

The Influence of Chief Executive Officer's Compensation on Firms' Performance in the Nigeria Banking Industry

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Abstract:

The study examines the influence of Chief Executive Officer's (CEO) compensation on a firm's performance. The objectives of the study were to determine if CEO compensation, firm size and leverage do significantly influence a firm's performance. 10 banks quoted on the Nigerian Stock Exchange were sampled for easy accessibility of data. The least square regression technique was used to test the hypotheses of the study. Three hypotheses were tested and from the study, we summarize the following results; there is a significant relationship between CEO compensation and firm performance in the Nigerian banking industry. In addition, firm size does significantly influence firm performance in the Nigerian banking industry. In addition, there was a negative and insignificant relationship between leverage and firm performance in quoted companies in Nigeria. The study recommends that there should be proper compensation review as this will increase the productivity of the executives. Further, since increased pay is necessary for the efficiency of the workers, it is advised to ensure a considerable pay as this will ensure efficiency in the organization.

Keywords

Chief executive officer; compensation; firm performance; Nigeria banking industry, chief executive officer compensation; firm size; return on asset; leverage

Introduction

Considerable research has focused on the level of compensation and the observed relationship with firm performance. Research on top management compensation has been done for over 70 years and has amassed towards a total of more than 300 studies as postulated by Manders (2012). The conflict of interest amid CEOs and shareholders has gained importance in public policy debates and within academic research in recent years. Bhagat, Bolton and Subramanian (2010) posit that one of the most important roles of a board is to take into service a CEO with remarkable skill. Finding and taking into service an apt CEO is an important task for the board of a firm. On the other hand, even though the apt CEO is employed, there are a number of concerns which come about.

The key concern that comes up is the CEO pay, and whether or not this can influence the performance of a firm. Investors nevertheless expect the CEO who is receiving high pay to perform and prove his merit. Shareholders, politicians, regulators and the media have all evaluated on the suitability of the level of CEO compensation. Further, the structure and level of compensation for Chief Executive Officers (CEOs) is an imperative issue in this day and age. It is in the best interest of a firm that its executives perform well.

Several pieces of evidence from the studies of compensation and performance have exhibited mix outcomes and patterns with some suggesting the alignment of managers' interest with those of shareholders through right compensation packages to encourage the executive to perform in the good interest of shareholder (John, Mehran & Qian, 2010 and Olaniyi & Obembe, 2015). Critics assert that CEO's compensation is disproportionate because it is feebly linked to firm performance and also the problems linked to CEO compensation are therefore pervading that most CEO's get surplus pay.

Consequent upon the above, this article tries to evaluate the extent CEO's compensation influences the banking industry performance in Nigeria.

2. Chief Executive Officers (CEOs) Compensation

As stated by Shin, Lee and Joo (2009), chief executive officers' compensation consists of the monetary compensation along with other nonmonetary rewards received by an executive for their service into the firm. Chief executive officers' compensation is a combination of salary, bonuses, shares or call options on the benefits, company stock and perquisites, ideally configured to take into account the desires of the organization and the



executive, government regulation, tax law, and rewards for performance. A firm's Board of Directors designs the CEO compensation remunerations usually by the compensation committee consisting of independent directors, with the intent of incentivizing the executive team, who have a momentous impact on firm strategy, decisionmaking, and value creation in addition to enhancing Executive Retention (Adegoroye, Oluwafemi, Akanfe & Oladipo, 2017).

Sun, Xianging and Huang (2013) delineate executive compensation as reward packages paid to senior leaders in business, most habitually the CEO. Executive pay packages differ from employee pay both in scale and the benefits offered. Stock option forms a fundamental component of a lot of executive compensation packages, and a huge basic salary, though many will offer to a large extent more favourable stock choices and a low standard salary to lower the tax burden.

3. Firm Performance

Performance could be the accomplishment of task measured against predetermined or recognized standards of precision, cost, completeness, and speed. By comparison, performance is considered to be a satisfaction of an obligation in a way that discharges the performer from the liabilities laid down under the contract. Firm performance encircles the actual output or outcomes of a firm as quantified against its projected outputs (or objectives and goals). Firm performance encompasses three definite areas of firm outcomes: (i) Shareholder return (total shareholder return and economic value added) (ii) Product and market performance (share, sales, market) and (iii) financial performance (profit, return on assets and return on investment) The nature of corporate performance and measurement has been a topic for both practitioners and scholars since organizations were first formed. How to determine if the efforts of the organization are being put to their best use and are achieving the desired outcome at the heart of several disciplines.

