The Seybold Report
ISSN 1533-9211
DOI: 10.5281/zenodo.13859454

CEO PAY AND FINANCIAL PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

This study investigates the impact of Chief Executive Officer (CEO) compensation on the financial performance of listed deposit money banks in Nigeria, specifically focusing on Net Interest Margin (NIM) and Tobin's Q. Utilising regression analysis, the study examines whether variations in CEO pay influence these financial performance indicators. The findings reveal a statistically significant negative relationship between CEO Pay and NIM, with a beta coefficient of -0.0004677 (p-value = 0.02). This suggests that higher CEO Pay is associated with a decrease in NIM, contradicting the hypothesis that increased compensation would enhance financial performance. In contrast, no significant relationship was found between CEO Pay and Tobin's Q, as indicated by a beta coefficient of -0.000131 (p-value = 0.71). This suggests that CEO Pay does not meaningfully affect Tobin's Q. The results imply that while higher CEO Pay may negatively impact NIM, it does not significantly influence Tobin's Q, suggesting a need for a reassessment of compensation structures to better align with financial performance objectives. The study recommends reevaluating compensation models to emphasize long-term performance and implementing more comprehensive performance-based incentives to improve overall financial outcomes.

Keywords: CEO Compensation, Net Interest Margin (NIM), Tobin's Q, Financial Performance.

INTRODUCTION

Executive compensation remains a pivotal element in corporate governance, significantly influencing organizational performance and stakeholder interests. This issue is particularly pronounced in the context of listed deposit money banks in Nigeria, where aligning executive incentives with financial performance is essential for ensuring long-term stability and growth. The structure and level of executive pay can impact managerial behaviour and decision-making, with potential repercussions for financial outcomes (Adewale & Olufemi 2022).

In Nigeria, the banking sector plays a critical role in the national economy, acting as a major conduit for capital allocation and financial intermediation. Given the sector's importance, there is an increasing need to understand how compensation practices affect banks' financial health and operational efficiency. Previous research has highlighted a range of impacts from executive compensation on financial performance, including the potential for both positive and negative outcomes depending on the alignment of incentives (Olumide & Afolabi 2024). For instance, well-structured compensation packages can motivate executives to enhance performance, whereas poorly designed packages may lead to short-termism or risk-taking behaviours that undermine financial stability (Kelechi & Ifeoma 2023).

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Moreover, the dynamics of executive pay in Nigerian banks must be examined in light of regulatory frameworks and corporate governance practices. Recent studies have suggested that there is a complex interplay between executive compensation, regulatory oversight, and financial performance, with implications for both policy and practice (Nwachukwu & Obi 2024). This investigation aims to provide a comprehensive analysis of how current compensation strategies impact the financial performance of listed deposit money banks in Nigeria, offering insights for policymakers, investors, and corporate governance practitioners.

Statement of the Problem

In an ideal scenario, executive compensation should be carefully crafted to align with the financial performance and strategic goals of listed deposit money banks. This alignment ensures that the incentives provided to executives are closely tied to enhancing the bank's profitability, operational efficiency, and overall stability. Such a well-structured compensation framework is intended to drive executives to make decisions that support long-term growth and shareholder value. The compensation packages should ideally motivate executives to work towards achieving sustainable financial success and to prioritize the bank's enduring health over short-term gains.

However, in practice, there is frequently a notable disconnect between the compensation packages offered to executives and the actual performance outcomes of these banks. This misalignment can manifest in several ways. Executives may be incentivized to focus on immediate financial metrics rather than long-term strategic goals, potentially leading them to pursue riskier strategies or short-term profit boosts that do not necessarily align with the bank's overall objectives. As a result, these compensation practices may fail to promote the desired behaviour and may even encourage actions that undermine the bank's stability and growth prospects.

If these issues related to executive compensation are not adequately addressed, the consequences could be significant and multifaceted. Misaligned incentives can lead to poor decision-making by executives, which in turn can result in decreased financial stability and an erosion of investor confidence. Over time, this could jeopardize the bank's performance, hinder its ability to attract and retain top talent and damage its local and international reputation. Moreover, persistent problems with executive compensation might attract increased regulatory scrutiny, further complicating the bank's operational environment and potentially leading to additional challenges in maintaining regulatory compliance and fostering stakeholder trust.

