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Azubike O. Oraka
Department of Accountancy
Nnamdi Azikiwe University, Awka
zubbike@gmail.com

EFFECT OF RELATED-PARTY TRANSACTION (RPT) ON FINANCIAL PERFORMANCE: EVIDENCE FROM NIGERIAN CONGLOMERATE FIRMS (2010-2019)

***Abstract**: This paper determined the effect of related-party transaction (RPT) on financial performance of Nigerian conglomerate firms. Ex Post Facto research design was adopted. The study selected five Nigerian Conglomerate firms using stratified random sampling and the simple random sampling method and obtained data using their audited annual accounts from 2010 to 2019. The formulated hypotheses were tested using Ordinary least square with E-view 9.0. The findings suggest that related party transactions do not has significant effect on earnings per share of conglomerate firms in Nigeria. Meanwhile related party transactions have significant influence in determining the Tobin Q of conglomerate firms in Nigeria. The study recommended that related party transactions however, should be minimized to avoid the likelihood of transgressing into a fraud opportunity for management.*

***Key words**: Related-party transaction, Financial performance, Conglomerate firms.*

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Introduction

In the course of doing business, transactions may be undertaken between related parties. Such transactions are considered usual and normal in today's trade and commerce. As such, many firms are involved in related party transactions (Gina, 2012). For example, a business may assign part of its operating activities to an investor who has significant influence or control over its financial and operating policies. However, related-party transactions are among the recurring areas of concern raised by recent corporate scandals**.** Several scandals in the U.S. and other parts of the world have cited RPTs as a means to manage earnings as well as divert resources from their companies. Accounting frauds in Enron, Tyco, Parmalat, and Satyam are glaring examples of the same. Kohlbeck and Maydw (2010) reported that these transactions are diverse complex business transactions between the company owners and their managers.

According to Padmini (2013), related-party transactions are uneasy to audit as well a potential indicator of audit risk. Related party transactions can be considered as one of the most common opportunistic behavior by management, while commercial activities' common features are held, it can also dramatically affect the performance of a firm. The little research has been done in this area; all indicate that there is an inverse relationship between these transactions and management performance in line with value creation for shareholders (Hadi, 2016). One of the basic assumptions of agency theory is that management to maximize its own personal benefits will take advantage of the company resources and related party transactions, often in favor of the managers and detriment of shareholders, is a kind of resource consumption of company (kahbalak & Bryan, 2004 in Hadi, 2016). Such abuses by the management, in addition to disrupting value creation, can also threaten job security of administrators, so administrators to protect against the bad effects of these transactions may distort the financial statements that it also will obscure of the process of value creation in the long run, because it will expropriate

them to make an informed decision due to distorted information (Henry, Gordon, Reed & Louwers, 2007).

Related-party transactions (RPTs) are defined as transactions between a company and its management, board members, principal owners, or members of the immediate families of any of these groups. Additionally, related-party transactions are transactions occurs between a company and its affiliates, these affiliates are those entities which are controlled by the company or they are controlled by another entity which also controls the company (Chen, Chen & Chen, 2009). For example, raising capital, acquiring production inputs, selling firm outputs, hiring employees, leasing assets, purchasing and divesting assets and signing franchising agreements are commonly referred to as related-party transactions. Related parties can therefore use their influence to procure such items and influence them in their favour. More importantly, as (RPTs) are usually made through complicated transactions between the company and its managers, directors, subsidiaries and major shareholders; it is hard for outsiders to discover questionable or fraudulent transactions, this as noted by Wahab, Haron and Yahya (2011) may have severe implication for the performance of firms.

However, related-party transactions create potential conflicts of interest illustrative of the principal-agency conflicts in Gordon et al, (2004) and thus economically harmful to the performance of firms. For example, although, directors and officers of corporations are charged with the duty of entering into contracts that maximize shareholders wealth, this duty is undermined by RPTs which benefit insiders but extract value from the firm and pose a major risk to outside investors in many countries (Baek, Kang & Lee, 2006; Cheung, Rau & Stouraitis, 2006). Recent accounting scandals have also raised considerable concern among regulators and stock market participants about related-party transactions. Enron's, Adelphia's and Parmalat's crises shed light on the inherent risks as related-party transactions emerged as a powerful instrument of financial frauds, shareholders' expropriation, etc., pulling back the veil to reveal many relevant loopholes affecting existing requirements. Matteo and Marco (2014) studies concludes that related party transactions and companies' financial performance results are not correlated and that there is no evidence of a cause-effect relationship. This view is corroborated by the studies of Kohlbeck and Maydew (2010) documented that firms reporting RPTs may be connected to poor financial performance and weaker corporate governance practices. RPTs may imply moral hazards, and can be carried out in the interest of directors in order to expropriate wealth from shareholders. It appears therefore that RPTs are inconsistent with shareholder wealth maximization.

