Compensation Practices and Financial Performance of Selected Quoted Companies in Nigeria

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Abstract

This study examined the influence of compensation practices and financial performance of selected quoted companies in Nigeria. Specifically, it sought to determine the influence of staff compensation, CEO compensation and director compensation on organisational performance. In pursuance of the above objectives, the study sourced data from quoted firms in Nigeria that had consistently published their audited annual financial reports for the period 2011 to 2016. A sample of sixty-two (62) quoted firms was used for statistical analysis. The study adopted a multiple regression analysis using panel data to test the formulated hypotheses. The empirical results from the fixed effect unbalanced panel regression models showed that staff compensation had a positive and an insignificant influence on organisational performance, CEO compensation had a negative and an insignificant influence on organisational performance and director compensation had a positive and an insignificant influence on organisational performance. The study recommends that management of quoted firms should be less concerned about compensation practices due to the insignificant influence on organisational performance.

Keywords: CEO compensation, Director compensation, Organisational performance and staff compensation.

1.0 INTRODUCTION

The structure of executive pay has been linked to corporate failures in the US (Felton, 2004). In view of large stock options and desire for higher stock prices, executives inflated earnings and manipulated their books. Scholars therefore, concluded that much may be wrong with executive compensation (Hall & Murphy, 2003). Executive compensation has also become more transparent,

as companies are required to publish details of compensation data in Nigeria and other countries (Njogu, Gekara, Waititu, & Omido, 2017). Jensen and Murphy (2010) observed that compensation is one of the largest single cost incurred by most organisations. The effectiveness of compensation and performance systems depends on long term organisational performance. Executive compensation is one of the promising researches in the field of management sciences (Njogu, Gekara, Waititu, & Omido, 2017). The executive pay- performance relationship has attracted the attention of scholars and practitioners alike in recent years. The compensation of top executives has escalated in recent times, while lower staff's pay has stagnated (Njogu et al., 2017).

Directors' compensation package has been criticised because it only incentivizes excessive risk-taking which is a major factor among commercial banks that contribute to financial distress (Alon & Yoram, 2010). Therefore, the relationship between performance and executive compensation has received a lot of attention from accounting and finance managers and the academia (Adegoroye, Sunday, Soyinka & Ogunmola, 2017). The primary reason why an organisation gives compensation parcels to directors is to encourage them to assist the organisation to achieve the corporate goals and objectives that will ensure maximum return on the shareholders' wealth (Jensen & Murphy, 2010).

Top executive stock options are awarded to increase exposure of executives to stock prices in order to align compensation of top executives to shareholders' wealth (Khalid & Rehman, 2014). Guthrie, Sokolowsky and Wan (2012) opined that the amount of compensation awarded to directors depended on the performance of the organisation and other related factors. Thus, Kanagaretnam, Lobo and Mathiew (2012) agreed that extant and empirical literatures on organisational performance and CEO compensation were inconclusive. The incomplete or inconclusive and/or inconsistent nature of much of the existing literature revealed the need for further studies on the relationship among executive compensation, innovation and performance. The study took an analytical approach and investigated the empirical relations among these variables controlling for size and ownership structure with the use of econometric model.

Research Objectives

The broad objective of the study was to empirically examine the effect of executive compensation on the organisational performance of selected quoted companies in Nigeria. The specific objectives were to:

(i) examine the influence of staff compensation on organisational performance of quoted firms in Nigeria

(ii) determine the influence of CEO compensation on organisational performance of quoted firms in Nigeria

(iii) investigate the influence of director compensation on organisational performance of quoted firms in Nigeria

Research Hypotheses

The hypotheses tested in this study were stated in null form as follows:

H_{O1}: staff compensation has no significant influence on organisational performance of quoted firms in Nigeria.

H_{O2}: CEO compensation has no significant influence on organisational performance of quoted firms in Nigeria.

H_{O3}: director's compensation has no significant influence on organisational performance of quoted firms in Nigeria.

