**DIRECTORS’ COMPENSATION AND INSURANCE FIRMS’ PERFORMANCE IN NIGERIA**

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**Abstract**

*Researchers, academicians and policy makers have been devoting much time and efforts to understand the innumerable factors that underlie top management compensation; particularly how it relates to firms’ performance. Studies show that compensation is one of the most important strategies in the human-resource management functions; as it influences the growth of organizations. Yet, there is dearth of literature on the linkage between compensation and corporate performance. The issue of concern to the study has to do with finding out if directors’ compensation is one of the most identifiable areas to look at as core to improving on shareholders’ wealth. Regression analysis was used to find if there exists any relationship among variables studied. Findings are that that there is a significant relationship between directors’ compensation and return on assets and on net claims paid.*

**Key words:**

Compensation scheme; corporate performance; corporate governance; executive directors; investing public; insurance firms.

**Introduction**

Compensation is a well debated topic. Sarkar and Jafar (2012) point out that researchers, academicians and investors have devoted much time and effort to understand the innumerable factors, which underlie top management compensation; particularly how it is related to firm performance. In the words of Yablon (1999), executive compensation has been a matter of concern to corporate law policy makers.

Compensation could define as rewards that employees earn on the basis of the value of their jobs, their personal contributions, and their performances (Obasan 2012). The reward could be monetary or otherwise. It could be indirect or direct rewards too.

Obasan further states that the growing suspicion that compensation promotes productivity is in agreement with the early work of Peter Drucker. In 1956, Peter Drucker had written that ‘happy workers are productive workers.’ In line with this, Darmadi (2011) stated that compensation scheme is significant in motivating labour to perform their managerial duties; in line with the best interest of the shareholders.

In regard of this, Erick et al (2014) explain that good compensation schemes motivate directors to make prudent decisions that maximize shareholders’ wealth. In other words, compensation serves as a motivating force that encourages individuals within an organization to perform their duties effectively and efficiently.

Moreover, the agency problem which is caused by the clash of interests between directors and the shareholders has been identified to be persistent. Jensen and Meckling (1976) and Torluccio (2014) maintain that in tandem with the agency theory, a potential problem exists when the ownership of a firm is separated from its management. This is typical of the modern corporation.

The findings of Miyienda et al (2013) tend to point towards a high possibility of the agency problem. According to them, directors can benefit themselves by using up earnings without due regard to firm’s long term performance and market value. For most people, the idea of compensation is important to solve the agency problem.

According to Bebchuk and Fried (2003), executive compensation is a pay arrangement to remedy the agency problem.

Ismail et al (2014) explain that where the conflict of interest between managers and shareholders exists, instituting good corporate governance structure is the remedy. Progress could be restored through re-visiting remuneration packages for motivation of managers to work in the interest of shareholders. How these remuneration packages impact on the corporate performance of insurance firms in Nigeria is the object of focus in this study.

Insurance is risk transfer mechanism. It is in use primarily to hedge against unforeseen contingencies (Isimoya, 2014). It is a social scheme, which provides financial compensation for the effects of a misfortune. Through insurance, financial compensations emanate from the pool of accumulated contributions of all members participating in the scheme (Isimoya, 2007). In any typical capital market economy around the globe, the insurance industry is seen an indispensable tool of economic growth. It is vital to the well-being and smooth functioning of modern economies (Ezirim and Muoghahu, 2002).

The importance of the insurance industry is becoming increasingly recognized to economic stability and development of many nations; as it helps to reduce the burden of risks on individuals and businesses. Growth in insurance industry therefore remains one of the major indices for measuring the level of development of nations’ wealth. Notably, insurance plays very significant roles in the mobilization of investible resources of the economy and gives greater security to the fortunes of the investing public.

However, in Nigeria today, there is a concern over a number of challenges that seem to be plaguing the insurance industry. It is a common complaint that insurance companies in Nigeria are performing below expectation. There is also a public outcry that insurance companies in Nigeria do not settle claims promptly when necessary, and in most cases only with the intervention of the regulatory bodies.

The issue of concern now to this study is to find out if directors’ compensation is one of the most identifiable areas to look at as core to improving on shareholders’ wealth. That is, if directors of insurance companies in Nigeria are suitably motivated to carry out their oversight functions.

Irukwu (2003) noted that as a key service industry in the financial sector, insurance contributes a lot to the growth and stability of the national economy, both in the context of its primary role of risk bearing and as regards its secondary functions, in the nation’s financial services industry. It particularly plays its roles in the mobilization of funds for investment in the national economy, promotes savings’ culture and facilitates the credit system.

Ujunwa and Modebe (2011) explain that the insurance industry is generally seen as the backbone of any country’s risk management system. This is because it ensures financial security, serves as an important component in the financial intermediation chain, and offers a ready source of long term capital for infrastructural projects.

Irukwu (2009) opines that the insurance sector is known to be a major driver of the economy of nations through its activities. Elendu (2013) explains that insurance remains one of the major indices for the level of development of a nation’s wealth and plays very significant roles in the mobilization of investable resources of an economy. The insurance industry is a highly specialized industry that gives greater security to the fortunes of the investing public (Ozumba, 2013).

