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By Universitas Muhammadiyah Sidoarjo

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Directors' Compensation, Corporate Attributes, and Firm Performance of Selected Listed Firms in Nigeria

Kompensasi Direktur, Atribut Perusahaan, dan Kinerja Perusahaan pada Perusahaan Terpilih yang Terdaftar di Nigeria.

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Abstract

This study investigates the impact of Directors' Compensation and Corporate Attributes on firms' performance using data from sixty-seven listed firms on the Nigerian Exchange Group (NGX) spanning from 2012 to 2021. Through regression analysis, the research reveals a negative relationship between Director Compensation and firm performance, measured by returns on assets (ROA). Additionally, firm size exhibits a negative association with performance, while firm value positively influences success. Leverage, on the other hand, is found to negatively correlate with firm performance. The study suggests strategic management overhauls in Nigerian firms, emphasizing optimized financial structures, balanced leverage, and prudent debt management to mitigate financial risks and enhance overall performance. Furthermore, aligning Director's compensation with performance metrics is recommended to foster accountability, efficient resource management, and alignment of individual interests with overall corporate objectives.

Highlights:

- **Negative ROA Correlation:** Directors' Compensation shows a negative relationship with firm performance measured by ROA.
- **Strategic Overhauling Recommendation:** Suggests optimizing financial structures and prudent debt management in Nigerian firms.
- **Compensation-Performance Alignment:** Advocates aligning Director's compensation with metrics for accountability and efficient resource management.

Keywords: Directors' Compensation, Return on Asset, Corporate Attributes, Performance, Firms Size

Published date: 2024-01-05 00:00:00

Introduction

The emphasis devoted to director compensation developed from the realization of "agency" difficulties between shareholders (principals) and managers (agents), motivating the need to connect director performance with compensation and the quality of financial reporting which sought to promote higher corporate performance. However, the relationship between director compensation and business performance has been a primary topic in accounting and finance over the past three decades and since the last global economic crises, however a consensus on this relationship remains elusive. Rewarding performance through salary or compensation is considered a critical human resource management strategy that significantly influences organizational productivity, efficiency, and growth [1]. Although studies abound regarding compensation and organizational differences, the impact of director compensation on organizational financial quality or performance remains less debated. Nonetheless, there is an acknowledged impact of compensation towards business expenses on compensation towards performance.

An important question arising from this is concerning the effect of directors' compensation on business performance and financial statement quality. Despite numerous studies on director compensation and firm performance in Nigeria, the majority have centered on financial firms, particularly banks, as evidenced [2] among others. Notably, prior investigations in this area have yielded mixed results regarding the relationship between director compensation and firm performance [3].

The outcome of empirical research in this domain may be influenced by various factors, including the choice and measurement of variables. Many prior studies used a single measure of firm performance without considering a combination of multiple measures, potentially impacting the outcomes. This study aims to address these identified issues by evaluating the influence of directors' compensation on a business's financial performance quality. It examines existing literature, identifies potential gaps, and proffer suggestions based on available empirical evidence, and proposes future courses of action. To guide this study, research hypotheses were formulated to enable us enquire about how director compensation affects its relationship with firms' size, firm value and leverage on a firm's financial quality.

Literature Review

2.1 Firms' Performance

The performance of an organization is generally described by its efficiency in utilizing available resources to generate maximum profitable income. Elucidate that firm performance encompasses the effective and efficient utilization of resources by managers to achieve predetermined objectives [4], particularly referring to financial performance. Further emphasize that a company's financial performance revolves around its ability to effectively employ assets to generate financial benefits for shareholders [5]. Echo this sentiment, stating that financial performance encompasses various financial outcomes or values captured by diverse metrics [6].