2.0 REVIEW OF RELATED LITERATURE

Theoretical framework

Based on theoretical reviews, the study would be anchored on the managerial power theory. The theories were reviewed below:

Agency Theory

The concept of agency theory was based on the idea that profit maximisation was one of the preferences of the principal (Jensen & Meckling, 1976). Utility maximisation is the key preference

of the agent. Note that utility maximization includes discretionary profits and emolument (Jensen & Meckling, 1976). It is observed that utility and profit maximization always go hand in hand because emoluments bring about better organisational practices. Sometimes, the utility of management conflicts with the profit maximization ideology of the principal. The maxim, principal agent relationship, is a contractual relationship where the principal ensures their platforms for appropriate compensation for the agent (Furubotn & Richter, 2005). The relationship between the principal and the agent brings external disturbances because of the degree of information available. Due to this assertion, the principal does not in any way monitor the activities of the agent. The agent is responsible for his or her actions at any time. The agency theory believes that the principal has the responsibility to develop an appropriate compensation structure for the agent. This helps the agent to guide him or herself against unforeseen circumstances or opportunistic behaviour.

Managerial Power

The theory focused on the executive's selfish ability to give detailed explanations about discoveries in different compensation plans and the enormous level or volume of directors' compensation (Finkelstein, 1992). The theory believed that the position of directors in a company is desirable, profitable and responsible, and gives them an opportunity to have access to the economic profit of the organisation (Finkelstein & Hambrick, 1990). It was observed that the level of compensation received by a director was not commensurate with the amount of time and energy involved. According to Finkelstein (1992:520) the election of the director of a company was not usually done outside the company due to takeover context because most aspirants nominated for the position hardly lost the election. It is very important for any director who still wishes to remain in office to appeal to the minds of those who determine the person to be the director of the company. Researchers have argued that in publicly quoted companies, the decision as to who will be the director lies with the executive. And scholars have argued that it is an informal way of nominating the director. Finkelstein (1992) asserted that directors, who wished to remain in office, must therefore, appeal the minds of the executive for support. Most times, management cares more for the compensation plans of the directors than for any other issues affecting the director's work.

Conceptual Overview

Organisational Performance

Organisational performance is described as the scale of the extent an organisation effectively allocates the available assets to generate maximum return for itself (Adegoroye, et al., 2017). Performance refers to the manner in which the resources of the organisation utilised to achieve predetermined goals and objectives within a defined structure. According to Ehikioya (2009), organizational performance influences corporate governance significantly. All this help to increase the level of performance of the firm in the long-run. This imply that effective organisational monitoring prevents issues of financial fraud, enhances rapid organisational growth and helps to increase the level of organisational performance (Ehikioya, 2009). Atrill, McLaney, Harvey and Jenner, (2009) saw organisational performance as the measure of the level which firms utilise their assets to realise revenues. Therefore, the term, performance, is the measure of achievement of the assigned responsibilities that is an embodiment of the employee's role in the organisation (Atrill, McLaney, Harvey & Jenner, 2009). Thus, performance is used as a performance appraisal technique to evaluate employees' contribution to the corporate objectives of the organisation.

Organisational performance is the level of organizational achievement with regard to organisation regulations, expectation and requirement in meeting its goals and objectives (Folorunso, Adewale & Abodunde, 2014). In the view of Armstrong (2017), organizational performance is the extent of the effective and efficient utilization of resources to achieve objectives for which managers are responsible. Therefore, organisational performance is concerned with work related activities, especially those activities expected of an employee and how well such were executed. Organisational performance is the ability of the organisation to effectively manage the available resources within the firm to predetermined goals and objectives (Nwadukwe & Court, 2012).

Organisational performance evaluation assesses the efficiency and effectiveness of the company using its earnings financial positions at the end of its accounting period (Neely, Gregory & Platts, 1995). Koufopoulos, Zoumbos and Argyropoulou (2008) asserted that organisational performance was the firm's ability to designate its evaluation to relate with the firm and functional objectives and vision. It has been measured through non-financial and financial indicators in modern research (Bakar & Ahmad, 2010). Waiganjo, Mukulu & Kahiri (2012), opined that firm performance was not easy to measure as business organizations had multi faced objectives of profitability and social

responsibility among others. They further stated that performance could be measured by financial and non-financial parameters (Waiganjo, et al., (2012). The financial aspect of the performance provides detailed information which is relevant to the accounting information such as productivity, quality and overall organisational performance (Kafetzopoulos & Psomas, 2014). More importantly, according to Tavitiyaman, Zhang and Qu, (2012:142) net profit margin, Return on Assets (ROA) and Return on Investment (ROI) are the mostly used means of measuring organisation performance. However, other researchers have employed other indicators as non-financial measurements to meet the changes of external and internal environments. Therefore, this study employed Net Profit Margin (PATM).

