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Effect of Directors' Tunneling on Financial Performance of Selected Listed Deposit Money Banks in Nigeria

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ABSTRACT

This study investigated the effect of directors' tunneling on financial performance of selected listed Deposit Money banks in Nigeria. A sample of 10 Deposit Money banks listed on the Nigerian Stock Exchange for a period of 9 years (from 2012-2020) was selected. Secondary method of data collection was adopted; data was sourced from the Nigerian Stock Exchange fact book. This study applied the longitudinal research design. Data collected were analyzed using Ordinary Least Square regression Method. The results show that for Deposit money banks in Nigeria, directors' remuneration has a positive insignificant effect on return on asset (financial performance). This study therefore concluded that directors' tunneling have an insignificant positive effect on financial performance of selected listed Deposit Money banks in Nigeria and recommended that regulators should make it mandatory for listed banks to clearly show all the remunerations and bonuses in monetary value on the annual reports and accounts to enable stakeholders determine the extent to which shareholders wealth maximization objective is in pursuit, thereby reducing the possibility of corporate tunneling.

KEYWORDS: *Directors' Tunneling, Financial Performance, Deposit Money Banks, Directors' Remuneration and Return on Asset*

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INTRODUCTION

The recent wave of high level of corporate failure and bankruptcy of businesses, especially in the banking sector as we have seen cases where banks had to be merged for incapability to meet stakeholders needs, shares of investors sunk as a result of poor management and eventual wind up of some banks such as Afribank, intercontinental bank, etc. coupled with the unending competitive business environment has placed greater responsibility on manager's which require the use of professional skill, experience and discretion in taking some decisions especially those relating to finances and operations of the firm. This privilege most times enhances the manager's investment opportunity set which contributes positively toward increasing the information asymmetry problems between executives and shareholders (Robert, 2011). Elijah, William and William (2003) observed that in such an atmosphere, a greater degree of managerial discretion will be required as there is no assurance that the self-interested behaviour of directors will conform to the expectations of shareholders in order to reduce agency problems. Directors will compromise the wealth maximization objective in order to satisfy their selfish interest by undertaking both legal and illegal actions which may be detrimental to the sustainability of the business. This can be termed "tunneling". Tunneling occurs when a controlling shareholder can transfer resources from the firm for his own benefit through self-dealing transactions and inter firm loan (usually in related party transactions) and also via the following transactions: Asset sales and contracts, excessive executive compensation, loan guarantees, expropriation of corporate opportunities, dilutive share issues, right issue, insider trading, etc. This has led to agency problems in several high ranked businesses in both the developed and developing parts of the world, between directors and shareholders and between majority shareholders and minority shareholders. Traditionally, the focus of the agency

literature in the U.S. has been on the conflict between firm managers and a diffused group of shareholders (Berle and Means, 2005 and Jensen and Meckling, 2007). However, recent international studies show that well dispersed ownership is relatively rare outside of the U.S. and Japan, and that large block holders control most European and Asian companies. In this broader setting, the central agency problem is the threat of "tunneling" – i.e., the expropriation of minority shareholders by the controlling block holder. Over the years, in an attempt to reduce and ensure the conformity of executive interest to that of shareholders, government and other stakeholders had advocated for corporate governance guidelines and better incentive package to align both interests as these will enhance board accountability, transparency and better disclosure which can promote fairness and curb the effect of conflicts of interest between directors and shareholders. Public companies in Nigeria have board of directors, which set the level and structure of chief executive officer (CEO) compensation. The members of the board are also member of the shareholder's and management staff of the companies. Since shareholder have their representative in the board, they hope, but cannot ensure that, in setting CEO compensation, board of directors help ameliorate the conflict of interest between the shareholder and managers. In practice however, the CEO of most public companies has a significant influence in the selection, appointment and re-appointment of the members of the board of directors and service on the board generally. As fiduciaries, the directors face a conflict of interest while setting CEO compensation because of their relationship with the CEO and the private incentives they expect to gain (Nnubia, et. al., 2018). These factors are considered by the Board in the compensation decisions they make. It is against this backdrop that this study seeks to ascertain the effect of directors' remuneration on financial performance of selected listed Deposit Money Banks in Nigeria as a specific objective.

