

**EFFECT OF BOARD CHARACTERISTICS ON RELATED PARTY TRANSACTION
OF NIGERIAN CONGLOMERATE FIRMS**

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Abstract

This study examines the effect of board characteristics on related party transaction of Nigerian conglomerate firms. Ex Post Facto research design was adopted for the study, the population of the study consist of six Conglomerates firms in Nigeria. Data for the study were extracted from audited report and accounts of the sampled firms. The formulated hypotheses were tested with Ordinary Least Square (OLS) using E-View 9.0 to arrive at logical conclusion. The study found that board composition has a negative insignificant effect on related party transaction of manufacturing firms in Nigeria. The study recommended that manufacturing firms adjudged to play a significant role in publicly listed entities as well encouraged board independent as they are likely to carry out a more thorough diligent assignment.

Keywords: Board characteristics, Board composition and Related party transaction

Introduction

The amount of corporate governance reports released in a lot of nations demonstrates that board characteristics issues have become a global problem (Rossouw, 2005). In emerging economies, where governance mechanisms and institutions such as market for control, financial markets, regulators, monitoring, and the legal system are generally weak, the board of directors is especially crucial (Ujunwa, Salami & Umar, 2013). This has been blamed for various company failures in Nigeria, particularly in the banking sector (Oso & Semiu, 2012).

Meanwhile, in recent years, there has been a surge in interest in the topic of Related Party Transactions (RPTs). RPT issues are particularly important in developing nations with inadequate levels of investor protection and law enforcement. Users of financial statements in these nations have found it difficult to determine if a transaction was conducted for economic, earning management, or tunneling motives due to a lack of RPT disclosure and insufficient

investor protection. Tunneling was defined by Johnson, La Porta, Lopez-de-Silanes, and Shleifer (2000) as the movement of resources out of a firm for the advantage of the company's controlling shareholders. Tunneling techniques, according to Bae, Kang, and Kim (2002), can vary from open theft or fraud to dilutive share offerings that discriminate against minority owners.

Studies on the expropriation of minority shareholders' rights and RPTs provide contradictory results since two opposing viewpoints, namely transaction efficiency and conflict of interest, are related with the impact of RPTs. According to Louwers, Henry, Reed, and Gordon (2008), the most common type of transaction that expropriates minority shareholders' interests is related-party loans and guarantees, which were detected in 83 SEC actions including both fraud and RPTs. Ullah and Shah (2015) looked at the effect of corporate governance mechanisms on RPTs and discovered that associated firm ownership, CEO duality, and management ownership all act as agents for the expropriation of minority shareholder rights. Hu, Xu, and Fan (2012) investigated the determinants of RPTs and discovered that the size of cross-border RPTs is positively associated with concentrated ownership, CEO duality, and power imbalance among large shareholders, as well as a link between outside director compensation and cross-border RPTs. Gordon, Henry, and Palia (2004) attempted to determine the factors that influence RPTs. The findings suggest that RPTs are related with inferior corporate governance mechanisms, and there is a negative association between industry adjusted returns and RPTs. When compared to standalone enterprises, group connected firms report a higher degree of RPTs since their economic demands were met through their affiliates (Ming and Wong, 2003; Hwang & Kim, 2016). RPTs are heavily influenced by internal corporate governance structures and external monitoring methods (Kohlbeck & Mayhew, 2004; Lo Wong, & Firth, 2010; Yeh, Shu, & Su, 2010). (2012). More RPTs are connected with poor corporate governance, which has a negative impact on business value and performance (Gordon et al., 2004). Self-dealing transactions can be reduced with an effective governance framework that includes a diverse Board of Directors and a high proportion of outside directors (Chauhan, Lakshmi, & De, 2016). RPTs can ruin a firm's value, according to Nekhili and Cherif (2011), while Chen, Chen, and Chen (2009) found that only enterprises with poor operating performance use RPTs to boost their earnings. Controlling shareholders tunnel out firm's resources for personal purposes, according to Dahya, Dimitrov,

and McConnell (2008) and Jian and Wong (2010), if their control right is greater than their cash flow right and they divert the firm's resources from where they have low cash flow right to where they have high cash flow right. According to Wan and Wong (2015), the form of ownership has a negative impact on RPTs, with state-owned enterprises tunneling more than privately held firms. RPTs and accounting have a statistically significant association, according to Ariff and Hashim (2013).

