# Directors' Compensation and Insurance Firms' Performance in Nigeria Adebanjo Joseph Falaye Ph.D., Rasak Bamidele Ph.D., Uthsu Ruth Libonghaunim

Landmark University

#### Abstract

Compensation is a complex and controversial subject. Researchers, academicians and consultants have devoted much time and efforts to understand the innumerable factors that underlie top management compensation. Of more importance to this study is how compensation imparts on firms' performance.

For some time now, executive compensation has been a matter of concern to corporate policy makers. Studies have shown that compensation is one of the most important strategies in human resource management; as it influences the productivity and growth of organizations. There is also a public outcry that insurance companies in Nigeria do not settle claims promptly; and in most cases only with the intervention of the regulatory bodies.

There are many published issues on compensation that focus on organizational differences; there is little on whether compensation has any significant linkage with performance. Besides, improvement of corporate governance standards has been at the forefront of international debate in recent times. Compensation of directors and executives is one of the key issues in this debate. This study aimed at finding out if there is any relationship between remuneration and incentive systems on Nigerian insurance firms' productivity.

The net claims paid to contributors depict a measure of productivity as perceived by the insured, while the returns on assets depict productivity from the shareholders perspective. The two represent the dependent variable for study.

Key words: Remuneration, incentives, directors, performance, management, corporate organization and insurance

#### Introduction

Compensation is a well debated topic. Sarkar and Jafar (2012) point out that researchers, academicians and those in practice 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.

However, Obasan (2012) is of the view that compensation is one of the most important strategies in the human resource management; as it influences the productivity and growth of an organization. According to him, though literatures abound on compensation that focuses on organizational differences, there is little debate on whether compensation has any significant linkage with performance.

Yatim (2012) opines that remuneration and incentive systems have been shown to play a key role in influencing risk taking behaviours of managers in recent years. Improvement of corporate governance standards and disclosures has been at the forefront of international debate in recent times and compensation of directors and executives is one of the key issues in this debate.

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 used primarily to hedge against an unforeseen contingency (Isimoya, 2014). By definition, insurance is a social scheme which provides financial compensation for the effects of a misfortune. The financial compensation is provided from the pool of accumulated contributions of all members participating in the scheme (Isimoya, 2007). In a typical market economy, the insurance industry is an indispensable tool for progress, growth and development. It is vital to the well-being and smooth functioning of economies. The insurance sector is a key part of the financial sector. Insurance provides stability by allowing large and small businesses operate with a lesser risk of volatility or failure. Insurance is also seen as a compliment to government's security programs and the emphasis being placed on greater private ownership and responsibility.

Furthermore, Irukwu (2003) noted 'as a key service industry in the financial services, 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). The nature of Nigerian environment makes insurance important as there is high death rate, high theft rate and frequent occurrence of accidents. (Akinbola and Isaac 2010).

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.

The National Insurance Commission (NAICOM), which is the regulating body for insurance companies in Nigeria, rose to the challenge and introduced recapitalization. The outcome of the consolidation and recapitalization exercises in the insurance sector led to a drastic shrinking of insurance operators to a total of 49 insurance companies and 2 re-insurance companies. The total recapitalization of the industry improved remarkably from pre- consolidation level of 30billion Naira to the present level of 200billion Naira.

The corporate governance codes have also been adopted. Section 5.0 of the Code of Corporate Governance for Insurance in Nigeria points out that, the corporate governance framework shall be anchored on an effective and accountable board of directors who is appointed to ensure the strategic guidance and effective management of the company. The board which is viewed as the main functional organ of any business is collectively responsible for its operations. Directors are expected to preserve and enhance shareholders'

value. They should therefore be legally empowered and suitably compensated in order to evaluate the performance of the management.

With a focus on the insurance industry, the issue of customer satisfaction through claims payment is important. While the agency approach is needful through the compensation of agents, it centres particularly on the shareholders of a company. The stakeholder approach is important as it represents a practical shift in the traditional role of the board of directors as a defender of shareholders to one that seeks to defend every stakeholder. Therefore, one can infer from the stakeholder theory that, it is not the interest of the shareholders alone that should be protected.

#### **Statement of Problem**

The insurance industry is becoming increasingly important to economic stability and development of many nations as it helps to reduce the burden of risks of individuals and businesses. Growth in insurance industry therefore remains one of the major indices for measuring the level of development of a nation's wealth, plays very significant roles in the mobilization of investible resources of an economy and gives greater security to the fortunes of the common people among the whole society.

However, in Nigeria today, there is a concern and public outcry 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 as compared to companies of other industries in Nigeria. There is also a public outcry that insurance companies in Nigeria do not settle claims promptly when due, and in most cases only with the intervention of the regulatory bodies.

