Agency Cost: Does It Matter for Shareholders' Return of Publicly Listed Nigerian Firms?

Eloho Elizabeth Osevwe-Okoroyibo and Lucky Mmamefune Ogbolu
Department of Accounting, Faculty of Administration & Management
Southern Delta University, Ozoro, Delta State, Nigeria
Corresponding Author: eloholizzybetty@gmail.com

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Abstract: *The study investigated whether agency cost maters for shareholders' return of publicly listed Nigerian firms by drawing samples from non-finance firms. Ex-post facto design was used and agency cost was measured using asset tangibility, managerial ownership and remuneration of directors while shareholders' return was measured in terms of return on equity. Secondary data was obtained for nineteen (19) non-finance firms from the annual published financial statements from 2014-2023. Data obtained were analyzed using descriptive, post-estimation and inferential statistics. The statistical results indicated that while insignificant relationship exists between variables of asset tangibility, directors' remuneration and shareholders' return, a significant relationship was found between managerial ownership and shareholders' return. The implication of this finding is that agency cost variables (asset tangibility and directors' remuneration) do not matter for increased shareholders' return while agency cost variables of managerial ownership appears to be a matter for increased shareholders' return. It recommends that although high ratio of current asset to total asset offer creditors with high level of security, management of firms should endeavor to keep an adequate level of current assets so as to reduce agency cost and increase shareholders return. It also recommends that managerial ownership should be decreased to mitigate agent-principal conflicts and hence improve shareholders' return.*

Keywords: agency cost, managerial ownership, asset tangibility, directors' remuneration, shareholders return, non-finance firms

JEL Classification: M41; M49.

INTRODUCTION

Share capital is one of the sources of raising finance, and most companies benefit from it either as a seller or as buyer or as both. As the operation of any business without finance is impossible, share capital has become a veritable source of raising substantial and cheap finance for firms. In the views of Yung-Ling (2023), share capital represents a unit of companies' capital allocated to shareholders. Shares issued to shareholders qualify holders for residual interest in the asset of the firm which represents their investment or interests in the firm. Akani and Kurotamunobaroami (2023) assert that traditional finance theory has laid emphasis and prioritized shareholders wealth maximization as it considered shareholders as owners of a firm who contribute to the capital for formation and running of the affairs of the firm, and hence their interests must be prioritized. Thus, generating wealth for shareholders is one of the most imperative goals of publicly listed firms.

Drawing inference from the agency conflict paradigm, shareholder's wealth maximization pursuit may take a backseat because management sometimes may pursue their goals (Jensen, 1986). The agency cost is the internal expense resulting from conflict of interests between the principals and the agents; it is hidden in any decision which is not aimed at maximizing firms' wealth. Agents refer to managers of a firm, working on behalf of shareholders but because shareholders are unable to regularly control all activities of management, it led to asymmetric information (Adibe & Ezebunwo, 2023). Agency costs have the potential to retard performance, shareholder's returns and destroy shareholder's wealth maximization goal together with its adverse effect on other corporate stakeholders. Jensen (1986) as cited in Tuan, et al (2019) defined agency cost as a cost expended by a firm owners or management to structure and oversee management performance in ways that fit their goals. Thus agency costs occur between external shareholders and internal managers or between debt-holders and shareholders (Eboiyehi & Willi, 2018).

The conflict of interest may result to a situation where management (agents) may take decisions that are detrimental to the shareholders (principals) and it requires cost in terms of monitoring the activities of management (Khidmat & Rehman, 2014). Pandey and Sahu (2019) argued that agency problem arises when management and shareholders have diverse goals and monitoring the activities of management is cumbersome and costly for shareholders. Agency costs are even higher in countries having weak protection to investors and ineffective legal systems (Wang, 2010). To overcome this, emphasis has been on corporate governance that has gained a prominent place in academics and corporate world. The conflict of interest between shareholders and management is the classical agency conflict (Fama and Jensen, 1983).

