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### Executive Compensation and Financial Performance of Banks in Nigeria

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#### Abstract

This study looked at how executive pay affects a Nigerian commercial bank's financial performance. It was decided to do a correlational study. The study's population and sample size include all of Nigeria's commercial banks that are currently listed on the NSE. Multiple linear regressions, correlation analysis, and descriptive statistics were used in the study's analysis of the data. Sampled banks' financial performance and executive salary are shown to have a

substantial positive correlation in this study's findings. According to the findings, organisations should pay their executives well enough to incentivize them, because the more money they make, the better their financial performance. Aside from the standard salary, it was also advised that executive compensation packages include various benefits designed to keep employees motivated.

**Keywords:** Executive Compensation, Financial Performance, Banks, Corporate Governance

#### 1. Introduction

In wealthy nations such as the United Kingdom, the United States, Switzerland, New Zealand, and others, executive remuneration has been a common issue of controversy (Adeyemi, 1991) <sup>[1]</sup>. Scholars and academics (Campbell, 2015; Hassaen, 2015; Sigler, 2011; Nulla, 2014) <sup>[6, 9, 12]</sup> have been sceptical about several elements that impact a company's financial success (Campbell, 2015; Hassaen, 2015; Sigler, 2011; Nulla, 2014) <sup>[6, 9, 12]</sup>. The fact that a wide range of factors might affect a company's success should be taken into consideration. One of the numerous things that might have an impact on a company's performance is executive remuneration (Ayodele, 2012) <sup>[2]</sup>. It is rare for studies to reveal how top executives should be compensated and other kinds of incentives and remuneration are rarely examined. When Jensen and Meckling (1979) <sup>[10]</sup> wrote on the relationship between CEO salary and business performance through the agency theory, it was not until the eighteenth century. Since then, a number of investigations, primarily in industrialised nations, have been conducted (Jensen & Murphy, 2010)

Defining executive pay is straightforward because it is a precise phrase in meaning. Executive compensation is a broad word that encompasses a wide range of benefits provided to top-level executives, as well as their corresponding salaries. It is frequently used as a synonym for executive pay or compensation, which is a combination of salary and incentives. Incentives can include both cash and non-monetary items. Compensation for executives can be paid either in cash or in the form of stock, but each has a wide range of possible derivatives.

However, it is anticipated that the managers of organisations are suitably compensated for their strategic responsibilities in steering the company's operations toward accomplishing its goals and objectives via optimal performance. The fundamental objective is widely acknowledged to be the maximisation of wealth. Establishing it would be doomed from the start if company management failed to see this. Executives who perform at their best are in high demand on a regular basis. Because of this, Fama (1980) <sup>[7]</sup> claims that top-performing executives should be compensated more than their lower-performing colleagues.

Rewards and incentives for executives' excellent performance and risk management behaviour are the goal of executive compensation. In order to ensure the long-term stability of the company's value generation, it is important to have a well-defined pay policy. Compensation levels must be provided in such a way as to recruit, retain and motivate directors of the proper quality and competence necessary for the strategic function of managers (Bhatnagan & Trimm, 2011) <sup>[5]</sup>. To address the conflict of interest between managers and shareholders, executive remuneration packages have been considered as a need. Recognizing that pay packages may be a major factor in motivating senior executives, numerous corporate governance rules have recommended that a considerable amount of salaries be performance-based (Bhatnagan & Trimm, 2011) <sup>[5]</sup>.

Whether a company is large or little, public or private, successful or not, Jensen and Murphy (2010) found that the top

employees and managers are sought after by significant corporations. Because of this, it was concluded that CEO salary is a crucial means of promoting a company's image (Sandra, 2008). It has, however, been a big problem for firms to make money from this strategy (Saheed, 2015).