Objective of the Study

This study seeks is to ascertain the impact of executive compensation on the financial performance of listed deposit money banks in Nigeria. Specifically, the objective of the study is to:

i. Ascertain the effect of CEO Pay on the financial performance of listed deposit money banks in Nigeria.

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Research Question

The study provided answers to the following research questions.

i. How does CEO Pay affect the financial performance of listed deposit money banks in Nigeria?

Statement of Hypotheses

The following hypotheses in null form (H_0) guided this study:

i. H_0: CEO Pay has no significant effect on the financial performance of listed deposit money banks in Nigeria.

Significance of the Study

The investigation into the impact of CEO Pay on the financial performance of listed deposit money banks in Nigeria is of considerable importance to a diverse group of stakeholders. The findings from this study have far-reaching implications for individual investors, banking institutions, policymakers, regulatory bodies, and academic researchers.

i. Individual Investors: For individual investors, the study offers a crucial understanding of how executive compensation practices can directly affect the financial performance and stability of banks. By analyzing the relationship between compensation structures and bank performance, investors can gain insights into which banks are likely to deliver sustained financial returns. This knowledge empowers investors to make more strategic and informed decisions regarding their investment choices, potentially leading to better investment outcomes and enhanced portfolio management.

ii. Banking Institutions: Banking institutions themselves stand to benefit significantly from the results of this study. The insights gained can help banks reassess and refine their executive compensation strategies to ensure that they are aligned with their financial goals and performance metrics. By addressing any misalignments identified, banks can develop compensation packages that better motivate executives to pursue long-term strategic objectives rather than short-term gains. This alignment can lead to improved operational efficiency, enhanced profitability, and stronger overall organizational performance, which is crucial in a highly competitive and dynamic banking environment.

iii. Policymakers: For policymakers, this study provides valuable evidence to guide the development and refinement of regulatory frameworks concerning executive compensation. An understanding of how different compensation structures impact bank performance can help in crafting policies that promote fair and effective compensation practices. Policymakers can use the study's findings to create regulations that ensure compensation practices encourage responsible risk-taking and align with the long-term interests of both the banks and their stakeholders. This can contribute to a more stable and resilient financial system, ultimately benefiting the broader economy.

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iv. Regulatory Bodies: Regulatory agencies tasked with overseeing the financial sector will find the study's insights particularly relevant. The research highlights the potential effects of compensation practices on financial stability and risk management. By utilizing the findings, regulatory bodies can develop more nuanced guidelines and monitoring mechanisms to prevent practices that might encourage excessive risk-taking or short-termism. Effective regulation based on this research can enhance the integrity and stability of the banking sector, reducing the likelihood of financial crises and maintaining investor confidence.

v. Academic Researchers: The study also holds significance for academic researchers and scholars in the fields of finance, management, and corporate governance. It provides empirical evidence and theoretical insights into the dynamics between executive compensation and financial performance. The findings can serve as a foundation for further academic inquiry and discussion, contributing to the broader understanding of compensation practices and their impacts. Researchers can build upon this study to explore additional dimensions of executive compensation, such as its effects on different sectors or in various regulatory environments.

Concept of Executive Compensation

Executive compensation is a multifaceted system designed to attract, motivate, and retain senior management through various financial rewards. This includes base salaries, performance bonuses, stock options, and other incentives, all intended to align executives' interests with those of the shareholders (Jensen & Murphy, 1990). Historically, executive compensation has evolved from simple salary structures to more complex packages that incorporate performance-based elements to drive company success (Murphy, 2013). The ideal compensation structure should not only reward immediate achievements but also reflect long-term strategic goals and performance metrics. This alignment helps ensure that executives are motivated to enhance organizational success and shareholder value over time (Baker et al., 2021). Contemporary studies suggest that integrating both short-term incentives, such as annual bonuses, and long-term rewards, such as stock options or restricted stock units, is essential for fostering sustainable performance and mitigating risks associated with executive compensation (Hsu & Liu, 2022).

Alignment of Incentives

The alignment of incentives is a fundamental principle in corporate governance, aiming to ensure that executives' interests are congruent with those of the shareholders. Effective alignment reduces potential conflicts of interest and promotes long-term value creation by tying compensation to performance outcomes (Eisenhardt, 1989). When compensation structures are aligned with organizational goals, executives are more likely to focus on sustainable growth and value creation rather than short-term gains. Misalignment, on the other hand, can lead to executives pursuing strategies that boost short-term performance at the expense of long-term stability (Bebchuk & Fried, 2023). Recent research highlights the need for compensation plans that balance immediate rewards with long-term incentives to avoid risky behaviours and ensure

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ISSN 1533-9211

DOI: 10.5281/zenodo.13859454

that executives are motivated to achieve sustainable success (Chen et al., 2023). Effective alignment involves integrating performance-based components that are contingent on achieving both short-term and long-term strategic objectives, thus fostering a holistic approach to incentive design.

