Weickgenannt et al. (2021), accounting or finance experts on audit committees improve financial reporting, internal control supervision and helps reduces risks of firms. Also, Chen and Hassan (2021) indicate that the presence of women in audit committees increases transparency, disclosure and helps reduces risks of firms since women are more risk averse than men. According to Oussii and Boulila (2021), when a business has an audit committee that is independent, the riskiness of the firm's operations is lowered because the members of the audit committee are able to evaluate each action objectively in relation to the best interests of the organisation. As a direct consequence of this, hypotheses 3a, 3b, and 3c can all be accepted as true. According to the findings of the study, the existence of audit committees in organisations will

assist minimise the level of risk that the company faces, which in turn will help the company's performance improve at a satisfactory rate.

Based on the previous empirical studies, the impact of equity-based executive compensation on company performance is found to be complex, and the features of the audit committee appear to be crucial in determining this association. Previous research has shown varied results with respect to the direct correlation between executive remuneration and corporate success. However, it is apparent that a recurring topic is around the significance of the audit committee in potentially alleviating any negative consequences arising from equity-based executive compensation. According to the research conducted by Krishnan and Lee (2009), it was suggested that the presence of financial knowledge within audit committees enhances the quality of financial reporting and aids in the management of risks. Chen and Hassan (2021) highlight the significance of gender diversity in fostering openness and promoting cautious risk-taking, particularly in light of the inherent risk aversion commonly observed among female directors. Moreover, the study conducted by Aanu et al. (2014) highlights the advantages of maintaining audit committee independence as a means of mitigating operational risks. The authors emphasise the need for impartial evaluation in this context. The empirical findings indicate that certain audit committees' attributes, such as financial expertise, gender diversity, and independence, may serve as stabilising factors in the intricate association between equity-based executive compensation and company performance. The previously discussed data provides substantial empirical evidence in favour of hypotheses H3a, H3b, and H3c, indicating that the characteristics of audit committees may certainly have a significant moderating effect on this relationship.

H2a: Financial expertise of audit committees positively moderates the negative relationship between equity-based executive compensation and firm financial performance

H2b: Gender diversity of audit committees positively moderates the negative relationship between equity-based executive compensation and firm financial performance

H2c: Independence of audit committees positively moderates the negative relationship between equity-based executive compensation and firm financial performance

2.8 Chapter Summary

This chapter reviewed important literature that is connected to the study. The literature reviewed shows the theoretical underpinnings of the study, some definitions, and insights into the variables being studied. Empirical and conceptual frameworks on the topic of the study were also presented. This study directly contributes to the ongoing academic discussion by addressing identified gaps in the existing body of research, specifically focusing on the complex effects of audit committee characteristics on firm financial performance. The approaches utilised in this study provide a distinctive way to investigate these interactions, therefore adding unique empirical data to the subject matter. This study emphasises the tangible consequences of corporate governance, providing useful direction for professionals and decision-makers.



CHAPTER THREE

METHODOLOGY

3.1 Introduction

This section of the study examines the methodological approach utilised for the collection of data and information for the study. The collection of data for this project focused on equity-based executive compensation, firm financial performance, and audit committee characteristics. It also covers the paradigm of research, research design, sample size and sources of data, the study model, measurement of constructs, method of data analysis, and the ethics followed to undertake the study.

3.2 Research Paradigm

Underlying each and every piece of research is a set of philosophical assumptions regarding what constitutes genuine research and which research procedures are acceptable for furthering knowledge in a certain area of study (Leitch et al., 2010). Understanding these presumptions is essential to both the beginning and conclusion of any research project. In the next part, we will explore the philosophical presumptions that underpin our research. According to Lowe and Locke (2005), the three main components of the research process are ontology, epistemology, and methodology. One definition of the term "paradigm" is "a culture of research defined by a common set of ideas, attitudes, and assumptions among a community of researchers about the nature and conduct of research" (Brad, 2011). As a consequence of this, the term "paradigm" is shorthand for a model of the scientific principles, assumptions, and concepts, as well as the structure, framework, or system.

A positivist paradigm was adopted for this study. French philosopher Auguste Comte initially developed the positivist research paradigm (1798–1857). Researchers that adhere to the Positivist

paradigm adhere to the scientific method of inquiry in their studies. According to Comte (1856), the basis for grasping human behaviour ought to be experimentation, observation, and reason that is founded on experience. As a result of this, it is considered to be the sole legitimate method of developing both knowledge and human understanding. Observation and rational thought, as proposed by Comte in 1856, are the most effective methods for understanding human behaviour. Therefore, the foundation of authentic knowledge is a sensory experience, and it is possible to acquire this experience through observation and experimentation. To put it another way, knowledge is something that can be measured and is objective.

The primary advantage of the positivist paradigm is its dedication to empirical objectivity (Marsonet, 2019). The perspective emphasises that the most dependable understanding of a phenomena is obtained via the utilisation of objective and systematic approaches (Coetsee, 2011). In light of the objective of your research, which aims to analyse the connections between factors such as equity-based executive compensation and business performance, it is crucial to minimise subjective judgements. According to Brad (2011), when examining your study from a positivist perspective, the outcomes are grounded on phenomena that can be directly observed and quantified, without being influenced by subjective or communal judgements. The implementation of a systematic strategy in research also guarantees the consistency of findings in comparable circumstances, hence upholding the idea of reproducibility (Coccia, 2018). Consistent findings of this nature can then be extrapolated to other situations, so enhancing the confidence and dependability of the study outputs.

Furthermore, one notable benefit of the positivist method is its fundamental dependence on well-established ideas (Leitch et al., 2010). The objective of this research is to have a comprehensive understanding of the interrelationships among certain variables. The facilitation of positivism is

achieved by the first use of established ideas, followed by the subsequent testing of hypotheses derived from these theories (Coetsee, 2011). Deductive reasoning, a fundamental aspect of positivism, enables one to start with a comprehensive theory and thereafter examine its ramifications within particular situations, such as those under investigation (Coccia, 2018). Furthermore, positivism is characterised by its emphasis on the prioritisation of quantitative observations. Considering the many measurements available to measure business performance, such as return on investment or profit margins, adopting a positivist perspective allows for precise and quantitative interpretations of the impact of variables like equity-based executive compensation on these metrics.