On the other hand, drawing inference from the stewardship theory, shareholders' wealth will increase if there is a unity of command in management where top executives are holding the chair position (Khan, Muttakin & Siddiqui, 2013). Similarly, resource dependency theory shows the directors' role in bringing and using resources for maximizing firms' value (Bijoy & Mangla, 2023). The aim of this study was to examine whether agency cost matters for shareholders return of publicly listed non-finance firms in Nigeria. We investigated this since most past studies are in relation to agency cost and firm performance. In general, empirical inconsistencies among varied studies in developing and emerging economies suggest that there is need for further country-level test of the portability and plausibility of whether agency cost is imperative for shareholders' return.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Shareholders' Returns

The modern finance theory offers the axiom that the only goal/objective of a firm should be to maximize market value of shares or shareholders' wealth. According to Ohiokha and Yesufu (2023), shareholder wealth is denoted in the market value of firms' shares, which in turn depends largely on the investment (long and short-term) and others, mainly long-term issues like financing and dividend decisions. Return on share depends on changes in share price at the end of an investment period.

Vijayakumaran (2023) argued that large firms' stock returns respond swiftly to new information compared with small firms' stock returns. Chaudhary (2021) find empirical support the agency hypothesis. In this study, we measured shareholders' return using return on equity (ROEQ). ROEQ can be used to assess management success in company's capital in providing returns to shareholders. A higher ratio is better because it offers a greater rate of return to shareholders of companies.

Asset Tangibility

Tangible assets are physical assets that go through a relatively lengthy period of usage in the operation of a firm. These tangible assets include but not limited to land, buildings, machinery, and construction in progress that can be offered as collateral to creditors. A higher ratio of non-current assets to total assets offers creditors with a high level of security because companies will be able to liquidate more assets in case bankruptcy (Birhan, 2017).

Empirical studies on asset tangibility offers mixed findings. For instance, Olatunji and Tajudeen (2014); and Khan, Shamim and Goyal (2018) documented statistically insignificant negative relationship for asset tangibility and financial performance. On the other hand, Kocaman, et al (2016) documented a statistically significant negative relationship between asset tangibility and financial performance. On the basis of the foregoing, we hypothesized that:

$H_0 1$: Asset tangibility has no significant effect on shareholders' return of publicly listed non-finance firms.

Managerial Ownership

Managerial ownership refers to the percentage of shares held by management who actively participate in the corporate decision-making of a firm. As observed by Khan, Shamim and Goyal (2018), managerial ownership allows management to dominate a firm and decide which strategies/policies a firm will take because management also act as a shareholder. Okere, Rufai and Olorunkunle (2022) found that the relationship between managerial ownership and agency

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cost is non-linear. In other words, increasing managerial ownership can lead to increased agency costs.

The entrenchment effect dominates incentive alignment effects. However, Vijayakumaran (2019) showed evidence of service listed companies in Chinese Securities Exchange that when management hold a suitable percentage of firms' share, it can align the interest between them and the other stakeholders This incentive alignment can be via stock options, preference shares etc. On the basis of the foregoing, we hypothesized that:

$H_0$2: Managerial ownership has no significant effect on shareholders' return of publicly listed non-finance firms.

Director's Remuneration

Remuneration of the board and executives needs to be considered in governance because the level of remuneration must be designed in a way that makes it attractive enough to incentivize the board and executives to run the firms' efficiently. Based on the agency theory, the goals of shareholders and management must be harmonized; hence, a higher compensation rate will result in higher shareholders' return in broadly diversified ownership companies (Mosimanyane & Marozva, 2023). Tayeh, Mustafa and Bino (2023) showed that chief executive officers (CEO) compensation is positively related to shareholders' returns in firms with low concentrated structure of ownership.