In exploring director compensation practices and firm performance, prior studies [7], adopted proxies such as Return on Equity (ROE), Tobin's Q, stock price, and Return on Assets (ROA) as measures for firm performance. Conversely, compensation encompasses the rewards received by workers based on job value, individual contributions, and performance. This term extends to the wide array of rewards granted to company directors. The determination of CEO compensation packages, [8] lies within the purview of an organization's board of directors, subject to shareholder approval usually during the annual general meeting (AGM). [9] Define director compensation as packages allocated to Chief Executive Officers (CEOs) and other directors involved in daily company operations, typically comprising salary, annual bonuses, benefits, and stock options [10]. Describe director remuneration as benefits received by senior managers and directors, immediate or deferred, inclusive of fixed elements like salary, allowances, and insurance, and variable components such as bonuses and shares contingent on the company's financial performance. [11], Assert that robust compensation schemes motivate CEOs to make prudent decisions maximizing shareholders' wealth, acting as a motivator for efficient employee performance within a firm [12].

2.2 Directors Compensation

Numerous academic inquiries have tried to determine the relationship between CEO salary and business performance, mostly focusing on the banking industry but also spanning various countries and businesses. A study revealed a high association between CEO performance and corporate performance [13]. The correlation between financial performance of Nigerian firms and executive compensation and recommended the redesigning of executive compensation structures to suit both short-term and long-term financial performance for sustainable wealth enhancement [14]. Study in the UK indicated a substantial positive relationship between CEO salary and firm performance, whereas overall remuneration displayed minimal correlation with business performance.

2.3 Firms' Size

Firm size and its impact on firm performance in Nigeria have been a subject of substantial inquiry within the scholarly landscape. Studies exploring this relationship within the Nigerian context have yielded varied findings.

While some research suggests a positive correlation between firm size and performance metrics, indicating that larger firms tend to exhibit better financial performance [15], other studies suggested an insignificant or even negative relationship, asserting that smaller, more agile firms might outperform larger counterparts due to greater adaptability and efficiency. This divergence in findings underscores the complexity of the relationship between firm size and performance in Nigeria [16], hinting at the need for more nuanced investigations that consider industry-specific dynamics and evolving market trends within the Nigerian business landscape.

2.4 Leverage

The exploration of leverage and its implications on firm performance within Nigeria's business landscape has generated diverse findings with several studies indicating a complex relationship between leverage and firm performance metrics. While some research highlights a positive association between leverage and performance, suggesting that judicious use of debt can bolster profitability and growth [17], other studies propose a negative correlation, indicating that higher leverage might lead to financial strain and reduced performance. Additionally, there are investigations asserting a non-linear relationship, implying an optimal level of leverage beyond which further increases negatively impact performance [18]. Focused on financial leverage and business performance within the fuel and energy sector of the Karachi Stock Exchange [19], discovering a favourable relationship between financial leverage and firm performance among the ten public listed companies analysed. Evaluated leverage and firm performance across 101 non-financial enterprises, finding a negative relationship between leverage and firm performance [20].

2.5 Theoretical Framework

2.5.1 Agency Theory

The foundational premise of agency theory, as introduced by Jensen and Meckling in 1976, revolves around the dynamics between a principal and an agent within a contractual relationship. The core goal of this relationship is to enhance the company's performance and revenue. Within the framework of agency theory, the principal-agent relationship embodies a scenario where the agent, in this case, the CEO or manager, acts on behalf of the principal, the shareholders or owners of the company. This relationship establishes a critical relationship age between the decisions made by the CEO and the wealth of the principal, yet, inherent conflicts of interest often emerge as both parties aim to maximize their wealth, potentially leading to actions that might not align with each other's best interests. Moreover, the principal lacks direct oversight over the day-to-day activities of the CEO, necessitating mechanisms to align the interests of both parties.

Central to agency theory is the concept of incentivizing the agent (CEO) to act in the best interests of the principal (shareholders). This involves structuring compensation packages, particularly incentive-based compensation, which directly ties the CEO's performance to shareholder interests. CEOs are often incentivized through performance-related goals and compensated in relation to the outcomes of their decisions, aligning their interests with those of the shareholders. This ensures that CEOs work towards goals that benefit the company and its owners, hence mitigating conflicts of interest inherent in the principal-agent relationship. Therefore, within the theoretical framework of this study, agency theory serves as a guiding lens to analyse and forecast the potential impact of Director compensation on business performance. It emphasizes the necessity of aligning the interests of shareholders and managers through remuneration systems that incentivise CEOs to act in the best interests of the firm, hence trying to optimize overall performance and shareholder value.