In addition to apparent relationships, positivist research aims to investigate and establish causal linkages (Brad, 2011). By embracing this paradigm, the research is positioned to investigate the direct influence of one aspect on another, thus enhancing the comprehensiveness and complexity of the results. The emphasis on operational clarity is a defining feature of positivism. Each idea inside the paradigm is precisely defined in relation to its measurement. The ability to navigate complex ideas, such as equity-based executive compensation and company performance, with accuracy is of great value in academic research (Leitch et al., 2010).

Since positivism's underlying assumption is that reality is objectively given and quantifiable through properties that are ontologically independent of the researcher and his or her tools, this study adopts a positivist paradigm (Marsonet, 2019). Positivist thinkers employ scientific methodologies to standardise processes of knowledge creation and use quantification to increase parameter descriptions and relationship accuracy. Positivism focuses on identifying and empirically presenting truth (Coetsee, 2011). In addition, the research focuses on developing hypotheses that are formed using existing ideas and then evaluating those assumptions. Therefore,

positivists rely on the line of reasoning known as deductive reasoning to create hypotheses that may be verified by empirical examination of existing social conditions (Coccia, 2018). In essence, the positivist paradigm offers an avenue for objective, rigorous, and systematic research. By emphasizing empirical data, reproducibility, foundational theories, quantifiability, and causal relationships, the study gains a robust framework. The nature and objectives of the study, when viewed through the lens of positivism, ensure a comprehensive exploration, making this paradigm not only suitable but also indispensable for the research.

3.3 Research Design

Kumar (2019) describes a research design as a written strategy for a study that expresses the researcher's aims. It is possible to state that the design is the research's logical underpinning. The nature of the topic being addressed or the research problem, as well as the researcher's personal experiences and the study's target audience, all have a role in determining the research design (Creswell & Creswell, 2017). The purpose of the study design is to ensure that the researcher can answer the initial question as definitively as feasible based on the facts gathered. Using a quantitative approach, the study set out to examine whether or not the composition of the audit committee moderates the relationship between equity-based executive compensation and firm financial performance. The study included both a descriptive and a causal research approach. The descriptive research approach is a scientific procedure that involves observing and documenting a subject's actions without intervening in any way (Kirmi, 2017). Causal research is the study of cause-and-effect relationships (Samii, 2016), and it is used when there is enough data to investigate a phenomenon's cause-and-effect link.

In this study, descriptive research was valuable in attempting to explain the phenomena as it currently exists (which is the relationship between the variables under study). The causal research

design is helpful for determining whether or not a shift in one of the study variables results in a shift in the dependent variable. Therefore, the purpose of this study is to employ a causal research methodology to determine how various traits of audit committees influence the dynamics between equity-based executive compensation and business performance. This research design was deemed appropriate to be used for this study because it focuses on establishing casual relationships with controls among variables and also allows the prediction of future events from present knowledge.

The combination of both descriptive and causal research methods offers a holistic approach to understanding the research problem (Kumar, 2019). Utilizing the descriptive method captures the current state of the variables, providing a snapshot of prevailing patterns and trends (Creswell & Creswell, 2017). On the other hand, the causal method digs deeper to identify the nuances of cause-and-effect relationships (Samii, 2016). Such a meticulous approach ensures that every facet of the research question is thoroughly investigated, presenting an all-encompassing view of the issue at hand (Kirmi, 2017). Also, the adoption of a causal research design is pivotal in unravelling the intricacies between variables. This design excels in pinpointing even the subtlest of influences, especially crucial when exploring complex relationships such as those between equity-based executive compensation, audit committee characteristics, and firm financial performance (Kumar, 2019). This research design's dual approach notably bolsters the validity and reliability of the results (Creswell & Creswell, 2017). By providing a current overview through descriptive research while also validating observed relationships with causal research, confidence in the findings is considerably enhanced (Kirmi, 2017). A significant strength of causal research lies in its ability to establish controls, thereby ruling out potential extraneous causes (Samii, 2016). Through this, a clearer and more precise cause-and-effect relationship between the independent and dependent variables becomes discernible. Beyond merely offering insights into the present dynamics,

understanding these relationships also paves the way for insights into potential future trends and patterns (Kumar, 2019). By discerning how variables interact in the present scenario, predictions about similar future interactions become more attainable. Furthermore, the insights derived from understanding the causal relationships between variables hold immense practical value. Organizations and firms can leverage this knowledge to make well-informed decisions regarding equity-based executive compensation and audit committee composition. By doing so, they can anticipate how such decisions might impact their overall performance, enabling them to strategize more effectively.

3.4 Sample and Sources of Data

The collection of data is often derived from a sample, which can consist of either a group of things or a singular piece (Morse, 2016). The significance of data collecting accuracy is underscored by Morse (1991), as mistakes occurring during this step cannot be rectified by future analysis. According to Palys (2008), the selection of an appropriate sampling technique depends on the specific study environment and objectives. This provides researchers the flexibility to choose the best suitable methodology that matches with their research aims. In this study, data was gathered at the firm level, taking into consideration the prompt availability of yearly financial reports, limitations in resources, and the particularities of data analysis. The selection of the sample was conducted using a strategic approach, focusing on non-financial companies that are actively engaged in trading on the stock markets of Ghana, Nigeria, and South Africa. The selection of these nations was based on their prominent positions in the African financial markets, since they are widely recognised for hosting very vibrant and varied stock exchanges within the continent. The integration of their respective marketplaces offers a diverse range of data, enabling a thorough and all-encompassing examination. In addition, these nations have a combination of developing

and established financial markets, rendering them very suitable for research work aimed at investigating the correlation between equity-based executive compensation, audit committees, and firm financial performance.

The selected time period, spanning from 2010 to 2019, holds significant importance. Following the global financial crisis that occurred between 2007 and 2009, several organisations underwent significant adjustments and reconfigurations to their financial strategy and operational frameworks. Commencing from the year 2010 guarantees that the data encompasses this significant period of transformation, so providing valuable insights into the subsequent evolution of enterprises following the crisis. The data preceding 2010 might potentially be influenced by the disruptions caused by the financial crisis, which may result in an inaccurate depiction of the actual dynamics of the businesses. The purposeful exclusion of the year 2020 is partly motivated by the intention to account for the atypical interruptions created by the COVID-19 pandemic, which have the potential to introduce bias into the data.