Consequently, for management to act in the firms' long-term interest, it requires the alignment of incentives among management and stakeholders (Vintila & Nenu, 2015). On the basis of the foregoing, we hypothesized that:

$H_0$3: Director's remuneration has no significant effect on shareholders' return of publicly listed non-finance firms.

Theoretical Framework

The theoretical framework of this study was anchored on the agency theory. Berle and Means (1932) as cited in Korkmaz and Karaca, (2014) were the first to address the agency problem between shareholders and management. According to them, agency cost occurs due to separation of ownership from control. Management's interest conceivably coincides with owners to raise agency conflict. Thus, agency theory extends its argument and accentuates that management may get a hold of cash because holding cash benefits them. Shareholders on the other hand try to force management to maximize their cash or shareholdings which should be the main goal of management.

Furthermore, for management to achieve this goal they may strive to either invest shareholders fund in positive net present value (NPV) projects which will raise value of shares or get a capital gain. On the other hand, management may payout ideally whatever is obtained as profit in form of dividends. Hence, if there are no positive NPV projects available and management is unable to pay dividends, then according to Jensen and Meckling (1976) as cited in Korkmaz and Karaca

(2014), agency problem may arise. Proponents of agency theory suggest that if agency problem continues, then there is a likelihood of corporate takeovers. The relevance of this theory is that because management is unable to use free cash flow in suitable manner, it offers outside parties to jump in and take hold of the firm and maximize shareholder's wealth for the fear of decreasing shareholders' return.

METHODOLOGY

This study was based on an *expo-facto* research design and it covered a period of ten (10) years (2014-2023) involving non-finance firms listed on the floor of the Nigerian Exchange Group (NGX). The study population consists of all listed non-finance firms on the NGX. As of 31st December 2023, the total number of listed non-finance firms was 119. Sample of 19 non-finance firms were obtained via purposive sampling. This sampling technique was employed because it assisted in meeting criteria of homogenous sample as well as enabling the researchers to have a balanced panel data.

In this study, secondary data were sourced from the yearly published financial statements and NGX (where applicable). This study used descriptive, post-estimation and inferential statistical techniques in the analysis of data. While the descriptive statistics was used to evaluate attributes of the data in terms of their mean median, maximum score, minimum score, standard deviation, the other descriptive statistics such as skewness and kurtosis was used to check for normality of the dataset. Post-estimation statistics like variance inflation factor (VIF), Breusch-Pagan/Cook-Weisberg and Ramsey regression specification-error test (RESET) were used to diagnose dataset for multi-collinearity and heteroscedasticity problems

On the other hand, the fixed and random effects panel regression technique was employed to find the cause-effect relationship between the independent and dependent variables. The study adapted the model of Hoang, et al (2019) and was modified to suit the peculiarity of our dataset. Succinctly, the econometric form of the empirical model is expressed as:

$$ROEQ_{it} = \beta_0 + \beta_1 ASSTG_{it} + \beta_2 MANOP_{it} + \beta_3 DIRREM_{it} + \beta_4 FSIZ_{it} + \mu_{it}$$

Where: ROEQ is Return on equity; ASSTG is Asset tangibility; MANOP is Managerial ownership; DIRREM is Director's remuneration; FSIZ is firm size (control variable); β_0 is constant; β_1- β_4 is slope coefficient; μ is Stochastic disturbance; i is i^{th} companies; t is time period

RESULTS

The study examined whether agency cost matters for shareholders return of publicly listed firms in Nigeria by drawing samples from non-finance firms from 2014-2023. This section reports the descriptive, post-estimation and inferential statistics for the independent and dependent variables of the study.