REVIEW OF RELATED LITERATURE

Directors' Tunneling

The term tunneling was first used in Czech Republic to refer to the expropriation of minority shareholders (as in removing assets through an underground tunnel) and to describe the transfer of assets and profits out of firms for the benefit of those who control them (Henemana & Schwab, 1972). This term was used during the first half of the 1990s, when several large, previously privatized banks and factories unexpectedly went bankrupt. It was discovered later that the managements of these companies were deliberately transferring company property and real estate into their own private businesses, sometimes in offshore locations. The term later became a common label for this kind of criminal activity among Czechs and Slovaks. The transfers of firm resources were accomplished through huge loans that were issued without any expectation of repayment, massive overpayment for outsourced services, or simply by selling corporations real estate for a fraction of its market price. The main conditions enabling such a fraud are weak law against conflict of interest, non-existent legal liability of managers for leading their employer towards bankruptcy, and incompetence of financial authorities.

In modern times, tunneling comes in two forms. First, a controlling shareholder or directors can simply transfer resources from the firm for his own benefit through self-dealing transactions. Such transactions include outright theft or fraud, which are illegal everywhere though often go undetected or unpunished, but also asset sales, contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, expropriation of corporate opportunities, and so on. Secondly, the controlling shareholders can increase their share of the firm without transferring any assets through dilutive share issues, minority freeze outs, insider trading, creeping acquisitions, or other financial transactions that discriminate against minorities.

In Nigeria, most companies especially the banking sector have concentrated ownership (block ownership, major shareholder). Those controlling shareholders have the opportunity to perform expropriation through various methods. For instance, Johnson, La Porta, Lopez-de-Silanes and Shleifer (2000) report that the controlling shareholders are inclined to extract or extort cash by selling assets, goods, or services to the company through transactions that benefit themselves. They obtain a loan with a term that is likely more attractive and imposing and then subsequently transfer the assets of a listed company to another company that is still in control. Reciprocally, they might have diluted the interest of minority shareholders to acquire additional shares at preferential prices.

Financial Performance

The notion of performance is a controversial issue in finance and accounting largely because of its diverse meanings. The profitability of a company measures its gains over its operative years. Performance can be explored from two points of view: financial and organizational (the two being interconnected); a company's performance can be measured based on

variables that involve productivity, profitability, growth or even customer satisfaction (Tudose, 2015).

Financial performance plays a large role in measuring the success of business companies. Evaluating the company's performance has three dimensions: the companies' productivity, profitability and market premium (Omondi and Muturi, 2013). Firm's financial performance is generally defined as a measure of the extent to which a firm uses its assets to run the business activities to revenues. It examines the overall financial health of a business over a given period of time and can be used to contract the performance of identical firms in similar industries or between industries in general (Atrill et al. 2009). The main source of data for determining firm financial performance is the financial statement, the product of accounting which consists of the balance sheet which shows the assets liabilities and equities of a business, the income statement that records the revenues, expenses and profits in a particular period, the cash flow statement which exhibits the sources and uses of ash in period, and the statement of changes in the owners' equity that represents the changes in owner's wealth. Firm financial performance is commonly reflected in the calculation of financial ratios that show the link between numbers in the financial statement. The financial ratios may include the computation of the profitability, efficiency, liquidity, gearing, and investment of a particular firm. Moreover, firm financial performance generally may also be reflected in market-based (investor returns) and accounting-based (accounting returns) measures. Examples of market-based indicators to measure firm financial performance are price per share and Tobin's Q which indicate the market value or the share of the firm as well as the financial prospect of the firm in the future. Additionally, what the shareholders have perceived from the returns distributed by the firm is also the driver of the share price. This price may lead to the market value of the firm. Alternatively, accounting-based measures, including profitability, efficiency, liquidity, gearing, and investment ratios, are calculated using the figures from the financial reports and may represent a firm's financial performance. According to Atrill et al. (2009), the ratios that may be utilized to calculate the firm's profitability are the return on assets (ROA), return on equity (ROE) and return on investments (ROI). These ratios express the success of a firm in generating profits or returns from the resources owned. For the purpose of this study, we made use of return on asset as the proxy for financial performance.

Return on asset, which was developed by Dupont in 1919, is the most common measure used as a proxy for financial performance. Return on assets (ROA) is a measure of how efficiently a company uses the assets it owns to generate profits. It compares the value of a business's assets with the profits it produces over a set period of time.Managers, analysts and investors use ROA to evaluate a company's financial health.

ROA is a helpful metric for gauging a single company's performance. When a firm's ROA rises over time, it indicates that the company is squeezing more profits out of each dollar it owns in assets. Conversely, a declining ROA suggests a company has made bad investments, is spending too much money and may be headed for crisis.

