

INFLUENCE OF EXECUTIVE DIRECTORS COMPENSATION AND ASSET UTILIZATION RATIO ON FINANCIAL PERFORMANCE OF QUOTED CONSUMER GOODS FIRMS IN NIGERIA

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ABSTRACT

The study examined the influence of executive directors' compensation and asset utilization ratio on financial performance of Nigeria quoted consumer goods firms. This study employed causal research design. The study was conducted on ten consumer goods firms which were purposively chosen based on accessibility of annual reports. The study covered a period of 5 years ranging from 2015 to 2019. Data utilized for the study were analyzed using both inferential and descriptive statistics, the inferential statistics used are correlation and panel regression. The results of the hypothesis one tested for this study showed that there is a negative significant connection between executive directors' compensation and return on asset evidenced via t-statistic = -2.222500, p-value (0.0040). However, the result of the second hypothesis tested revealed that there is a positive significant connection between asset utilization ratio and return on equity supported via t-statistics = 2.251443, p-value (0.0051). More so, this study concluded that a significant association exist between executive directors' compensation, asset utilization and financial performance. The study suggests that management of quoted consumer goods companies in Nigeria should formulate remuneration packages that will give executive directors an inducement to act in the best interests of the shareholders and also inspire them to effectively use firm's resources and asset. The implication of the study is that high executive directors' compensation does not guarantee high financial performance. Therefore, company management should ensure that executive compensations are pegged in a constantly flexible manner. Also, managers should aim at increasing the organization asset utilization.

Keywords: *Asset utilization ratio, executive compensation, return on asset, return on equity.*

INTRODUCTION

This study adopts an assimilated model that tends to expand on how the financial performance of listed consumer goods organizations can be affected by organisation internal costs which arises due to agency problem. Agency costs includes monitoring cost, residual losses, cost of selecting suitable agents, bonding expenses and investigating cost. (Chen, 2010). Further, countries like Britain have developed new legislations to regulate the compensations of executive directors and also influence it through the opinion of the shareholders (Abdul, Muhammed, Ghazanfar & Muhammad, 2014). Several studies have revealed that reward system play a crucial role on how the decisions to improve directors' performance are being taken since top management board are receptive to what they perceived will result in to a subjective gravity (Muhammed, Hafiz, Ghazanfar & Muhammad, 2014; Adeoye, 2015). The executive board reward scheme of firms cannot be overlooked, as the method of compensating top management has a critical part to play in how organization activities are shepherded in their corresponding organizations. However, Ebimobowei,

Tebepah, Felix, Awuji and Evans (2020) states that executive directors' compensation is a direct agency cost incurred by an organization.

Managers according to Boatright (2008) can be expected to engage in opportunism by taking advantage of any opportunity to enrich themselves at the expense of the shareholders. The separation of ownership and control of organizations has continued to appeal the attention of researchers throughout the world. More so, both agents and principal are encouraged by their individual self-interest and separation is present at different stages (Jensen & Meckling, 2006). Managers in developing economies tend to manage funds profligately, which in turns directly affects organization performance. Also, there are various multi-national companies which have less agency problems because of their size. Siregar, Sembel and Maulan (2015) disputed that the bigger a firm the more effectual it functions. In other words, bigger firms are most expected to have lesser agency costs. The fact that bigger organizations may have some benefits likened to smaller firms makes it essential to observe the influence of firm size on agency cost. Therefore, it is assumed that bigger firms are bound to gain more support, have access to more funds and overcome monetary difficulties than smaller firms, even in time of monetary distress (Lukviarman, 2008).

Furthermore, financial performance is an act of assessing the effectiveness and efficiency of an action (Kyazze, Nsereko & Nkote, 2020). Effectiveness is regarded as the point to which clients' needs are met while efficiency is the degree at which costs of resources are employed when providing a particular client service. However, the need for this study becomes vital as it empirically determines the influence of executive directors' compensation, asset utilization on return on asset and return on equity of Nigeria companies in the consumer goods sector. This research study will bridge the gap by utilizing both direct and indirect agency cost proxies which are executive director's compensation and asset utilization ratio while return on assets (ROA) and return on equity (ROE) were utilized to measure financial performance of the carefully chosen quoted consumer goods company. Agency problems also includes the conflict between the shareholders as the controlling interest or majority in the company, and the noncontrolling owners or minority (Olagunju, Adebayo, Adenle, & Bamidele, 2021). Some of the agency problems may arise when the company engage in the following: misdemeanours, expropriating creditors or exploiting workers, and misleading consumers, which can lead to clash of interest between the organisation and those whom the company have a contractual relationship with.

