

DOES RELATED-PARTY TRANSACTIONS AFFECT FINANCIAL PERFORMANCE OF FIRMS IN NIGERIA? (EVIDENCE FROM PUBLICLY QUOTED FIRMS)

Godsday Edesiri Okoro¹, Edirin Jeroh²

¹ Godsday Edesiri Okoro., Department of Accountancy, Faculty of Management Sciences, Nnamdi Azikiwe University, Awka, Nigeria, edesirioracle@yahoo.com

² Dr. Edirin Jeroh (ACA), Department of Accounting and Finance, Faculty of The Social Sciences, Delta State University, Abraka, Nigeria, jeroh4laff@yahoo.com

Abstract: Related-party transactions (RPTs) are usually dual in nature since they fulfill the economic needs of the firm while at the same time, they serve as mechanisms through which the resources of firms are manipulated, exploited and diverted. This paper takes cognizance of both aspects by investigating the relation between transactions deemed to have taken place by related parties and the financial health/position/performance of Nigerian firms. The financial health/performance parameters of concern to this study are Return on Assets (ROA), Return on Equities (ROA) and Earnings. The ex-post-facto design was employed and performance data were sourced from the financial reports/statements of sampled firms during the period 2007 – 2014. The data so obtained were analyzed by the simple regression technique. The insinuation from our findings is that transactions deemed to have taken place by related parties are not significant, and are not correlated with financial performance. We also found no proof of cause-effect link amid such transactions and the performance measures adopted by this study. On this note, we recommend a stern regulation of transactions that are deemed to have taken place by related parties in Nigeria. It is believed that this would discourage their non-transparent use especially in the area of earnings manipulation.

Keywords: Business Exchange; Return on Asset, Return on Equity, Earnings; Dual Transactions

JEL Classification: M41

INTRODUCTION

Related Party Transactions (RPTs) are considered usual and normal in today's trade and commerce. Transactions of such nature are mostly classified as being two-folded, since by their nature, they have the ability of either reducing the costs associated with certain transactions, thereby enhancing firm value, or because they are seen as tools for the exploitation of the firms scarce resources and for other purposes like fund diversion (Amzaleg

and Barak, 2011; and Amzaleg and Barak, 2013).

According to Pozzoli and Venuti (2014) RPTs reflects to a very large extent, business connections that tend to accomplish economic desires of firms, while at the same time offering itself as a channel through which firm's resources are manipulated. Similarly, Huang and Liu (2010), reiterated that RPTs are business connections between any identified corporate entity and her associates. Associates in this regards could be seen as what Gordon,

Henry and Palia (2004) described as entities with the following traits: first, they regulate the activities of the firm; second, they are regulated by the firm or by another entity which also regulate the activities of the firm.

Given the above, one may not just overrule the possibility of such identified corporate entities apportioning fragments of their operational undertakings to an investor who has momentous power over its financial and/or operational policies. The resulting association from this type of arrangement becomes that of such identified entities/firms and their investors. With these possibilities in mind, we must take note of the fact that the International Accounting Standard (IAS) No. 24 stipulates that corporate entities financial statement should disclose their actual financial performance/position/results in such a way that the existence of related-party transactions does not likely impinge the reported financial positions of the firm.

In spite of the provisions of IAS No. 24, RPTs are one of the recurrent aspects of trepidation due to corporate scandals (Gordon, Henry and Palia, 2004) which of course, have rocked Nigeria, the world over. Anchoring on findings of prior researches, Padmini (2013) and Renna and Yanuar (2015), reiterated that RPTs have over the years resulted in cases of corporate scandals because they are problematic to audit and are indications/possible signals of audit risk. Nekhili and Cherif, (2011) sees RPTs as possible conflicts of interest that can compromise management's agency duty to shareholders or a board of director's supervising role.