Using board composition, Johl (2006); Ali (2011) found that profitability and Board composition do not have any significant association with graphical disclosure level. Satirenjit, Shireenjit and Barry (2015) found that board composition has positively associated with firm performance in Malaysia.

The empirical evidence on the effects of board characteristics on related party transactions is inconsistent, and some findings are contradictory; the results range from positive to negative to statistically insignificant relationships, depending on the measures used, statistical tools used, sample composition, and time period. Furthermore, because the majority of this research was conducted in Asean nations, such as Malaysia and Turkey, Nigeria's empirical literature on similar studies is sparse. In view of the foregoing, the purpose of this research is to examine the impact of board features on the tunneling of Nigerian conglomerate corporations' directors. As a result, the study determines how board composition affects related party transactions in Nigerian conglomerate corporations.

Literature Review

Related Party Transactions (RPT)

Minority shareholders' rights may be expropriated as a result of transactions between related parties, and dominant shareholders may utilize RPTs as a tool to shift the firm's resources for their own gain (Henry, Gordon, Reed, & Louwers, 2012). According to the efficiency-enhancing theory, RPTs boost a firm's efficiency by creating an internal market within organizational groupings (El-Helaly, 2016). According to the conflict of interest hypothesis, RPTs are destructive to the firm's interests since minority shareholders' interests may be expropriated by dominating shareholders (Cheung, Jing, Lu & Rau, 2009; Elkelish, 2017; Gordon et al., 2004; Chen, Chengb & Xiao 2011). The violation of the concept of arm's length pricing occurs when

minority shareholders' interests are expropriated. Many publicized accounting frauds around the world involving firms Satyam (India), Enron (USA), and Tyco (Ireland) show the abusive nature of RPTs, but the law does not prohibit it because RPTs are normal business transactions, and within corporate groups, RPTs facilitate efficient allocation of resources (Abdul Rasheed, Iqbal & Mallikarjunappa, 2021).

Although there isn't much research on the link between corporate board social networking and controlling shareholder tunneling, several new studies look into the relationship between board social networks and corporate finance. According to Kuhnen (2009), mutual fund directors and fund administration consulting firms prioritize hiring one other based on their previous level of communication, but that such strong director-consultant ties do not translate to better or worse outcomes.

The number of directors who serve on the boards of two companies is used to determine centrality. An average yearly excess return of 4.68 percent can be generated by building a portfolio by buying stocks of companies with a central position in a board network and selling stocks of companies without. Their results show that the board of director network is a signal of economic benefits not immediately reflected in stock prices. In the Chinese capital market, Chen and Xie (2011, 2012) investigate the relationship between the board network of independent directors of listed companies and investment efficiency or executive incentives.

Composition of Board Members

The composition of the board of directors is also suggested as a way to cope with the agency problem (Hermalin and Weisbach, 1991). The proportion of outside directors on the board of directors is predicted to have a favorable link with firm performance. Outside directors, as opposed to internal directors, are better equipped to confront CEOs. Outside directors are required to make up at least two-thirds of the board in the United Kingdom, probably in recognition of their importance. In the United States, they must make up at least three-quarters of the board (Bhagat and Black, 2001).

The body of empirical evidence has risen, yet the results are highly contradictory. Outside directors have a favorable impact on corporate performance, according to studies by Mehran (1995) and Pinteris (2002). Other studies have shown no evidence of a link between firm

performance and the number of outside directors on the board of directors (Bhagat & Black, 2002). In fact, according to Weir and Laing (2001), there is a negative correlation! The importance of committee structure in strengthening the board's independence is emphasized by John and Senbet (1998). They use Klein, Shapiro, and Young (2005) to advocate for the creation of specialist audit, pay, and appointment committees.

Laing and Weir, in contrast to the prior argument in favor of board arrangements, According to them, firms managed by dynamic CEOs tend to perform better than other categories of firms. On the assumption that foreign firms are managed by more experienced CEOs. Hannifa and Cook, (2002) stated that board composition is defined as the proportion of outside directors to the total number of directors.