In addition, most of the scholars that have conducted studies on financial performance and agency cost are fond of using indirect agency costs as proxies for agency cost whereas ignoring direct agency costs. This study however, bridge the gaps by examining the influence of executive directors' compensation and asset utilization on financial performance of quoted consumer goods firms in Nigeria. Where executive directors' compensation and asset utilization are the independent variables while return on asset (ROA) and return on equity (ROE) are the dependent variables as well as debt ratio and firm size are used as control variables. The aims of this study are to:

- i. Investigate the influence of executive directors' compensation on return on Asset (ROA) of quoted consumer goods firms in Nigeria.
- ii. Determine the influence of asset utilization ratio on return on equity (ROE) of quoted consumer goods firms in Nigeria.

Research Hypotheses

The following research hypothetical propositions were formulated for the study.

H₀₁: Executive directors' compensation does not have any significant relationship with return on asset (ROA) of quoted consumer goods firms in Nigeria;

H₀₂: Asset utilization ratio does not have any significant connection with return on equity (ROE) of quoted consumer goods firms in Nigeria.

LITERATURE REVIEW

Conceptual Review

Bonding cost are the costs which the managers incurred in order to provide assurance to the owners of the organization that they are acting in the owners' utmost interest, and they are viewed as the cost acquired in order to provide inducements to the firm directors so as to motivate them to act in the preeminent interest of the shareholders (Olagunju, Adebayo, Adenle & Bamidele, 2021). Bonding costs are expected to diminish the magnitude of agency problem. Senior managers and directors may be given inducements in form of share options or free shares in the company. Therefore, payment packages for managers are vital components of agency cost.

However, the aim of executive directors' reward is to entice and preserve skilled labor. Executive directors' reward encourages directors to act in agreement with all the stakeholders' needs and thus lessen probable clashes of interest within the firm. Junaidu and Sanni (2014) defined executive rewards or remuneration as monetary benefits and additional non-monetary rewards given to the executive directors for their services to the organization. This is typically a combination of remuneration, shares on company stock, bonuses, benefits and privileges, preferably designed to take into consideration the tax law, government regulations, desires of the organisation management, and rewards for performance. The reward system of executive directors is in contrast with that of other members of staff. Top executive directors are not only more compensated than other members of staff, their remuneration structures also vary. Further, executive directors' rewards consist of three elements, namely: an annual cash bonus plan (shortterm inducement), a base salary and a stock-based plan. Executive directors' compensation is one of the numerous factors that can affect firms' performance (Adeyemi, 2012). Hence, the goal of executive compensation is to motivate, entice and retain worthy people for achievement of the firm performance (Adeoti & Isiaka, 2006). Some of the researchers that have studied the connection between executives' compensation and financial performance are Frydman & Saks (2010); Murphy & Sandino (2010); Kurawa & Saidu (2014) and Olalekan & Bodunde (2015).

Furthermore, asset utilization ratio is assessed as the ratio of annual total sales to annual total assets based on the postulation that management decisions create more value for shareholders if the ratio is higher. This measure has attracted wide application in literature (Nguye, Doan & Nguyen, 2020; Rashid, 2015; Yim, 2020). It is also recognized as a measure of management capacity to efficiently utilize the firm's assets and it is inversely related to the agency costs (Chen & Yur-Austin, 2007). In addition, higher value of asset utilization ratio indicates that management team are efficient in utilizing the firm's assets to produce more sales. However, low asset utilization ratio is ascribed to ineffective usage of assets subsequent to poor management and investment decisions (such as mismatch in asset funding and investing in non-productive assets), or from bad management behavior (Brealey & Myers, 2000). A lower value of asset utilization ratio also signifies higher agency costs, whereas greater value of asset utilization specifies lesser agency costs.