Fodio et al (2013) observe that the Nigerian insurance industry has over the years faced unique challenges precipitated by lack of clear operational guidance, high premium cutting, and weak corporate governance dynamics. The industry however has prospects of playing a big role in the nearest future of Nigeria. Oyelade (2013) acclaims that though the insurance industry has over the years been an ill-perceived sector; it has sauntered to one beginning to acquire a dominant role within the purview of the Federal Government of Nigeria’s Vision 20:20:20.

**Research design**

The study population consists of 14 general insurance companies listed in the Nigerian Stock Exchange. The data used for the study are secondary, which were obtained from the audited financial statements as shown in the annual reports of the general insurance companies listed on the Nigerian Stock Exchange between the three years’ period of 2011 and 2013.

The data was analyzed using the regression analysis method. The tool was used to investigate the relationship among variables. The method helped to ascertain the causal effect of the independent variables on the dependent variables. The study sought to find out the relationship between defined variables representing directors’ compensation and those representing firm performance, Regression analysis was chosen for the study, given the ratio nature of the data obtained.

In analyzing the data obtained, study used executive directors’ annual salaries and non-executive directors’ board allowances as the independent variables to quantify directors’ compensation. The dependent variables used to represent firms’ performance include net claims paid and return on assets. In the other way round, the net claims paid represent the satisfaction of the insured by the insurance company, while the return on assets represents shareholder satisfaction.

**Data analyses**

Table 4.1: Regression Statistics for Net Claims

|  |
| --- |
| Regression Statistics |
| Multiple R | 0.965894113 |
| R Square | 0.932951437 |
| Adjusted R Square | 0.910601916 |
| Standard Error | 107878462.6 |
| Observations | 5 |

The results in table 4.1 above indicate that the adjusted r square value is 0.91 thus indicating that 91% of the variation in net claims is accounted for by the variations in directors’ compensation.

Table 4.2: Analysis of Variance for Net Claims

|  |
| --- |
| ANOVA |
|   | Df | SS | MS | F | Significance F |
| Regression | 1 | 4.85803E+17 | 4.85803E+17 | 41.74369 | 0.007522177 |
| Residual | 3 | 3.49133E+16 | 1.16378E+16 |   |   |
| Total | 4 | 5.20716E+17 |   |   |   |

The table for the analysis of variance which is represented in table 4.2 above indicates a calculated F statistic of 41.74 with an asymptotic significance probability of 0.007 thus indicating that the test is significant at a 99% confident level. The implication is that the overall significance of the model is good. In other words, the simple linear model is a good fit for the data.

Table 4.3: T-Test and P-Value for Net Claims

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|   | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
| Intercept | -149728416.3 | 157538733.1 | -0.950422879 | 0.412014 | -651086975.3 | 351630143 | -651086975 | 351630142.8 |
| DC | 22.71535023 | 3.515798914 | 6.460935563 | 0.007522 | 11.52650897 | 33.9041915 | 11.52650897 | 33.9041915 |

The T-test for significance of regression parameters represented in table 3 shows a calculated value of 6.460935563 for directors’ compensation with an associated asymptotic significance probability of 0.007 thus indicating that the test is significant at a 99% confident level. The T- test shows 149728416.3 as the constant while the coefficient of directors’ compensation (DC) is 22.7. This means that net claims (NC) = 149728416.3 + 22.7 DC. The implication of these results is that the effect that directors’ compensation has on net claims is significant.

Table 4.4: Regression Statistics for Return on Assets

|  |
| --- |
| Regression Statistics |
| Multiple R | 0.90593163 |
| R Square | 0.820712118 |
| Adjusted R Square | 0.760949491 |
| Standard Error | 1.102701436 |
| Observations | 5 |

The results in table 4.4 indicate that the adjusted R square value otherwise known as the coefficient of determination is 0.76. This indicates that 76% of the variations in return on assets (ROA) are accounted for by variations in directors’ compensation.

Table 4.5: Analysis of Variance for Return on Assets

|  |
| --- |
| ANOVA |
|   | Df | SS | MS | F | Significance F |
| Regression | 1 | 16.69848 | 16.69848 | 13.7328654 | 0.034140859 |
| Residual | 3 | 3.647851 | 1.21595 |   |   |
| Total | 4 | 20.34634 |   |   |   |

The analysis of variance table indicates a calculated F statistic of 13.73 with an asymptotic significance of 0.03 thus indicating that the test is significant at a 97% confidence level. This implies that the simple linear regression model is a good fit for the data.

