Impact of Agency Costs on Financial Performance of Listed Consumer Goods Companies in Nigeria

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Abstract
This paper examined impact of agency costs on financial performance of listed consumer goods companies in Nigeria. The research utilized documentary data collected from annual reports of consumer goods companies in Nigeria for the period of 2007-2016. A panel data regression technique was employed. The study reveals inverse relationship between agency costs and financial performance, indicating that agency costs will lead to a decline in financial performance, if not properly managed. Based on this result the study recommends that managements of listed consumer goods companies in Nigeria should lay down effective rules and regulations that will ensure avoidance of keeping free cash flow at managers' discretion so that agency costs could be minimized and effectively managed. This could be achieved by complying with the suggestions by free cash flow hypothesis paying it out in the form of cash dividend or committing the firms in to more financial obligations which requires periodic interest payments. There should be critical reviewed before such action are taken by companies in consumer goods industries.

Keywords: Free Cash flow, Agency Cost, Financial performance, Consumer goods

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INTRODUCTION
Financial performance is the process of measuring how revenue is generated using available assets in the firm. It also refers to as a way of assessing overall financial health of an organization over a given period of time which could be used to compare similar firms across the same industry. Financial performance is a relevant concept in strategic management research and is frequently used as a dependent variable in this study. Kyazze, Nsereko and Nkote (2020) opines that financial performance is a practice of measuring effectiveness and efficiency of an action. Efficiency is a measure of how costs effective of the resources are used when providing specified customer service while effectiveness is the extent to which customer needs are met. Jayiddin, Jamil and Roni (2017) viewed the concept of performance as debatable issues in the financial strategy of most corporate organizations due to its compound meanings. According to them, performance measures are either financial or organizational, performance is termed as financial when its maximize profit on assets, maximize shareholders benefits which can result to firm effectiveness, while organizational performance is the managerial style of individual companies that can lead to an increase in the output of an organization.

Moreover, financial and organizational performance works together in promoting the overall organizational objectives of maximizing shareholders wealth. Mohammed and Malik (2012) described financial performance as an expression of the assets of an organization, the level of the competitiveness in the same sector and a thorough knowledge about the cost and profit centre within the firms. It is vital to the economic well-being of the shareholder and the overall economy. The concept is seen as the actual outcome in monitory term achieved as a result of effective and efficient management of resources. Jensen and Meckling (1976) and Jensen (1986) described three kinds of agency costs as monitoring costs, bonding costs and residual loss. Monitoring costs are cost associated with issuing financial statements, employee stock
options and having board of directors. Bonding costs are those costs incurred by the agents to provide assurance to the principal that they are acting in the principal’s best interest. Residual loss occurs whenever the actions that would promote the self-interest of the principal differ from those that would promote the self-interest of the agent, despite monitoring and bonding activities. Perquisite consumption and shrinking behavior of the managers’ leads to an increase in agency costs, also, the projects they invest is almost to maximize their own personal interest, thereby exposing shareholders to unnecessary investment risk. Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business to generate revenue. It is also used to refer to a general measure of a firm’s overall financial health over a given period of time and could be used to compare similar firms across the same industry or to compare industries sectors in aggregation. Financial performance is a relevant construct in strategic management research and is frequently used as a dependent variable in this study.

This study examines impact of agency costs on financial performance of listed consumer goods companies in Nigeria. This study raises the following research question; to what extent does an agency cost affect financial performance of listed consumer goods companies in Nigeria? In order to provide answer to this question, this paper is focused at examining the impact of agency costs on financial performance of listed consumer goods companies in Nigeria.

HO: Agency costs have no significant impact on financial performance of listed consumer goods companies in Nigeria. The economic growth and development of every nation depends largely on the functions of its manufacturing sector, such as consumer goods companies because of its tremendous contribution to the Gross Domestic Product (GDP) (Rathnaweera, 2019). Although the consumer goods industry is not the largest sub-sector in Nigeria or even in African economies in terms of employment generation or product output, the growth of this sector has long been considered crucial for economic development. The special interest in the consumer goods industry emerges from the belief that the sector is a creator of skilled jobs, a potential engine of modernization and a generator of positive effects in the context of the application of modern technologically driven machines (Barasa, et al., 2019).