Executive Compensation Practices

Executive compensation practices have attracted considerable academic interest in recent times. Compensation is a key indicator in human resource management practices (Mittar, Saini & Agarwal, 2014). The optimal contracting school of thought maintains that observed compensation is the result of market performance for executive ability and capability (Edmans & Gabaix, 2016). However, the managerial power school, on the other hand, argued that rising compensations are the result of inefficiencies in the market for executives. Adeniyi (2013) asserted that directors' compensations termed the economic reward for efforts made by directors of the company was measured in terms of basic pay, bonuses and stock options. Theoretical and empirical evidence was obtained from corporate governance literatures on how efficient the role of directors' compensation was in ensuring the effective administration of the organisation (Bushman & Smith, 2001).

Shin, Lee and Joo (2009) believed that executive compensation was financial compensation and emoluments given to the executive for their services to the firm. Adegoroye, et al. (2017) argued that executive compensation was a term used for financial compensation given to board chairmen and executives. Thus, the concept of corporate governance showed that the idea behind the concept is to manage the organisation in a way that gives the shareholders opportunity to get enough return on their investments while ensuring that adequate compensation for other stakeholders are all met as well (Magdi & Nedareh, 2002). The amount of directors' compensation organisations give to executives assist in attracting, motivating and retaining qualified and efficient directors who will

provide an effective business atmosphere and ensure shareholders' wealth maximisation which have been issues in recent times (Ogbeide & Akanji, 2016).

Staff Compensation

Employees receive compensation packages in the form of wages, salaries and pay (Aslam, Ghaffar, Talha & Mushtaq, 2015). However, good compensation motivates the employee to perform better. Azeez (2017) believed that staff compensation is a reward system that encourages long stay in the firm. Staff compensation means the actual money employees receive from their employers for jobs done or services rendered. Ojo (2008) said there are three components of staff's compensation in an organization: the basic pays; the fringe benefits; and performance incentives or bonus. The basic pay is the basic wage in the form of salary; fringe benefits are supplementary compensation awarded to employers over and above the basic wage or salary. A compensation structure that is good will benefit the performance and effectiveness of a firm (Aslam, Ghaffar, Talha & Mushtaq, 2015). Staff compensation systems based on employee performance are seen as a way to correct some of the imperfections in labour, product and capital markets that affect the employment relationship (Pendleton, Whitfield & Bryson, 2009). They emphasize that money as a compensation criterium tends to create money motivation rather than good-work motivation in the sense that when people struggle for monetary compensation, they may sacrifice quality to take the shortest and fastest way to maximize their monetary gain (Pendleton, et al., 2009).

Director's Compensation

Many researchers such as Javad and Xia (2015) and Welker and Gribbin (2010) argued that management is motivated to manipulate earnings when their performance linked with either cash or equity compensation. According to Mulford and Comiskey (2011), management compensation was one of the major motivations of creative accounting in many firms to show their positive state. Matsunaga and Park (2001) observed that managers compensation are made to enable them to beat analysts' forecast. Xie, Davidson and DaDalt (2003) added that managers were compensated directly in forms of bonus, salary, future promotions, job security as well as other benefits. They further identified a combination of management's discretion over reported earnings and explained

that the effect those earnings had on their compensation and benefits may be incentives for creative accounting.