Interestingly, it is believed that even though related-party transactions do not occur at a given point in time, the financial positions/performance of firms may still be impinged by mere incidence of such relationships between individuals classified to be related parties. For instance, a given company may dismiss its transactions/dealings with a trading associate since it made a significant investment in a firm believed to have been involved in similar line of trade (Gina, 2012). This is why Padmini (2013) believed that the existence of related-party relationships

may have serious implications for the performance of corporate entities even when no direct transaction may have occurred between the identified parties.

Although related-party transactions efficiently accomplish the fundamental economic desires of firms (Gordon, Henry and Palia, 2004; Lin, Lin and Keng, 2010, and Pozzoli and Venuti, 2014), questions, concerns and doubts about the fundamental nature of related-party transactions plus the possibility of having negative impact on firm performance still occur.

Despite the aforementioned, there seem to be little empirical evidence to confirm or disapprove the views on whether or not related-party transactions impinge performance (financial) of listed firms in Nigeria, hence this study.

1. REVIEW OF RELATED LITERATURE

In this paper, the review of related literature is discussed under the following subheadings:

1.1 An Overview of Related-Party Transactions (RPTs)

Related-party transactions refer to business dealings between corporate entities and their subsidiaries, associates, directors or such firms controlled by its management (Claessens, Fan and Lang, 2006; and Huang and Liu, 2010). RPTs are deemed to result in wealth transfer from a firm towards the advantage of shareholders with a controlling interest (Johnson, Boone, Breach and Friedman, 2000). Certain RPTs result in the outright alteration of financial statements' figures or balances of firms. For instance, management may decide to illegally price interest rates on related-loans in a bid to obtaining undue advantage (Shastri and Kahle, 2004), thereby leading to the alteration or manipulation of earnings. In addition to this, Khanna and Yafeh (2005) maintained that suppliers to a given firm may increase earnings simply by changing next period's related-supplies to that of the current period. This is why IAS 24 had prescribed the disclosure requirements for RPTs with the hope of avoiding distortions in financial reporting.

The possibility of RPTs having effect on the financial positions/performance of corporate entities cannot be undermined (Gina, 2012). This is because related parties have the opportunities of entering into transactions that unrelated parties would not (Jian and Wong, 2010). Such transactions entered into may thus have a multiplier effect on the results of such reporting entities in the long run. For instance, an entity that supplies goods to its parent firm at low-price may not supply at low-price to another firm. In the case of lending, related party connections may cause a firm to borrow or lend money at an interest rate that varies from the prevailing interest rate. However knowledge on related-party transactions is needful since it will assist users' gain superior understanding of the prevalence of this transaction, thus guiding them in the process of making informed decision.

1.2 Linking Financial Performance and Related Party Transactions

Financial performance is mostly viewed as a subjective measure of the extent to which firms, in their normal course of business, could generate revenue from the use of their available assets which they have acquired over time. It measures the overall well being or financial health of firms over time. Studies have argued that financial performance is a quantitative measure that is used to compare the performance of firms in the same industry or to compare the aggregate performance of industries or sectors over time (Lin, Liu and Keng, 2010; Wu, et.al, 2010; Khanna and Palepu, 2005).

In the accounting literature, the consequence of related-party transactions on the financial position and performance of firms have been identified by researchers as ranging from the impact it has on earnings, ROE and ROA, and the overall profitability of firms. It is on this note that findings from previous empirical investigations have indicated that accounting variables and measurements like ROA (Jian and Wong, 2010), earnings (Khanna and Palepu, 2005), ROE (Peng, 2011), free cash flow (Jensen, 1986), return on stock price (Gordon Henry and Palia, 2004), stock price

(Johnson, Boone, Breach and Friedman, 2000) and book value of debt (Tsai, Chang and Chang, 2015) should generally be seen as measures of the financial health/performance of firms. It is noteworthy however that from the results of notable prior studies (Claessens, Djankow, Fan and Lang, 2002; Lemmons and Lin, 2003; Jian and Wong, 2004; Cheung, Rau and Stouraitis, 2006; Lin, Lin and Keng, 2010 and Gina, 2012), arguments on whether RPTs has positive or negative impact on firm financial health/performance has remained debatable (Lin, Lin and Keng, 2010) given their mixed results so far.