2.6 Empirical Review

Investigated the correlation between executive remuneration and the valuation of publicly traded deposit money banks (DMB) in Nigeria [21]. The study utilised a correlational research methodology, employing balanced panel data from 14 listed banks as the study's population. The data covered the period from 2010 to 2021. Generalised Least Square (GLS) regression was used as the analytical tool. The study revealed a favourable correlation between CEO Pay and Chairman's remuneration and the value of listed banks. Conversely, the highest paid director was found to have a negative impact on the banks' value. This suggests that the remuneration of the CEO and Chairman has a positive impact on the overall worth of banks. Hence, it is advisable, among other suggestions, for bank management to augment CEO compensation and prioritise performance as the primary determinant for increasing pay, in order to ensure a consistent enhancement in the banks' worth

Explored the relationship between the financial performance of firms and the compensation of executives in Nigeria, drawing upon agency and stakeholder theories [22]. To meet its objectives, the study utilized annual financial statements from ten listed firms in the Nigerian exchange Group market covering the period from 2012 to 2017. Employing descriptive statistics and the panel least square technique, the collected data was thoroughly analyzed. The results indicated a significant and positive correlation between the financial performance of these sampled firms and the compensation received by their executives in Nigeria. As a result, it is recommended that the structure of executive compensation should be redesigned to suit both short-term and long-term financial performance of firms in order to ensure the sustainable enhancement of shareholders' wealth.

Examined the influence of chief executive officer (CEO) remuneration on the performance of 155 French firms

listed on SBF 120 between 2009 and 2018 [23]. Evidence indicates that an escalation in CEO remuneration appears to enhance the firm's accounting-based performance, although it adversely affects the firm's stock market valuation. Significant outcomes are shown when we account for the connections between sector compensation. We contend that offering an appealing remuneration package has the potential to enhance the performance of executives in attaining the goals of shareholders. However, it appears that investors do not value an increase in CEO salary. According to the agency theory, it can be claimed that investors are concerned about executives potentially engaging in opportunistic behaviour, which could lead to excessive compensation.

Study examined the salary trends of directors in India's top 30 publicly traded firms from 2002 to 2019 [24]. The research aimed to determine the correlation between director compensation and company performance, considering factors like size, governance, leverage, and risk. The study found a significant increase in compensation, especially after the 2013 Indian Companies Act regulations. The remuneration structure also changed, with a higher proportion of fixed income and a decrease in variable components like bonuses, commissions, and perquisites. The study also confirmed a temporary two-way connection between director compensation and company performance factors. The results of panel least square regression showed a robust correlation between pay and performance for directors' compensation. The study also found a strong correlation between board size and the lack of control in preventing excessive payment for directors. The correlation between directors' salary and firm performance metrics is partially consistent, but the findings challenge the established correlation between board size and directors' salary, emphasizing the need for improved governance mechanisms in the Indian context.

Method

This study adopted the *ex-post facto* research design while the population of the study consisted of selected firms listed on the Nigerian exchange Group within the period 2012-2021 financial year end. Simple random selection technique was employed in pick 67 non-financial enterprises as the sample size for this investigation. The study adopted the robust regression technique, and the data retrieved from the annual reports of sampled organizations were examined with the aid of statistical tool to run the descriptive statistics, Pearson correlation and robust regression. The models for the study are thus;

$$FPERFit = \beta_0 = \beta_1 DCOMit + \beta_2 FSIZEit + \beta_3 FRVit + \beta_4 LEVit + \mu it$$

Where:

FPERP= firm performance (measured by Return on Assets (ROA) measured as profit after tax divided by total asset (%)).

