

Analysis of the Relationship between Management Remuneration and Financial Performance of Selected Public Listed Companies in the Nairobi Securities Exchange

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Abstract: This study aimed at evaluating the relationship between management remuneration and financial performance of selected listed companies in Nairobi Securities exchange and adopted quantitative research method while utilising secondary data from the companies' websites and the 2016 – 2018 annual financial reports and stratified and criterion sampling. The study considered salary, benefits, bonus and allowances on remuneration and ROA and ROE for financial performance. Based on analysis using both descriptive and inferential analysis (Spearman correlation analysis) in the Stata statistical software, the study has established that, the financial performance (ROA and ROE) differed from company to company in the three years evaluated, with, average annual ROA and ROE both decreasing from 3.5 and 0.113 to 3.1 and 0.068 respectively. Management remuneration strategies also differed from company to company with salary (all companies) and benefits (83.3%) being the most utilised. Bonus was the only management remuneration strategy that significantly correlated with ROE (r value= 0.4737) and ROA (r value= 0.3941). It is thus recommended that organisation to leverage management remuneration strategies such as salary, benefits and bonus to improve overall financial performance.

Key words: Management remuneration; Financial performance; public listed companies

I. INTRODUCTION

Remuneration refers to the way through which the organization rewards employees for their contribution to the organization and facilitate meeting of organization's goals (Bach, 2009). Management remuneration encompasses salary, benefits and rewards that the top management employees receive due to the work that they undertake in the organization. It can also include benefits that families of the employees receive from the organization (Jaafar et al., 2012). Grissom and Mitani (2016), and Bussin (2015) identified that salary is important in employees' performance.

Financial performance is one of the methods used in measuring organizational performance (Upadhaya et al., 2014) and includes measures such as sales growth, return on assets, return on investment, return on equity, annual income, profitability, market share, share prices among other variables (Ongore & Kusa, 2013; Smirnova & Zavertiaeva, 2017). Return on asset is significant as it assesses the earning of the company relative to the assets that it owns and the efficiency

of the organisation in utilising assets (Tian et al., 2016). Return on investment refers to the ratio between profit and cost of investment. The higher the ratio the higher the performance hence important in measuring organisation financial performance (Ameer & Othman, 2012).

Public companies are companies that are listed in the stock exchange whose shares are freely traded, and ownership is distributed through general public shareholders. Securities exchange refers to facilities where traders and stockbrokers buy and sell securities (Karmel, 2005). Nairobi securities exchange is the only listed stock exchange market in Kenya (Omondi & Muturi, 2013).

This study is based on agency theory that addresses the relationship between principals and agents where the principals are the shareholders and the management are the agents, employed to work for the interest of the owners (Lindström & Svensson, 2016).

Discerning if management remuneration such as benefits, salary, shares and bonus influence return on investment is one step toward developing framework that increases management incentive to work (Depken et al., 2013). This research thus aims to enhance principal agency relationship by assessing the effect of management remuneration on the financial performance to identify the most efficient remuneration strategies that improve the overall business performance. Agency theory assumes that the interests of employees and employer are different and aims to identify the difference of interest and ways through which they can be harmonized (Johnson & Droege, 2004). Principal and agent interests aligning is considered to be more effective when utilising incentive compared to other methods such as monitoring (Fong & Tosi, 2007). Donaldson and Davis (1991) using agency theory identified that the remuneration influence aligning CEO interest with that of shareholders and leads to better performance of the organisation. The agency theory can provide an important framework of management remuneration for an organisation (Kang et al., 2006; Pepper & Gore, 2015).

Previous studies have shown a positive correlation between the management remuneration and financial performance of the organization (Ahammad et al., 2015;

Scholtz & Smit, 2012; Shields et al., 2015; Zameer et al., 2014). Due to the wide nature of financial performance, the influence of management remuneration on a specific component of the financial performance would be crucial in informing decisions to improve overall organizational performance.

