

1 **EFFECT OF DIRECTOR’S TUNNELING ON ASSETS UTILIZATION: EVIDENCE**
2 **FROM CORPORATE ORGANIZATIONS IN NIGERIA**

3
4 **Abstract**

5 *This study evaluates the effect of director’s tunnelling on asset utilization of companies in*
6 *consumer goods sector in Nigeria using a panel data collected from annual financial report of*
7 *thirty listed consumer goods firm in Nigeria between 2011 and 2016. The study was based on ex-*
8 *post-facto research design and the data collected were analysed using descriptive statistics,*
9 *correlation analysis and multiple regression. The study finds that the director’s pay and equity*
10 *holding varies widely among consumer goods firms. Chairman’s pay and director’s equity*
11 *holding have a statistically significant effect on asset utilization at 5% level. While the director’s*
12 *pay policy has no statistically significant effect on asset utilization. The finding shows pay,*
13 *chairman’s pay and director’s equity holding are three major avenues used for tunnelling as*
14 *they have a significant effect on tunnelling. The study recommends that policymaker should*
15 *formulate a policy that will reduce the tunnelling tendency of directors and board chairman.*

16
17 **Keywords:** *Director’s tunnelling, Director’s pay, asset utilization, Chairman’s pay and*
18 *Director’s equity holding.*
19

20 **INTRODUCTION**

21 The competitive business environment has placed a greater responsibility on manager’s which
22 require the use of professional skill, experience and discretion taking some decision especially
23 those relating to operations of the firm. This privilege most times enhances the manager’s
24 investment opportunity set which contributes to positively toward increasing the information
25 asymmetry problems between executives and shareholders (Robert (2011). Elijah, William and
26 William (2003) observed that in such an atmosphere, a greater degree of managerial discretion
27 will be required and there is no assurance that the self-interested behaviour of directors will
28 conform to the expectations of shareholders thereby reducing agency problems. In an attempt to
29 reduce and ensure the conformity of executive interest to that of a shareholder, corporate
30 governance and incentives package has been used as the alignment for both interest.

31 Asset utilization is a tool used in indentifying asset opportunity gap. It measures the
32 difference between what an asset is capable of producing and what it actually produces. The
33 opportunity gap if properly measured can be used as a metric for focusing reliability efforts or
34 planning and performance enhancement. The non-directors and executive directors'
35 compensation are based on the performance of the firm. A director like the chief executive
36 officer has an incentive for a good performance. Hence the maximum utilization of asset is of
37 great importance to the management like another organizational goal due to its interest in
38 performance-based incentives. According to Weisbach (2006), executive directors have the
39 incentive to keep their jobs and they can provide additional benefit to non executive directors in
40 many different ways. This gives the non executive directors the incentives to act on behalf of the
41 executive directors. This give and take the relationship between the executive directors and the
42 non executive directors has made the director's tunneling come under increased public scrutiny
43 especially in most developed countries. The performance of every organization depends on how
44 effective and efficient they are able to utilize the assets available. directors compensation
45 increases when the performance of the organization is high compared to when it is low especially
46 when the company operates a fractional compensation (when director bonuses is a percentage of
47 the profit). This compensation system encourages the executive director to work harder and it
48 also aliens the interest of both the shareholder to that of the executive director. Such a system can
49 reduce tunnelling tendencies (Weisbach 2006).

50 Various studies have been carried out on the effect of director's tunnelling on the
51 performance of firms those studies include; Guohua, Charles and Heng (2008), Thomes (2013),
52 Kevin and Leigh (2003), Takao and Cheryl (2005), Kun and Xing (2012) Ridwan, Fitri and
53 Barto (2015), Mohammad (2015), Wenqian, Georgakopoulos, Ioannis and Konstantinos (2011)

54 most of those studies were carried out in developed countries whose legal and business
55 environment differs from developing nation like Nigeria and they evaluate the nexus between
56 tunnelling and performance. There is a need to evaluate this relationship under the Nigeria
57 context. Thus the main objective of the study is to evaluate the effect of director's tunnelling on
58 asset utilization of companies in the consumer goods sector of Nigeria. Its specific objectives
59 include:

- 60 i. Ascertain the effect of Director's pay on assets utilization of firms in Nigeria.
- 61 ii. Examine the effect of Chairman's pay on assets utilization of firms in Nigeria.
- 62 iii. Determine the effect of Director's Equity Holding on assets utilization of firms in
63 Nigeria.