This is substantiated with Business Day (2014) publication of 17<sup>th</sup> July on the successful facilitation of 83 claims payment by NAICOM between January 2014 and June 2014 but the outstanding complaints standing at 189. This must be a most visible effect of an underlying problem. Board compensation is one of the most identifiable areas to look at as the major responsibility of board of directors is to monitor management and create wealth and value for the company while the directors in turn are compensated for this fiduciary function.

The questions that plague the mind of the researcher include: Are directors of insurance companies in Nigeria suitably compensated to motivate them to carry out their oversight functions? Could there be a link between directors' compensation and firm's performance? It is in view of the challenges above that this research work seeks to find out if the compensation of executive and non-executive directors in the insurance industry in Nigeria is significantly related to the performance of the industry.

#### **Research Questions**

To achieve the aim of the research, this study sought to find out if there is any significant relationship between directors' annual compensation and Return on Assets in the Nigerian insurance industry; and if there is any significant relationship that exists between directors' annual compensation and annual net claims paid in the Nigerian insurance industry.

#### Justification for the Study

The study sought to find out the relationship between director compensation and the financial performance of quoted insurance companies in Nigeria. While literature on Chief Executive Officer's compensation within banks in Nigeria is becoming large, there is lack of empirical evidence in respect to the compensation practices in the insurance industry in Nigeria. There is abundant research on the sizes and composition of boards of directors, chief executive officer/chairman dual roles, but a study on directors' compensation has not received due attention; even within the insurance sector. This study seeks to fill these gaps.

Secondly, through the analysis of insurance industry in Nigeria, the study hopes to provide empirical evidence on the relationship between directors' compensation and firm's performance. The result obtained from the study could help policy makers and all stakeholders in the insurance industry to make decisions that will improve earnings and create a good public image for the industry. It will also contribute to the existing body of knowledge in insurance administration and service delivery in Nigeria.

In addition, the findings at the end of the study would provide a stepping stone on which further researches could be carried out relative to directors' compensation and firm's performance in Nigeria. It is hoped that the findings from the study will find practical application in the Nigerian insurance industry and help to solve some of the inherent challenges faced by the industry.

#### Objectives

The study aimed purposed to examine the relationship between directors' compensation and firm performance in the Nigerian insurance industry. However, in more specific terms, the study sought to find if there exists a significant relationship between directors' annual compensation and Return on Assets in the Nigerian insurance industry. Equally, it sought to examine if a significant relationship exists between directors' annual compensation and annual net claims paid in the Nigerian insurance industry.

### **Research Hypothesis**

In order to accomplish the study objectives and give meaningful answers to the research questions, The null hypotheses tested in the study include if no significant relationship exists between directors' annual compensation and Return on Assets in the Nigerian insurance industry. The second null hypothesis tested is if there existed no significant relationship between directors' annual compensation and annual net claims paid in the Nigerian insurance industry.

#### Scope of the Study

The study established the nature of the relationship that exists between compensation of directors and performance of selected insurance companies in Nigeria. This sector is chosen based on the fact that the stability of the insurance industry is crucial to the management of financial risk in the economy as a whole. To this effect, while there are 30 general insurance companies listed on NAICOM website, the study was on 14 general insurance companies quoted in the Nigerian Stock exchange whose annual reports were complete could be assessed for 2011-2013 as at December, 2016. The study period chosen is 2011-2013.

The reason for the choice of a recent time frame is because of the recapitalization in the industry that concluded in 2007 and introduction of corporate governance codes in 2009. The year 2014 is exempted as all the annual reports for 2014/2015 for all the companies studied were not available.

Furthermore, the study measured performance by using the Return on Assets (ROA) and Net Claims paid as the variables. Claims payment is adopted as the ability of companies to pay the claims of the insured as at when due indicates the liquidity level of the companies. Executive directors' annual salary and nonexecutive directors' compensations are used to establish a relationship with the above variables.

#### **Research Design**

The *judgmental sampling* technique was used in selecting certain insurance companies listed on the Nigerian Stock Exchange. Doucouliagos et al (2007) in a bid to explore the relationship between directors' and chief executive officers' pay and performance within Australian banking, used a panel data of 14 years, from 1992 to 2005 collected from annual reports gotten from banks. Uwuigbe (2011) carried out a similar research to examine the relationship between corporate governance variables and bank performance. The author made use of the corporate annual reports of the 21 listed banks in Nigeria. In line with these previous studies, this study will consider data gotten from annual reports of listed general insurance companies from the year 2011 to 2013. Cross-sectional data is to be used as the collection of data will be carried out once. Quantitative techniques will be adopted to analyse the data to be gotten. In particular, the Regression Analysis will be used to analyse further.

#### **Population of the Study**

The study population will consist of 14 general insurance companies listed in the Stock Exchange which have been in existence as at the beginning of the time frame used (2011). The time frame considered for the study will be 2011 to 2013. The three-year period allows for possible significant changes that might have occurred over time in the Insurance industry due to the recapitalization that was effected in year 2007. Also, the time frame chosen considers the introduction of corporate governance codes in the industry as at 2009.