In addressing the lingering effects of the 2007-2009 financial crisis on stock markets, the study utilized country, industry, and year fixed effects in the data analysis. This approach was crucial to control for unobserved heterogeneity and isolate the specific impact of equity-based executive compensation on firm financial performance. The implementation of year fixed effects was particularly vital in mitigating the influence of temporal economic conditions, including the residual impacts of the financial crisis. This methodological consistency helps in obtaining a more accurate understanding of the relationship between equity-based executive compensation, audit committee characteristics, and firm financial performance in the post-crisis period.

The study's sample which comprises non-financial firms from the various stock exchange markets of the three countries. Out of three hundred and forty-three (343) non-financial firms, sixty-two

(62) non-financial firms actively trading on these exchanges were selected. This focus is due to their unique operational and financial characteristics, distinct from financial institutions, which is key to exploring equity-based executive compensation in varied business settings. The data collected resulted in an imbalanced panel dataset consisting of 620 observations representing firm-year combinations, which is suitable for further analysis. The use of a larger sample size in this study contributes to its robustness, hence augmenting the statistical power of subsequent analyses and heightening the probability of identifying meaningful correlations.

The selection of Ghana, Nigeria, and South Africa as the countries for this study is strategic, reflecting their diverse economic environments, regulatory frameworks, and corporate governance systems. Ghana, with its emerging market conditions and evolving corporate governance practices, represents the growth and adaptation phase of market development. Nigeria, known for its rapid economic growth and unique regulatory challenges, provides insights into transitional market dynamics. South Africa, with more established market conditions and advanced corporate governance structures, offers a perspective from a more mature economic environment. This mix of countries with varying market maturities ensures a comprehensive understanding of the impact of equity-based executive compensation across different institutional contexts, thereby enhancing the study's external validity and applicability to a broader African context.

3.5 Measurement of Constructs

The constructs for the study were equity-based executive compensation, firm financial performance and audit committee characteristics. The measurement of these constructs are as follows:

Table 1: Variables and measurement

Variable	Measurement	References	Measurement of Variables
Equity-based Compensation	-Managerial shareholdings	(Bolton et al., 2015) (Kabir, Li, & Veldmerkoulova, 2013)	Managerial Shareholdings
Firm Financial Performance	Return on Assets	(Rohmawati & Shenurti, 2020) (Hendrani & Septyanto, 2021)	$ROA = \frac{Net\ Income}{Average\ Assets} * 100\%$
Audit Committee Characteristics	-Financial Expertise -Independence -Gender diversity	(Al-Matari et al., 2014) (Hsu et al., 2019) (Yatim, 2009)	Dummy variables: 1 = financial expert, 0 = non-financial expert on the committee 1 = More independent members, 0 = less independent members 1 = female on audit committee, 0 = no female member on the audit committee
Control variables	-Company Size -Leverage	(Sánchez-Ballesta & García-Meca, 2011) (Haniffa & Hudaib, 2006)	Company size = Log (Total Assets) Leverage = Total Debt/Total Equity

Source: Author's Construct (2022)

3.5.1 Independent Variable

In this particular study, equity-based compensation functions as an independent variable. Executive compensation, often commonly referred to as "executive pay," is the term used to describe compensation packages that are developed specifically for the use of a company's top executives, management, and other executive staff (Bolton et al., 2015). The majority of compensation packages take the form of equity. This equity often takes the form of either corporate stock or derivative forms of the corporate stock. Equity-based executive compensation is a powerful incentive since its value depends on the performance of the company's stock price. This

makes equity compensation an attractive employee benefit. The value of the firm increases and gives a boost to the manager to raise the success of the company and boost its market value. Thus, the company's value increases (Bolton et al., 2015; Kabir et al., 2013). This variable is measured using managerial shareholdings. A managerial shareholder is any employee receiving joint shares and holding issued shares equivalent to or surpassing 1% of the issued equity stock of the company who is a current employee or former employee of a company. The extent of managerial ownership was determined by counting the number of shares certain company executives had. There was information on this in the annual reports of the main stock exchanges. The "Director's Report" or "Shareholder Information" sections of firms' annual reports contained this data. A number of studies, including Bolton et al. (2015) and Kabir, Li, and Veld-Merkoulova (2013), have used managerial ownership as a proxy for equity-based executive compensation.

3.5.2 Dependent Variable

The Return on Assets (RoA) is the dependent variable in this research. Return on Assets (RoA) quantifies a business's profitability in relation to the assets under its control. The Return on Assets (RoA) is a popular metric used by investors to screen potential investments in a given firm (Hendrani & Septyanto, 2021). For a corporation to have a growing RoA, it must be generating profits with each investment, but a decreasing RoA indicates the firm may be in trouble as a result of overinvesting in assets that have not resulted in revenue growth. For the sake of comparability and ease of interpretation, RoA is employed in this study (Rohmawati & Shenurti, 2020). RoA is measured by comparing a company's net income to the amount of capital that the company has invested in its assets. The formula Net Income divided by Average Assets is used in the study to estimate RoA. This is evident in studies such as Rohmawati and Shenurti (2020) and Hendrani and Septyanto (2021).

3.5.3 Moderating Variable

A moderating element in our analysis was the audit committee's structure. The audit committee of a firm is a crucial entity in charge of monitoring financial reporting and openness. The committee has the authority to conduct special inquiries if accounting methods are found to be questionable or if major staff issues arise. Financial competence on the board, executive board makeup, and gender diversity are all factors that go into calculating this metric. To be able to spot abnormalities in financial reports and lower the risk level of the firm's investments, the board members of the company must have a strong financial background.

Also, for the executive committee, having more non-executive directors will mean that most management decisions can be challenged since the committee works on majority votes. Therefore, if there are more executives of the firm on the board, decisions will unanimously go in favour of management. Moreover, according to Nelson (2015), men tend to take greater risks than women do. Thus, when there are women on the board, they will be very critical about the activities of management, which are very risky. Extant literature proves that there is a relationship between gender and risk-taking in the sense that women are more risk-averse than men.