The Nigerian manufacturing sector and consumer goods companies in particular have over the years been facing serious challenges as regards to company corporate financial performance with regards to cash management as the king of every business undertaking. Moreover, studies on the consumer goods manufacturing sub-sector are very scanty in developing economies, suggesting the need for further research. Furthermore, other studies in the African context reveal that consumer goods manufacturing performance has been very poor. For instance, Nigeria has only 4% of its GDP in consumer goods manufacturing. This is considered low when compared to other African countries, especially the 20% levels for South Africa and Mauritius (Ibeh, Wilson & Chizema, 2012). The aggregate statistics for the Nigerian macro-economy and its manufacturing sector shows that the 1990s was a relatively static period. However, the end of the decade witnessed moderate economic recovery and growth in the consumer goods manufacturing subsector despite a certain degree of macroeconomic instability. Agency cost is the relationship between managers and shareholders. Managers are running the business for their own benefit to the detriment of the shareholders. Financial performance is used as dependent variable proxies by return on assets because consumer goods companies used assets in producing goods to generate revenue. Using agency cost and financial performance in consumer goods companies will give a very good picture on the relationship between manager and shareholders.

LITERATURE REVIEW

However, in ensuring an efficient performance and optimum firm value, agency costs are a kind of internally induced costs to the firm as a result of agent, principal relationship and should be paid to the agent. Jensen and Meckling (1976) and Jensen (1986) described three kinds of agency costs as monitoring costs, bonding costs and residual loss. Monitoring costs are costs incurred in engaging auditors in a firm in support of the shareholders to check and control the manager’s natural process to confirm action that increase value for the shareholders, the costs of engaging the auditors is therefore refer as agency costs. The bonding costs entails bond covenant which is an agreement that restrict the firm from venturing in specific action example limitation on dividend payment. Residual loss on the other hand is costs sustain from conflicting shareholders and managers interest notwithstanding the use of other costs. Similarly, Safari, Mirshekary and Wise (2011) categorized the agency costs into two components: gross costs and loss: Monitoring and bonding costs represent the gross costs while residual loss represents the losses. Monitoring and bonding, like audit fees, director fees and legal binding that can reduce the agent’s fraud and reduce the agency problem as well, are regarded as gross costs while loss is the costs incurred from divergent principal and agent interests despite the use of gross costs. Both of them are saying the same thing but in different way.

Studies on agency costs and financial performance are mostly carried out in developed countries. For instance, Antoniadis et al. (2008); Migunyi, Zanjird and Gasemy (2013), Wambua (2013), and Nobance, Ellili and Abraham (2017) were almost from developed countries and finding in other economy may not to be applicable to our economic settings due to difference in other factors. In measuring agency costs, most studies concentrated on using many proxies to represent agency costs for instance, the study by Chen and Lin (2006) measured agency costs using firm size, leverage, growth, free cash flow and managerial ownership. On the other hand, Wang (2010) used a total asset turn over, administrative expenses, advertisement, R & D, operating expenses, net income volatility and operating income volatility to measure agency costs. Similarly, Pouraghjan et al. (2013) used total assets turn over, operating income volatility, operating costs, R & D and advertisement costs. Khidmat and Rehman (2014) measured agency costs using operating income volatility, net income volatility, total assets turn over and operating income expenses. But this study is using different proxy interest expenses to proxy agency costs and most of the studies used other sector of the economy but this study is using listed consumer goods companies in Nigeria. Interest expenses are part of monitoring costs that this research included as proxy for agency costs. The bases are interest paid on loan and loan is a form of monitoring mechanism that helps owners to checkmate managerial behavior when it comes to agency opportunism.

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Therefore, interest expense is also an agency costs variable because even if owners have the capacity to finance a business entity with equity, they will still prefer to employ debt because of the debt covenants hypothesis relationship, which leverage creates by monitoring mechanism, by getting a third party that will monitor the managers. Debt covenant gives a restriction or defines how the management uses the assets, so that they cannot bring their opportunistic behavior but in the interest of the business. (ii) Financial discipline because of the payment of interest, shareholders’ money can be managed to meet debt obligation which failure to do that can make bond holders force liquidation. For that reason, managers want to secure their jobs. Interest can be the extent of managing the conflict between shareholders and managers. The measurement is interest expenses to sales. To the best of the researcher’s knowledge this is the first study that used interest expenses as agency cost proxy for the reason given above.

Based on objective of this research, the following hypothesis is developed with a view to documenting evidence on impact of agency costs from the business activities of listed consumer goods companies in Nigeria.

**METHODOLOGY**

The ex-post facto and descriptive research design was employed for the study. The sources of data for the research is secondary sourced from the annual reports and account of consumer goods companies for a period of 10 years and the NSE Fact Book 2016. Panel regression technique of data analysis was adopted. The design is believed to be appropriate for examination of the relationship between agency costs and financial performance of the listed consumer goods companies in Nigeria. In view of availability of data for all the selected firms census approach was adopted by the research which enables the study to examine all the consumer goods companies. Based on the positivist paradigm, this study is anchored on the methodological philosophical assumption.