Tobin's Q= measured as market capitalization plus total liabilities minus cash divided by total asset

Director compensation=DCOM = (measured by Total value of salary, bonuses, life and health assurance, bonus stock accruing to Director directors

Firm Size = FSIZE=Natural logarithm of total assets.

Firm Value=FRV= Tobin's Q

Leverage =LEV=measured as total liabilities divided by total asset

μ = Error term, β_0 = intercept of the relationship, and $\beta_1 - \beta_4$ = Unknown coefficients of the independent variables.

Result and Discussion

A. Presentation of Data

This section provides a structured representation of the information gathered or analyzed within the study through tables.

Variable	Mean	Std.	Min	Max	Skewness	Kurtosis
FPERF	1.4512	16.94	-179.92	176	-1.1955	48.1037
DCOM	2.0839	15.3999	0	385.65	23.3116	578.2904
LEV	65.6684	39.8256	-20.78	395.45	3.4998	23.0245
FRV	0.7610	1.2132	0.01	12.06	4.1107	27.7046
FSIZE	5,6711	2.4185	0.0015	15.1343	-0.6675	2.7661

Table 1. Descriptive Statistics

Table 4.1 gives descriptive data for the variables in the study. The dependent variable, Firm Performance (FPERF), has a mean of 1.4512 with a standard deviation of 16.94. The data displays a wide spread, ranging from -179.92 to 176, with a skewness of -1.1955, showing a little left-skewed distribution. The kurtosis score of 48.1037 shows a heavy-tailed distribution with strong outliers, signaling potential extreme values influencing the general distribution of company performance. In respect to the independent variables, Director's compensation (DCOM) exhibits a mean of 2.0839 and a bigger standard deviation of 15.3999. The data ranges from a minimum of 0 to a maximum of 385.65, demonstrating great variability and a right-skewed distribution with a skewness of 23.3116 and a high kurtosis of 578.2904, indicating extreme values and potential outliers that significantly impact the distribution. Leverage (LEV), a measure of business financial structure, exhibits a mean of 65.6684 and a standard deviation of 39.8256. The data distribution spans considerably from -20.78 to 395.45. The skewness of 3.4998 and kurtosis of 23.0245 reflect a fairly skewed distribution with a considerable number of observations deviating from the mean. Additionally, Firm Value (FRV) and Firm Size (FSIZE) indicate means of 0.7610 and 5.6711, respectively, with variable standard deviations. FRV ranges from 0.01 to 12.06, demonstrating a skewed distribution with a skewness of 4.1107 and a high kurtosis of 27.7046, indicating potential outliers. FSIZE spans from 0.0015 to 15.1343, displaying a moderate distribution with a minor negative skewness (-0.6675) and considerable kurtosis (2.7661), suggesting a comparatively more normalized distribution compared to the other variables.

Variable	FPER	DCOM	LEV	FRV	FSIZE
FPER	1.0000				
DCOM	-0.0858	1.0000			
LEV	-0.3590	0.0840	1.0000		
FRV	0.2026	-0.0048	-0.0307	1.0000	
FSIZE	-0.0114	0.0109	-0.0362	0.0327	1.0000

Table 2. Correlation Analysis

Table 4.2 present correlation coefficients between the variables evaluated. Firm Performance (FPER) has a weak negative relationship with Director's compensation (DCOM), evidenced by a correlation coefficient of -0.0858. This implies a minor inverse association between these factors. Moreover, there appears to be a moderate negative relationship between Firm Performance (FPER) and Leverage (LEV), with a correlation coefficient of -0.3590. This suggests that when the level of leverage increases, there is a tendency for business performance to fall moderately. However, when it comes to Firm Value (FRV) and Firm Size (FSIZE) in relation to Firm Performance (FPER), the correlations are relatively weak and mixed. Firm Performance (FPER) shows a slight positive correlation with Firm Value (FRV) of 0.2026, indicating a minor tendency for these variables to move together in a positive direction. Meanwhile, Firm Performance (FPER) showcases an almost negligible negative correlation with Firm Size (FSIZE), suggesting an extremely weak inverse relationship between these variables. The analysis suggests varying degrees of correlation between Firm Performance (FPER) and the other variables studied, with weak to moderate negative correlations observed with Director's compensation (DCOM) and Leverage (LEV), a slight positive correlation with Firm Value (FRV), and a very weak negative correlation with Firm Size (FSIZE).