The management remuneration theoretically is expected to enhance both individual and organizational performance. However studies undertaken in different parts of the world including South Africa, Nigeria, Britain, and Norway on the relationship between management remuneration and organisation performance found different association, with some finding positive correlation (Al-Najjar, 2017; Deysel & Kruger, 2015; Harper & Jin, 2016; Jaafar et al., 2012; Luo & Jackson, 2011) while others found no significant relationship (Bussin & Modau, 2015; Kirsten & Du Toit, 2018; Lindström & Svensson, 2016). There have been few studies undertaken in Kenya evaluating the relationship between management remuneration and financial performance (Erick et al., 2014; Nyaribo & Nyakundi, 2016; Ongore & K'Obonyo, 2011; Ongore & Kusa, 2013).

Researches undertaken in Kenya on the relationship between management remuneration and organisation financial performance have focused only on one industry at a time (Erick et al., 2014; Ongore & K'Obonyo, 2011) making generalization to be impossible. Further, similar researches have been undertaken in other countries with differences in social and legal structures, and economic performance history as compared to Kenya which also makes generalization to be impossible. There is thus need for research to be undertaken in the context of public listed company to evaluate the relationship between management remuneration and financial performance. The fundamental research question addressed herein is, "Is there a significant relationship between management remuneration and financial performance of the selected public listed companies in the Nairobi securities exchange?"

II. THEORETICAL REVIEW

A. *Concept of Financial Performance*

Financial performance refers to the degree to which the organization has met the set financial objectives (Trivedi, 2014). It is used to measure the outcome of organization operation in monetary value. It is determined objectively and can be used as an index for comparison of the performance of different companies (Trivedi, 2014). Financial performance can be measured using different indices or determinants such as return on investment (ROI), returns on assets (ROA), sales growth, return on equity (ROE), ROA growth, Cash flow, and profit before taxation (Ameer & Othman, 2012).

Financial performance of an organization can be broadly categorized into market based financial return and account-based measures of financial returns. Market based returns include market to book ratio, and stock returns while

account-based returns include return on equity and return on assets (Cordeiro et al., 2013; Homburg et al., 2012). Financial performance can be assessed through the use of monetary accounting performance. For accounting performance, five determinants can be used which include a net profit margin, Return on Investment (ROI), Return on Assets (ROA), Return on Sales (ROS) and Return on Equity (ROE). The ROA and ROE are identified as the most effective methods that can be used to measure the financial performance of the organization (Saeidi et al., 2015). ROA refers to the ratio of organization income to the total asset it owns. The higher the ROA of the organization the higher the efficient of asset utilization by the organization. ROE refers to a financial ratio of the total profits of the organization to the total investor's equity in the organization. The ROE presents the profitability of the organization in its operations (Ongore & Kusa, 2013).

B. *Management Remuneration strategies*

Remuneration describes the manner in which the employee is rewarded for the contribution undertaken at the work place (Kessler, 2015). Remuneration can be extrinsic or intrinsic reward. Extrinsic refers to the tangible non-monetary and monetary reward that an employee received for work done. The intrinsic reward refers to the personal value generated from working such as fulfilment, experience, self-esteem among others (Kessler, 2015). Strategic human resource management aims to link the payment strategies to business model to facilitate the use of payment in improving the performance of the business (Kessler, 2015). The move has broadened remuneration scope of employees to incorporate non-monetary value. The effectiveness of the remuneration system is crucial for the maximizing of its benefits in the organisation.

Remuneration is considered to incorporate compensation and other benefits that can be intangible. The remuneration can be fixed which is usually on a contractual basis or variable remuneration that is exposed to discretion based on other factors such as performance. The variable remuneration can be short term or long-term (Tafkov, 2013). For the long term, some of the strategies utilized can be cash based or equity based long-term remuneration. The equity based can be associated with being allowed to buy shares, own share options or be legible to share grants. The equity-based strategy is used to link the performance of the employees to the interests of the stockholders (Geiler, 2013). There is also the activity based long term incentives which is based on earning from activity undertaken. The activity-based earning can be informed of commission, and piece rates. Other remuneration incentives that organization adopt includes protection programmes such as healthcare and retirement plan, and experience remuneration such as training and development, organisation cultures, work environment and acknowledgement (Halvorsen et al., 2012; Søggaard et al., 2015). Executive remuneration is open to changes due to various factors that includes improvement of performance, compliance with corporate governance good practices, change

in organisation strategy and culture and change in market minimum remuneration (Geiler, 2013).