The audit committee characteristics were used as dummy variables in this study. Thus, for the financial expertise of the audit committee, "1" was used to indicate if there is a member who is a financial expert or has financial expertise on the audit committee for that particular year and "0" if otherwise. Also, for the gender diversity of the audit committee, "1" was used to indicate if there is a member who is a female on the audit committee for that particular year and "0" if otherwise. And for the independence of the audit committee, "1" was used to indicate if there are more nonexecutive directors on the audit committee for that particular year and "0" otherwise. This was possible since companies listed on various stock exchanges as part of their annual reporting must

include a report on the audit committee. The researcher was able to extract information on the various audit committee characteristics variables used in this study from the “Report on Audit Committee” section of the annual statements. Other companies also reported this information in the “Director’s Report” section of the annual reports.

3.5.4 Control Variables

The regression model includes additional controls to account for any confounding factors that affect equity-based executive compensation and business financial performance. This was done so that variables like firm size and leverage may be accounted for without misrepresenting the results. Consistent with Haniffa and Hudaib (2006) research, firm size is quantified as the natural log of total assets, whereas Sánchez-Ballesta and García-Meca (2011) analysis of leverage uses the ratio of total debt to total equity as its measure.

3.6 Study Model

The goal of this study was to utilise a multivariate regression model to determine if there is a connection between equity-based executive compensation and the performance of publicly traded companies. The data was run via a multiple regression model.

The models for the study are

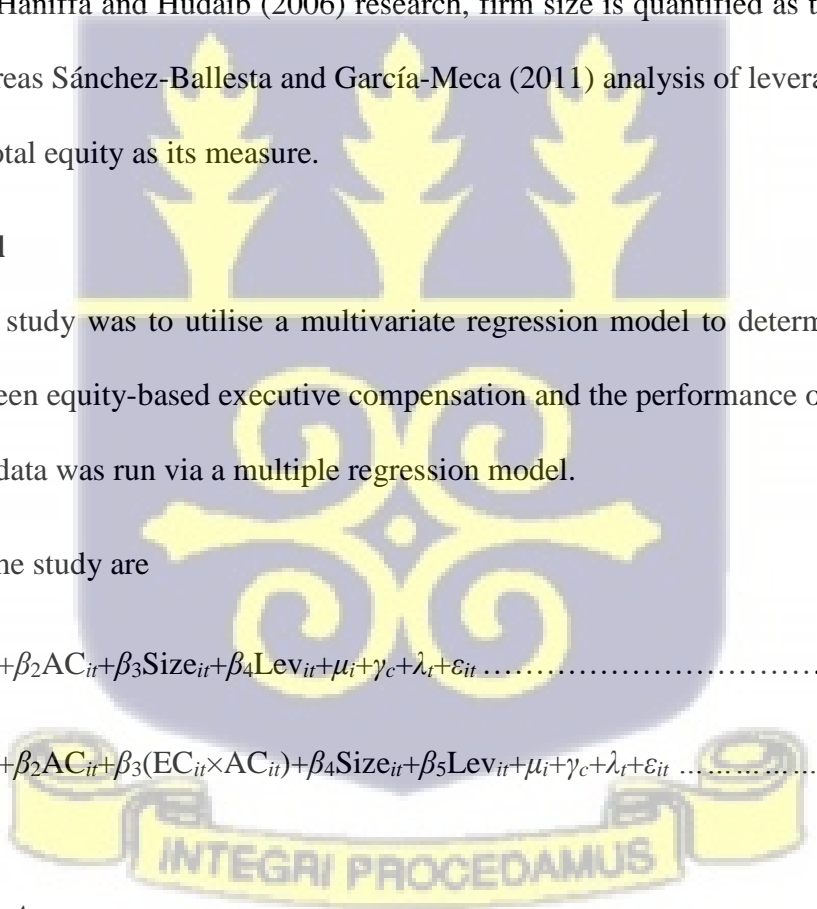
$$RoA_{it} = \beta_0 + \beta_1 EC_{it} + \beta_2 AC_{it} + \beta_3 Size_{it} + \beta_4 Lev_{it} + \mu_i + \gamma_c + \lambda_r + \varepsilon_{it} \dots \dots \dots (1)$$

$$RoA_{it} = \beta_0 + \beta_1 EC_{it} + \beta_2 AC_{it} + \beta_3 (EC_{it} \times AC_{it}) + \beta_4 Size_{it} + \beta_5 Lev_{it} + \mu_i + \gamma_c + \lambda_r + \varepsilon_{it} \dots \dots \dots (2)$$

Where

RoA = Return on Assets,

EC = Equity-based executive compensation,



Size = firm size,

Lev = Leverage,

AC = Audit Committee Characteristics which includes

FE = Financial Expertise of the audit committee

ID = Independence of the audit committee

GD = Gender Diversity of the audit committee

*EC*AC: Interaction Term between Equity-based Executive Compensation (EC) and Audit Committee Characteristics (AC)*

μ_i = firm-specific fixed effects.

γ_c = country-specific fixed effects.

λ_t = time-specific (year) fixed effects.

ε = error term

3.7 Data Analysis Method

After gathering the data, it was necessary to organise it into useful information for decision making. There were descriptive statistics used to observe and describe the behaviour of the variables under research, which included the minimum, maximum, mean, and standard deviation. The information was analysed using inferential statistics so that useful inferences could be drawn. Inferential statistics, such as the Pearson's Coefficient and the Regression Analysis, were employed to evaluate the findings' reliability and consistency with the study's primary aim. The first stage of data analysis was prearranging and organising the data collected before capturing the same

statistical packages or social sciences of analysis. Descriptive statistics were used to observe and characterise the behaviour of the variables under study in the second stage of data analysis. Inferential statistics, such as Pearson's Coefficient and regression analysis, were then used to determine the level of trustworthiness and consistency of the results with respect to the study's overarching purpose.

Hausman's specification test was conducted on the data collected from financial statements. The study used the Fixed Effects regression model in analysing the data according to the Hausman test conducted. This study is an international panel. Thus, data were collected from different countries, in different industries and over some time. The study, therefore, controlled for country, industry and time-specific effects in the analysis of the data collected. Special codes were created for the countries, industries and companies over various years. This made it possible to use the fixed effect regression model in analysing the data.