Regulatory Framework

The regulatory framework governing executive compensation is crucial for ensuring fairness, transparency, and accountability in compensation practices. Regulations and guidelines established by governmental and regulatory bodies aim to prevent excessive compensation and ensure that practices align with best governance standards (Nwachukwu & Obi, 2024). In Nigeria, regulatory bodies such as the Central Bank of Nigeria (CBN) and the Nigerian Exchange Group (NGX) enforce rules and guidelines that oversee executive compensation practices. The CBN provides corporate governance guidelines that address compensation practices within the banking sector, while the NSE mandates disclosure requirements for listed companies (CBN, 2023; NGX, 2022). These regulations are designed to promote transparency and protect shareholder interests by ensuring that executive compensation is both fair and justifiable. Recent updates to these regulations reflect a growing emphasis on enhancing transparency and accountability in executive pay practices (Oke, 2023). Regulatory reforms aim to address emerging challenges and ensure that compensation practices remain effective and equitable in a dynamic financial environment.

Current Perspectives

Recent trends in executive compensation indicate a shift towards greater transparency and long-term performance alignment. Innovations such as performance-based equity grants, long-term incentive plans, and enhanced disclosure requirements are increasingly common (Barkema & Gomez-Mejia, 2023). These innovations are designed to better align executive rewards with organizational success and shareholder interests. Regulatory reforms are also being introduced to address emerging challenges and enhance the effectiveness of compensation practices (SEC, 2023). These developments reflect a broader movement towards more responsible and transparent compensation practices, aimed at fostering long-term value creation and financial stability. The ongoing evolution in executive compensation practices underscores the need for continuous improvement in aligning rewards with organizational success and addressing regulatory and market changes.

Financial Performance

Evaluating financial performance is critical for understanding the effectiveness of executive compensation structures. Key metrics include Return on Assets (ROA), Return on Equity (ROE), and various profitability margins. ROA measures how efficiently a company utilizes its assets to generate profit, while ROE assesses the profitability relative to shareholders' equity, reflecting the effectiveness of equity deployment (Ibrahim & Adamu, 2021). Profitability margins, such as net profit margin and operating profit margin, offer insights into the company's overall financial health and operational efficiency. These metrics provide a benchmark for assessing whether executive compensation correlates with financial

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ISSN 1533-9211
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performance outcomes. Recent research underscores the importance of these metrics in evaluating compensation effectiveness, as they offer a clear indication of how well compensation structures contribute to overall financial success (Hsu & Liu, 2022). Studies have shown that well-designed compensation packages can lead to improved financial performance by aligning executives' rewards with the company's financial goals (Deng et al., 2023).

Theoretical Review

The study was theoretically underpinned by Agency Theory and was supported by Principal-Agent

Agency Theory

Agency Theory, introduced by Michael Jensen and William Meckling, addresses the principal-agent problem where executives (agents) may pursue personal goals that conflict with the interests of shareholders (principals). This misalignment can lead to inefficiencies and reduced shareholder value. The theory proposes that compensation structures, such as performance-based rewards, can bridge this gap by aligning executives' incentives with company performance (Eisenhardt, 1989). This study will utilize Agency Theory to investigate how different forms of executive compensation impact the financial performance of listed deposit money banks in Nigeria. It aims to assess whether banks with performance-based compensation structures exhibit superior financial outcomes compared to those with less effective compensation strategies. The findings could offer valuable insights for policymakers and regulators, potentially leading to reforms in executive pay practices. Additionally, the research may help Nigerian banks benchmark their compensation practices against global standards, identify best practices, and enhance stakeholder trust by demonstrating that well-aligned incentives contribute to better financial performance.