Those who advocate for more non-executive directors on the board and those who argue against additional non-executive directors on the board have two different points of view. Those who argued for more non-executive directors on the board of directors relied on agency theory and resource dependency to back up their claims. The addition of outside directors improves the board's ability to monitor top management and ensures that top management does not expropriate stakeholders' money as a means of enhancing their status as decision-control experts (Fama and Jensen, 1983 cited in Muhammed, 2014). This is so because the non-executive directors comprises of independent directors that are appointed based on their experience and competence and do not have any interest in the shareholding of the firm but to maintain their reputation so they always strive to maximize the firms value (Yousef, Nur & Kharil, 2014). It is believed that the independency of board of directors depends on the number of outside directors that is, the board of directors are more independent as the proportion of outside directors' increases.

Empirical Review

Nekhili and Cherif (2011) investigated the relationship between analysts' earnings forecast errors and firm compliance with the disclosure requirements of IFRS. Using a comprehensive disclosure index of selected IFRS, the study showed that forecast error is negatively related to IFRS compliance. It suggested that compliance with disclosure requirements of IFRS reduces information symmetry and enhances the ability of financial analysts to provide more accurate forecasts. It also showed that the extent of compliance with accounting standards is as important

as the standards themselves. Roman and Persida (2012) examined the relationship of selected Board of Directors' characteristics and firms' financial performance. Using a sample of large U.S firms in 2005-2009, the study found that the degree of insider ownership influences positively firm performance, because it reduces agency problems. To some extent, the age of the Board of Directors is also important. Younger members are likely to be more ready to take on greater risk and make big structural changes in order to boost the firm's long-term prospects. On the other hand, they discover that independent directors have a detrimental impact on corporate performance, which was amplified during the recent financial crisis. Overall, their findings indicate that corporate governance is critical to a firm's financial performance. Juliarto, TowerVan der Zahn, and Rusmin (2013) analyze the degree of tunneling behavior in five ASEAN nations and the factors that influence it (i.e. Indonesia, Malaysia, Philippines, Singapore, and Thailand). Tunneling is simulated via related party transactions (RPTs) in the form of loans to related parties. With 200 firm-year observations over the period 2006-2009, this study finds a positive association between managerial ownership and the extent of tunnelling. The other important findings are that business environment (BE), foreign ownership, and independent directors are ineffective governance mechanisms to rein in tunnelling behaviour. Yunling, Xinwei, and Chi-Wen (2013) investigated independent directors' supervision efficiency in terms of information disclosure. The study finds that independent directors had a considerable positive effect on the accuracy of management projections in the absence of ownership balance, using data from 2007 to 2009. Furthermore, independent directors' personal backgrounds have an impact on management earnings estimates. The accuracy of management projections is considerably improved by directors who are certified public accountants (CPAs). Directors with industrial experience, on the other hand, greatly diminish the accuracy of management projections. In other words, independent directors with CPA experience increase board independence, whereas independent directors with industry experience have the opposite effect. Kabir (2014) used a sample of 76 businesses to investigate the relationships between firm characteristics and the level of optional segments disclosure on IFRS 8 Operating Segments in order to acquire a better understanding of the disclosure practices among Nigeria's major publicly traded corporations. The findings show that the size of the company and the kind of

industry have a favorable relationship with voluntary segment disclosure. Furthermore, there is a negative relationship between business listing age, growth, and return on investment, as well as ownership diffusion and voluntary segment disclosure. From 2003 to 2010, Alves (2014) investigated the impact of board independence on the profits quality of 33 Portuguese listed non-financial enterprises. According to the research, board independence increases earnings quality by lowering earnings management. The study made use of more recent data and concentrated on deposit money banks. In addition, the current study added more board diversity factors, and their combined effect on earnings quality was investigated. From 2009 to 2014, Bala and Kumai (2015) investigated the impact of board features on earnings management of listed food and beverage companies in Nigeria. They discovered that by limiting earnings management, board independence did not increase earnings quality. The scope of their research differs from that of the current study. Their research looked at the impact of board independence on earnings management as a single factor. From 2006 to 2010, Hoang, Abeysekera, and Ma (2017) investigated the impact of board diversity on the profits quality of 150 listed non-financial enterprises in Vietnam. A random sample of 150 non-financial companies was taken. They classified demographic attributes (gender, age, educational qualification, and nationality) as diversity-in-boards, and statutory attributes (CEO duality, director block shareholding, representative directors' ownership, and promoters) as diversity-of-boards, based on Vietnam's statutory provisions. They created a single standardized aggregate measure of earnings quality by combining the four accounting-based earnings quality metrics of accruals quality, earnings persistence, earnings predictability, and earnings smoothness. According to the study, diversity on boards (statutory diversity) increases earnings quality, whereas diversity in boards (demographic diversity) does not. Their research, once again, failed to show that the structural and demographic characteristics of board diversity have a combined influence on the profits quality of the companies studied. The study by Sari, Fatimah, and Djajadikerta (2017) aims to construct a detection model that can distinguish related party transactions from tunneling activities. This research also looks into whether corporate governance mechanisms can explain tunneling actions. The study's main findings suggest that companies with concentrated ownerships in Indonesian listed companies are more likely to engage in tunneling transactions