3.7.1 Hausman Specification Test

Using the Hausman Test, a regression model may be checked for endogenous regressors (predictor variables). Factors whose value is determined by other variables are known as endogenous. Before settling on the best regression method, though, you'll need to find out if your predictor variables are endogenous. When analysing panel data, the Hausman test may be used to choose between a fixed-effects model and a random-effects model. It is expected that both random effects and fixed effects models would be utilised in this study. The tests check if there is any connection between the model's regressors and the unique mistakes. A lack of association between the two is the null hypothesis. Thus, when the p-value of the Hausman test is small (i.e., less than 0.05), the null hypothesis is rejected. The results of the test conducted are presented in the table below.

Table 2: Hausman's (1978) specification test

	Coef.
Chi-square test value	83.02
P-value	.002

Source: Field study, (2022)

From Table 2, it can be seen that the p-value for the Hausman specification test is 0.002, which is less than 0.05. Thus, the results show that the group level variations are not related to any of the independent variables. The test, therefore, rejects the null hypothesis as the p-value was less than 0.05. Thus, the fixed effects model is preferred and used for further analysis.

3.8 Ethical Consideration

Ethical considerations are important in guaranteeing the validity of research findings, and they are more prominent in research investigations (Akaranga & Makau, 2016). As a result, when conducting research, the researcher is expected to use and pick the optimal methodology to guide data collection and methods for interpreting and reporting findings. The researcher and the research subjects are usually the focus of ethical considerations. Within the scope of this study, the researcher must guarantee that all university-related ethical problems are addressed as thoroughly as possible. As a result, plagiarism and copyright violations must be taken into account at all times.

3.9 Chapter Summary

In summary, this chapter discussed the methodology used to execute the study. The chapter provides justifications for the use of research approaches and designs. Also, the data used and how it was collected and analysed are presented in the chapter.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

The research data is presented and analysed here. Information was gathered from the annual reports of non-financial companies trading on the stock exchanges of Ghana, Nigeria, and South Africa. Descriptive statistics and the results of any applicable correlations or regressions are shown first in the data presentation. This study used multiple regression analysis to examine the impact of equity-based executive compensation on firm financial performance, audit committee characteristics on firm financial performance, and the moderating effects of audit committee characteristics on the relationship between equity-based executive compensation and firm financial performance. Results are discussed and summarised in this section of the study.

4.2 Descriptive Statistics

After data collection, a total of 620 firm-year observations were realised. After initial data cleaning and coding, 620 firm-year observations were included in the final dataset utilised for study. The following table provides descriptive statistics for the variables of interest.

Table 3: Summary statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
RoA	620	-1.276	.667	-4.906	1
EC	620	6.445	1.542	3.108	10.162
ID	620	.889	.315	0	1
FE	620	.974	.159	0	1
GD	620	.694	.461	0	1
Lev	620	7.372	70.407	-15.412	1207.91
Size	620	.823	.076	.610	.984

Source: Field study, (2022)

Note: RoA = Return on Assets, EC = Equity-based executive compensation, Size = firm size, Lev = Leverage, FE = Financial Expertise of audit committee and ID = Independence of audit committee, GD = Gender Diversity of audit committee

The descriptive statistics provide a comprehensive snapshot of the characteristics and operational metrics of the sampled firms. A closer examination of the Return on Assets (RoA) reveals a concerning trend. The negative mean value of -1.276, juxtaposed with the maximum value of 1.000, indicates that a significant portion of firms in the study were not generating positive returns on their assets. This suggests issues with their operational efficiency or financial health. Moreover, equity-based compensation seems to be a prevalent practice among these firms. With a mean of 6.445 and a relatively small standard deviation of 1.542, it's evident that many firms use equitybased incentives, likely to align the interests of their executives with shareholders. This is an important strategic choice, aiming to drive performance and shareholder value.

The characteristics of the audit committees are equally enlightening. A mean value of 0.974 for Financial Expertise (FE) suggests that the vast majority of companies recognize the importance of having financial experts on their audit committees. This can be pivotal for ensuring stringent financial oversight and maintaining integrity in financial reporting. Additionally, the data underscores a positive trend in terms of gender diversity. With a mean value of 0.694 for Gender Diversity (GD), it's clear that a significant number of firms are making strides in incorporating women into their audit committees. This can amplify diverse perspectives, enriching the decisionmaking process. Furthermore, the high mean value for Audit Committee Independence (ID) at 0.889 underscores that many firms prioritize non-executive members in their audit committees, emphasizing a commitment to unbiased and rigorous financial oversight.

Diving into the control variables, the mean leverage value stands at 7.372. However, when contrasted with its maximum value of 1207.91, it suggests a vast disparity in how different firms structure their finances, indicating varied strategies and risk appetites. Lastly, the mean firm size of 0.823 suggests that most firms in this study can be classified as large entities. This could have various implications, from market influence to operational dynamics. Therefore, these descriptive statistics offer profound insights into the financial, operational, and governance structures of the sampled firms, setting a robust foundation for further analysis and hypothesis testing.

4.3 Correlation

The predicted relationship between the dependent variables and the independent factors was displayed using the Pairwise Correlation coefficient in this research. Also, the correlation results presented assess the multicollinearity of the variables. This expected relationship is presented in the table below.

Table 4: Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) RoA	1.000						
(2) EC	-0.003*	1.000					
(3) FE	0.096*	-0.255*	1.000				
(4) GD	0.003	-0.010	-0.644*	1.000			
(5) ID	0.230*	0.345*	0.037	-0.087*	1.000		
(6) Lev	-0.172*	-0.034	-0.027	0.031	-0.100*	1.000	
(7) Size	-0.171*	0.218*	-0.303*	0.035	0.121*	0.092*	1.000

* shows significance at $p < 0.05$

Source: Field study, (2022)

Note: RoA = Return on Assets, EC = Equity-based executive compensation, Size = firm size, Lev = Leverage, FE = Financial Expertise of audit committee and ID = Independence of audit committee, GD = Gender Diversity of audit committee

Delving deeper into the relationships between the study variables, the Pairwise Correlation coefficient offers significant insights. Beyond merely showcasing the relationships, it also serves as an indicator for potential multicollinearity, crucial for the validity of subsequent regression analysis. A key observation from the correlation matrix is the negative, statistically significant relationship between Equity-based executive compensation (EC) and the Return on Assets (RoA) with a coefficient of -0.003. This suggests that firms offering higher equity-based compensations might experience diminished performance. Such a negative correlation potentially points towards a misalignment between executive incentives and the broader strategic objectives of the firm. If executives are primarily driven by equity rewards, they might engage in short-term strategies to boost stock prices, possibly at the expense of long-term health and sustainability of the firm.