Hansen and Mowen in their study in 2005 postulates' that firm performance is quite vital to the executive since it is a result that's been achieved by an individual or some people in a firm related to its authority and duty in reaching the goal legally, not despite regulations, and in compliance with the moral and ethics. Performance may be the purpose of the capability of an organization to manage and gain the resources at unique procedures to successfully come up with a competitive advantage. While the management disciples concentrate on how to improve collaborate performance particularly and in particular entrepreneurship and strategic management research, accountants devote their attention to fairly presenting the performance of the organization.

In this study, firm performance is proxy by return on asset and used as the dependent variable.

4. Review of Prior Studies

Kazan (2016) carried out a study aimed at investigating the impact of CEO compensation on firm performance in Scandinavia. The test sample consists of Scandinavian firms that had a spot on the Forbes Global 2000 List of 2016. The impact of CEO compensation on firm performance is tested by using the performance measures of ROE and ROA. The results show a non-significant negative relationship between CEO compensation and firm performance.

Fallatah (2015) carried out a study to examine CEO Compensation, Firm Performance and Corporate Governance: An Empirical Investigation of Saudi Arabian Companies. This paper examines two major themes: (a) the relationship between CEO compensation and firm performance; and (b) the influence of corporate governance (e.g., board size, board independence, government ownership, large shareholder ownership, and CEO duality) on determining CEO compensation. The data provided consist of all the companies listed on the Saudi Stock Market (Tadawul) for the period 2008-2012. The data were controlled for firm size, growth opportunities, risk, age, and leverage. A significant relationship between CEO compensation and firm performance measures was noted. In addition, a negative and significant relationship between CEO compensation and corporate governance structure (board independence) was observed. This suggests that boards may attempt to use compensation contracts to align executives' actions with company's success. The idea is that CEO performance provides value to the organization. "Pay for performance" is the mantra most companies use when they try to explain their compensation plans. This paper adds more empirical evidence to the idea of CEOs pay being dependent on one's performance.

Olalekan and Bodunde (2015) in a study examined the impact of CEO pay on the performance of 11 selected Nigerian quoted banks between 2005



and 2012, using a dynamic Generalized Method of Moments (GMM). The research makes known that the CEO pay exerts significant but negative influence on bank performance in Nigeria. This study, therefore, concludes that rather than being a significant corporate governance mechanism to align the interests of CEO with those of shareholders, the CEO pay of Nigerian quoted banks is indeed part of agency issue in the industry.

Shakerin, Natalie and Low (2014) study investigated the relationship between CEO pay and firm performance (return on asset, return on equity and profit margin) of 100 companies from the consumer product sector in Malaysia listed on Bursa Malaysia from 2006 to 2010. Overall, most of the attestations results were found to have a relationship between CEO pay and firm performance. The correlations and regressions among the sub-variables of the firm performance and the CEO pay were found to be consistently positive ranging from weakly positive to the strong positive.

5. Theoretical Framework

The theoretical framework will look into various theories that have been formulated in the field of CEOs compensation management and its impact on firms' performance.

5.1. Managerialism theory

Managerialism theory is a concept that is built on the idea that separation of ownership from control can cause a discrepancy of interest between the management and owners (Tosi et al. 2000). Managers focus on taking advantage of firm size rather than the value of the company. In doing so, they get prestige, power and more pay. This could lead to less or negative returns for the shareholders.

5.2. Stakeholder theory

The term stakeholder refers to any group or individual who has a legitimate claim on the firm. Each stakeholder of a firm creates value for the company. Since managers are considered to be stakeholders of a firm, the CEO is also included in this consideration. Thus this theory is built on the premise that CEOs are also affected by the outcomes of the firm. That is to say, a positive firm performance will ultimately make the position of the CEO stronger. This will make the probability of a layoff smaller. Thomsen & Conyon (2012) explicates that the view of corporate expenditure of CEO's change when they buy or receive company's stock. Thus, setting appropriate incentives for the CEO or changing the compensation structure can provide results.

6. Materials and Methods

This study is a combination of both explorative and descriptive type of research design. In other to obtain information to examine the relationship between the variables, the convenience sampling technique, with the combination of both the crosssectional and time-series data (panel data) were used.

The focus of this article is to examine the influence of CEOs' compensation on firms' performance in the Nigerian banking industry, for the period, 2010-2014. The data collection approach for the research is quantitative and the study made use of secondary data. These data were sourced from the financial statements of the 10 selected quoted banks (selected based on the availability of the financial statement of the various firms from 2010-2014) listed on the Nigeria Stock Exchange as at 31st December 2014. The statistical technique utilized in this research is the Panel Least Squares (PLS) with the aid of EViews 8.