Directors' Remuneration and Return on Asset

Directors' remuneration is used to indicate directors' gross earnings in the form of financial rewards and benefits (Akewuosha and Saka, 2018). This can also be referred to as directors' compensation. Generally, compensation can be examined as a system of rewards that can motivate the employees to perform. Compensation structure takes into consideration qualification, experience, attitude and prevailing rates in the labour market or industry. According to Junaidu and Sanni (2014) directors' remuneration is composed of the financial compensation and other non-financial awards received by the directors from their firm for their service to the organization. It is typically a mixture of salary, bonuses, shares of or call options on the company stock, benefits and perquisites, ideally configured to take into account government regulation, tax law, the desires of the organization and the executive, and rewards for performance.

Tunneling can be done through high compensation scheme to the board members. The compensation of CEO as well as the remuneration of directors is decided by the board members. According to Weisbach (2007), CEOs have substantial influence over their own pay by providing a different set of incentive to directors. They are power agent that can shift the board of director's focus to consider their own interests rather than the interest of shareholders which they represent. According to Weisbach (2007), directors have incentive to keep their jobs and CEOs can provide benefits to directors in many different ways. Furthermore, CEOs can use their influence to help directors attain additional benefit. Thus the directors have incentives to act on behalf of the CEOs. This give and take relationship between the directors and the CEOs has made the Directors compensation come under increased public scrutiny especially in most developed countries. Hence the use of equity based compensation as a motivating tool for

executives has been a major focus of many debates. The resulting concerns have led to demands for greater transparency in executive stock option programs and, possibly, the elimination of the programs altogether. Since additional incentives is tied to performance, CEO tries all within their reach to improve and increase their performance, this has a direct impact on the return on asset of the firm.

Empirical Review

Ifurueze et al (2019) study examined the effect of directors tunneling on performance of quoted manufacturing companies in Nigeria. The study has four specific objectives to achieve, four research questions that guided the study and four null hypotheses were formulated. The study used ex-post factor research design. Fifteen (15) firms were selected from the Nigeria Stock Exchange (NSE). The data used were secondary data and were drawn from 2008 to 2017. The secondary data collected were analyzed using descriptive statistics, correlation and regression analysis. The data used in this study were sourced from the firm's annual report and Nigerian Stock Exchange fact book. This study applied ex post facto research design. The data collected were analyzed using Ordinary Least Square Method. The results show that only Director's equity holding is negative and has significant effect on performance of quoted manufacturing companies in Nigeria. Board of director's pay and Chairman's pay are negative, and Dividend payment to directors is positive and has insignificant effect on performance of quoted manufacturing companies in Nigeria.

Onuorah, Okeke and Ibekwe (2019) examined the effect of compensation management on employee performance in Nigeria organization. The study adopts descriptive survey research design. The study was carried out in Anambra State. The population of the study comprises 257 public secondary schools in Anambra State. The sample size for the study consists of 257employees drawn from the population of the study. The sample consists of entire population. The instrument for data collection is a structured questionnaire. The face content validity of the instrument was employee. The instrument was trial-tested on a representative sample of 20 employee randomly selected of Anambra State. In analyzing the data for the null hypotheses, Z-test was be used to test the hypotheses at 0.05 level of significance. Equity based compensation has no negative significance effect on employee performance in Nigeria organization. Competency based compensation has no negative significance effect on employee performance in Nigeria organization. Performance based compensation has no negative significance effect on employee performance in Nigeria organization. Therefore the study concludes that compensation management has significance effect on employee performance in Nigeria organization.

Nwaogu, Odesa and Nzoegbu (2019) evaluates the effect of director's tunneling on asset utilization of companies in consumer goods sector in Nigeria using a panel data collected from annual financial report of thirty listed consumer goods firm in Nigeria between 2011 and 2016. The study was based on ex-post-facto research design and the data collected were analyzed using descriptive statistics, correlation analysis and multiple regression. The study finds that the director's pay and equity holding varies widely among consumer goods firms. Chairman's pay and director's equity holding have a statistically significant effect on asset utilization at 5% level. While the director's pay policy has no statistically significant effect on asset utilization. The finding shows pay, chairman's pay and director's equity holding are three major avenues used for tunneling as they have a significant effect on tunneling.

Akewuosha and Saka (2018) studied executive compensation and organizational financial performance of selected diversified firms in Nigeria. Their study adopted ex-post facto research design that made use of the annual reports of six (6) firms in Nigeria. The annual report was used and was analysed using panel data regression model. The research findings revealed that profitability, size of firm, return on equity and return on investment have significant influence on what is to be paid as executive compensation.