Turning attention to audit committee characteristics, a generally positive trend in relation to firm financial performance is observed. Both Financial Expertise (FE) and Independence (ID) of the audit committee have positive, significant relationships with RoA, with coefficients of 0.096 and 0.230 respectively. This highlights the importance of expertise and unbiased oversight in enhancing firm financial performance. Committees equipped with financial expertise can offer more nuanced guidance and scrutiny, ensuring that the firm operates within optimal financial parameters. Furthermore, an independent audit committee, devoid of potential conflicts of interest, ensures rigorous oversight, maintaining the integrity of financial reporting. Interestingly, while Gender Diversity (GD) of the audit committee also had a positive correlation with RoA, its relationship wasn't statistically significant at the 5% level. While it's evident that gender diversity brings a plethora of perspectives to the table, its direct impact on firm financial performance, as per this data, is not clearly established.

Lastly, both control variables, Size and Leverage, revealed negative and statistically significant relationships with RoA, with coefficients of -0.172 and -0.171 respectively. The inverse relationship with Size suggests that as firms grow larger, challenges might be faced that dampen their returns on assets. Bigger firms might grapple with issues like operational inefficiencies or challenges in maintaining a unified strategic direction. As for Leverage, the negative relationship implies a potential over-reliance on debt over equity financing among the sampled firms. This debt-heavy structure might increase financial risk, thereby adversely impacting firm financial performance. Therefore, this correlation analysis offers a foundational understanding of how the various firm attributes and governance structures relate to performance, setting the stage for deeper causal investigations.

4.4 Regression Results

The regression results obtained from the data collected are presented in this section of the study. First, the table below displays the regression outcome between equity-based executive compensation and firm financial performance, with firm financial performance serving as the dependent variable and equity-based executive compensation serving as the independent variable. The table also displays the relationship between audit committee traits and business performance in the second column of the regression output. This analysis relies on the audit committee characteristics of financial expertise, gender diversity, and independence. Finally, the third column of the regression output in the table below presents the moderating effects that the audit committee characteristics have on the relationship between equity-based executive compensation and firm financial performance. The section presents the findings based on the research hypothesis and research models presented in the previous chapters of the study.

Table 5: Regression: the moderating role of audit committee characteristics on the relationship between equity-based executive compensation and firm financial performance

Dependent Variable	RoA Coef. (t-stat)	RoA Coef. (t-stat)	RoA Coef. (t-stat)	RoA Coef. (t-stat)	RoA Coef. (t-stat)
EC	-0.055*** (-2.700)		-0.072** (-2.38)	-0.113 (-4.800)	-0.063 (-2.960)
FE		0.439*** (4.700)	0.030 (0.770)		
EC*FE			0.101** (4.710)		
GD		0.283*** (3.500)		-1.045 (-4.500)	
EC*GD				0.156*** (4.830)	
ID		0.349*** (2.680)			1.008 (2.440)
EC*ID					-0.106*** (3.210)
Lev	-0.001*** (-3.560)	-0.001*** (-3.270)	-0.001*** (-3.440)	-0.001*** (-3.510)	-0.001*** (-3.360)
Size	-2.309*** (-6.010)	-2.004*** (-5.220)	-2.265*** (-5.380)	-2.097*** (-6.010)	-2.227*** (-5.370)
Constant	0.725** (2.210)	-0.068* (0.834)	0.569 (1.570)	1.038*** (3.110)	-0.013 (-0.030)
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes
Number of observations	620	620	620	620	620
R ²	0.130	0.169	0.149	0.164	0.151

t statistics in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Source: Field study, (2022)

Note: RoA = Return on Assets, EC = Equity-based executive compensation, Size = firm size, Lev = Leverage, FE = Financial Expertise of audit committee and ID = Independence of audit committee, GD = Gender Diversity of audit committee

Table 5 presents a comprehensive breakdown of the relationship between equity-based executive compensation and firm financial performance. A particularly striking observation is the negative coefficient of -0.055 between EC (Equity-based executive compensation) and RoA (Return on Assets), which is significant at the 1% level (t-stat of -2.700). This implies a negative association between equity-based executive compensation structured around equity and the subsequent performance of the firm. The R-squared value of 0.130 highlights that equity-based executive compensation can explain approximately 13% of the variations in firm financial performance.

This negative trend confirms the hypothesis suggesting a reverse relationship between the two variables. The inference here is clear: as firms lean towards equity-based compensation for their executives, it might adversely impact their overall performance. This insight aligns with the findings of prior research, notably from Anyigbah et al. (2021), Basu et al. (2007), and Villagrasa et al. (2018), which recognized a significant negative connection between equity-based executive compensation and performance, especially in firms with larger agency issues. However, it's essential to acknowledge differing perspectives from studies like Spoor (2020), Namases (2019), and Buck et al. (2008), which found a positive correlation. Such contradictions emphasize the multifaceted nature of the subject and the influence of different variables and contexts.

The complex correlation between the features of audit committees and the performance of firms can be understood by the specific information shown in Table 5. The primary purpose of the second column is to provide insights into the correlation between various attributes within the audit committee and the Return on Assets (RoA). It is apparent that the three separate features of an

audit committee, namely financial skill, gender diversity, and independence, each have a positive and statistically significant influence. These traits maintain their relevance at the 1% level. Upon further examination of the statistical data, it is observed that the committee's financial knowledge exhibits a coefficient of 0.439, accompanied by a significant t-statistic of 4.700. This implies that there is much merit in having individuals who possess a keen understanding of financial affairs. The user's deep comprehension guarantees strong supervision, which is likely to result in an increase in the company's financial performance.