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Table 1: Summary of Descriptive Statistics

Parameters	ROEQ	ASSTG	MANOP	DIRREM	FSIZ
Mean Score	2.8980	23.828	14.150	0.5085	7.0281
Median	3.8600	10.385	1.153	0.2269	6.8400
Standard Dev	18.891	50.822	22.811	1.3306	0.6842
Minimum Score	-119.63	0.1500	0.0065	0.0043	5.9700
Maximum Score	53.960	347.96	98.563	17.591	9.2400
Skewness	-2.8444	4.9281	1.4891	11.271	1.1696
Kurtosis	18.673	29.266	3.9711	144.55	4.3554
Obs.	190	190	190	190	190

Source: Authors' Compilation, (2024)

The results obtained from the summary of descriptive statistics revealed among others that the mean score for shareholders return (Return on Equity-ROEQ) is 2.8980 with a standard deviation of 18.891; it also indicates that ROEQ recorded minimum and maximum scores of -119.63 and 53.960 respectively. In terms of the agency cost variables (Asset Tangibility-ASSTG, Managerial Ownership-MANOP and Directors' Remuneration-DIRREM), the mean scores were 23828 14150 and 05085 with standard deviation scores of 50.822 22.811 and 1.3306 respectively.

Thus ASSTG ranged from 0.15 to 34796 while MANOP from 0 to 98.563. The minimum and maximum scores of DIRREM were 0 and 17591 while firm size (FSIZE) obtained mean score of 7.0281 with a standard deviation of 0.6842.

Table 2: Summary of Descriptive Statistics

Parameters	ROEQ	ASSTG	MANOP	DIRREM	FSIZ
ROEQ	1.0000				
ASSTG	-0.0164	1.0000			
MANOP	-0.1041	0.1334	1.0000		
DIRREM	0.0964	-0.0405	-0.0702	1.0000	
FSIZ	0.0803	-0.0212	-0.1199	-0.1163	1.0000

Source: Authors' Compilation, (2024)

Results in Table 2 revealed that two measures of agency cost - ASSTG (-0.0164) and MANOP (-0.1041) had negative relationship with shareholders return (ROEQ) while the other agency cost variable (DIRREM – 0.0964) and control variable (FSIZ - 00803) had positive relationship with ROEQ. The result suggests a positive relationship between ROEQ, DIRREM and FSIZ and a negative relationship between ROEQ, ASSTG and MANOP

Table 3: VIF Result

Variables	VIF	1/VIF
MANOP	1.04	0.9622
FSIZ	1.03	0.9699
DIRREM	1.02	0.9782
ASSTG	1.02	0.9811
VIF Mean	1.03	

Source: Authors' Compilation (2024)

Table 3 showed the multi-collinearity result for the panel data; the VIF is 1.03 which is less than accepted VIF mean (10.0); this indicates an absence of multi-collinearity in the model of agency cost and shareholders returns. Hence, the dataset is exceptionally fit for performing inferential statistical tests.

Table 4: Heteroscedasticity Result

Parameters	
Chi2(1)	52.330
Prob. > Chi2	0.0000

Source: Authors' Compilation (2024)

Table 4 showed the heteroscedasticity result (Breusch-Pagan/Cook-Weisberg test). The result of chi2(1) = 52.330 and Probability chi2 = 0.0000 which is less than 0.05% implies an absence of heteroscedasticity in the variables; hence, the sample employed do not contain unequal variance and there is evidence that the results are valid.

Table 5: Ramsey RESET Result

Parameters	
F(3, 182)	5.5500
Prob. > F	0.0011

Source: Authors' Compilation (2024)

Table 5 showed the Ramsey regression specification-error test (RESET) for omitted variables and fitted scores of the response variable (ROEQ). The result indicates that F(3, 182) is 5.55 and probability F is 0.0011, indicating that the model has no omitted variable, thus agency cost and shareholders return model do not suffer from omitted variable/functional form misspecification.