Nyaribo and Nyakundi (2016) identified that non-financial compensation such as working environment, training, career development, empowerments, participation, and recognition among others can be used to assess the impact of remuneration on the performance of the organization. Shields et al. (2015) identified that reward is an important motivation for the employees and can modify their behavior to impact different aspect of organization performance. Creating a positive reward system is associated with positive performance of the organization which in turn result to improved overall organization sustainability.

Long and Fang (2012) utilised panel data of established companies in Canada on the influence of profit sharing on employee performance and the overall performance of the organisation. Profit sharing plan was recognized as one of the important strategies that have been adopted by organizations. It is associated with the employees aiming to maximize the organization profitability in orders to increase the profit share that they will receive.

The pay for performance is considered to be one of the incentive-based strategies that can ensure the balance between the employees of the organization and the other organization stakeholders (Cuevas-Rodríguez et al., 2012). Pay for performance was found to lead to higher performance in the organization as compared to fixed salary payment method. There was, however, difference in preference in the two systems by the employees as risk averse employees preferred the fixed salary while hardworking employees preferred the pay per performance method (O'Halloran, 2012).

Financial reward is one of the method that is considered efficient in motivating employees in undertaking their responsibilities. Other incentives are adopted by organisation included individual bonus, overtime allowances, cash allowances, housing provisions, year-end bonuses, merit pay and base salary. companies adopt multiple incentive strategies to improve their motivation and retaining of employees (Aguenza & Som, 2012). Aktar et al. (2012) identified that the incentive utilized in by the commercial banks of Australia were different and composed both intrinsic and extrinsic rewards. The reward included career advancement, challenging working place, learning opportunities, and recognition. Performance bonus and basic pay were the main extrinsic rewards. Sajuyigbe et al. (2013) also identified the utilization of extrinsic and intrinsic reward system in organizations. They evaluated the impact of reward on employees' performance for Nigeria manufacturing firms. The rewards were measured both for intrinsic and extrinsic reward variables. Extrinsic rewards composed of performance pay bonus and pay while the extrinsic included praise and recognition. The research identified that the reward system plays an important role in the performance of the employees

and the overall organization performance. The rewards, however, could be determined differently.

C. Employee's remuneration and Financial Performance of Organization

The success of the organization is dependent on the work of the management and the employees which in turns influences the financial performance of the organization (Lam et al., 2013; Lin et al., 2013). Various studies have shown that rewards are critical in impacting on organizational performance. They include Nujjoo and Meyer (2012), who evaluated reward importance on South African companies, Schlechter, Thompson, and Bussin (2015) who evaluated non-financial rewards of workers from UK, USA, Zimbabwe and South Africa, Sajuyigbe, Olaoye and Adeyemi (2013) accessed rewards importance in Nigerian manufacturing companies, and Shields et al. (2015) who evaluated the extrinsic and intrinsic remunerations that are used to motivate employees.

Additionally, various studies have shown that compensation is an important factor that influences financial performance (Deysel & Kruger, 2015) and financial decision of the organization (Bennett et al., 2017). According to a research by Deysel and Kruger (2015) using historical data, a positive correlation between compensation of South African CEOs and the overall organization performance exists. Harper and Jin (2016) through the use of secondary data found that CEO compensation was positively correlated with the market capitalization and profit margin for the general merchandise sector in USA. In assessing public listed hospitality companies, Li and Singal (2018) identified that CEO compensation had a relation with the returns of the organizations. Both equities based and cash compensation of the firm had positive influence on the accounting-based performance of the organizations (Wijst, 2018). In the banking sector, the remuneration of the CEO increases with increase in the overall financial performance of the bank (Deysel & Kruger, 2015).

The relationship between remuneration with organizational performance has been inconsistent with other research studies finding negative, weak or no relationship. Lindström and Svensson (2016) identified that context is important in the relationship between management compensation and organization performance. In Swedish companies' incentive for management had no relationship with organization performance which contrasts findings of research done for USA and British companies (Lindström & Svensson, 2016). Excess compensation of management has a negative impact on the performance of the organization. The research was based on historical data of the companies that were studied in the research (Brick et al, 2006).