64

65 **LITERATURE REVIEW**

66 **Conceptual Framework**

67 The term tunnelling was coined originally to characterize the expropriation of minority
68 shareholders in the Czech Republic to describe the transfer of assets and profits out of firms for
69 the benefit of those who control them (Henemana & Schwab 1972). Director's tunnelling is the
70 transfer of company resources out of its shareholder reach for personal use and gain. This may
71 come in two ways: a controlling shareholder can transfer resources using the executive director
72 (which his appointment and continuation of the office can be majorly determined by him) from
73 the firm for his own benefit through insider dealings and transactions. Such transaction includes
74 theft or fraud which is illegal, it can also use assets sales (below market value) and contracts such
75 as transfer pricing advantageous to the controlling shareholder, excessive executive
76 compensation, loan guarantees, expropriation of corporate opportunities. Secondly; the

77 controlling shareholder can increase his share in the firm without transferring any assets through
78 dilutive share issues, right issue, minority freeze out, insider trading, creeping acquisition or
79 other financial transactions that discriminate the minority shareholder.

80 The main conditions enabling such fraud are weak law against conflict of interest, non-
81 existent legal liability of managers for leading their employer towards bankruptcy, and
82 incompetence of financial authorities. In tunnelling assets, profits, or corporate opportunities, the
83 controlling shareholder can expropriate minority shareholders through financial transactions,
84 such as diluting their stakes through a closed subscription to new shares. Dwinanto (2010)
85 examine the effect of insider director on tunnelling activities using a cross-section of 395 firms
86 listed in Indonesia stock exchange in 2009. The finding reveals that firms with a high level of
87 insider director are highly prone to resource tunnelling than firms with lower insider director.
88 Guohua, Charles and Heng (2008) examine tunnelling in China, using inter-corporate loans as a
89 measure of tunnelling. The made use of selected listed firms in Shanghai stock exchange
90 between 1996 and 2006. The data collected were analysed using panel regression approach. The
91 finding reveals that the director's incentives to tunnel firms resources diminish as controlling
92 shareholder ownership increase.

93 **Theoretical Literature**

94 **Director's Expropriation, Tunneling, and Shareholders of quoted firms'**

95 Expropriation is an action taken by controlling shareholders with the intention to benefit through
96 either legal or illegal methods (Faccio et al., 2001). When the flow of benefits that are enjoyed
97 by the controlling shareholders is clearly perceptible, it can be identified as moving in one of two
98 directions: from the subsidiary to the parent company or from the parent company to its
99 subsidiary. Johnson et al. (2000) argue that the term of tunnelling refers to the expropriation

100 activity conducted by the controlling shareholders of a company in the lower level (e.g.,
101 subsidiary) to the higher level (parent company). The term "propping" leads to the opposite
102 condition in which the controlling shareholders drain either funds or resources from the parent
103 company to a subsidiary.

104 The exploitation of minority shareholders by controlling shareholders has attracted the attention
105 of researchers. For instance, Shleifer and Vishny (1986) find that when the majority shareholders
106 control the company, the agency problem is no longer about the conflict of interest between
107 management and shareholders but about how to prevent controlling shareholders from exploiting
108 minority shareholders. Tunnelling is not only detrimental to the interests of minority
109 shareholders but also seriously precludes the development of the capital market (Wurgler, 2000;
110 Bertrand et al., 2002).