6.1. Model Specification

Hypotheses

 H_{01} : There is no significant relationship between CEO compensation and firm performance in the Nigerian banking industry.

 H_{02} : There is no significant relationship between firm size and firms' performance in the Nigerian banking industry.

 H_{03} : There is no significant relationship between Leverage and firms' performance in the Nigerian banking industry.

The linear multiple regression model is specified below:

The theoretical form

ROAt = F (CEOCt, FSIZEt, LEVt)

$$ROA = B_0 + B_1 LOG(CEOC) + B_2 LOG(FSIZE) + B_3 LOG(LEV) + U_t$$

Where:

 $B_0 = Intercept$ $B_1, B_2 = Co-efficient$

 $B_1, B_2 = Co-efficient$

ROA = Firm Performance measured using return on asset

FSIZE = Firm Size

LEV = Leverage

CEOC = CEO Compensation

Ut = The Stochastic Error term

7. Presentation and Analysis of Result 7.1 Correlation Analysis Table 1: Correlation Matrix



	ROA	CEOC	FSIZE	LEV
ROA	0.29726	-0.01048	-0.20636	0.00027
CEOC	-0.01048	0.00075	0.00473	-1.30E-06
FSIZE	-0.20636	0.004732	0.16060	-0.00026
LEV	0.00027	-1.30E-06	-0.00026	1.87E-05

Source: Author's Compilation Using E-views 8.1

From the correlations analysis, CEO compensation has a strong positive relationship with firm size and return on asset and negatively related to leverage. It is also observed that firm size is positively related to return on asset.

7.2 *Presentation of Result* **Table 2.** Pooled Least Square Result

Variable	Coefficient	Std. Error	t-Statistic	e Prob.
C CEOC FSIZE LEV	1.10450 0.04170 0.85899 0.00593	0.543062 0.026923 0.395937 0.00410	2.03384 2.50627 2.16951 1.44726	0.0478 0.0242 0.0352 0.1546
R-squared Adjust R-squared S.E. of regression Sum squared resid Log-likelihood F-statistic Prob(F-statistic)	0.91533 0.90763 0.04246 0.08293 89.09743 14.98837 0.00734	Mean depen S.D. depend Akaike info Schwarz cr Hannan-Qu Durbin-Wa	ndent var dent var o criterion iterion iinn criter. tson stat	0.03048 0.04374 -3.40390 -3.25094 -3.34565 2.10320

From the table above, a high value of R^2 is given as 0.91533 implying that a 91.5% systematic variation in ROA is explained by CEOC, LEV and FSIZE. Only 8.5% is left unexplained and this is assumed to be captured by the stochastic error term, μ . This shows that the model is a good measure of fit determining the explanatory power of the model.

The adjusted R^2 is given as 0.90763. This means that after adjusting for the degree of freedom, the adjusted R^2 explains approximately 90.8% systematic variation in the dependent variable. The higher the adjusted R^2 , the lower the residual variance error due to a one-on-one relationship between the both of them and this means our model have a better predictive ability.

The F-ratio with the value of 14.98837 shows that the model easily passes the F-test at 5% level of significance and this means that the hypotheses of a significant linear relationship between the dependent and independent variables taken together are validated. It shows that the overall significance of the model is met.

The T-statistics using the rule of thumb (which states that when the t-value of the parameter estimate is greater than or equal to 2 then it is statistically

significant in explaining the dependent variable but when it is less than 2, then it is not). The t-values shows that CEOC and FSIZE which have values of 2.37769 and 2.16951 taken in their absolute form are statistically significant in explaining ROA while LEV is not statistically significant in explaining ROA with a t-value of 1.44726. This means that the variables are an important determinant in explaining ROA in the selected companies.

The Durbin Watson test for 1^{st} order serial correlation shows the absence of autocorrelation as we have a value of 2.10320.

A close observation of the coefficients shows that they are correctly signed based on the theoretical proposition. CEOC, FSIZE and LEV are positively related to ROA. The intercept and coefficients are interpreted as follows:

Intercept

The intercept of 1.10450 means that the model passes through the point 1.10450. This indicates that when all the independent variables are zero, then ROA is given by 1.10450units.

CEO Compensation (CEOC)

The coefficient of CEO compensation is 0.04171 which has a positive sign. This conforms to the standard theoretical proposition which postulates that CEOC increases ROA in companies.