This particular study adopted descriptive and correlational research designs further, the study adopted quantitative research method in assessing the quantitative information in the research (McCusker & Gunaydin, 2015).

The target population of research was the 64 public listed companies in the Nairobi securities exchange classified under agricultural, automobiles and accessories, banking, commercial and services, construction and allied, energy and petroleum, insurance, investment, investment services, manufacturing and allied, telecommunication and technology, real estate investment trust, and exchange traded fund. Additionally, the study adopted a sample of 24 companies that had satisfied the inclusion criteria that included reporting of CEO remuneration from 2016, and financial records could be accessed.

III. SUMMARY OF FINDINGS

The study shows a best average ROE of 0.408 while other high ROEs were 0.280, 0.20, 0.20, 0.16, and 0.17 and that ROE generally decreased annually from 2016 to 2018 from 0.113 to 0.068 pointing to a general decrease in the performance of the companies over the period under study as shown in table 1.

Table 1: ROE of Public Listed Company in NSE Between 2016 and 2018

Company	Comparison of ROE		
	2016	2017	2018
C1	-0.355	0.007	-0.469
C2	0.326	0.451	0.446
C3	0.203	0.205	0.209
C4	0.080	0.011	-0.058
C5	0.055	0.030	0.026
C6	0.027	0.024	0.063
C7	0.195	0.162	0.134
C8	0.110	0.142	0.177
C9	0.198	0.059	0.018
C10	0.121	0.115	0.030
C11	0.002	0.015	0.126
C12	0.052	0.053	0.072
C13	0.096	-0.113	0.134
C14	0.198	0.146	0.174
C15	0.143	0.119	0.118
C16	0.091	0.090	0.072
C17	0.204	0.186	0.211
C18	0.039	0.049	0.042
C19	0.139	0.023	-0.092
C20	0.168	0.129	0.120
C21	0.196	0.155	0.167
C22	0.534	0.127	0.179
C23	-0.228	-0.353	-0.379
C24	0.115	0.128	0.102
Average	0.113	0.082	0.068

While some of the companies had continuous increase in ROE, others had continuous decrease in ROE

performance, while for others there was variation of increase and decrease in performance.

Return on Assets

Table 2 presents the return on Assets (ROA) companies under study for the period between 2016 and 2018. The average ROA performance was highest in 2016 and lowest in 2018 ranging from 3.504 to 3.106 with the worst performing company having a score of -13.28 while the best performing company had ROA score of 30.99. The findings indicate that for some companies, the ROA improved consistently while for others, ROA performance decreased while still others had an inconsistent ROA performance.

Table 2 : ROA of Public Listed Company in NSE between 2016 and 2018

	Comparison of ROA		
	2016	2017	2018
C1	-19.815	0.439	-20.454
C2	23.937	29.961	39.085
C3	3.505	3.607	3.457
C4	1.259	0.187	-0.988
C5	4.530	2.572	2.265
C6	0.916	0.862	2.219
C7	19.372	16.001	13.363
C8	5.574	7.203	7.626
C9	14.432	4.180	1.219
C10	2.485	2.194	0.570
C11	0.181	0.492	3.079
C12	3.414	3.474	4.244
C13	4.507	-4.728	5.588
C14	3.471	2.288	2.766
C15	2.555	2.010	2.029
C16	1.789	1.807	1.502
C17	3.313	3.047	3.359
C18	1.839	2.391	2.080
C19	2.965	0.533	-2.132
C20	2.356	1.906	1.875
C21	3.686	3.025	2.947
C22	2.605	3.803	3.357
C23	-10.954	-14.218	-10.392
C24	6.175	7.204	5.891
Average	3.504	3.343	3.106

Remuneration strategies utilized by selected public listed companies.

The two main leading forms of management remuneration utilized by the companies were salary and benefits. Whereas all companies provided salaries, 83.3% reported providing benefits to the top management, and 54.17% reported provision of bonuses. Further, 42% allowed top management to own shares, and 21% paid their CEO with

shares. The highest salary proportion was 0.01224, while the lowest was 0.00004, an indication of the differences in the salary that the top management earned as indicated in table 3.