than companies with dispersed ownerships, and that overall corporate governance mechanisms implemented by the companies cannot be used as predictors of tunneling behavior. Kutigi, Taiye, and Abubakar (2018) carried out a study on the effect of board size and independence on earnings quality of listed deposit money banks in Nigeria for the period 2007 to 2016. The study discovered that board independence has a beneficial impact on the quality of earnings. Their research focused solely on the impact of board independence on earnings quality. More board diversity characteristics and their overall (combined) effect on the profits quality of listed deposit money banks in Nigeria are included in this study. Nwakoby, Ezejiolor, and Ajike (2018) investigate the association between board traits and directors tunneling in Nigerian conglomerates. Time series data and an ex post fact study design were used. With the help of SPSS Version 20.0, hypotheses were tested using multiple regression and Pearson Coefficient Correlation. According to the findings, board size has a negative significant link with related party transactions in Nigerian conglomerates. Another finding is that the board of directors is independent. In their study of board features and earnings management of 60 listed non-financial enterprises in Sri Lanka, Hemathilake, Ruparatne, and Meegaswatte (2019) looked at the impact of board financial expertise (a proxy for educational level) on earnings quality. They discovered that financial knowledge on the board had a favorable but negligible impact on earnings management, implying that financial competence on the board does not increase earnings quality. The research is based on panel data from Nigeria's financial sector. For an eight-year period, Osakuni and Onuora (2019) investigated the relationship between related party transactions (RPTs) and financial performance of Nigerian listed corporations (2008-2015). The Pearson correlation approach was used to look at the relationship between the dependent and independent variables, and the data was analyzed using simple regression analysis. With the exception of net worth (NW), which was found to be strongly influenced by related party transactions, the data analysis reveals that related party transactions have no meaningful impact on return on equity. The majority of related party transactions had a positive correlation with the companies' net value, according to their findings. The effect of related party transactions (RPTs) onboard compensation in Iran is investigated by Bahman, Hossein, Elahe Farmanbar-Fdafan, and Mahdi (2020). From 2012 to 2017, the research population included 870 observations and 145

firms listed on the Tehran Stock Exchange (TSE). Their findings showed that board compensation is linked to overall transactions with other relevant parties. This supports the theory that managers influence earnings and, as a result, change their compensation through non-routine transactions with linked parties. We also discovered that using complete buy and sale transactions, loans, and the insuring of other associated parties is an indirect technique of incentive enhancement. Finally, their findings imply that in the presence of both normal and aberrant RPTs, market competitiveness has no effect on compensation. By demonstrating that not all types of RPT entail the same level of fraud risk, this study has policy implications for legislators who focus on related party transactions. Our research provides some preliminary insight into how various RPT categories might be employed.

Methodology

The study used an ex-post facto research design. This is appropriate because the study's goal is to determine the link between two variables without manipulating the variables. This entails generating a financial analysis based on an organization's financial accounts in order to find the major difference.

From 2012 to 2019, the researcher used the six (6) Conglomerates corporations listed on the Nigerian Stock Exchange as a sample for the study. The companies that were chosen were those that disclosed information about their linked party transactions. These businesses include:

1. A.G Leventis Nigeria plc
2. John Holt plc
3. Chellarams Plc
4. SCOA Nigeria Plc
5. Transnational Corporation Plc
6. UAC

Secondary sources of data were used in respect of this study. Data will obtain from the audited financial accounts of the sampled firms from 2012 to 2019.