Table 4.6: T-Test and P-Value for Return on Assets

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|   | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
| Intercept | 9.644589933 | 1.610313894 | 5.98926083 | 0.00931958 | 4.519852431 | 14.76932743 | 4.519852431 | 14.76932743 |
| DC | -1.3318E-07 | 3.59374E-08 | -3.7057881 | 0.03414086 | -2.4755E-07 | -1.88076E-08 | -2.47546E-07 | -1.88076E-08 |

Table 4.6 indicates 9.644589933 as the constant of the relationship between ROA and DC. The coefficient of DC is -1.33. This implies that ROA and DC are inversely related. The T-test for significance of regression parameters shows a calculated value of -3.705 with a significant probability of 0.03 thus indicating that the test is significant at a 97% confidence level. The implication is that the relationship between return on assets and directors compensation is significant.

Table 4.7: Regression Statistics for Net Premium

|  |
| --- |
| Regression Statistics |
| Multiple R | 0.560450222 |
| R Square | 0.314104451 |
| Adjusted R Square | 0.085472601 |
| Standard Error | 14671654.32 |
| Observations | 5 |

The result in the above table shows that the value of the adjusted R square (coefficient of determination) is 0.085 thus indicating that 8.5% of the variation in net premium accounts for the variations in directors’ compensation.

Table 4.8: Analysis of Variance for Net Premium

|  |
| --- |
| ANOVA |
|  | Df | SS | MS | F | Significance F |
| Regression | 1 | 2.9573 | 2.9573 | 1.373843808 | 0.32576394 |
| Residual | 3 | 6.45772 | 2.1526 |   |   |
| Total | 4 | 9.41502 |   |   |   |

The analysis of variance table shown in table 4.8 above shows a calculated F statistic of 1.37 and a significant probability of 0.32. This shows that the relationship between net premium and directors’ compensation is not significant.

Table 4.9: T-Test and P-Value for Net Premium

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|   | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
| Intercept | 332207.5523 | 36700265.72 | 0.009051911 | 0.993346014 | -116464417 | 117128832.6 | -116464417 | 117128832.6 |
| NP | 0.013867248 | 0.011831004 | 1.172110834 | 0.325763935 | -0.02378429 | 0.051518784 | -0.0237843 | 0.051518784 |

The T- test for significance of the regression parameters shows that the intercept is 332207.5523 while the coefficient of net premium is 0.014. This means that DC = 332207.6 + 0.014 NP. The relationship between directors’ compensation and net premium is not significant since the P-value is 0.33.

Table 4.10: Regression Statistics for Earnings per Share

|  |
| --- |
| Regression Statistics |
| Multiple R | 0.159888923 |
| R Square | 0.025564468 |
| Adjusted R Square | -0.299247376 |
| Standard Error | 5.524710257 |
| Observations | 5 |

From table 4.10 above, the adjusted r square indicates -0.29. This means that -29% of the variations in earnings per share is accounted for by the variations in directors’ compensation.

Table 4.11 Analysis of Variance for Earnings per Share

|  |
| --- |
| ANOVA |
|   | df | SS | MS | F | Significance F |
| Regression | 1 | 2.402281587 | 2.4022816 | 0.07871 | 0.797293846 |
| Residual | 3 | 91.56727029 | 30.522423 |   |   |
| Total | 4 | 93.96955188 |   |   |   |

The analysis of variance table indicates a calculated F statistic of 0.078 with an asymptotic significance of 0.79 thus indicating that the test is not significant.

Table 4.12: T-Test and P-Value for Earnings per Share

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
| Intercept | -0.2839193 | 8.0679297 | -0.035191 | 0.974138 | -25.9596724 | 25.3918338 | -25.95967243 | 25.39183383 |
| DC | 5.0513E-08 | 1.801E-07 | 0.280545 | 0.797294 | -5.2249E-07 | 6.2352E-07 | -5.22494E-07 | 6.2352E-07 |

Table 4.6 indicates -0.28 as the constant of the relationship between earnings per share (EPS) and directors’ compensation. The coefficient of DC is 5.05. This implies that EPS = -0.28 + 5.05 DC. The T-test for significance of regression parameters shows a calculated value of 0.28 and the P-value is 0.79. The implication is that the relationship between earnings per share and directors compensation is not significant.

**Findings**

The decision rule is based on the adjusted R square and the t-statistics represented by the P-values. As put by Agbonifoh and Yomere (1999) it can be inferred from a significant t-statistic the extent to which a significant relationship exists.

From the analysis on table 4.4, the adjusted r square showed the coefficient of determination as 0.76. This means that 76% of the variations in return on assets (ROA) are accounted for by the variations in directors’ compensation (DC). The T-test shows that ROA and DC are inversely related as the coefficient of DC and the t statistic is -1.33 and -3.7 respectively. The p-value is 0.03. Since p< 0.05, the relationship is significant. Thus, the relationship between ROA and DC is negatively significant. Based on these results, since the negative effect is significant, we therefore reject the null hypothesis and accept the alternate hypothesis which states that there is a significant relationship between directors’ compensation and return on assets.

Table 4.1 indicates that the adjusted r square value is 0.91 thus indicating that 91% of the variation in net claims is accounted for by the variations in directors’ compensation. The P-value is 0.007. Since p-value< 0.05, this result implies that directors’ compensation has a significant and positive impact on net claims paid.

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