Variable	LEV	DCOM	FSIZE	FRV	Mean VIF
VIF	1.01	1.01	1.00	1.00	1.01
1/VIF	0.99068	0.99270	0.99749	0.99805	

Table 3. Variance Inflation Factor

Table 4.3 shows Variance Inflation Factor (VIF) values for the variables studied in a regression study. The VIF evaluates the degree of multicollinearity between independent variables in a regression model. Looking at the VIF values, all variables—Leverage (LEV), Director's compensation (DCOM), Firm Size (FSIZE), and Firm Value (FRV)—show VIF values close to 1. This shows relatively limited multicollinearity among these variables. Typically, a VIF score above 10 denotes significant multicollinearity, whereas values between 5 and 10 indicate moderate multicollinearity. In this situation, with values around 1, there's a lack of major multicollinearity among the variables. The reciprocal of the VIF (1/VIF) further corroborates this conclusion. These values, ranging from 0.99068 to 0.99805, likewise show minimal multicollinearity. Higher values closer to 1 reflect decreased multicollinearity, emphasizing the absence of substantial multicollinearity issues among the independent variables in the regression model. Based on the VIF and reciprocal VIF values presented, there seems to be no noticeable multicollinearity among the variables—LEV, DCOM, FSIZE, and FRV—within the regression analysis.

Breusch-Pagan/Cook-Weisberg Test for Heteroskedasticity	
Chi2(1)	845.22
Prob > chi2	0.0000

Table 4. Breusch-Pagan Multiplier Test

The Breusch-Pagan/Cook-Weisberg Test for Heteroskedasticity analyses whether the variance of the errors in a regression model is constant (homoscedastic) or fluctuates systematically (heteroskedastic).

- Chi2(1) refers to the test statistic, which is 845.22.

- Prob > chi2 denotes the p-value relationship with the test statistic, and it's reported as 0.0000.

A low p-value (near to zero) in the Prob > chi2 column, such as the one provided (0.0000), implies strong evidence against the null hypothesis. In this scenario, the null hypothesis often implies homoscedasticity (constant variance of errors). Therefore, with an extremely low p-value of 0.0000, it means that there is substantial statistical evidence to reject the null hypothesis of homoscedasticity. In other words, the regression model demonstrates heteroskedasticity, implying that the variance of the errors is not consistent across all levels of the independent variables. Instead, it varies systematically in a way that is not accounted for by the model.

Dependent Variable: Firm Performance				
Variable	Coefficient	Std. Error.	t-statistics	p-value
Director's compensation	-1.0135	0.0488	-20.74	0.000
Leverage	-0.0922	0.0049	-18.68	0.000
Firm Value	2.1172	0.1595	13.27	0.000
Firm Size	-0.0247	0.0801	-0.31	0.757
Constant	8.2976	0.6069	13.67	0.000
Prob > F				0.0000
F (4, 662)				278.76

Table 5. Robust Regression

Table 4.5 represents the results of a regression analysis with Firm Performance as the dependent variable and Director's compensation, Leverage, Firm Value, and Firm Size as independent variables.

1. Director's compensation

Starting with Director's compensation, the coefficient is -1.0135, with a standard error of 0.0488. The t-statistic, which assesses the significance of the coefficient, is -20.74, and the accompanying p-value is reported as 0.000. This reveals a fairly significant negative relationship between Director's compensation and Firm Performance. For every unit increase in Director's compensation, the Firm Performance is predicted to drop by around 1.0135 units.