While this may be the case, there is no evidence that CEO salary has a negative impact on business performance. Even if one assumes that recent events like the stock market bubble, the series of corporate malfeases, the Sarbanes-Oxley Act in 2002, and the financial shocks and recession of 2008-2009 have shattered the confidence of policymakers and their constituents in management's ability to deliver returns to investors, the Sarbanes-Oxley Act and other anti-fraud/corporate governance legislation reforms have not. The core concept is that the incentive-driven executive remuneration of public businesses, particularly that of their CEOs, increases shareholder wealth. Public opinion, the media, and legislators all have heightened scepticism when it comes to claims of widespread communal wealth. There have been a slew of calls for senior executive remuneration arrangements at public corporations to be overhauled (Michaud & Gai, 2009). In the previous two decades, accounting, economics, and research have focused on CEO remuneration as a result of these calls. There has been a great deal of attention paid to CEO salary in the United States and the United Kingdom because of their relative ease of access to data. Despite this, the research' concept and conclusion are incoherent. Thus, this study will examine the financial performance of Nigerian banks as a result of CEO remuneration.

## 2. Hypothesis development

Because of the numerous global financial booms and busts, as well as a string of high-profile corporate failures across Asia, Europe (including Greece), the United States (including Detroit), and Africa (including Nigeria), the necessity for good corporate governance has been brought to the fore. Many ideas have been proposed to explain how executive remuneration affects a company's performance. These theories are not necessarily conflicting, but they do show the multiple angles from which the topic of executive compensation may be viewed. The marginal productivity theory and the governance theory are two examples of these ideas.

### Marginal Productivity theory

For the most part, marginal productivity theory is based on macro and microeconomics, and it attempts to anticipate executive compensation (Roberts, 1959 and Gomez-Mejia & Balkin, 1992<sup>[8]</sup> cited by Ezekiel, 2016). Executives should be paid based on their production as a whole, rather than on the performance of each individual employee. It indicates that CEO pay will be determined by output, and that as production rises, so will executive pay. Several of its proposals for CEO remuneration are based on an examination of how profitable and productive the company can be. The level of executive pay is largely determined by two key findings of the marginal productivity hypothesis.

An executive's salary is a direct reflection of the company's net profit. Entrepreneurs who own and run their own businesses are motivated to maximise their investment's return on their capital. When the product's market price equals the marginal cost of manufacturing, it will happen. As a result, both the company and the CEO are able to

maximise their revenues at this moment. Most entrepreneurs rely on outside investors for funding, and choices must be made as to how much of the company's revenues are shared with those investors. An executive's share of profits is neither determined by the marginal productivity theory, nor is it a framework for allocating investor capital.

### Governance theory

From political science, sociology, finance, and economics, came managerialism and agency theory, which control executive compensation (Gomez-Mejia & Balkin, 1992)<sup>[8]</sup>. A suggestion was made that CEOs should focus on long-term shareholder value-creating initiatives and that they should be compensated accordingly. When executives are aware that they have minimal power to influence executive compensation, they may feel free to pursue objectives that may not align with those of the firm's owners. Consequently, CEO remuneration may not be adequately connected to the performance that produces or maximises the value of shareholders.

### Empirical literature

Some of the recent global financial crises have been blamed on executive salaries in most wealthy countries (Bebchuk & Spamann, 2009<sup>[4]</sup>; Uwalomwa, Daramola & Anjolaoluwa, 2014<sup>[17]</sup>). Thomsen and Pederson (2000)<sup>[16]</sup> found a link between CEO compensation and company profitability. The random sampling approach was used to gather data on 435 of the top European corporations. After adjusting for other factors, they found a link between CEO pay and profitability metrics including the market to book value of stock and ROA. Several studies have found that managers' interests are aligned with shareholders' interests when they get a bonus in the form of a portion of the company's stock. Only European enterprises are included in the study's scope, which excludes firms from other areas.

An investigation on the relationship between business performance and corporate governance and CEO compensation in Indonesian financial firms was undertaken by Wulan Suherman and Agung (2011). There are 13 financial businesses that were listed on the Indonesia Stock Exchange between 2007 and 2009 as the research sample. The study found that CEO remuneration has a large and favourable impact on a company's success. According to this theory, the executive's bonus is linked to the company's profit, and the greater the profit, the greater the executive's bonus.