Chief Executive Compensation

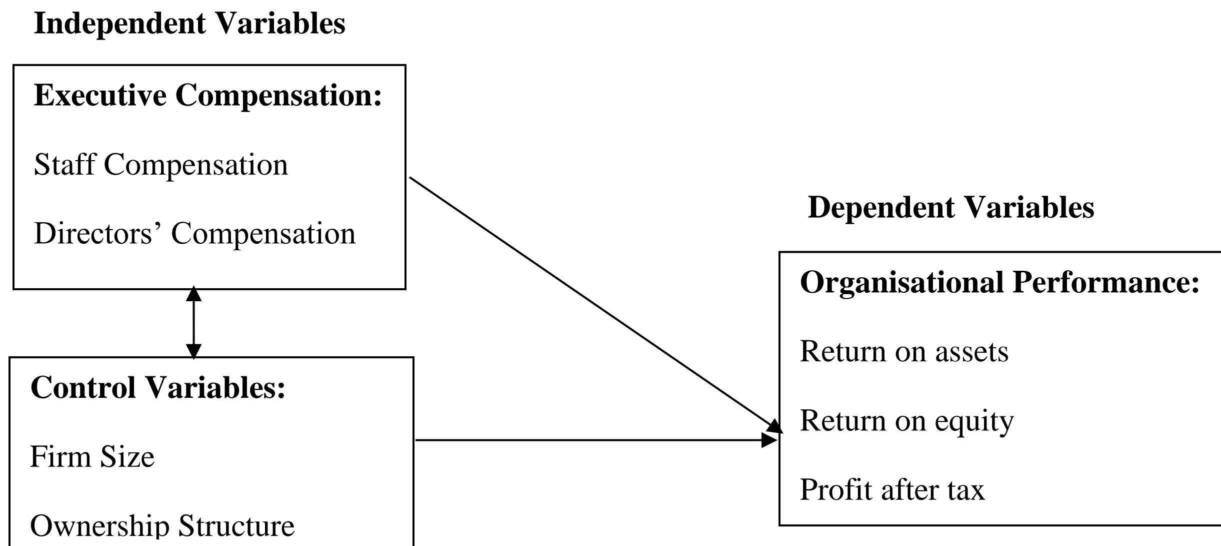
The existence of long-term incentives for chief executive officers in the Western world based on stock options had made it difficult for corporate organizations to separate rewards given to executive members from motivation (Buck, Liu & Skovoroda, 2008). Therefore, the executive directors of quoted companies in developing countries are normally given cash payment not long-term incentives in terms of equity-based pay. This gives ample opportunity to examine CEO pay as an incentive to perform rather than as a reward for performance (Buck, Liu & Skovoroda, 2008). CEO is committed to value rendering in a company for promoting the activities of the organization (Sajjad, Mubashar& Ahmad, 2015). It is important for the CEOs that want to effectively perform on the job to update their skill and knowledge of the executive position, external business environment and issues in labour relations. They must gather sufficient information about the degree of dynamism in both the external and internal environment (Hambrick & Fukutomi, 1991). Piketty (2014) argued in his work that an increase in executive pay simultaneously led to an increase in income inequality. This implies that the higher the pay the CEO receives the wider the inequality gap. The CEO will often have a position on the board, and in some cases, he is even the chairman. CEO change can be anticipated or unanticipated. Sun, Xianging and Huamg (2013) viewed executive compensation as the incentive packages given to senior employees in organizations such as board chairman and CEO compensation.

Empirical Reviews

Xue (2007) carried out a study on performance choice measures for directors' compensation contracts that affected managers' level of choice between R & D that is in-house and external acquisition framework for acquiring new level of technology. High technology firms in the United States were sampled. The study revealed that compensation based on cash motivated and encouraged managers to accept strategies rather than reject them. The study further revealed stock-based pay encouraged managers to accept strategy. Buck, Liu, and Skovoroda (2008) concluded a study on executive cash remuneration and firm performance. The study was carried out in China,

and it sampled Chinese companies for the period under review which was 2000 – 2003. The organisation performance indicators were shareholder value, return pre-tax profit and return on assets. The study indicated that there was a negative but significant relationship between organisational and executive compensation. Jaafar, Wahab and James (2012) did an empirical study on directors' compensation and firm performance among Malaysia family businesses. The indicators used for measuring the directors' compensation were salaries, fees, bonuses and other related benefits. The indicators were measured as dummy variables under the assumption that the firm was a family business with zero. The indicators for measuring organisational performance and non-family businesses were ROA (return on assets) and ROE (return on equity). The study adopted panel data analysis with findings showing that there was a positive and significant relationship between executive compensation and performance. The study of Idemobi, Onyeizugbe and Akpunonu (2011) on compensation management and organisational performance in Anambra State Civil Service revealed that compensation had no significant effect on performance in the Civil Service. Akinloye (2012) carried out a research work on whether there was a relationship between directors' compensation and earning indicators. The study established that a high profile of stock options to directors increased future earnings. Gathua, Ngumi and Kiragu (2013) did a study on the relationship between executive compensation and risk among commercial banks in Kenya. They found out that executive compensation had an insignificant relationship with bank risk portfolios. Kurawa and Saidu (2014) conducted an empirical investigation on CEOs' compensation and how organisations performed. The study was sampled among publicly quoted Nigerian banks and it revealed a positive relationship between CEOs' remuneration and performance of the financial institutions. An empirical investigation carried out by Olalekan and Bodunde (2015) on the impact of CEO pay on bank performance in Nigeria for the period 2005 to 2012 employed a dynamic Generalized Method of Moments (GMM) for the data analysis and the results showed that the CEO compensation had a significant negative influence on bank performance in Nigeria.