Likewise, the presence of gender diversity within the committee holds significance beyond a superficial inclusionary measure, as evidenced by its coefficient of 0.283 and a t-statistic of 3.500. The evidence suggests that keeping a diversified gender composition within the committee has clear advantages, as it indicates that various viewpoints and experiences can enhance decision making and, thus, lead to improved financial outcomes. Finally, the measure of independence, represented by a coefficient of 0.349 and a t-statistic of 2.680, underscores the significance of include non-executive directors. The external vantage point frequently provides a novel and impartial viewpoint, which may play a crucial role in protecting the interests of the organisation and guiding it towards increased profitability.

The R-squared value of 0.169, which encompasses all of these findings, is noteworthy. This finding highlights the significance of the combined influence of these three features of audit committees, as they account for about 17% of the observed variances in a firm's performance. These ideas align effectively with the current body of empirical evidence. The crucial function of audit committees in influencing and boosting a firm's performance trajectory has been emphasised in studies conducted by academics such as Ghafran and O'Sullivan in 2013, as well as Loukil et al. in 2019.

A more comprehensive understanding of the relationship between audit committee characteristics and company performance may be obtained by analysing columns 3 through 5 of Table 5. The primary emphasis of this study is to examine the potential moderating impacts of specific variables on the relationship between equity-based executive compensation and firm financial performance. The compilation of outcomes unveils a narrative of varied moderations, solidifying the complex character of these connections. Upon deeper examination of the significance of financial competence, a captivating narrative unfolds. A statistically significant positive moderation effect is seen, as evidenced by a coefficient of 0.101 and a t-statistic of 4.710 at a significance level of 5%. The presented data provides compelling evidence that companies with a greater proportion of financial specialists serving on their audit committees exhibit superior performance, even when considering the inclusion of equity-based CEO remuneration. The inclusion of these specialists might provide essential oversight and safeguards, guaranteeing that the possible difficulties associated with these remuneration systems are effectively addressed, resulting in an improvement in the performance of the organisation.

In the context of gender diversity, the narrative exhibits a parallel positive progression. The data reveals a statistically significant positive moderation effect, as shown by a coefficient of 0.156 and a t-statistic of 4.830, reaching significance at the 1% level. This implies that the presence of a diverse gender composition within the audit committee may serve as an effective measure in mitigating the possible negative consequences associated with equity-based CEO remuneration. The presence of a wide range of opinions and experiences resulting from a diverse gender composition appears to serve as a mitigating factor, contributing to the stability and possible positive outcomes of a company's performance. Nevertheless, this narrative of harmony takes a turn when considering the significance of autonomy. The narrative at this point deviates from the

previously presented optimistic discoveries. The coefficient is seen to be -0.106, with a corresponding t-statistic of 3.210, indicating statistical significance at the 1% level. These numerical figures suggest that the simple inclusion of non-executive directors may not be the ultimate solution for addressing the difficulties associated with equity-based CEO remuneration. This suggests that although the inclusion of independent members in the remuneration system may have benefits, their impact may not be sufficient to counterbalance the potential drawbacks.

Upon synthesising these observations, there emerges a validation of certain preliminary hypotheses, while others are confronted with captivating inconsistencies. The favourable impacts of financial competence and gender diversity are evident and align with the initial hypotheses. However, the hypothesis of the audit committee's independence faces a challenge, which requires a reassessment of its function within this particular setting. Upon concluding the examination of these facts, it becomes evident that the issues arising from equity-based executive compensation are indisputable. However, a potential solution may reside within the makeup of the audit committee. The inclusion of financial experts and a team composed of individuals from varied genders might potentially contribute to the improvement of the organisation, leading it towards more favourable outcomes. These results underscore the crucial importance of a well-structured and heterogeneous audit committee in effectively managing the volatile landscape of corporate performance.

4.5 Chapter Summary

The chapter presented and discussed study outcomes. The results showed that equity-based executive compensation negatively affects business performance, confirming the study's first hypothesis. Financial expertise and gender diversity of audit committees moderated the connection between equity-based executive compensation and firm financial performance, but audit

committee independence moderated negatively. The study accepted hypotheses 2a and 2b but rejected 2c.



CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter provides a research overview, a summary of significant results, the study's conclusion based on the findings, suggestions, and limits and future directions.

5.2 Summary of the Study

The main purpose of the study was to examine the moderating role of audit committee characteristics on the relationship between equity-based executive compensation and firm financial performance. The agency and resource dependency-based theories were used to support the study. The positivist research paradigm was adopted for this study, and as such, the quantitative research method, which included a descriptive and causal research approach, was used. The study collected data from africanfinancials.com for the period 2010 to 2019 and the Fixed Effects regression model was employed in analysing the hypothesised relationships. Managerial shareholdings were used to measure equity-based executive compensation. The return of assets (ROA) of the firms was used to measure firm financial performance. Financial expertise, gender diversity and independence of audit committees were used to measure audit committee characteristics. The control variables for this study included company size and leverage.

5.3 Summary of Major Findings

Executives who are paid in equity tend to have a detrimental impact on company performance, according to the results of this study. Furthermore, the research shows that audit committee features have a positive and significant effect on corporate performance. As such, with the introduction of such features in the organization, the performance of firms is expected to improve.

As before, we observed that financial expertise and gender diversity of audit committees positively moderate the negative impact of equity-based executive compensation and business performance. Equally important were findings about the moderating effect of audit committee members' financial knowledge and the presence of women on such panels. There was a negative and statistically significant effect of the audit committee's independence on the correlation between equity-based executive compensation and firm financial performance. The summary of the individual objectives is presented in the next sections.

5.3.1 Equity-Based Executive Compensation and Firm Financial Performance

This study's first goal is addressed by the conclusions drawn about the relationship between equity-based executive compensation and firm financial performance. Results show that there is a statistically significant negative relationship between equity-based executive compensation and firm financial performance at the 1% level. Thus, this study concludes that equity-based executive compensation negatively and significantly influences the performance of a firm. This means that when executives of a company are paid with more equity-based compensation, the performance of the firm is likely to be reduced. The first hypothesis was therefore accepted since the study found that there existed a negative relationship between equity-based executive compensation and firm financial performance.