The coefficient of 0.04171 implies that over the study period, on average, a one unit increase in CEOC will lead to a 0.04171 units increase in ROA. **Firm Size (FSIZE)**

The sign of FSIZE coefficient is positive. This conforms to the theoretical postulation which stressed that FSIZE is positively related to ROA. The coefficient of 0.85899 implies that a one unit increase in FSIZE will on the average lead to an increase in ROA by 0.85899units.

Leverage (LEV)

The sign of LEV coefficient is positive. This conforms to the theoretical postulation which stressed that LEV is positively related to ROA. The coefficient of 0.00593 implies that a one unit increase in LEV will on the average lead to an increase in ROA by 0.00593 units.

 Table 3. Panel Regression Result (Random Effect)

Variable	Coefficien	t Std. Error	t-Statistic	Prob.
C CEOC FSIZE LEV	1.07600 -0.01678 -0.86562 0.00582	0.54522 0.02731 0.40075 0.00432	1.97353 -0.61460 -2.16000 1.34781	0.0545 0.5418 0.0360 0.1843
	Effects Specification		S.D.	Rho



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Cross-section random Period random Idiosyncratic random		0.01019 0.02583 0.04041	0.0432 0.2775 0.6793
	Weighted	Statistics	
R-squared Adjusted R-squared S.E. of regression F-statistic Prob(F-statistic)	0.11254 0.05466 0.03926 1.94440 0.13565	Mean dependent var S.D. dependent var Sum squared resid Durbin-Watson stat	0.01312 0.04038 0.07090 1.49745
	Unweighted	1 Statistics	
R-squared Sum squared resid	0.11439 0.08302	Mean dependent var Durbin-Watson stat	0.03048 2.99041

From the result above, it can be observed that the parameters are not satisfactory in explaining the relationship between CEO compensation and Return on Asset. With respect to the t-values which show the individual significance of the model, judging by the rule of thumb which state that when the calculated t- value is greater than 2, then it is statistically significant. It shows that CEO compensation and leverage are not statistically significant in explaining ROA. This means the variables individually are not an important determinant of ROA in Nigerian companies.

With respect to the coefficient of the variables, it was observed that CEO compensation and firm size are negatively related to ROA which does not conform to theoretical proposition while LEV is positively related to ROA.

The DW statistics of 1.49745 shows the presence of autocorrelation in the model judging by the rule of thumb.

Table 4. Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	34.08325	6	0.0254

The table indicates the Hausman Test. It shows a Chi-Sq. Statistic of 34.08325 with the probability value of 0.0254 (P>0.05) indicating significant differences. This indicates that the correlated random effect is less than 5% (0.05). We, therefore, accept the fixed effect model on the basis for discussion of findings as well as hypotheses testing.

Table 5. Panel Regression Result (Fixed Effect)

Variable Coefficient Std. Error t-Statistic Prob.

С	1.70579	0.83690	2.03821	0.0496
CEOC	0.03019	0.04567	3.66102	0.0132
FSIZE	1.76389	0.72656	2.42773	0.0208
LEV	-0.00294	0.01937	-0.15183	0.8802

Effects Specification

Cross-section fixed (dummy variables
Period fixed (dummy variables)

R-squared	0.82508	Mean dependent var	0.03048
Adjusted R-squared	0.74633	S.D. dependent var	0.04374
S.E. of regression	0.04041	Akaike info criterion	-3.31488
Sum squared resid	0.05389	Schwarz criterion	-2.66479
Log likelihood	99.87204	Hannan-Quinn criter.	-3.06733
F-statistic	21.44939	Durbin-Watson stat	1.95437
Prob(F-statistic)	0.00023		

From the fixed effect regression estimation result, the R^2 of 0.82508 indicates that a 82.5% systematic variation in ROA is explained by CEO compensation, firm size and leverage while the 17.5% unexplained variation is assumed to be captured by the stochastic term.

The Adjusted R^2 of 0.74633 indicates that after adjusting for degree of freedom, R^2 was able to explain 74.6% systematic variation in the dependent variable. This shows that the model has a high predictive power.

The F-value of 21.44939 indicates that the model passes the F-test at 5%. This means that there is a linear relationship between the dependent variables (ROA) and the independent variables (CEO compensation, firm size and leverage) taken together. Hence, the overall significance of the model is met.

With respect to the t-values which show the individual significance of the model, judging by the rule of thumb which state that when the calculated t-value is greater than 2, then it is statistically significant. The result shows that CEO compensation and firm size are statistically significant in explaining ROA with the t-values of 3.66102 and 2.42773. This means the variables individually are an important determinant of ROA in some selected banks in Nigeria while LEV is not a significant determinant of ROA. This is indicated by the t-values of 0.15183.