Fried, Kamar and Yafeh (2018) examined the effect of minority veto rights on controller tunneling in Israel. To assess these rights' efficacy, they exploit a 2011 regulatory reform in Israel that gave the minority the ability to veto pay packages of controllers and their relatives ("controller executives").They find that the reform curbed the pay of controller executives and led some controller executives to quit their jobs, or work for free, in circumstances suggesting their pay would not have received approval. These findings suggest that minority veto rights can help curb controller tunneling.

Shahid Hussain and Nabeel Safdar (2018) investigates a critical aspect of agency conflict between dispersed minority and majority (controlling) shareholders in firms affiliated with family business groups. For years 2009-2013, the study uses a unique hand-picked data set of 290 non-financial (i.e. 177 family business group and 113 stand-alone or non-

group) firms listed on Pakistan Stock Exchange (PSX). The study finds that majority shareholders expropriate minority shareholders by tunneling (transferring) important resources from low cash-flow rights firms affiliated with family business group. While measuring the sensitivities of firms to the industry earnings shocks, the empirical results reveal that about 15% resources of low cash-flow rights firms are tunneled to high cash-flow rights firms in family business groups. It is also confirmed that equity held by directors representing majority shareholders has negative relationship with earnings of minority shareholders in low cash-flow rights firms affiliated with family business groups.

Aroh, Aroh and Odum (2018) examined the relationship between firm performance and abnormal directors‟ compensation for thirteen (13) listed banks in Nigeria for the period from 2012 through 2016. The study adopted Robust Least Square Regression Analysis in finding coefficient estimates that will be used for policy recommendations. The researcher found that there is a positive but insignificant relationship between firm performance measured by shareholders‟ value of Tobin Q and abnormal directors' compensation. The results also showed that the size of the firm significantly influence shareholder's wealth but not significantly affecting firms' profitability.

Nnubia and Fabian (2018) investigates the effect of director's tunneling on firm performance of quoted companies in Nigeria. A sample of 15 Nigerian consumer goods firms listed on Nigerian Stock Exchange for a period of 8 years (from 2010-2017) was selected. The main type of data used in this study is secondary; sourced from the Nigerian stock exchange fact book. This study applied ex post facto research design. The data collected were analyzed using Ordinary Least Square Method. The results show that for the Nigerian listed consumer goods firms, the explanatory variables- Chairman's pay and Director's equity holding has negative significant effect on the dependent variable – asset utilization (Performance); whereas Board of director's pay is positive and has no significant impact on the asset utilization (Performance).

METHODOLOGY

This study is based on longitudinal research design as panel data covering a period of nine (9) years that is, from 2012 to 2020 employing banks listed in the Nigerian Stock Exchange. The population consists of the total number of Deposit Money Banks with national and international authorization by the Central bank of Nigeria. The population size of the Deposit Money banks from CBN official website as at 31st December, 2020 is nineteen (19). A sample of ten (10) banks were purposively selected based on a criterion that the shares of the banks must be independently listed on the Nigerian Exchange Group between 2012-2020. Banks whose shares are not listed or are listed under a holding company were excluded from the study. Thus, nine banks including First Bank Ltd., Stanbic IBTC and FCMB are not part of the sample size. For the purpose of this study, secondary method of data collection was employed, as data on directors' remuneration ratio and financial performance proxied by return on asset for a period of 9years from 2012 to 2020 was sourced from each listed bank's annual audited financial reports. In analyzing the data, the study adopted descriptive statistics and regression analysis. The descriptive statistics was used to evaluate the characteristics of the data such as mean, maximum, minimum, standard deviation and also checks for the normality of data. It also shows the homogeneity of data collected. The normality test, in this case, the Jarque-Bera statistic test determines if the data series were normally distributed by evaluating the disparity of the skewness as well as the kurtosis of the series compared with those from the normal distribution. The Jarque-Bera statistic test is a goodness-of-fit test of whether the sample data have the skewness and kurtosis matching a normal distribution. If the residual is normally distributed, then the histogram must be well shaped while the Jarque-Bera statistic will not be significant. In that case, a series would be normally distributed if the probability of the Jarque-Bera statistic is greater than 5% which is 0.05. In evaluating the regression results, the Ordinary Least Square regression was used. The individual statistical significance test (T-test) and overall statistical significance test (F-test) was deployed. Importantly, the goodness of fit of the model will be ascertained using the coefficient of determination (R2). The panel analysis was done after descriptive statistics, normality test, and correlation analysis (test for multicollinearity). All analyses were conducted at 5% level of significance using E-VIEW 10 and STATA 14 software.