More so, return on assets reveals how lucrative a firm is relative to its overall assets. Return on assets gives an impression as to how effective an organisation management is at expending its assets to generate returns. Return on assets is usually assessed as profit after tax divided by average total assets of the organisation as utilized by Olagunju, Adebayo, Adenle, and Bamidele (2021) and Khidimat, Pakistan and Rehman (2014) to measure financial performance. Meanwhile return on equity measures companies' lucrativeness by revealing the amount of profit a firm earn from the money invested in to the company by the stockholders. Return on equity is evaluated as profit after tax obtainable from common stockholders divided by the average total equity of the company (Yasser *et. al.*, 2011).

Theoretical review

Asset utilization ratio and executive directors' compensation are proxies of agency cost, and several models have been used in examining the relationship between agency costs and performance in research such as agency, pecking order and stakeholders' theories. The underpinning theory of this study is agency theory.

Agency Theory

The initial scholars to propose, expressly, that agency theory should be created were Stephen Ross and Barry Mitnick in 1973. Further, Kiel and Nicholson (2003) states that agency theory pointed out that disintegration of ownership from control signifies skilled managers running a firm on behalf of the firm's stockholders. More so, the most renowned work on agency theory accredited to Jensen and Meckling (1976) originally propounds agency theory within the context of principal-agent connection. Agency theory states that, a firm consist of a nexus of agreements between the principals (the owner of monetary resources) and the agents (managers) who are charged with utilizing and controlling the company's resources (Jensen & Meckling 1976). One of the assumptions of agency theory is that an agent has access to more information than the principal. This imbalance of access to information will be unfavorable to the principals and their capability to monitor whether the agents are working in their interest or not.

In addition, another assumption of agency theory is that agent and principal are expected to act logically and use contracting to increase their own wealth. Agents in maximizing their own wealth; may encounter various dilemma in the course of acting in the interest of their principal. Moral hazard problem and low effort level are some of key causes of agency cost conflicts, and the low effort level occurs when the managers work less hard than they would if they were the owners of the organization. This lack of effort could result to lower share price or lower profits.

However, agency theory was criticized by Perrow (1986) on the ground that agency scholars only concentrate on the agent side of the 'principal and agent problem', and stated that the problem likewise occur from the principal side. Perrow also perceived that agency theory is not concerned about the principals, who mislead and exploit the agents in a state where the principal act as an opportunistic. Despite agency theory being popular and being the most used theories on agency cost, agency theory faces many problems such as information asymmetry, fraud and rationality.

Empirical review

Bhatnagan and Trimm (2011) examined the agency managerial power theories and use it to expound on the connection between numerous mechanisms of unsystematic risk, executive compensation and firm performance in the United State of America monetary sector. Establishments in the monetary sector registered on the National Association of securities dealers, automated quotation (NASDAQ) which have been in reality since the pre-financial emergency time frame from January 3, 2006 to the post monetary crisis December 27, 2009 are analysed. They revealed in their findings that the Agency theory does not completely describe the executive risk appetite and behavior. The result of their study discloses that stock options does not influenced unsystematic risk while remuneration of managers is being influenced by market risk and firm performance.

Jabbary, Hajiha, and Labeshka (2013), in their study examined the impact of agency costs on organization performance of 73 firms listed in Tehran Stock Exchange between 2006 - 2010. Asset turnover ratio, Q-Tobin and ratio of operating expenses are used to measure agency costs whereas return on assets and return on capital were employed to measure the performance. Findings of the study revealed that there is a significant connection between agency costs and firm performance.

Empirical study by Rashid (2015) measured agency costs with asset utilization ratio in a study of Bangladesh banks and the results of the study analyzed using panel regression method revealed that asset utilization ratio has significant association with financial performance of listed deposit money banks in Bangladesh.

A related study by Nguyen, *et. al.* (2020) using a sample of 281 listed firms on Ho Chi Minh Stock Exchange in Vietnam between 2013 and 2018 using fixed effect regression method found that foreign interest in a firm triggers decline in agency cost using asset utilization ratio to proxy agency costs.

METHODOLOGY

This study utilized causal research design. Both cross-sectional and time series properties were used for this study which makes it a panel study. Secondary data is needed for this study to attain the company’s research objective, and the secondary data utilized for this study were gotten from the websites of the consumer goods manufacturing sector statements of accounts and published annual reports of the sampled companies and in the Nigerian Stock Exchange (NSE) Fact-book. Ten (10) consumer goods companies in the manufacturing sector were selected purposively based on accessibility of annual reports on the NSE as at 31st December, 2019. The sampling techniques used for this study is random sampling technique. This research work adopted both inferential and descriptive statistics to achieve the specified purposes. The inferential statistics to be adopted are correlation and panel regression analysis.