111

112 **Director's Tunneling and Asset Utilization**

113 Asset utilization can be used as a tool used to identify the asset opportunity gap and it could be
114 measured the difference between what an asset is capable of producing and what it actually
115 produces. The director can approve the sales of asset which they underutilize to another company
116 which the major shareholder has interest in. The underutilization of the asset is to show that the
117 asset is absolute or not functioning properly. They also support the transfer pricing scheme
118 which favours the other firm which the major shareholder has interest in. The diversion of
119 resources using such scheme favour's the majority shareholder at the expense of the minority
120 shareholder and can be successfully done with the collaboration of the board of director which
121 the majority shareholder control through its agent in the board. Tunnelling can be done through
122 high compensation scheme to the board members. The resulting concerns have led to demands

123 for greater transparency in executive stock option programs and, possibly, the elimination of the
124 programs altogether. Since additional incentives are tied to performance, executive directors tries
125 all within their reach to improve and increase their performance, this have direct impact on the
126 level of asset utilization.

127 **Theoretical Framework**

128 **The Agency Theory.**

129 This study is anchored on the agency theory as propounded by Jensen and Meckling
130 (1976). The agency theory mainly explains the relationship between the principal (shareholders)
131 and the agent (Managers) of the principal and how it relates to the investment decisions of the
132 firm. They postulated that due to a continuous devaluation of equity ownership of large
133 corporations, ownership and control became more separated. This situation gives directors the
134 opportunity to pursue their interest at the expense of that of the shareholders as this goes a long
135 way in explaining the tunnelling decisions of directors and what they stand to gain.

136 **Empirical Review**

137 Several studies have been carried out on directors tunnelling and performance of firms
138 below are some of the works revealed.

139 Thomas (2007) study executive tunnelling and executive compensation of listed firms in
140 the United State of America between 2000 and 2005. Thomas develops a new model in which
141 resource diversion, director compensation and corporate performance are simultaneously and
142 endogenously determined. The finding reveals that the director's compensation directly reduces
143 the director's tunnelling tendency. The study of Takao and Cheryl (2005) evaluate executive
144 compensation, firm performance and corporate governance in of listed firms in Shanghai stock

145 exchange between 1998 and 2002. The findings reveal that: Executive compensation positively
146 affects sales growth. Government ownership negatively affects director compensation.

147 In another related study carried out by Ridwan, Fitri and Berto (2015) on the director's
148 tunnelling: using firms quoted in Indonesia stock exchange using 277 listed firms between 2005
149 and 2012. The study used board size, outsider's directors, group ownership and big five
150 ownership. The finding reveals that firms with family and state ownership experience more
151 tunnelling activities than others. The study also finds that family, state and leverage ownership
152 structure has a positive effect on tunnelling. A related study was carried out in the USA between
153 1992 and 1993 by Klien (2004), abnormal accrual was used as a measure for the director's
154 tunnelling. The study finds that firm's with majority independent director to minority
155 independent director structure experience a large increase in abnormal accrual than other with
156 minority independent director.

157 Kun and Xing (2012) examine controlling shareholder tunnelling and executive
158 compensation of 6,670 quoted firms from China between 1999 and 2005. The finding shows that
159 if the director's incentives scheme are adopted, controlling shareholders who obtain private
160 benefit from companies will have less incentive to do so. In another study by Chrisostomos and
161 Aydin (2006) on the impact of managerial entrenchment using firm quoted in UK stock
162 exchange. The study finds a negative relationship between asset turnover ratio (an inverse proxy
163 for agency cost) and managerial entrenchment. The finding also reveals that managerial
164 incentives positively moderate managerial entrenchment and asset turnover.

165

166

METHODOLOGY

167 The study used longitudinal data and was based on ex-post-facto research design. The
 168 longitudinal data used were collected from the financial statement of quoted consumer goods
 169 firms in the Nigeria Stock Exchange between 2007 and 2016. The longitudinal data were
 170 collected from all the quoted consumer goods companies in Nigeria within the period of ten
 171 years. The variables and their proxy were operationalization of variables are follow.

Variables	Proxy/ Measurement	Authority's
Dependent variable		
Asset utilization (ASUT)	Total asset turnover = Sales revenue / Total asset-depreciation	Gladys, & Job, (2017) and Kakja (2009).
Mediating variables		
Director pay (DAY)	Director's pay /Operating expenses	Thomas (2007) Kelvin et al (2003)
Chairman pay (CHPAY)	Chairman pay / Staff cost	Imam and Dewi (2015)
Director's equity holding (DEQH)	Director's equity holding/ Total equity	Kun and Xing (2012)
Covariate		
Firm performance	Return on Assets = net earnings / Total asset	Ifurueze et al (2013)
Firm size (SIZE)	Log of total assets	Ifurueze et al (2013)

172

173 *Model Specification*

174 The model for this study is premised on the main objective and was adopted from the work of
 175 Kun and Xing (2012) and modified to suit the variables used in this study.