It is pertinent to point that the accounting measurements analysed by prior studies are usually generated from the annual accounts prepared by reporting entities. In a bid to ascertain whether or not, related-party transactions affect the financial performance of corporate firms in Nigeria, positively or negatively, this study thus focused on three performance measures – Earnings, ROE and ROA.

2. MATERIAL AND METHODS

This study investigated the connection between related-party transactions and the performance (financial) of firms in Nigeria. The performance parameters used in this study are ROA, ROE and Earnings. The ex-post-facto design was employed and these financial health/performance data were obtained from the financial reports/annual accounts of sampled firms during the period 2007 – 2014 (8 years). The study tests the independent variable (Related-Party Transactions) and how it influenced financial health/performance indices of Nigerian firms. The model for the study was based on the functional equations below:

$$EARN = F(RPTs) \quad (1)$$

$$ROE = F(RPTs) \quad (2)$$

$$ROA = F(RPTs) \quad (3)$$

In order to estimate equations 1-3 we can translate this into equation 4-6 as below:

$$EARN_{it} = \beta_0 + \beta_1 RPT_{sit} + \varepsilon_{it} \quad (4)$$

$$ROE_{it} = \beta_0 + \beta_1 RPT_{sit} + \varepsilon_{it} \quad (5)$$

$$ROA_{it} = \beta_0 + \beta_1 RPT_{sit} + \varepsilon_{it} \quad (6)$$

Where:

RPT_s = Related-Party Transactions

$EARN$ = Earnings of each firm

ROA = Return on Assets

ROE = Return on Equity

ε = Error Term (variables not captured in the model)

it = Time Period

β_0, β_1 = Regression Coefficients

In this study, we excluded all banks and financial service firms. This was informed by the exemption of banks from the disclosure of

RPTs by IAS 24. Thus the firms studied were those in the industrial good sector. Specifically, eight (8) industrial goods firm - Adswitch Nigeria Plc, Ashaka Cement Plc., Avon Crown caps Plc., Berger Paints Nigeria Plc., Beta Glass Company Plc., Dangote Cement Plc., DN Meyer Plc. and Larfarge Africa Plc were studied. The data obtained were analyzed with the Ordinary Least Square (OLS) estimation technique.

3. RESULTS

3.1 Descriptive Statistics of The Variables

Tab. 1, 2 and 3 presents the descriptive statistics of the variables used in this study. The descriptive statistics used were mean, standard deviation maximum and minimum values while Tables 4-6 reports the t-test results.

Tab. 1: Descriptive Statistics of Related Party Transactions (RPTs) and Return on Assets

Periods = 8	Mean	Std. Dev.	Min. Value	Max. Value
Coefficient	10.0314	10.33937	0	21.5281

Source: SPSS 21 Output

Tab. 1 above presents the estimates of Related-Party Transactions (RPTs) to changes in Return on Assets (ROA). A cursory look at the result revealed that the mean RPTs is 10.0314 and standard deviation 10.33937. This implies that RPTs can deviate from mean to

both sides by 10.03 %. The mean disclosure for related-party transactions is 10.03 % for ROA. Also, on the average, there is one transaction for every computed ROA. The maximum value in millions of Naira for RPTs was reported at N21.5281.

Tab. 2: Descriptive Statistics of Related Party Transactions (RPTs) and Return on Equity

Periods = 8	Mean	Std. Dev.	Min. Value	Max. Value
Coefficient	2.4025	3.23303	0	21.5281

Source: SPSS 21 Output

Tab. 2 above presents the estimates of Related-Party Transactions (RPTs) to changes in Return on Equity (ROE). A quick look at the result showed that the mean RPTs is 2.4025 and standard deviation 3.23303. This implies that RPTs can disperse from its mean to both sides by 2.4 %. The mean disclosure for

related-party transactions is 2.4 % for ROE. Also, on the average, there is zero transaction for every computed ROE. This implies that the extent to which RPTs impinge ROE cannot be ascertained due to the zero value reported. The maximum value in millions of Naira for RPTs was reported at N21.5281.