As it employs an objectivist approach in studying agency costs and financial performance, it focuses on quantitative analysis

**Variable Measurement and Model Specification**

The study primarily used agency costs as independent variable proxy by interest expenses while the dependent variable is financial performance represented by ROA with firm age, size and liquidity as control variables.

<table>
<thead>
<tr>
<th>S/N</th>
<th>VARIABLES</th>
<th>MEASUREMENTS</th>
<th>PROXIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Performance</td>
<td>Profit after tax divided by total asset as used by</td>
<td>ROA</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pouraghjan et al. (2013); Jabbar, Hajha and Labesha (2013); Heydari, Mirzaifar and Javadhayedi (2014) and Khidmat and Rehman (2014).</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Agency Costs</td>
<td>Interest expenses divided by sales as interest expenses (researcher’s measurement). Interest payment can bring a monitoring mechanism and financial discipline that can enhance performance. It can also be the extent of managing conflict between principal and agent and will also reduce the managers’ opportunistic behavior of investing in unprofitable projects. According to Gull and Tsui (2001) increase in</td>
<td></td>
</tr>
</tbody>
</table>

The following is the model to empirically test the hypothesis of the study as formulated.

\[ FP = f(AC, \text{firm age, size and liquidity}) \]

From the above general equation, the regression model is derived as follows:

\[ FP_{i} = \beta_{0} + \beta_{1} AC_{i} + \lambda_{2} Age_{i} + \lambda_{3} Size_{i} + \lambda_{4} LTD_{i} + \epsilon_{i} \]

**RESULTS AND DISCUSSION**

The descriptive statistics of the dependent and explanatory variables of the study are presented in Table 2. It provides summary statistics of the variables, which include the mean, standard deviation, minimum and maximum values of the data.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Obs</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>FP</td>
<td>169</td>
<td>7.622</td>
<td>10.574</td>
<td>-44.16</td>
<td>42.85</td>
</tr>
<tr>
<td>AC</td>
<td>169</td>
<td>3.504</td>
<td>6.699</td>
<td>0</td>
<td>53.133</td>
</tr>
<tr>
<td>Age</td>
<td>171</td>
<td>27.737</td>
<td>13.508</td>
<td>1</td>
<td>52</td>
</tr>
<tr>
<td>Size</td>
<td>169</td>
<td>7.389</td>
<td>0.726</td>
<td>5.25</td>
<td>8.56</td>
</tr>
<tr>
<td>LTD</td>
<td>171</td>
<td>0.708</td>
<td>0.420</td>
<td>0.03</td>
<td>2</td>
</tr>
</tbody>
</table>

Agency costs have a mean of 3.50, indicating that about 3.50% of interest expenses are incurred in trying to generate sales. The minimum AC of 0 and a maximum 53.13 show that at the minimum level sales are generated without borrowing and thus no interest is paid, but at a maximum level interest paid is up to 53.13% indicating that sales are generated through borrowing which leads to the payment of interest of about 53.13%. AC has a standard deviation of 6.70, an indication that is widely dispersed.

The mean Age is 27.77, showing that on average the sampled companies are 27 year and a minimum of just 1 year in 2007 and a maximum of 52 years showing that the youngest company is just 1 year and the oldest is about 52 years for example, Dangote Sugar Nigerian Plc is just 1 year old in 2007 and Guinness Nigeria, Plc is about 52 years. The standard deviation of 13.51 from the mean is not high. Table 2 reveals Firm size has a mean value of 7.39 with minimum of 5.25 and maximum a value of 8.56. The standard deviation of 0.73 indicates a considerable level of dispersion in the variable. Liquidity has a mean of 0.708% with a minimum of 0.03% and a maximum of 2%, respectively. The standard deviation of 0.42 suggests a moderate level of dispersion for the period under review.
Correlation Analysis
Table 3 shows the Pearson correlation values between the dependent and explanatory variables and among the explanatory variables themselves.