2. Leverage

Moving to Leverage, the coefficient is -0.0922, with a standard error of 0.0049. The t-statistic is -18.68, and the p-value is 0.000. Similar to Director's compensation, Leverage likewise reveals an extremely substantial negative association with Firm Performance. This shows that as Leverage grows, the Firm Performance is likely to drop by about 0.0922 units.

3. Firm Value

For Firm Value, the coefficient is 2.1172, with a standard error of 0.1595. The t-statistic is 13.27, and the p-value is 0.000, showing a highly significant positive relationship with Firm Performance. As Firm Value increases by one unit, the Firm Performance is predicted to increase by approximately 2.1172 units.

4. Firm Size

However, the coefficient for Firm Size is -0.0247, with a standard error of 0.0801. The t-statistic is -0.31, and interestingly, the p-value is 0.757, demonstrating that the association between Firm Size and Firm Performance is not statistically significant. In this example, the data does not give solid evidence to show those changes in Firm Size had a major impact on Firm Performance. Additionally, the Prob > F value (0.0000) and the F-statistic (278.76) indicate that the total regression model is statistically significant, implying that at least one of the independent variables has a substantial effect on Firm Performance.

B. Discussion of Findings

Director's compensation and Leverage indicate statistically significant negative relationships with Firm

Performance. This implies that higher levels of Director's compensation and leverage likely to coincide with poorer Firm Performance in Nigerian enterprises. The consequences of this are rather substantial. Elevated Director's compensation could signify inefficiencies or mismanagement inside the organization, harming its overall performance. Similarly, excessive Leverage could suggest increased financial risk or an overreliance on debt financing, perhaps leading to financial instability, which could impede a firm's capacity to compete optimally in the Nigerian market. This study agrees with those of who reported a substantial association between leverage and firm performance [24]. While it contradicts the findings of who reported that director's salary has insignificant relationship with firm performance [25].

Conversely, Firm Value exhibits a substantial positive relationship with Firm Performance. This conclusion implies that when the perceived worth of the firm improves, its performance tends to improve. In the Nigerian context, this could indicate that enterprises pursuing tactics to boost their perceived worth, such as through good branding, market positioning, or innovation, are more likely to have higher performance. This finding corresponds with findings of demonstrated that firm performance retains a substantial association with firm value in Nigeria [26].

Interestingly, Firm Size does not reveal a statistically significant relationship with Firm Performance in this study focused on Nigerian enterprises. While Firm Size is frequently considered a critical determinant in performance, the lack of relevance in this context shows that, within the factors analyzed, the size of a firm might not directly influence its success in Nigeria. This could imply that in the Nigerian market, elements beyond sheer size, such as efficiency, market flexibility, or specialized industry characteristics, might play more critical roles in deciding business performance.

In Nigeria's business scene, these findings show that cautious management of Director's compensation and Leverage could be crucial for increasing Firm Performance. Firms may benefit from optimizing their financial structures, eliminating excessive reliance on debt, and ensuring that Director's compensation matches with performance goals to encourage efficiency and good management [27]. Additionally, emphasizing tactics that boost perceived Firm Value could generate good consequences on overall performance. Understanding these relationships can benefit Nigerian organizations in establishing more effective strategies, strengthening corporate governance processes, and prioritizing areas that significantly contribute to enhancing Firm Performance in this specific market scenario.

Conclusion

The study delved into the intricate dynamics influencing Firm Performance within Nigerian businesses. Through a comprehensive analysis of variables including Director's compensation, Leverage, Firm Value, and Firm Size, significant insights were unearthed. Director's compensation and Leverage emerged as key factors negatively impacting Firm Performance, signaling the importance of prudent financial management and strategic decision-making. On the other hand, Firm Value showcased a robust positive correlation, emphasizing the significance of strategies that augment a firm's perceived value. Interestingly, Firm Size did not exhibit a significant association, suggesting that other nuanced factors beyond sheer scale might drive performance in the Nigerian business landscape. This study provides valuable guidance for Nigerian firms, spotlighting critical areas that demand attention and strategic recalibration to foster enhanced performance in this dynamic market.

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