DATA PRESENTATION AND ANALYSIS

Descriptive Statistics of the Variables

Table 1: Descriptive Statistics of Data

	DIREM	ROA
Mean	5.648334	0.014391
Median	5.652662	0.011984
Maximum	6.399801	0.061537
Minimum	4.840439	-0.095318
Std. Dev.	0.330906	0.021618
Skewness	-0.385901	-1.918846
Kurtosis	2.497841	11.86327
Jarque-Bera	3.497346	384.8026
Probability	0.174005	0.000000
Sum	559.1851	1.424731
Sum Sq. Dev.	10.73086	0.045801
Observations	90	90

Source: Analysis Output (2021) Using EVIEW 10

Table 1 above gives the descriptive statistics of the variable which indicates that Directors' Remuneration (DIREM) as a measure of directors' tunneling has a mean value of about 5.65 with a standard deviation of 0.33. The maximum and minimum values of DIREM are 6.399 and 4.840, respectively. The mean value of Return on Asset (ROA) is 0.0144 with a standard deviation of 0.0216. ROA fluctuated between -0.0953 and 0.0615.

Normality Test

The skewness of a normal distribution is arbitrarily zero. According to **1 above,** all the variables are negatively skewed, which implies that the distribution has a long left tail. A normal distribution is expected to have a kurtosis value of 3. If the kurtosis exceeds 3, the distribution is peaked (leptokurtic) relative to the normal; if the kurtosis is less than 3, the distribution is flat (platykurtic) relative to the normal. **Table 1** above shows that DIREM come from a normal distribution but ROA whose kurtosis is greatly different from 3 do not come from a normal distribution. This position was supported by the Jarque-Bera Probability. Variables that have Jarque-Bera Probability that is less than 0.05 are normally distributed. However, the results of OLS regression analysis are still valid even though the normality assumption is defaulted.

Test of Hypotheses

The test of hypotheses was carried out using ordinary least square regression. The model used in the study is as follows:

ROAit = $\hat{a}_0 + \hat{a}_1$DIREMit

The result from the regression analysis carried out shows the effect of directors' tunneling on financial performance of listed deposit money banks in Nigeria. Specifically, it reveals how Director's remuneration (DIREM) influence the Return on Asset (ROA) of the firms under study. The coefficient of determination is $R^2 = 0.2579$ shows that about 25.79% of total variation in ROA is accounted for by changes in the predictor variable, DIREM. The F-statistic that tests the explanatory power of the model is 8.26 with the corresponding probability value of 0.0000. Thus, the model is significant at 5% since the Prob(F) is less than 0.05. Therefore, this implies that the DIREM has an influence ROA of quoted deposit money banks in Nigeria ($F = 8.26$, p-value = 0.0000).

Test of Hypothesis One

H_0: Directors' remuneration has no significant effect on financial performance of selected listed Deposit Money Banks in Nigeria.

H_a: Directors' remuneration has a significant effect on financial performance of selected listed Deposit Money Banks in Nigeria.

According to the result, it indicates that the coefficient of DIREM is $\beta_1 = 0.0305$ (t = 0.29, p-value = 0.774). The value for β_1 shows that an increase in DIREM will lead to an increase in ROA by 0.0305. However, the result reveals that the coefficient is not different from zero given that the p-

value in the test is greater than 0.05. Therefore, this positive effect is not statistically significant.

Since the *p-value* (0.774) is greater than 0.05, the null hypothesis is, therefore, accepted while the alternate hypothesis is rejected. Thus, directors' remuneration has no significant effect on financial performance of selected listed Deposit Money Banks in Nigeria at 5% level of significance (t = 0.29, *p*-value >0.05).

Conclusion

Based on the results of these findings, this study concluded that directors' remuneration is positive and does not have statistical significant effect on return on asset of Deposit Money banks in Nigeria. Thus, the study accepts the null hypothesis and rejects the alternate hypothesis. These findings corroborate the findings of Erick, Kefah and Nyaoga (2014) on the effect of executive compensation on performance of insurance companies in Kenya. In as much as directors' remuneration can boost the financial performance of an entity, they can also be deployed as a tool for tunneling if proper control is not established. The result provides useful information insight for managers, shareholders and policy makers which can aid them in planning and formulating policy that can

Recommendations

Based on the conclusion, this study therefore recommends the following:

1. The study recommends bank decision makers to include shareholders in fixing the remuneration scale of directors to avoid misuse of authority by the board. Also, the regulators are encouraged to make it mandatory for listed banks to clearly show all the remunerations, bonuses and packages in monetary value on

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