Model specification

In the specification of the model for the study, the researcher adapted the Nosakhare, Ayoib Noriah (2016) as follows:

$$RPT_{it} = a + \beta_3 BDC_{it} + \mu_{it} \dots \dots \dots -i$$

Where:

The Independent variables: (Board characteristics) =

BDC = Board Composition

The dependent variable: (RPT) Related party transaction

(β) = Coefficient to be estimated for firm in period

Variable Description

Dependent Variable:

Related Party Transactions (RPTs): Obtained from notes in the annual accounts of the companies, such as RPT sales, receivables, purchases, payables, directors related party expenses, transaction with key management personnel etc.

Independent Variables:

Board Composition (*BDC*): The percentage of membership of the board constituted of by non - executive directors.

Method of Data Analysis

The hypotheses formulated for the study were tested with the Ordinary Least Square regression with aid of E-view version 9.0 software package.

The dependent variable director tunneling is operationalized in this study using loan to related party divided by total assets as a proxy for tunneling (Gao & Kling 2008; Juliarto et al. 2013).

While independent variables are measured using, Board Composition Diligence (BC).

Decision rule:

Using E-view, 5% is considered a normal significance level. Accept null hypothesis if the p-value is less than the 0.05 level of significance, otherwise reject null hypothesis and accept alternative hypothesis.

Data Analysis and Result

Test of Hypothesis

H₀₃ Board composition has no significant effect on related party transaction of Nigerian conglomerate firms

H₀₃ Board composition has a significant effect on related party transaction of Nigerian conglomerate firms

Table 1: Regression analysis between board composition and related party transaction

Dependent Variable: RPT
Method: Least Squares
Date: 08/13/21 Time: 21:41
Sample: 2012 2019
Included observations: 8

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.78E+09	6.68E+09	0.714890	0.5015
BC	-5.35E+08	1.48E+09	-0.362611	0.7293
R-squared	0.021445	Mean dependent var		2.37E+09
Adjusted R-squared	-0.141648	S.D. dependent var		1.95E+09
S.E. of regression	2.09E+09	Akaike info criterion		45.96773
Sum squared resid	2.61E+19	Schwarz criterion		45.98759
Log likelihood	-181.8709	Hannan-Quinn criter.		45.83378
F-statistic	0.131487	Durbin-Watson stat		0.557440
Prob(F-statistic)	0.729326			

In table 1, a panel least square regression analysis was conducted to test the relationship between board composition and related party transaction. R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable. From the findings in the table 4.4, the value of R squared was 0.02, an indication that there was variation of 2% on related party transaction due to changes in board composition. This implies that only 2% changes in related party transaction of conglomerates could be accounted for by board composition, while 98% was explained by unknown variables that were not included in the model. The probability of the slope coefficients indicate that; $P(= 0.729 > 0.05)$. The co-efficient value of; $\beta_1 = -5.35$, implies that RPT is negatively related to BC, though not statistically significant at 5%.

The Durbin-Watson Statistic of 0.5574 suggests that the model does not contain serial correlation. The F-statistic of the RPT regression is equal to 0.1315 and the associated F-statistic probability is equal to 0.7293, so the null hypothesis was accepted and the alternative hypothesis was rejected.

Decision

Since the Prob (F-statistic) of 0.729 is higher than the critical value of 5% (0.05), then, it would be upheld that there is no significant relationship between board composition and related party transaction of conglomerates in Nigeria at 5% level of significance, thus, H_0 is preferred over H_1 .

Conclusion and Recommendation

This study adds to the body of knowledge about RPTs in a variety of ways. To begin with, the literature on the subject of the study, the relationship between RPTs and board characteristics, is still limited, with a focus on a few corporations in East Asian countries (China, Indonesia, Malaysia, and Taiwan) and the United States of America in many situations. This research focuses on Nigerian businesses, and thus on a specific market in Western Africa. The variables utilized were drawn from the manufacturing enterprises' official audited reports and accounts and can be considered devoid of discretionary bias. The findings of the study show that board size, board makeup, and board independence have no impact on related party transactions in Nigerian conglomerate companies.

According to the findings, board composition has a minor detrimental impact on related party transactions in Nigerian manufacturing enterprises. As a result, we accept the alternative hypothesis that the board composition of manufacturing firms in Nigeria has a large impact on related party transactions. As a result, this discovery backs up our expectations as well as Roman and Persida's conclusions (2012). This refutes Ali's point of view (2011).

Based on the study's findings, it was suggested that manufacturing enterprises adjudged to play a large part in publicly traded corporations be encouraged to have independent board members, as they are more likely to carry out a more complete diligent assignment.

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