From 2006 to 2009, Sigler (2013)<sup>[15]</sup> analysed the link between CEO compensation and New York Stock Exchange performance for 280 companies. Sarbanes-Oxley Act implementation and SEC approval of corporate governance rule on executive compensation for New York Stock Exchange (NYSE) corporations are both included in the study's scope. Using both descriptive and inferential statistics, a positive and substantial correlation between overall CEO salary and firm success was found. Also found was that the size of the company appears to be the most important factor in influencing how much the CEO is paid in total. Return on equity is significantly affected by the length of service of the chief executive officer, according to the findings. CEO remuneration was measured in terms of monthly salary, cash compensation, and overall compensation in this investigation. There is a possibility of multi-co-linearity in the data since total pay includes both

monthly wage and cash compensation. Due to the research's focus on the New York Stock Exchange, it was only able to examine publicly traded firms in the city.

Using data from 390 UK nonfinancial enterprises from the FTSE All-Share Index for 1999-2005, Ozkan (2011) [13] studied the association between CEO salary and performance using the data set. In his research, he used both cash and equity-based components of CEO remuneration. Cash remuneration for CEOs is positively and significantly linked to performance, although the association between total compensation for CEOs was positive but not significant. According to the findings of his research, larger companies tend to pay their CEOs more, which may be seen as a reflection of the increased demand for high-quality CEOs. The CEOs of companies with big board sizes receive a greater overall remuneration level than those of smaller companies. No matter how many non-executive directors are on a company's board, CEO salary is not affected. As a result of their share ownership, non-executive directors are more likely to monitor CEO remuneration packages since they have a financial incentive for doing so.

In 2015, Baixauli-Soler and Sanchez-Marin conducted a research of CEO salaries and corporate governance in Spanish listed companies. They looked at how CEO remuneration packages affected the company in Spain as well as the role of major investors. This has an adverse influence on executive pay, which in turn has an adverse effect on the company's performance. According to the findings, there is a negative correlation between CEO compensation at Spanish companies.

An investigation by Xiang Li (2010) studied the association between publicly listed Chinese enterprises' financial performance and executive salary. It is clear from the conclusions of his research that China's corporate governance structure is ineffective, yet executives are paid a lot of money for their efforts. As a consequence, the results will reveal that political linkages weaken corporate governance procedures, but do not have an adverse effect on the firm's performance.

From the empirical literature, the study hypotheses are;

**Ho1.** The financial performance of banks in Nigeria does not have any significant effect on their executive packages.

**Ho2.** The size of the board of directors of banks in Nigeria does not significantly affect their executive packages.

**3. Materials and methods**

An investigation using a correlational design was the best choice for this investigation. The study's primary objective was to examine the link between CEO pay and company success. The correlational design makes use of naturally occurring and continuously changing variables gathered from the study's target population (Rucker, McShane, & Preacher, 2015). As a result, the study's correlational design was appropriate. As of 2019, all commercial banks listed on the Nigerian Stock Exchange will be included in this study's demographic. To conduct this study, the sample size will be the whole population of Nigerian stock market-listed banks. Data analysis, according to Johnson (2007), is the process of

organising and giving meaning to the vast amount of data gathered throughout the course of a study. Executive remuneration on business performance is most commonly studied using multiple linear regressions and descriptive statistics.

**Model specification**

Regression analysis, a statistical approach for identifying correlations among variables in order to forecast future values, will be used to examine the data. formulas are based on;

$$ExCom = F(ROA, B Dsize) \tag{1}$$

This can be written in an explicit form as:

$$ExCom = \beta_0 + \beta_1 ROA + \beta_1 B Dsize + \mu \tag{2}$$

Where,

ExCom=Corporate executive compensation. This is measured by the Directors' Emolument.

ROA=Return on Asset. This is computed by dividing profit before tax by the firm's total assets, a proxy for firm performance.

BD size=Board size is measured as the number of board members in an organisation.

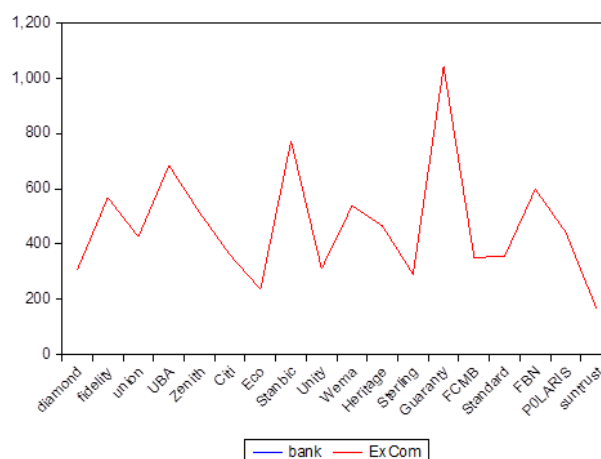
B=Coefficient of parameter

μ=Error term

**A priori specification**

The expectations for the co-efficient of the model: β1>0, β2<0.