Principal-Agent Theory

Principal-agent theory, formulated by Michael Jensen and William Meckling, explores the core issue of the principal-agent relationship where principals (such as shareholders) delegate decision-making authority to agents (such as executives). The theory identifies the potential for misalignment between the principals' goal of maximizing investment returns and the agents' incentives, which may not align with these goals. To address these conflicts, the theory suggests implementing effective mechanisms like performance-based compensation to ensure that agents' actions are in line with principals' objectives. This study applies the Principal-Agent Theory to evaluate how various compensation structures, such as base salaries, bonuses, and stock options, align executives' interests with those of shareholders in listed deposit money banks. It aims to determine whether performance-based pay systems effectively incentivize executives to enhance financial performance by examining their impact on key financial metrics. Additionally, the study explores how different compensation structures influence the mitigation of conflicts of interest and offers insights for policymakers and regulators to develop better compensation frameworks. By providing a contextual understanding of how compensation practices affect executive behaviour in the unique Nigerian market, the study seeks to enhance the alignment of executive incentives with financial goals and contribute to

ISSN 1533-9211
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more effective and transparent compensation practices in the banking sector.

Empirical Review

Olalekan & Bodunde in 2015 examined the impact of CEO pay on performance of 11 quoted banks in Nigeria using CEO pay, bank size, leverage, board size and board composition as proxies of executive compensation and EPS for performance. In spite of the importance of executive compensation as a vital tool in the realm of corporate governance to bring interests' alignment between shareholders and CEOs, the study emphasized that rather than being a mechanism that would motivate the CEOs to pursue the shareholders' interest, the CEO pay of Nigeria banks deteriorates bank performance and shareholders' value.

Ibrahim and Adamu (2021) explored "The Effect of Executive Compensation on Bank Performance: Evidence from Nigeria" using longitudinal data from 15 banks over 2015-2020. Through Fixed Effects and Random Effects models, they discovered that while fixed salaries had minimal impact, performance-related pay was significantly associated with improved ROA and Net Interest Margin (NIM). This suggests that performance-based compensation is effective in enhancing bank performance metrics.

Okoro and Ezeani (2023) investigated "Executive Pay and Financial Performance: Evidence from Nigerian Banks," utilizing a cross-sectional design with data from 12 banks for the year 2022. They applied Ordinary Least Squares (OLS) regression and found that performance-based incentives positively impacted Profit before Tax (PBT) and Earnings per Share (EPS), while base salaries had a neutral effect. Their study highlighted the efficacy of performance-linked pay in enhancing financial outcomes.

Alabi and Onyekuru (2024) conducted a study titled "Executive Compensation and Financial Performance: Insights from Nigerian Deposit Money Banks," employing a mixed-methods approach. They analyzed quantitative data from the annual reports of 8 banks from 2018 to 2023 and supplemented it with qualitative interviews. Their findings confirmed that performance-linked compensation was positively correlated with financial performance, with transparent and well-defined reward structures being crucial for aligning executive interests with bank performance.

METHODOLOGY

Research Design

The study uses a longitudinal research design to explore how executive compensation affects the financial performance of listed deposit money banks in Nigeria over time. This approach collects data from the same banks at multiple points, allowing for observation of changes and better control of time-related factors like economic conditions and regulatory shifts. The study also employs an ex post facto design, which analyzes existing financial performance outcomes to infer potential causal factors, such as executive compensation. Combining these methods helps in both predicting and understanding the causal relationship between executive compensation and financial performance in Nigerian deposit money banks.

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Area of Study

The study was carried out in Nigeria, with a primary focus on the country's deposit money banks.

Sources of Data

This study employed secondary data collected from the audited financial statements of various deposit money banks in Nigeria, covering the period from 2008 to 2022.

Population and Sample Size of the Study

The study focuses on a population of 22 banks listed on the Nigerian Exchange Group as of December 31, 2022, which have been classified as Deposit Money Banks by the Central Bank of Nigeria. These 22 banks make up the entire sample for this research.

Model Specification

This study utilized the Multiple Regression Model (MRM) to analyze the influence of explanatory variables on the main variable and to forecast their relationships. The Multiple Regression Model is defined as:

$FPit = \beta_0 + \beta_1 CEOPit + \varepsilon_{it}$ …….………………..…………………………………..... (i)

Where:

CEOP = CEO Compensation

FP = Financial Performance

e = Error term

i and t = bank i and year t

β1 = Coefficients of the Explanatory Variables

Table 1: FGLS Regression Results for NIM and Tobin's Q

	FGLS Regression Result NIM				GLS Regression Result Tobin's Q			
	Coef.	**Std. Err.**	**Z**	**P>z**	**Coef.**	**Std. Err.**	**Z**	**P>z**
CEOP	-0.0004677	0.0002006	-2.33	0.02	-0.000131	0.000350	-0.38	0.71
Constant	0.3191745	0.0257743	12.38	0.00	0.358369	0.059581	6.01	0.00
Wald chi2(9)	24.78				16.21			
Prob > chi2				0.00				0.06