The Conceptual Framework



Source: Adapted from Ogbeide and Akanji (2016).

3.0 METHODOLOGY

Research Design

Panel survey was adopted for the study with the intended population under investigation over time. The panel survey assumes cross sectional heterogeneity and time heterogeneity among the sampled companies. This enabled the researcher to examine executive compensation and organizational performance of selected quoted companies in Nigeria.

Population and Sample Size

The population for the study consisted of the one-hundred and eighty-six (186) quoted companies in the Nigerian Stock Exchange (NSE). The firms used for the population had the responsibility to publish their financial statements for six consecutive years for the period 2011- 2016. Sauders, Lewis and Thornhill (2003) suggested that a minimum number of thirty (30) for statistical analysis provided a useful rule of the thumb. The sample size was based on the one-hundred and eighty-six (186) quoted companies as at 31 December, 2016 in the Nigerian Stock Exchange (NSE, 2016 Fact Sheet). The sample size of the study was based on Ewododhe (2011) sample size computation

formulae. The sample size of 62 was computed by taking One-third (1/3) of the total population of 186 quoted companies. Then, it was mathematically expressed as n=1/3N 1/3 x 186 = 62. In order to avoid bias, simple random sampling techniques were used to select the 62 quoted firms that formed the sample.

Model Specification

Panel data multiple regression models were required for the study. The specification of the models was based on different methodological gap obtained from both conceptual and empirical literature discussed in the previous section. The panel data multiple regression model defined a dependent variable as a linear function of the independent variables with consideration for the cross section of the sampled companies. This implied that the shared regression model asserted that there was nonconformity in the pooled companies while panel regression model believed cross sectional heterogeneity (Cross section fixed effect) and period heterogeneity (Time fixed effect). In specifying our panel regression model, we included cross sections (companies) and year dummies (2011 - 2016). The panel multiple regression model with an error term (ε_t) was specified in econometric form in model as shown below:

Performance and Executive Compensation Model

$PATM_{it} = \beta_0 + \beta 1SCOMPit + \beta_2 CEOC_{it} + \beta_3 DIRC_{it} + z_{it} + \varepsilon_{it}$ ……................................... (1)

Where;

PATM = Profit after tax margin for organisational performance

STCOMP = Staff Compensation.

CEOC = CEO Compensation

DIRC = Director Compensation

β_0 = constant

β = variables that vary across companies but do not vary over time

Akinwale & Akrawah (2019)

ε_{it} = error terms over the cross section and time.

The presumptive signs of the parameters in the specifications are:

$\beta_1, \beta 2, \beta_3 > 0$

Table 1: Measurement and Operationalization of Variables

Variable	Measurement	Sources
PATM = Net Profit margin (Dependent variable)	Net Profit margin as a measure of organisational performance. It is measured by dividing profit after tax by total gross revenue.	Claudia, Theresa & Cristina (2010); Brown & Caylor (2004).
STCOMP= Staff Compensation (Independent variable)	Staff compensation will be measured by the amount of money paid to the staff.	Ali, Amin & Cobanoglu (2015).
CEOC = CEO Compensation (Independent variable).	This is measured by the annual pay of the chief executive officer / managing director of the company.	Olaniyi & Obembe (2015)
DIRC = Director Compensation (Independent variable).	This is measured by the annual pay of the directors of the company.	Jaafar, Wahab & James (2012)

Method of Data Analysis

The individual statistical significance test (t-test) and overall statistical significance test (F-test) served as the basis for determining the estimation results from the panel data. The coefficient of determination (R-squared) served as the basis for the goodness of fit of the model. The nature of

data under investigation was properly described using descriptive statistics and correlation analysis. A Microsoft Excel and EViews 8.0 software package were adopted for all data analyses carried out in the study.

4.0 PRESENTATION, ANALYSIS AND DISCUSSION OF RESULTS

The compensation practices unbalanced panel data regression results examined how the three types of compensation practices impacted on firms' ability to generate statistically significant positive return on and net profit margins (PATM) as indicators of organizational performance. The results obtained were presented in table 2.