176 The model for the study is anchored on the objective.

177 $ASUT = f(DPAY, CHPAY, DEQH, ROA, SIZE) \dots\dots\dots 1$

178 This can be econometrically express as

179 $ASUT_{it} = d_0 + d_1DPAY_{it} + d_2CHPAY_{it} + d_3DEQH_{it} + d_4DIVP_{it} + d_5ROA_{it} + d_6SIZE_{it} + \mu_{it} \dots 2$

180 Equation 1 is the linear regression model used in testing the null hypotheses.

181 Where:

182 ASUT = Asset utilization; DPAY = Director's pay; CHPAY = Chairman Pay; DEQH =
 183 Director's equity holding; ROA = return on asset; SIZE = Firm size; d_0 = Constant; $d_1 \dots d_6$ = are
 184 the coefficient of the regression equation. μ = Error term; i = is the cross section of firms used; t
 185 = is year (time series); log = Logarithm.

186

187 **DATA ANALYSIS AND DISCUSSION OF FINDINGS**

188 In analyzing the data, the study adopted multiple regressions. However, some preliminary
 189 analysis such as descriptive statistics, correlation matrix and diagnostic test like normality test,
 190 multi-collinearity and autocorrelation test were done to ascertain the nature, characteristics and
 191 normality of the data used in the study. The variables for this study included firm financial
 192 performance metric like assets utilization (ASUT), as the response variable while the explanatory
 193 variables are the director's pay, chairman pay, and director's equity holding. Firm size and firm
 194 performance were used as covariate variable.

195 **Descriptive Statistics**

196 The descriptive statistics result shows the mean (average) for each of the variables, their
 197 maximum values, minimum values, standard deviation and the Ryan-joiner test (normality test).

198 Descriptive Statistics Table:1

Variables	Mean	Max	Min	Std Dev	Ryan-Joiner (RJ)	RJ (P-value)
ASUT	1.1142	2.3899	0.1224	0.4688	0.078	0.130
DPAY	0.1644	0.4909	0.0700	0.0673	0.896	0.010*
DEQH	0.3484	0.5600	0.1820	0.0783	0.983	0.017*
CHPAY	0.1325	0.1889	0.1000	0.1701	0.896	0.010*
SIZE	0.3589	0.9570	0.1388	0.1812	0.898	0.001*
ROA	7.1065	8.1438	5.6314	0.6350	0.977	0.010*
No of cross section	-	-	37	-	-	-

199 Source: Researcher's (2017) summary of descriptive statistics from Minitab 16.

200 Note: *1% level of significance **5% level of significance
201

202 The result provided some insight into the nature of the data collected from the selected firms that
203 were used in the study. Firstly, it was observed that within the period under review, the sampled
204 firms asset utilization have a mean value of 1.1142, maximum and minimum value of 2.3899 and
205 0.1224 respectively. The large difference between the maximum value and the mean value and
206 between the minimum value and the mean value shows that the sampled firms used for the study
207 are not dominated by either firm with high asset utilization ratio or firm with low asset utilization
208 ratio. Secondly, it was observed that on the average over the period, the selected firms have
209 director pay value of 0.1644, maximum and minimum director's pay value of 0.0700 and 0.4909
210 respectively, the large difference between the maximum and minimum director's pay reveals that
211 gyrating nature of the director's pay among the selected firms. The causes of the large variation
212 in director's payment may be attributable to the size of the firm and director's influence in the
213 board which fix the pay. Director's equity holding has a mean value of 0.3484, the maximum
214 value of 0.5100 and a minimum value of 0.1820. The mean value indicates that the director's
215 holds about 34.8 per cent of the shares of the selected firms. While in some firms the director's
216 holding is about 18.2 per cent. On the maximum, the director's holding is about 56 per cent. The
217 table also reveals the chairman's pay's for the selected firms, the ratio of chairman's pay to total
218 staff pay on the average is 13.54 per cent, the minimum payment is 10 per cent while the
219 maximum pay is 18 per cent of total staff pay. The close value between the maximum and
220 minimum chairman's pay reveals that the chairman's pay of the selected firms are almost
221 similar. Lastly, the Ryan joiner (RJ) which test for normality of the data or the existence of
222 outlier or extreme value among the data in the variables used shows that all the variables are
223 normally distributed at 1% level of significance except asset utilization. The result means that