Variable Measurements

	Measurements	Previous Researchers	A priori Expectation
Dependent variable			
Return on asset (ROA)	<u>Net Income</u> Total Average Assets	Olagunju, Adebayo, Adenle, & Bamidele (2021)	+
Return on equity (ROE)	<u>Net Income</u> Shareholders’ Equity	Yasser et. al. (2011)	+
Independent variables			
Executive directors’ compensation (EDC)	Board compensation is measured as natural log of total board compensation.	Murphy & Sandino, (2010) and Frydman & Saks, (2010).	-
Asset utilization ratio (AUR)	<u>Net Sales</u> Average Total Asset	Nguye, Doan & Nguyen, 2020	+
Control variables			
Debt ratio	<u>Total Debts</u> Total Asset	Olagunju, Adebayo, Adenle, & Bamidele (2021).	+
Firm size	Natural log of total assets.	Olagunju, Adebayo, Adenle, & Bamidele (2021).	+

Source: Author’s (2021).

Model specification ROA Model 1

$$ROA_{it} = \beta_0 + \beta_1 \text{Log EDC}_{1it} + \beta_2 \text{LogFS}_{2it} + \beta_3 \text{Log DBR}_{3it} + \mu_{it} \quad \text{-----} \quad 3.0$$

ROE Model 2

$$ROE_{it} = \delta_0 + \delta_1 \text{LogAUO}_{1it} + \delta_2 \text{LogFS}_{2it} + \delta_3 \text{LogDBR}_{3it} + \mu_{it} \quad \text{-----} \quad 3.1$$

RESULTS/FINDINGS

Table 3.2: Descriptive Statistics

	ROA	ROE	AUR	EDC	DBR	FSIZE
Mean	0.049043	1.622363	0.825833	5.385095	0.09025	10.47819
Median	0.037613	0.087646	0.820865	5.392154	0.000601	11.065
Maximum	0.264935	44.68897	2.133652	7.199179	0.915564	11.58969
Minimum	-0.04044	-0.134831	0.081468	3.922725	0.00019	7.43978
Stand. Dev.	0.06438	7.404418	0.419035	0.8507	0.22065	1.23069
Observation	50	50	50	50	50	50

Table 3.2 displays the result of descriptive statistics of the influence of executive directors’ compensation and asset utilization ratio on financial performance of listed consumer goods organizations in Nigeria. The analysis revealed all identified variables such as return on asset (ROA), return on equity (ROE), asset utilization ratio (AUR), executive directors’ compensation (EDC) and the control variables debt ratio (DBR) and firm size (FSIZE), with a mean value of 0049 percent, 1.622 percent, 0.826 percent, 5.39 percent, 0.090 percent and 10.478 percent respectively. ROA has standard deviation value of 0.0643 percent, minimum and maximum value of -0.040 percent and 0.265 percent respectively. ROE was also found to have a standard deviation value of 7.40 percent, minimum and maximum value of 0.135 and 44.68 percent respectively. Further, executive directors’ compensation has a standard deviation value of 0.851 percent with a maximum and minimum value of 7.199 and 3.922 percent correspondingly. More so, AUR has a standard deviation, maximum and minimum values of 0.419, 2.134, and 0.081 percent correspondingly. The Debt Ratio (DR) has a standard deviation, minimum, maximum values of 0.221, 0.00019 and 0.916 percent respectively. Lastly, firm size was found to have standard deviation value of 1.23, minimum and maximum values of 7.44 and 11.59 percent respectively.

Hypotheses testing

The following hypotheses stated in null forms were tested.