Table3: Management Remuneration Strategies Utilised by Public Listed Companies on Its Top Management

Stats	Remuneration types						
	Salary	Benefits	Bonus	Allowances	employee performance share	Paid in shares	Own shares
Mean	0.0035 518	0.0004 735	0.0007 265	0.0008 365			
Standard deviation	0.0030 531	0.0005 609	0.0008 589	0.0009 043			
Min	0.0000 374	7.09E-06	0.0000 225	0.0001 097			
Max	0.0124 081	0.0021 578	0.0032 336	0.0025 915			
Percentage of company that use	100.00 %	83.33 %	54.17 %	37.50%	8%	21 %	42 %

Base salary is considered an important component of the reward system of most organizations (Prouska et al., 2016). The use of benefits as an important compensation factor was also concurred by Klonoski (2016) and Hung and Wang (2017), who recognized the importance of benefits on motivating employees. Klonoski (2016) also identified that there are various benefits that organisations can utilise to compensate their employees and influence their performance. The findings concur with that of Sajuyigbe et al. (2013), who identified that bonus is an extrinsic reward that plays a crucial role in motivating of employees and enhancing their performance. Shares were another remuneration method that was utilized by some of the companies. Shares has not been widely adopted by companies. The use of share as part of remunerations concurs with the findings of Geiler (2013) and Manzanque, Merino, and Banegas (2016) who recognized that the Shares is an important motivator for top management of organization. Furthermore, most of the companies were identified to utilize a combination of different remuneration strategies as a method of motivating their top management. The findings concurs with those of Zameer et al.(2014) who identified that the majority of the organisation utilise a combination of different management remuneration strategies for the top management.

Return on Assets and Management remuneration

The study in table 5 shows that only bonus had a significant correlation with ROA with r-value of 0.3941. The study has not revealed any significant correlation between ROA and other remuneration strategies. Overall, there was a positive correlation between the financial performance metric (ROA) and bonus as shown in table 4.

Table 4: Spearman Correlation between ROA and remuneration strategies.

	ROA	Salary	Benefits	Bonus	Allowances
ROA	1				
Salary	-0.2704	1			
Benefits	0.1184	0.235	1		
Bonus	0.3941*	0.086	0.2251	1	
Allowances	-0.0233	-0.0819	0.0534	0.1062	1

*. Correlation is significant at the 0.10 level (2-tailed).

**. Correlation is significant at the 0.05 level (2-tailed).

Return on Equity and Management remuneration

Table 5 presents the Spearman correlation between ROE and the remuneration strategies. Bonus was found to have statistically significant positive correlation with ROE with r value of 0.4737.

Table 5: Spearman Correlation between ROE and Remuneration Variables

	Roe	salary	benefits	bonus	allowances
Roe	1				
Salary	-0.2513	1			
Benefits	0.101	0.235	1		
Bonus	0.4737**	0.086	0.2251	1	
Allowances	0.0342	-0.0819	0.0534	0.1062	1

*. Correlation is significant at the 0.10 level (2-tailed).

**. Correlation is significant at the 0.05 level (2-tailed).

Subramony (2009) found similar finding in which compensation influence the organisation performance through influencing motivation of employee and lowering organisation turn over which in turn lead to increase in performance. Ton and Huckman (2008) also found similar result that points to significance influence of remuneration strategies on the financial performance.

IV.CONCLUSION

The study reveals a positive correlation between bonus and both ROE (0.1) and ROA (0.05), thus positively impactign on the financial performance in agreement with the findings of Nyberg, et al. (2016) indicating a positive correlation between bonus and organizational financial performance.

The study concludes that, the financial performance based on ROA and ROE varied. Secondly, various remuneration strategies such as bonuses, benefits, salary, allowances, shares paid or allowed to be owned and employee performance share have been adopted by the companies with bonus significantly influencing the financial performance of the companies unlike the others, thus making bonus to be the best predictor of financial performance. However, in general, the Spearman’s correlation analysis model found a significant influence of management remuneration strategies on the financial performance (ROE and ROA) and thus, the study

concludes that management remuneration strategies have significant influence on the financial performance of public companies listed in the Nairobi securities exchange.

V. RECOMMENDATIONS

The study has established that bonus influences the financial performance, it is recommended that companies to adopt bonus as part of top management remuneration strategy to influence improvement in financial performance of the organisation.

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