224 there is no independent variable with outliers, even if there is any variable with outlier, they are
 225 not likely to distort our conclusion, hence our result is reliable for drawing generalization. This
 226 also means that ordinary least square estimation techniques can be used to estimate the panel
 227 regression model.

228 **Correlation Analysis**

229 In examining the relationship between the variables, the study employed the Pearson correlation
 230 coefficient.

231 Pearson correlation analysis Table:2

Variables	ASUT	DPAY	DEQH	CHPAY	SIZE	ROA
ASUT	1.000					
DPAY	-0.035	1.000				
DEQH	-0.287	0.009	1.000			
CHPAY	-0.334	0.256	0.227	1.000		
SIZE	0.193	0.322	0.061	-0.481	1.000	
ROA	-0.224	0.031	0.741	0.156	0.064	1.000

232 Source: Researchers summary (2017) of Minitab 16 correlation analysis

233 The use of a correlation matrix is to check for multi-collinearity and to explore the relationship
 234 between the explanatory variable and the dependent variable.

235 The findings from the correlation analysis table show that asset utilization has a negative
 236 relationship with the director’s pay, director’s shareholding, chairman’ pay, return on asset. But
 237 has a positive relationship with firm size. This shows that large firms have a high asset utilization
 238 ratio than smaller firms and the higher the director’s pay, director’s shareholding, chairman’ pay,
 239 the less the firm utilizes their assets. Director’s pay has a positive relationship with the
 240 chairman’s pay, director’s shareholding, firm’s size and returns on asset, this reveals the give and
 241 takes politics of the board. When the director’s pay increases, chairman pay tend to increase also,

242 this increases the wealth of the director with which they increase their shareholding. Chairman's
 243 pay has a strong positive relationship with director's equity holding, return on asset and weak
 244 relationship with firm size. The strong relationship between the chairman's pay and director's
 245 equity holding shows the influence of director's in fixing the chairman pay.

246 In checking for multi-collinearity the study noticed that no two explanatory variables were
 247 perfectly correlated. This indicates the absence of multi-collinearity problem in the model used
 248 for the analysis and justifies the use of the ordinary least square.

249 **Regression analysis:**

250 Summary of regression analysis Table:3

	DPAY	CHPAY	DEQH
Coefficient	0.5459	2.5778	1.5959
T-value	0.78	2.47	-2.36
P- value	0.439	0.014	0.020
R. sq	59.5		
R. sq(Adj)	54.2		
F-start	3.71		
F-stat P-value	0.002		
Durbin Watson	1.7146		

251 Source: Researchers summary of OLS regression Analysis from E-view 9.5

252 The above table report, the OLS regression result. The OLS result follows the assumption of
 253 homogeneity hence there is the absence of **heteroscedasticity**. In the table above, the study
 254 observed from the result the R. sq value of 59.50 and R-sq(adj) 54.2(54.2%) this indicates that all
 255 the independent variables jointly explain about 54.2% of the variation in asset utilization of the
 256 sampled firms. Hence about 54.2% of the asset utilization level of consumer goods firms can be
 257 attributable to the director's tunnelling. The F-statistics value of 3.71 and its probability value of
 258 0.002 shows that director's tunnelling has an effect on asset utilization and the effect is

259 statistically at 1% levels. The Durbin Watson statistics result was 1.7146 can be approximated
260 into two, this indicates the absence of autocorrelation in our model hence the model used is
261 appropriate for the study.