5.3.2 The Moderating Role of Audit Committee Characteristics on the Relationship between Equity-based Executive Compensation and Firm Financial Performance

The final objective of this research is related to the findings of the moderating impacts of audit committee characteristics on the relationship between equity-based executive compensation and firm financial performance. The study's overarching goal was to find a way to use audit committees as a tool to deal with the agency problem in a business by introducing features of audit committees

as a moderating variable. The research found that financial expertise and gender diversity on the audit committee impacted the relationship between equity-based executive compensation and firm financial performance more positively and significantly. The study concluded that audit committee independence had a negative and statistically significant effect on the relationship between equity-based executive compensation and firm financial performance. Thus, hypotheses 2a and 2b were accepted, whilst hypothesis 2c was rejected.

5.4 Conclusion

The task of reconciling the interests of managers and shareholders might be likened to navigating a complex and delicate situation. On one side, this alignment seeks to address an inherent agency dilemma, which refers to the potential gap between the managers, who act as guardians of an organisation, and the shareholders, who are the ultimate owners of the organisation. The implementation of equity-based compensation has emerged as a prospective resolution, effectively converting managers into stakeholders. By doing so, the motives of employees become inherently interconnected with the financial performance of the firm, therefore successfully integrating their personal ambitions with the overarching objectives of shareholders. Nevertheless, this alignment is not without its drawbacks. Equity-based remuneration establishes a mutually beneficial relationship between managers and shareholders; yet, it also has ramifications for corporate success. Occasionally, the use of this remuneration approach may unintentionally hinder a company's success, therefore diminishing its effectiveness. The challenge faced by organisations is twofold: aligning the interests of managers with those of shareholders, while also enhancing the overall performance of the firm.

Exploring the complex nature of this delicate interplay, the present study has revealed several crucial findings. The membership of the audit committee has the ability to play a crucial role in

aligning the interests of executives with the overall objectives of a corporation. The study's findings highlight that certain characteristics of the audit committee can have a significant impact on enhancing business performance, particularly in a compensation environment that is more focused on equity-based rewards. The key argument of this research is that while the alignment of interests between managers and shareholders is crucial, it is not the exclusive factor determining the performance of a corporation. The audit committee, characterised by its unique qualities, serves as a guiding force for the organisation in navigating the complex realm of equity-based pay and its associated effects. The process of aligning management goals with business success is a complex endeavour, although given appropriate guiding principles, it is a worthwhile pursuit.

5.5 Recommendations

After successful completion of the study, the following recommendations were made to policy, practice and academia as follows:

5.5.1 Recommendations to Policy

It is essential for policymakers to recognise that compensation plans function as mechanisms to match the interests of managers with those of shareholders, yet they may inadvertently result in unforeseen outcomes. While the pursuit of enhanced shareholders' wealth is of utmost importance, it is imperative to use caution in order to prevent any adverse effects on the organisation or other stakeholders. Therefore, it is crucial to:

1. The formulation of policies that proactively mitigate risks and minimise agency costs is crucial, acknowledging the significance of maintaining a delicate equilibrium between the interests of shareholders and the overall well-being of the organisation.

2. It is imperative to establish a set of rules that guarantee the appointment of highly skilled people who are dedicated to the authentic production of shareholder value in management positions.
3. Promote a policy framework that ensures the protection of the interests of all stakeholders. This not only tackles current problems related to agency costs but also strengthens the long-term sustainability of the organisation.

5.5.2 Recommendations to Practice

Practitioners are often responsible for implementing rules in real-world settings. There is a need for the evolution of corporate practises in order to ensure the simultaneous generation of shareholder value and organisational health. In a precise manner,

1. Enhance the supervisory function of audit committee boards, guaranteeing their continued vigilance in identifying and mitigating tactics that may enhance shareholder wealth in the short term but have the potential to adversely affect business performance in the long term.
2. It is imperative to accord high priority to the implementation of sound corporate governance practises. This entails the development of pay systems that incentivize the generation of authentic value while maintaining the overall performance of the organisation.
3. Promote the integration of diversity among audit committees. It is important to prioritise financial acumen, gender diversity, and the involvement of non-executive members. The presence of diverse individuals within a group or organisation contributes to a range of viewpoints, which in turn facilitates checks and balances. This variety may also serve as a safeguard against circumstances where choices are taken and endorsed solely by a homogeneous group of individuals.

5.5.3 Recommendations to Academia

This study, albeit a noteworthy addition, represents only a fragment of the broader picture concerning equity-based executive compensation, audit committee characteristics, and corporate performance. Academic study of these subjects deepens as follows:

1. Acknowledge the significance of this research as a preliminary investigation of the relationship between audit committee attributes and corporate performance in relation to CEO remuneration.
2. This inquiry aims to further examine various dimensions of executive remuneration and analyse their potential effects on the overall performance of firms. This study has shed light on the topic of equity-based pay; nevertheless, there are additional components that have to be explored in academic research.
3. Expand the focus of the research to investigate the secondary effects of executive remuneration. The inclusion of factors such as the cost of capital, equity, and debt within a company's financial structure is crucial. Gaining a comprehensive understanding of how these factors interact with compensation plans may provide valuable insights.

5.6 Limitations and Directions for Future Studies

The researcher has admitted that there are some limitations to this study. The study used secondary data from africanfinancials.com, which had some organisations' missing data. This affected the analysis of the study as some companies had to be removed to get the sample size for the study. Despite the contribution of the study to the existing literature, there are still some gaps that require future studies. Non-financial companies trading on Africa's different stock markets provided the data used in the study. Will firms in the financial sector show different results? Can these features of audit committees moderate the relationship between equity-based executive compensation and

firm financial performance for such firms? Thus, the financial sector could also bring up other results, and thus, this sector of the economy remains unexplored. The relationship between equity-based executive compensation and business performance in the financial industry may be further investigated by studying the moderating impact of audit committee characteristics.

In addition, the study's results showed that financial performance was not improved by the presence of an independent audit committee. This correlation's origins were not investigated further because the study was quantitative. To further understand why audit committee member independence does not correlate with firm financial performance, future research may want to use qualitative or hybrid methods.



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