Hypothesis One

H₀₁: Executive directors’ compensation does not have any significant relationship with return on asset (ROA) of quoted consumer goods firms in Nigeria

Table 3.3: Panel regression analysis

Variables	Coefficient	Std. Error	t-Statistics	Prob.
C	-0.146624	0.135791	-1.079774	0.2859
EDC	-0.024450	0.011001	-2.222500	0.0040
DR	0.059041	0.071066	0.830787	0.4104
FSIZE	0.020452	0.012855	1.590988	0.1185
R-squared	0.163956	Mean dependent varb		0.049043
Adjusted R-squared	0.09291	S.D. dependent varb		0.064379
F-statistics	11.047670	Durbin-Watson stats		1.612855
Prob(F-statistics)	0.0009528			

Table 3.3 shows an R squared of 0.16. This entails that 16% explanatory ability of the estimation for the systematic variation in the dependent variable with an unadjusted value of 84% and 11.048 F-statistics value. The table also shows p-value of 0.0009 which suggests that the model is fit. The EDC (t-statistic = - 0.262405, p-value of 0.0001) which appear to have a negative significant effect at 5% level. The outcomes further indicate that a percentage rise in executive directors' compensation will lead to a significant 2.4% decrease in the ROA of quoted Nigeria consumer goods firms. This infers that the null hypothesis should be rejected.

Hypothesis Two

H₀₂: Asset utilization ratio does not have any significant connection with return on equity (ROE) of quoted consumer goods firms in Nigeria.

Table 3.4: Panel regression analysis

Variables	Coefficient	Std. Error	t-Statistics	Prob.
C	-14.17669	15.59572	-0.909011	0.3681
AUR	2.59263	1.151541	2.251443	0.0051
DR	1.196312	8.531890	0.140217	0.8891
FSIZE	1.293163	1.458218	0.886810	0.3798
R-squared	0.651289	Mean dependent varb		1.622363
Adjusted R-squared	0.410583	S.D. dependent varb		7.404418

F-statistics	17.828949	Durbin-Watson stats	1.599878
Prob(F-statistics)	0.000975		

Table 3.4 shows an R squared of 0.651. This suggests that 65.1% explanatory ability of the estimation for the systematic variation in the dependent variable with an unadjusted value of 34.9%. The F-statistics value was 17.828 and p-value of 0.0009 which is less than 0.05 reveals the fitness of the model. The AUR (t-statistics =2.2514, p-value (0.0051) which have a positive and significant influence at 5%. The results, thus, show that a percentage increase in asset utilization would result into a significant 2.59% rise in the ROE of Nigeria quoted consumer goods companies. This infers that the null hypothesis should be rejected. Henry (2006) attested to the result of this study by affirming that companies that has low asset utilization ratio will produce more agency costs for shareholders when they make non-optimal investment decisions. To buttress this some scholars found positive relationship between asset utilization ratio and return on equity like Jabbary, Hajiha, & Labeshka (2013) and Khadimat, Pakistan & Rehman (2014). On the contrary, Craig, Giao and Salil (2014) in their findings revealed that asset utilization ratio is negatively significant to financial performance. Also the results of the studies conducted by Osman, (2014); Jabbary, Hajiha, and Labeshka, (2013) are consistent with the result of this study which shows that a significant connection exists between return on equity and asset utilization ratio.

DISCUSSION

Relationship between Executive Directors' Compensation (EDC) and Return on Asset (ROA)

The findings of this study indicate that a percent rise in executive directors' compensation would result into a significant 2.4% decrease in the ROA of the quoted Nigeria consumer goods companies. Executive directors' compensation encourages the directors to act in agreement with all the shareholders' wishes and consequently lessen likely clashes of interest inside the organization. Hence the purpose of executive remuneration is to fascinate; encourage and retain skilled directors for achievement of the firms' performance (Adeoti & Isiaka 2006). Whereas huge amount of executive directors' compensation can be problematic, however, high executive directors' reward deteriorates firm value. As a result, executive rewards in consumer goods firms should be maintained at a relatively lower level. More so, the higher the executive directors' compensation the greater the agency cost incurred, and higher executive directors' compensation tends to reduce firm value. Executive directors' compensation is a bonding cost which is incurred so as to encourage the managers to act in the interest of the stockholders. The accumulative levels of compensation to top management in turn lessen the sum of other investments, which indicates that executive directors' rewards for performance is not connected to improved performance, but moderately connected with firm underperformance (Grabke-Rundell & Gomez-Mejia, 2002). More so, companies should ensure that the executive directors' compensation is not high, and the board compensation should be pegged in a constantly flexible manner.