Table 2: PATM Unbalanced panel regression results of compensation

	Expected Sign	PATM (Fixed Effect)	PATM (Random Effect)
C		-0.01 (-0.15) [0.87]	0.06 (1.26) [0.20]
SCOMP	+	1.17 (1.27) [0.20]	3.96 (1.17) [0.24]
CEOC	+	-5.88 (-0.40) [0.68]	-6.17 (-0.74) [0.45]
DIRC	+	4.52 (0.41) [0.68]	-2.51 (-0.29) [0.76]
R-Squared		0.169473	0.004878
F-Statistic		0.81 (0.84)	0.54 (0.64)
Durbin Watson		2.194457	2.034712
Hausman Test		-	5.85 (0.11)
N(n)		62 (6)	62 (6)

The table 2 presented fixed effect and panel data estimator as the unbalanced panel data estimation methods. The result from Hausman test indicated that the high probability values of 0.11 implied that the fixed effect was rejected and the random effect

model accepted. From the table above, it was clear that the random effect model indicated that the R-squared value was estimated at 0.004878. The R –square values explained that all the independent variables jointly provided an explanation for about 1% of the changes in net profit margin (PATM) across the six years period (2011 -2016) of the sampled quoted companies. The table also provided an explanation for the F statistics which was valued at (0.54) with p value of (0.64). It implied that the PATM unbalanced panel random regression model was insignificant. The value obtained from Durbin-Watson statistics (DW) was 2.03, confirming the extent of validity of the model specification and thus the absence of problems of autocorrelation.

From the above, it should be noted that random effect unbalanced panel regression model that staff compensation (SCOMP) had a positive and an insignificant influence on organisational performance measured by net profit margin (PATM). It implies that an increase in staff compensation led to an increase in organisational performance but it was statistically insignificant. The result also revealed that CEO compensation (CEOC) had a negative influence on organisational performance measured by net profit margin (PATM) but it was statistically insignificant. It means that an increase in CEO compensation led to a decrease in organisational performance but it was statistically insignificant. In the case of director compensation (DIRC), the variable had an insignificant negative influence on organisational performance measured by net profit margin (PATM). The negative coefficient value therefore, meant that an increase in director compensation led to a decrease in organisational performance but it was statistically insignificant.

Discussion of Findings

Following empirical findings from the fixed effect unbalanced panel regression model, it was observed that staff compensation had a positive and an insignificant influence on organisational performance measured by net profit margin even at 10 percent. The findings were consistent with those of Idemobi, Onyeizugbe and Akpunonu (2011) and inconsistent with those of Omoayo (2014) cited in Aslam, Ghaffar, Talha and Mushtaq (2015). This result accepts Hypothesis (HO), which suggests that staff compensation has no significant influence on organisational performance. CEO compensation had a negative influence on organisational performance measured by net profit margin (PATM) but it was statistically insignificant even at 10 percent. The findings were inconsistent with those of Ismail, Yabai and Hahn (2014), Ramadan (2013), Ozkan (2011),

Olalekan and Bodunde (2015) and Olaniyi and Obembe (2015). This result accepts Hypothesis (HO), which suggests that CEO compensation has no significant influence on organisational performance. Director compensation had a positive and an insignificant influence on organisational performance measured by net profit margin (PATM). The findings were consistent with those of Doucouliagos, Askary and Haman (2008), Erick, Kefah and Nyaoga (2014), Gathua, Ngumi and Kiragu (2013) and inconsistent with those of Adegoroye, Sunday, Soyinka and Ogunmola (2017) and Ogbeide and Akanji (2016). This result accepts Hypothesis (HO), which suggests that director compensation has no significant influence on organisational performance.

5.0 CONCLUSION AND RECOMMENDATIONS

Compensation is an important instrument that helps to regulate business activities for both investors and directors to reduce agency issues that may likely arise from the problem of separation of control and ownership. Developed structures to adequately compensate directors help to attract, motivate, and retain qualified hands to manage the affairs of the organisation in terms of keeping the business more competitive and helping to achieve reasonable return on the investment of the shareholders. This has been an issue among scholars and practitioners. The term, organisational performance, embraces the efficient combination of productive assets such as human, material, physical and capital to fulfil the reason for the existence of the organisation. Compensation is a key indicator in human resources management practices. In view of the research findings, the following recommendations were suggested: The study recommends that compensation practices would help to explain financial performance in the long-run. It also recommends that management of quoted firms should be less concern about compensation practices due to the insignificant influence on financial performance.

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