**4. Results**



**Fig 1:** graphical representation of other listed commercial banks executive compensation.

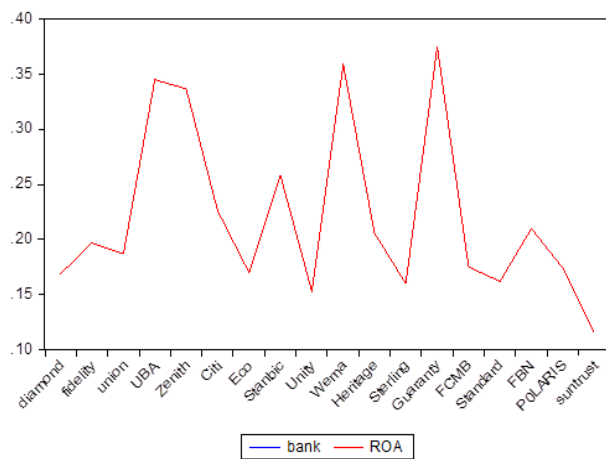


Fig 2: ROA of Banks in Nigeria

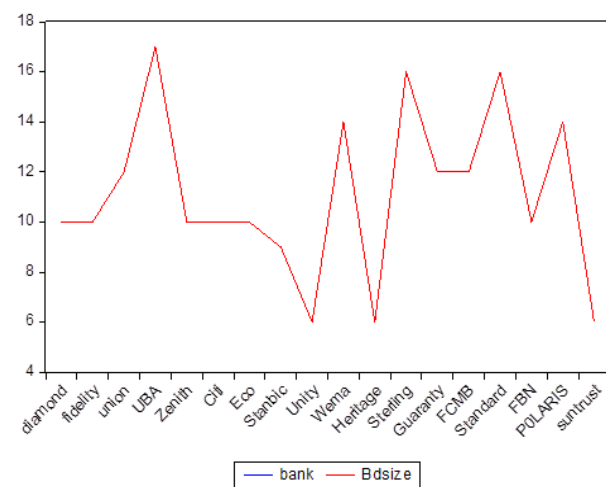


Fig 3: Board Size of Banks in Nigeria

Table 1: Descriptive Statistics

	EXCOM	BDSIZE	ROA
Mean	468.6111	11.11111	0.221067
Median	434.0000	10.00000	0.192000
Maximum	1043.000	17.00000	0.375000
Minimum	167.0000	6.000000	0.116000
Std. Dev.	213.0449	3.358727	0.079531
Skewness	1.084957	0.111903	0.882463
Kurtosis	4.052187	2.233027	2.390314
Jarque-Bera	4.361719	0.478753	2.615010
Probability	0.112944	0.787118	0.270494
Sum	8435.000	200.0000	3.979200
Sum Sq. Dev.	771598.3	191.7778	0.107528
Observations	18	18	18

Source: Author's Computation 2019

As shown in the table above, the findings from our descriptive statistics present an approximate mean value for executive compensation (ExCom) as 468.6111 (Million) for the selected banks. Similarly, the financial performance (ROA) and board size (Bdsiz e) depicts a mean value of 22.11% and 11.11, respectively, for the sampled banks.

Table 2: Test of Correlation between Dependent and Independent Variables

Correlations				
		Board Size	Return of Assets	Executive compensation
Board Size	Pearson Correlation	1	.302	.191
	Sig. (2-tailed)		.223	.448
	N	18	18	18
Return of Assets	Pearson Correlation	.302	1	.784**
	Sig. (2-tailed)	.223		.000
	N	18	18	18
Executive compensation	Pearson Correlation	.191	.784**	1
	Sig. (2-tailed)	.448	.000	
	N	18	18	18

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source: Author's Computation 2019

Executive pay (emoluments for board members) and bank performance in Nigeria are highly correlated, as shown in Table 2 above by the Pearson Correlation. The correlation coefficient ( $r=0.784$ ) is clearly visible, and it is statistically significant at a 5% probability level. In addition, the table shows that the size of the boards of the selected banks is positively correlated with the salary of corporate executives (directors' emolument) ( $r=0.191$ ). However, at a 5% probability level, this correlation is not significant.