However, the outcome of this study is in agreement with the outcome of Aduda (2011) and Nyaoga, Tarus and Bagweti (2014) who also found a negative significant connection between executive directors' reward and financial performance where as the result differs from the findings of Jaafar, Wahab and James (2012), Denirer and Yuan (2013) and Sigler (2013) who found a negative connection between executive directors' compensation and financial performance. However, Tosi and Gomez-Mejia (2000) and Wald, Palmon and Brick (2006) found no relationship between the two variables.

Relationship between Asset Utilization Ratio (AUR) and Return on Equity (ROE)

Asset utilization ratio is an inverse measure of agency cost. The agency theory also confirmed that higher agency cost leads to lower financial performance. This result corroborates to this study objective two which states that there is a significant connection between asset utilization ratio (AUR) and return on equity (ROE). The higher the asset utilization ratio the more resourceful a firm is at producing revenue from its assets. Managers will always want to have a high asset utilization ratio because it is a sign of better and efficient management of asset on hand. Conversely, if the firm has a low asset turnover, it signifies that the firm is not efficient in the use of its asset to generate sales. Ang, Cole and Lin (2000) pointed out that the causes of low asset turnover are insufficient efforts, non-optimal investment decisions and purchase of unproductive assets. If the managers without manipulations work towards increasing the asset utilization ratio, it will bring about high financial performance. In a realistic view, low asset utilization ratio brings about a low financial performance. A low asset utilization ratio is a result of high agency costs, and high agency costs brings about low financial performance.

Furthermore, the manipulation of asset utilization ratio by the managers for their own personal gain will bring about agency cost when the manager report an asset utilization ratio that is higher than what it should be in order to deceive the shareholders and make them believe that the company is efficient in the use of its asset to generate sale, directors can also manipulate revenue, liquidate some assets (obsolete, both unused), lease asset instead of buying it (leasing the asset at a high rate for his own personal gain) and increasing output of products by reducing the products quality. Manipulating the asset utilization ratio to a high value in order to satisfy the shareholders will later in turn leads to low return on equity. Also, the result of this study is related to the findings of some scholar's like Jabbary, Hajiha, and Labeshka (2013) and Khadimat, Pakistan, and Rehman (2014) who also revealed in their study that positive relationship exists between asset utilization ratio and return on equity. In contrary, the result of this study is in contrast with that of Wang (2010), Rakesh and Lakshmi (2013), and Nobance, Craig, Gao and Salil (2014) who found that agency cost is negatively significant to financial performance.

Limitations and Direction for further research

The limitation of this study is the period of study which covered only five years (2015 to 2019), thus this research could not account for time-lag effect of 2020. Nevertheless, this limitation has no effect on the empirical findings of this study as a result of the adequate supportive and statistical evidence deployed to make results reliable and fit for policy formulation. In order to improve on the limitations identified above, the findings suggest the following for future researchers interested in this study area:

- i. further research should look into a wider timing to include 2020 and 2021 data for which access could not be obtained as at the time of carrying out this research work.
- ii. further, researchers could expand the scope of the study to capture the influence of agency cost on financial performance of listed firms in other African countries.

CONCLUSION AND RECOMMENDATIONS

Agency costs are costs that affect financial performance of firms either positively or negatively. Majority of the firms in the Nigerian consumer goods sector are faced with the problems of identifying agency costs, and some are even facing the problem of determining how to reduce agency cost. This study provides solutions to these problems. Nevertheless, based on the outcomes of this research work, it could be conclusively stated that executive directors' compensation and asset utilization ratio are significantly related to financial performance of quoted Nigerian consumer goods firms. However, the study also recommends that managements of listed consumer goods firms in Nigeria should devise remuneration schemes that will motivate the directors to act in the best interests of the stockholders. This will encourage and motivate them to work towards achieving the organization objectives and goals. This will also motivate them to effectively utilize the company assets and resources.

IMPLICATIONS

The implication of the study is that high executive directors' compensation reduce firms value, also high executive directors' compensation does not guarantee high financial performance. Therefore, company management should ensure that executive compensations are pegged in a constantly flexible manner in order to increase firm value. Also, managers will always want to have a high asset utilization ratio because it is a sign of better and efficient management of asset on hand. Hence, managers should aim at increasing organization asset utilization ratio.

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