262 *1: Board of Director's pay does not have a significant effect on the asset utilization of companies*
263 *in the consumer goods sector in Nigeria.* The analysis result showed a coefficient value of
264 0.5459, t-value of 0.78 and a P-value of 0.439. The coefficient value which reveals the degree of
265 variation caused by the individual independent variable to the dependent shows a positive value
266 of 0.5459, this reveals that directors pay positively influences the asset utilization of firms. The t-
267 value of 0.78 shows that directors pay has a positive effect on the asset utilization of firms
268 (though the effect is small). The probability value of 0.439 shows that the effect of directors pay
269 on asset utilization of firms is not statistically significant.

270 *2: Chairman's pay does not have significant effects on the asset utilization of firm in the*
271 *consumer goods sector in Nigeria.* The result of the regression analysis of the effect of
272 Chairman's pay on asset utilization showed a coefficient value of 2.5778, t-value of 2.47 and a
273 P-value of 0.014. The coefficient value of 2.5778 indicates that a 1 unit increase in chairman pay
274 may lead to about 2.58% positive increase in the asset utilization of firm in Nigeria. The t-value
275 of 2.47 reveals that the changes in chairman pay have a strong effect on the asset utilization of
276 firms in Nigeria. The probability value of 0.014 reveals that the effect of chairman pay on the
277 asset utilization of firms in Nigeria is statistically significant at 1% level.

278 *3: Director's equity holding has no significant effect on asset utilization of companies in the*
279 *consumer goods sector in Nigeria.* The analysis result showed a coefficient value of 1.5959, t-
280 value of -2.36 and a P-value of 0.020. The coefficient value which reveals the degree of
281 influence/variation caused by the Director's equity holding to the dependent shows a positive

282 value of 1.5959, this reveals that Director's equity holding positively influence the asset
283 utilization of consumer goods firms. The t-value of 2.36 (above absolute 2) reveals that the
284 director's shareholding has a positive effect on the asset utilization of firms in Nigeria. The
285 probability value of 0.020 reveals that the effect of director's shareholding on asset utilization is
286 statistically significant.

287 **Discussion of Finding**

288 The analysis result shows that the director's pay and director's equity holding varies widely
289 among consumer goods firms. The dividend policy of consumer goods firm also varies widely
290 within the period under review. The result (correlation) shows that asset utilization is negatively
291 related to the director's pay, chairman pay and director's equity holding, thus the higher the
292 tunnelling the lower the asset utilization. The strong positive relationship between director's pay
293 and director's equity reveals that director tunnel firms using pay and other incentives scheme.
294 The regression analysis reveals that the chairman's pay and director's equity holding are
295 statistically significant. Hence the director's pay, chairman's pay and director's equity holding
296 are three major avenues **for director's tunnelling. The more** the director's tunnel the firm's
297 resources the less they tend to be in their asset utilization.

298 The result also reveals **that the director's equity** holding and board chairman **pay has a positive**
299 influence and effect on asset utilization of consumer goods firms. This finding is in line with that
300 Imam and Dewi (2015), Takao and Cheryl (2005), but contrary to that of Guohua, Charles and
301 Heng (2008). While director's pay and dividend **policy has an effect but** the effect is not
302 statistically significant on the asset utilization of consumer goods firms in Nigeria this finding is
303 in line with the study of Thomas (2007) and Christomas and Aydin (2006).

304 **Conclusion**

305 The result provides useful information insight for managers, shareholder and policymaker which
306 can aid them in planning and formulating policy that can curtail the tunnelling activities of
307 directors. A well-motivated employee can achieve much with little hence the welfare of the
308 director should be of most importance to shareholding but the give and take politics of the board
309 has bred a moister on his wing tunnelling strive.

310

311 Recommendation

312 Based on the findings, the study recommends that relevant Regulatory agency should formulate a
313 policy that increases and regulates director equity holding as this will reduce the incentive to
314 tunnel. Also, the chairman (non-executive director) allowances should not be fixed by the
315 executive directors rather it should be fixed by the entire shareholder during the annual general
316 meeting to reduce the influence of the executive directors and the give and take politics of the
317 board. Furthermore, a joint committee comprising of members of the board of director and
318 selected shareholder be set up to review the proposed non-executive directors allowances before
319 the final approval by the entire members during the annual general meeting.

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UNDER PEER REVIEW