Regression analysis

To examine the impact of financial performance and board size on executive remuneration in Nigerian banks, the study employed the OLS regression approach. The Pearson correlation matrix, shown in Table 2 above, was used to check for predictor variable collinearity, which might affect OLS findings, before doing the OLS regression. A regression model's parameters can be affected by multicollinearity, according to Field (2000). Correlation coefficients were less than 0.5 for 93.8% of the variables in the Pearson matrix (see Table 2), suggesting that collinearity would not be a concern for the remaining variables.

Table 3: Ordinary Least Square Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	31.17636	133.6008	0.233355	0.8186
ROA	2139.889	449.4967	4.760634	0.0003
BDSIZE	-3.206112	10.64361	-0.301224	0.7674
R-squared	0.616271	Mean dependent var		468.6111
Adjusted R-squared	0.565108	SD dependent var		213.0449
SE of regression	140.4954	Akaike info criterion		12.87924
Sum squared resid	296084.4	Schwarz criterion		13.02763
Log-likelihood	-112.9131	Hannan-Quinn criteria		12.89970
F-statistic	12.04506	Durbin-Watson stat		1.901830
Prob(F-statistic)	0.000759			

Source: Author's Computation 2019

Using OLS, we can calculate the R-squared and F-statistics for data on CEO pay, financial performance, as well as the size of Nigerian banks' boards of directors. The R2 is a



measure of the model's ability to explain the variation in the data. To assess how well a model fits the data, F-statistics are employed (Field, 2000). R<sup>2</sup> was found to be 0.616271 in this investigation. According to the R<sup>2</sup> of 0.616271, the dependent variable's value can be described by approximately 62% of its independent factors. Executive remuneration at the selected institutions is affected by more than only financial success and board size, thus this number is adequate. Similarly, the analysis of variance (Fishers - test) in Table 3 yields a p-value less than 0.05 (i.e., p-value < 0.05). Explanatory factors appear to be strongly linked to the dependent variable in this case (i.e., executive compensation). It might be said that the F-statistics, which demonstrate that the calculated models are statistically significant at 1%, support their validity.

### 5. Findings, conclusion and policy implications

The empirical findings from our research show that, as expected, there is a considerable positive correlation between the financial performance of the sampled banks and the executive salary (director's emoluments) of the banks. According to ( $P > |t| = 4.760634$  and  $0.0003$ ; demonstrating a rejection of the null hypothesis, which claims that bank financial performance has no substantial influence on executive remuneration, the acceptance of the alternate proposition is clear. As a result, rising financial performance at the banks studied is likely to be accompanied by an increase in director compensation. As Thomsen and Pedersen (2000) <sup>[16]</sup> and Sigler (2013) <sup>[15]</sup> found, overall CEO remuneration has a considerable positive correlation with the company's success, which supports this outcome. However, data on the second hypothesis reveal that, for the sampled banks, there is a negative correlation between board size and corporate executive salary (i.e., director's emoluments), which is in line with our prior anticipation (i.e., 20). There is, however, a lack of statistical significance to this correlation. For this reason, it is obvious in the probability and t-statistics values of ( $P > |t| = 0.7674$  and  $-3.206112$ ; implying an accepted null hypothesis, which indicates that executive packages of commercial banks in Nigeria are not affected by board size. " For the banks in the sample, this finding suggests a negative correlation between the size of the board and executive remuneration (i.e., director's emoluments).

From the result of this research work, the following are the policy implications to banks and other service rendering firms are;

1. The executive compensation of the company should be good enough to encourage the executive because the higher the compensation, the better the firm's financial performance.
2. Also, apart from the normal emolument, there should be other executive packages that will further motivate the executive to make sure that the firm's financial performance improves.

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