Tab. 3: Descriptive Statistics of Related Party Transactions (RPTs) and Earnings

Periods = 8	Mean	Std. Dev.	Min. Value	Max. Value
Coefficient	36.0439	111.84324	0	21.5281

Source: SPSS 21 Output

Tab. 3 above presents the estimates of Related-Party Transactions (RPTs) to changes in Earnings (EARN). A closer look at the result showed that the mean RPTs is 36.0439 while the standard deviation is 111.84324. The implication of the above is that related-party transactions can deviate from mean to both sides by 36.04 %. The mean disclosure for related-party transactions is 36.04 % for

earnings. Also from Table 3, it can be observed that the maximum value in millions of Naira for RPTs was reported at N21.5281.

3.2 Results of The T-Statistics

Below is the presentation of the results in relation to the t-statistics.

Tab. 4: T-Statistics for Related Party Transactions (RPTs) and Return on Equity

Variables	Coefficients	t-statistic	Prob.
Constant	1.029	2.043	.000
RPTs	0.033	0.139	.890

Source: SPSS 21 Output: RPTs & ROE

As shown in Tab. 4 above, RPTs (p-value = .890) was not statistically significant at 5 percent or lower. The result also revealed that

related-party transactions do not significantly influence return on equity of listed firms in Nigeria.

Tab. 5: T-Statistics for Related Party Transactions (RPTs) and Return on Assets

Variables	Coefficients	t-statistic	Prob.
Constant	1.029	2.043	.000
ROA	0.564	0.509	.780

Source: SPSS Output, 2016: RPT & ROA

As shown in Tab. 5 above, RPTs (p-value = 0.780 > 0.05) was statistically flawed at 5 percent or lower. The result also revealed that

related-party transactions do not significantly affect return on asset of listed firms in Nigeria.

Tab. 6: T-Statistics for Related Party Transactions (RPTs) and Earnings

Variables	Coefficients	t-statistic	Prob.
Constant	1.029	2.043	.000
RPTs	.004	1.457	.155

Source: SPSS 21 Output: RPTs & Earnings

As shown in Tab. 6 above, RPTs (p-value = 0.155 > 0.05) was not statistically significant at 5 percent or lower. The result also revealed that related-party transactions do not correlate significantly with the earnings of listed firms in Nigeria.

CONCLUSION - RECOMMENDATIONS

This paper contributes to empirical evidence on related-party transactions in diverse means. First, studies on the link between related-party transactions and financial position/performance

seem to be limited in Nigeria since most studies in this area were conducted in developed countries. Second, this paper takes into cognizance, the financial effects resulting from related-party transactions, presenting a quantitative analysis not affected by improbability and errors in variables. The variables used were obtained from the annual reports and accounts of listed companies and can be seen as free from discretionary bias.

As regards the results of the analysis, this paper confirms that related-party transactions do not significantly impinge the performance indices of listed corporate entities in Nigeria. Specifically, our results revealed that related-party transactions and firm's financial performance results are not correlated for Nigerian listed firms. Interestingly, this study did not find any evidence of cause-effect relation between firms' performance measures and transactions deemed to have taken place by individuals classified to be related parties.

On the basis of the above, we recommended a stern regulation by regulatory accounting framework for related-party transactions. This is needful to discourage non-transparent use of transactions (RPTs) in the area of earnings manipulation. The Financial Reporting Council of Nigeria should continually keep a closer watch on related-party transactions that may impinge financial performance or otherwise, and be sure that the financial/corporate reports currently prepared in the country are not manipulated to hide the effect of such transactions (RPTs) on the performance (financial) of Nigerian firms.

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