Table 6: Fixed and Random Effects Results

Variables	(Fixed Effect - FE)	(Random Effect - RE)
ASSTG	0.0282 {1.15}	0.0227 {0.94}
MANOP	-0.1895 {-2.73}	-0.1555 {2.40}
DIRREM	-0.1114 {0.11}	0.3274 {0.35}
FSIZ	-1.4365 {0.41}	0.3647 {0.13}
F-Value	2.04 0	
P-Value	0.0907	
R^2	0.0058	0.0127
Wald Ch2		6.6400
P-Value		0.1561
Constant		1.8269 (0.09)

Source: Authors' Compilation (2024); Hasuman Test = Chi2(2) = 3.19; Prob>Chi2= 0.790

Table 6 showed the fixed and random effects results for agency cost and shareholders return. Using RE result, coefficients are 0.0227 (ASSTG), -0.1555 (MANOP), 0.3274 (DIRREM), and 03647(FSIZ), suggesting that the sampled firm agency costs will lead to approximately unit increase in shareholders returns. Besides, all the agency cost and shareholders return measures were insignificant for both FE (F =2040; F-Prob. = 0.0907 < 0.05) and RE (Wald Ch2 = 6.64; Prob. Ch2 = 0.1561 < 0.05) at 5% significance level. Furthermore, t-test values revealed that all the individual agency costs are statistically insignificant in explaining the effect on shareholders returns.

The overall R^2 is 0.0127 for RE and is higher than FE; this implies that all agency cost variables jointly explained about 127% variation in shareholders return. Also, Hausman test (Prob>Chi2= 0.790 > 0.05) indicates that RE is more efficient than FE and provides support the proposition that agency costs does not matter for shareholders' return particularly among the publicly listed non-finance companies in Nigeria. This finding negates the agency cost theory which indicates that the fraction of tangible assets can decrease returns of shareholders. Particularly, we note that an enterprise with a high proportion of non-current assets is expected to be linked with high ability to repay liabilities, thus decreasing shareholders' returns since funds will be employed to defray liabilities (Yung-Ling, 2023; and Ohiokha & Yesufu, 2023)

Furthermore, the study offered evidence from the random effect regression model that MANOP has a significant negative effect on shareholder's return (ROEQ). We showed that the ownership structure that is linked with high agency costs may lead to decreased shareholders' returns. This result appears to be in line with the findings of Tayeh, Mustafa and Bino, (2023); Bijoy and Mangla (2023) who mentioned that independent board with high shareholdings may not be able to mitigate agency cost or problem and hence decrease shareholders' return. In addition, we found that DIRREM has an insignificant positive effect on shareholders' return. As observed by Vijayakumaran (2023), it is not always true that remuneration is wholly or even partially based on performance, thus, we carefully conclude that the insignificant relationship between DIREM and shareholders' return may be due to ineffective governance structures and agency problems which companies may experience.

CONCLUSION AND RECOMMENDATIONS

In a broader perspective, shareholders appear to irregularly control every facets of management and this usually results in asymmetric information which can cause ethical risk for organizations. Agency costs have the capability of decreasing performance, and in turn shareholders' wealth. Agency costs occur between external shareholders and internal management on the one hand and between debt-holders and shareholders. The agency cost may lead to conflict of interest between management (agents) who may take decisions that are detrimental to shareholders (principal. In this study, we examined whether agency cost matters for increased shareholders' return of publicly listed companies on the Nigerian Exchange Group drawing samples from non-finance companies from 2014-20223.

Findings indicated that while no significant relationship between exists between agency costs variables of asset tangibility, director's remuneration and shareholders' return, a significant link was found between managerial ownership and shareholders' returns. This led to the conclusion that agency costs (particularly asset tangibility and directors' remuneration) do not matter for increased shareholders' return while managerial ownership appears to be a matter for increased shareholders' return. The study recommends based on the findings that although high ratio of current asset to total asset offer creditors with high level of security because they may be able to sell off more assets in bankruptcy cases, management of non-finance firms should endeavor to keep an adequate level of current assets so as to reduce agency cost and increase shareholders' return. It also recommends that managerial ownership should be decreased in order to mitigate agent-principal conflicts and hence improve shareholders' return.

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