With respect to the coefficient of the variables, it was observed that CEO compensation and firm size are positively related to ROA in some sampled bank in Nigeria while leverage is negatively related to ROA. The DW statistics of 1.95437 shows the absence of autocorrelation in the model judging by the rule of

autocorrelation in the model judging by the rule of thumb which the DW value is close to 2, it shows the absence of autocorrelation in the model.

7.3 Test of Hypotheses

Three hypotheses were raised and are hereby restated below:



 H_{01} : There is no significant relationship between CEO compensation and firm performance in the Nigerian banking industry.

 H_{02} : There is no significant relationship between firm size and firms' performance in the Nigerian banking industry.

 H_{03} : There is no significant relationship between Leverage and firms' performance in the Nigerian banking industry.

Using Rule of thumb, t-value from the Panel Regression Result (Fixed Effect) is used for the hypotheses testing. The table below summarizes the test and conclude whether they are significant or not at 5% level significance;

Table 6: Test of significance	Table	6: Tes	st of sig	nificance
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	0		
Variable	t-statistic	Critical	Conclusion
		Value	
		using	
		Rule of	
		thumb	
С	2.03821	2	Statistically
			significant
CEOC	3.66102	2	Statistically
			significant
FSIZE	2.42773	2	Statistically
			significant
LEV	/-0.15183/	2	Statistically
			insignificant

Researcher's Computation (2018)

Findings

H₀₁:

The first finding indicates a significant relationship between CEO compensation and firms' performance in the Nigerian banking industry with respect to the findings in table 7 using the rule of thumb (which states that when the t-value of the parameter estimate is greater than or equal to 2 then it is statistically significant in explaining the dependent variable but when it is less than 2, then it is not). The t-value show that CEOC value of 3.66102 taken in its absolute form is statistically significant at 5% level (p=0.0132). This shows that CEO's compensation does influence the banking industry performance. Consequently, we reject the null hypothesis and accept the alternate hypothesis, which states that there is a positive significant relationship between CEO compensation and firm performance in the Nigerian banking industry. Due to its observed statistical significance, it is seen to be consistent with the findings of Carpenter & Sanders (2002), Doucouliagos, Askary and Haman (2008), Barb (2008), Sigler (2011), Ozkan (2007), Ramadan (2013), Ismail, Yabai and Hahn (2014), Shakerin, Natalie and Low (2014).

The second finding indicates a statistically significant relationship between firm size and firms' performance in the Nigeria banking industry with respect to the findings in table 7 using the rule of thumb (which states that when the t-value of the parameter estimate is greater than or equal to 2 then it is statistically significant in explaining the dependent variable but when it is less than 2, then it is not). The t-value shows that FSIZE which has a value of 2.42773 taken in its absolute form is statistically significant at 5% level (p=0.0208). This shows that firm size does significantly impact on firm performance in the Nigerian banking industry. Consequently, we reject the null hypothesis and accept the alternate hypothesis, that there is a positive significant relationship between firm size and firms' performance in the Nigerian banking industry and in agreement with the findings of Sigler (2011) and Ozkan (2007).

H₀₃:

The third finding indicates a statistically insignificant and negative relationship between leverage and firms' performance in the Nigeria banking industry with respect to the findings in table 7 using the rule of thumb (which states that when the t-value of the parameter estimate is greater than or equal to 2 then it is statistically significant in explaining the dependent variable but when it is less than 2, then it is not). The t-value shows that LEV which has a value of -0.15183 taken in its absolute form is statistically insignificant at 5% level (p=0.8802). This shows that firm size does not significantly impact on firm performance in the Nigerian banking industry.

9. Conclusions

The study set out to investigate the influence of CEO compensation on firm performance in the Nigerian Banking industry. The finding of the study suggests a significant relationship between CEO compensation and firm performance. Also, size of a firm seems to be the most critical factor in determining the level of total CEO compensation.

Therefore, based on the findings, there should be proper compensation review as this will increase the productivity of the executives. Since increased pay is necessary for the efficiency of the workers and since workers may be more likely to work harder or more motivated if they believe that they will receive the desired reward if they hit an achievable target, it is advised to ensure a considerable pay as this will ensure efficiency in the organization.

H02:



Nevertheless, since the focal objective of setting up any business is to make a profit, business organizations usually sort out ways of maximizing profit. This includes cutting down expenses such as cutting down excessive employees' pay (CEOs pay especially) and setting appropriate pay package for its employees. Thus, there is need to sensitize executives in Nigeria banks on the need to align their payment to performance measures as these measures are directly linked to wealth maximization and firm performance.

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