Table 3: Correlation Matrix

<table>
<thead>
<tr>
<th>Variables</th>
<th>ROA Correlation</th>
<th>AC Correlation</th>
<th>Age Correlation</th>
<th>Size Correlation</th>
<th>Ltd Correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AC</td>
<td>-0.544</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>0.047</td>
<td>0.041</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>0.242</td>
<td>0.066</td>
<td>0.240</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>Ltd</td>
<td>0.411</td>
<td>-0.369</td>
<td>-0.161</td>
<td>-0.213</td>
<td>1.000</td>
</tr>
</tbody>
</table>

From Table 3, the correlation coefficient of -0.54 for AC has a negative but moderate relationship with return on assets. This is in line with free cash flow hypotheses that opportunistic behavior by the managers make them to invest in projects with negative NPV which can lead to decrease in performance. In addition, correlation between age and return on asset is positive and very weak and a weak relationship exists between size and return on asset to the tune of 0.24. Also, the result depicts a moderate correlation between liquidity and return on asset to the tune of 0.41.

The relationship between age and AC depicts a very weak 0.04 but has a positive association. Also, size has a positive and very weak association with AC to the tune of 0.07 and liquidity has negative and moderate relationship with AC to the tune of 0.37. Again, age has positive and weak relationship with size to the tune of 0.24 while age is negatively weakly correlated with liquidity to the tune of 0.16. Similarly, size is negatively and weakly correlated with liquidity.

Presentation and interpretation of Regression Result
This presents and interprets regression results of the study, as shown below:

Table 4: Regression Result on Agency costs and Financial Performance (ROA)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>T-value</th>
<th>Prob.</th>
<th>R² Statistic</th>
<th>Prob.</th>
<th>Observation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-79.699</td>
<td>-3.89</td>
<td>0.000</td>
<td>0.0734</td>
<td>0.000</td>
<td>169</td>
</tr>
<tr>
<td>AC</td>
<td>-0.572</td>
<td>-5.11</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>-1.273</td>
<td>-4.72</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>16.287</td>
<td>4.69</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ltd</td>
<td>6.081</td>
<td>3.57</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The regression result on agency costs (AC_INT) and financial performance (ROA) revealed a probability value of 0.0000. This indicates fitness and reliability of the model, which show a statistically significant support between the dependent and independent variables. The results show a cumulative R² of 0.073 Thus, it signifies that 7% of the total variation in the ROA of the listed consumer goods companies in Nigeria is caused by AC_INT, age, size and LTD while 93% is accounted for by other variables not considered in the model. The probability value of <.0000 and the F-statistic of 19.04 show that the model is fit and significant at 1% level of significance and the variables were properly selected and combined.

Furthermore, the result reveals a statistically significant negative effect of AC_INT on ROA (P-value<.0000) this result indicates that ROA increases with decrease in AC_INT. Free cash flow hypotheses postulate an inverse association between agency costs and financial performance (Ang et al; 2000). The agency costs represented by interest expenses is able to have effect on financial performance in the same way as propounded by Agency Theory. The implication of findings is to reduce agency costs by encouraging managerial ownership in firms, it also provided support for the agency theory that agency costs lead to lower performance of an organization, as revealed by the model. The result is in line with that of Wang (2010), Jabbary, Hajjha and Labesha (2013), Rakesh and Lakshmi (2013), Alabdullah (2013), Pouraghjjan, Tabari, Mansourinia and Emamgholipour (2013), Khidmat and Rehman (2014) and Nobance, Ellie and Abraham (2017) who found an inverse association between agency costs and financial performance. On contrary some scholars found positive relationship between agency costs and financial performance like Miguiny, Zanjirdar and Gasemy (2013), Wambua (2013), Nguna and Moronga (2013), Alfadhi and Alabdullah (2013) and Tobari and Ghanji (2016).

CONCLUSION AND RECOMMENDATION
Based on the analyses and the results obtained from the study, the research concludes that: Agency costs leads to a decrease in the financial performance of listed consumer goods companies in Nigeria as a result of managers' opportunistic behavior in managing their resources by placing emphasis on their personal interest compare to the organizational goal congruence. The study recommendations that, the managements of consumer goods companies in Nigeria should find a way of laying down effective rules and regulations that will ensure avoidance of keeping free cash flow at managers' discretion so that agency costs could be minimized and effectively managed. This could be achieved by complying with the suggestions by free cash flow hypothesis paying it out as dividend or committing the firms in to more financial obligations which requires periodic interest payments. There should be critical reviewed before such action are taken by companies in consumer goods industries.

The research examines agency costs and the financial performance of the listed consumer goods companies in Nigeria paved way for further research in the area, relationship between agency costs and financial performance in other sectors of the economy, such as oil marketing firms, conglomerates, banks, other sector in the manufacturing firms which requires research effort, especially as it is not covered by this study. In addition, the same research can be conducted by using alternative measure of agency cost. More research in this area would not only complement this study, but it would also help in bringing about improvement in financial performance of quoted firms in Nigeria.

REFERENCES