Source: *Stata 13 Output, 2024***.**

RESULTS

Summary of Multiple Regression Result

The study investigates the relationship between CEO Pay and financial performance, measured by Net Interest Margin (NIM) and Tobin's Q. According to the Companies and Allied Matters Act (CAMA) 2020, CEO compensation is critical due to the CEO's role in overseeing both

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ISSN 1533-9211
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financial and operational aspects of a company. The hypothesis posits that higher CEO Pay does not enhance financial performance. However, the regression analysis reveals a beta coefficient of -0.0004677 for CEO Pay with NIM, indicating a negative relationship. With a p-value of 0.02, this result is statistically significant, suggesting that higher CEO compensation is associated with a decrease in NIM. Specifically, for each additional Naira in CEO Pay, NIM decreases by 0.0004677, contradicting the hypothesis that increased CEO pay would improve financial performance. Thus, the hypothesis is rejected. In contrast, the analysis shows a beta coefficient of -0.000131 for CEO Pay with Tobin's Q, but with a p-value of 0.71, indicating no significant relationship. This suggests that CEO Pay does not meaningfully impact Tobin's Q, and any observed effect is likely due to chance. Overall, while CEO Pay appears to negatively affect NIM, it does not significantly influence Tobin's Q, indicating that increased compensation might not necessarily lead to improved financial performance and could potentially be detrimental in terms of NIM.

Summary of Findings

The study's findings reveal important insights into the relationship between CEO Pay and financial performance, measured by Net Interest Margin (NIM) and Tobin's Q. The analysis shows a negative relationship between CEO Pay and NIM, with a beta coefficient of -0.0004677 and a statistically significant p-value of 0.02. This indicates that higher CEO Pay is associated with a decrease in NIM, contradicting the hypothesis that increased compensation would not influence financial performance. Specifically, for every additional Naira in CEO Pay, NIM decreases by 0.0004677. Conversely, the study finds no significant relationship between CEO Pay and Tobin's Q, as evidenced by a beta coefficient of -0.000131 and a p-value of 0.71. This lack of significance suggests that CEO Pay does not meaningfully impact Tobin's Q, and any observed effect is likely due to chance. Overall, the findings suggest that while higher CEO Pay may negatively affect NIM, it does not have a significant impact on Tobin's Q, indicating that increased compensation might not lead to improved financial performance and could potentially be detrimental to NIM.

CONCLUSION

In conclusion, the study highlights the complex relationship between CEO Pay and financial performance indicators, specifically Net Interest Margin (NIM) and Tobin's Q. The analysis reveals a significant negative association between CEO Compensation and NIM, suggesting that higher compensation may adversely affect this measure of financial performance. This finding challenges the hypothesis that increased CEO Pay enhances financial outcomes and implies that elevated compensation could be counterproductive in improving NIM. On the other hand, the study finds no significant relationship between CEO Pay and Tobin's Q, indicating that CEO pay does not meaningfully influence this broader measure of firm value. Overall, the results suggest that while CEO Pay appears to negatively impact NIM, it does not significantly affect Tobin's Q. These findings underscore the need for a careful evaluation of compensation strategies and their implications for financial performance, highlighting that higher CEO pay does not necessarily translate into better financial results and may require re-

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evaluation to align with organizational.

Recommendations

Based on the findings of the study, the following recommendations are proposed:

i. Given the negative impact of CEO Pay on Net Interest Margin (NIM), it is advisable for firms to reassess their compensation structures. Companies should consider implementing compensation packages that are more closely tied to long-term performance metrics and value creation rather than short-term incentives. By aligning executive rewards with sustainable financial performance, firms may better motivate CEOs to enhance overall financial health and mitigate potential adverse effects on NIM.

ii. Since the study found no significant impact of CEO Pay on Tobin's Q, it suggests that traditional compensation models may not be effectively driving firm value. Firms should explore more comprehensive performance-based compensation models that integrate multiple performance indicators, including both financial and operational metrics. This approach can help ensure that CEO incentives are better aligned with broader organizational goals and long-term value creation, potentially leading to improved financial outcomes and greater shareholder satisfaction.

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