#### Sampling Technique

The case study to be used in this study is the Nigerian Insurance Industry. While insurance companies are of three types, life, composite and general, more specifically, the study covers only general insurance companies that are quoted in the Nigerian Stock Exchange. Three criteria were identified for the general insurance companies chosen. They have been identified as general insurance companies on the official

website of NAICOM, they are listed on the Nigerian Stock Exchange, and they have annual reports from the beginning of the time frame (2011).

As at the 3rd March 2015, there were 58 insurance companies, out of which 30 are general insurance companies. As at the 3rd March 2015, 27 insurance companies were listed in the Nigerian Stock Exchange. 19 of them are general insurance companies. The researcher does not intend to study all the 19 publicly listed general insurance companies.

Only those companies whose annual reports were available and accessible were included in the study. So, the study consists of 14 General Insurance companies whose 2011, 2012, 2013 annual reports were complete for this study. General Insurance companies under the direct control of NAICOM were also left out.

### **Methods of Data Collection**

As a result of the nature of the study, this study utilized data from secondary sources. Therefore, the data that used for the study are secondary data which were derived from the audited financial statements as shown in the annual reports of the general Insurance companies listed in the Nigerian Stock Exchange between the three years' period of 2011 and 2013.

#### **Instruments for Data Collection**

As the data were collected from secondary sources, the use of questionnaires was applied. For most of the companies, the annual reports were derived from the companies' websites. The financial statements in the published annual reports were obtained from the websites of the companies concerned.

#### Method of Data Presentation and Analysis

Data obtained from the annual reports of the sample (insurance companies) were presented in tabular forms. From the data gotten, the average for each variable was statistically gotten and used to represent the aggregates of all the companies concerned. The data were analysed using the regression analysis to investigate the relationship among the dependent and independent variables.

To establish the relationship, executive directors' annual salary and non-executive directors' board allowance were used as the independent variables to quantify directors' compensation. The dependent variables used to represent firm performance include net claims paid and return on assets.

## **Data Presentation and Analysis**

Regression analysis was used to investigate the extent to which directors' compensation affects the performance of the insurance companies listed. The performance of the companies was represented by four variables which include net claims, return on assets, net premium and earnings per share. Regression model was used to analyse the relationship between the averages of variables across the eight companies used. The simple linear regression model was used to examine the extent to which directors' compensation has an impact on net claims, return on assets, net premium, and earnings per share.

REGRESSION STATISTICS						
Multiple R	0.965894113					
R Square	0.932951437					
Adjusted R Square	0.910601916					
Standard Error	107878462.6					
Observations	5					

#### **Table 4.1: Regression Statistics for Net Claims**

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.

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							

Table 4.2: Analysis of Variance for Net Claims

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	- 0.95042287 9	0.41201 4	- 651086975. 3	351630143	-651086975	351630142.8
DC	22.71535023	3.51579891 4	6.46093556 3	0.00752 2	11.5265089 7	33.904191 5	11.5265089 7	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.

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						

 Table 4.5: Analysis of Variance for Return on Assets

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.

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

Table 4.8. Analysis of Variance for Net Premium

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	36700265.7 2	0.00905191 1	0.99334601 4	-116464417	117128832. 6	- 116464417	117128832 .6
NP	0.013867248	0.01183100 4	1.17211083 4	0.32576393 5	- 0.02378429	0.05151878 4	-0.0237843	0.0515187 84

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.

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							

### Table 4.11 Analysis of Variance for Earnings Per Share

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.

## **4.3 Hypothesis Testing**

In the first chapter, two testable hypotheses were formulated on the relationship between directors' compensation and firm performance. It is on these hypotheses that that this study is anchored. In this section, the hypotheses are subjected to empirical testing drawing from the results of the statistical analyses. 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.

#### Hypothesis 1

H0<sub>1</sub>. There is no significant relationship between directors' annual compensation and return on assets in Nigerian general insurance companies.

HA<sub>1.</sub> There is a significant relationship between directors' annual compensation and return on assets in Nigerian general insurance companies.

In the first hypothesis, the null and alternative hypotheses were formed. For the null hypothesis, it was assumed that the relationship between directors' annual compensation and return on assets is not significant. For the alternative hypothesis, it was assumed that the relationship between directors' compensation and return on assets is significant. From the analysis on table 4.4, the adjusted r square showed the coefficient of determination as 0.76. It 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.

#### Hypothesis 2

H0<sub>2</sub>. There is no significant relationship between directors' annual compensation and annual net claims paid in Nigerian general insurance companies.

HA<sub>2</sub>. There is a significant relationship between directors' annual compensation and annual net claims paid in Nigerian general insurance companies.

In the second hypothesis, the null hypothesis assumed that there is no significant relationship between directors' compensation (DC) and net claims paid (NC). The alternative hypothesis assumed that the relationship between DC and NC is significant. 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. The null hypothesis is rejected and the alternative hypothesis is accepted.