Related-party transactions are a facet of corporate governance, due to the fact that they are usually comprised of complicated transactions between a company and its managers, directors, subsidiaries and major shareholders (Jian & Wong, 2010). It is a fact that related-party transactions result in higher agency costs due to the alignment of decision-making rights and monitoring rights. According to Gina (2012), some fundamental traditional accounting performance measures such as return on equity, return on assets, earnings per share, Tobin Q among others may be affected by related-party transactions (RPTs). A related party relationship could have an effect on the financial performance of a business entity. This is so because related parties may enter into transactions that unrelated parties would not. For instance, an entity that sells goods to its parent company at reduced selling price may not sell on those terms to another customer. Borrowing or lending money at an interest rate that differs significantly from prevailing interest rate may be a result of a related party involvement. It is possible that transactions between related parties may not be made at the same amounts as between unrelated parties. Now, even if related party transactions do not occur, the financial position and financial performance may still be affected by the mere existence of the relationship between related parties.

Empirical studies produced mixed results. This could be as a result of diverse means of measuring variables. The most prior studies on related party transaction were mostly carried out in foreign countries. On these note, this study intend to determine whether related-party transaction has affected financial performance of Nigerian conglomerate firms using earnings per share and Tobin Q as a performance measure.

REVIEW OF RELATED LITERATURE

Related-Party Transactions (RPTs)

Related-party transactions are defined as transactions between a company and its subsidiaries, affiliates, principal owners, officers or their families, directors or their families, or entities owned or controlled by its officers or their families (Claessens, Fan & Lang, 2006). The parties involved in the transactions could be a parent company and its subsidiaries, affiliates, employees, the principal owner, directors or management of the company and the subsidiaries, or members of their immediate families. Therefore, related-party transactions are common for firms affiliated to business groups, since most group members do a lot of RPTs within their own groups (Chen & Chien, 2007). These transactions are likely to cause wealth transfers out of a company for the benefit of shareholders with a controlling interest (Johnson et al., 2000). For example, sellers may inflate earnings simply by shifting next period's related sales to the current period (Khanna & Yafeh, 2005) or a Chief Executive Officer (CEO) may receive a lower salary (Gordon,

Henry & Palia, 2004) and the interest rates on related loans may be unfairly priced, given the potential for default (Shastri & Kahle, 2004).

Related party transactions are a normal feature of business yet it can distort financial reports. IAS 24 prescribes the disclosure requirements for related party transactions. A related party relationship could have an effect on the financial position or performance of a business entity (Beerbaum &Piechocki, 2017). Related parties may enter into transactions that unrelated parties would not (Jian & Wong, 2010). For instance, borrowing or lending money at an interest rate that differs significantly from prevailing interest rate may be a result of a related party involvement. It is possible that transactions between related parties may not be made at the same amounts as between unrelated parties. Now, even if related party transactions do not occur, the financial performance may still be affected by the mere existence of the relationship between related parties. For example, a company may terminate its business relations with a trading partner because it made a substantial investment in a company that is engaged in the same line of business as the former trading partner. International Accounting Standard (IAS) 24 defined related party transaction as “a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged” (Beerbaum &Piechocki, 2017).

As the first researchers use the word “RPT” to describe the misuse of company funds by controlling shareholders, Johnson, La Porta, Lopez-de-Silanes and Shleifer (2000) list several methods by which it is achieved: transferring growth opportunities belonging to listed company to themselves or their subsidiaries; transferring profits via intra-group transactions from listed companies to other subsidiaries they own or control; using assets or capital belonging to the listed company or using them as collateral or guarantees for their financing activities; and capital operations aimed at diluting the interests of other shareholders. Friedman et al. (2003) propose a model showing how large shareholders tunnel or prop listed companies in different financial positions. Meanwhile, companies with a pyramid ownership structure are more likely to be tunneled, but are more likely to be propped when facing adverse shocks.

Jian & Wong (2010) examine other receivables in Chinese listed companies to examine the nature, content and economic consequences of controlling shareholder behavior. Jian and Wong (2010) point out those abnormal related sales are one means of propping used by the controlling shareholders of listed companies, and that it is more prevalent in state-owned listed companies and regions with a poor institutional environment.

Financial Performance

Financial performance involves how well a firm can utilize its assets in order to generate revenues. It is a means of measuring the firm's general financial strength at a given period of time, as well used to compares similar firms across the same industry or to compare industries or sectors in aggregation (Lin, Liu & Keng, 2010; Wu, et.al, 2010; Khanna & Palepu, 2005). In the same vein, Amzaleg & Barak (2011) stressed that the term financial performance refers to a firm's ability to generate revenue and measure of a company's ability to generate income over a given period of time.

Financial performance arises from the incongruence of the interests of the equity owners and managers, and significant research has been conducted towards resolving it (Chen & Chien, 2007). Akinsulire, (2008) points out that no performance review is beyond dispute, for instance, reported profit is a matter of opinion. If income is to be measured in terms of the increase or decrease in the wealth of an enterprise, obviously some definitions of that stock of wealth is required.

Earnings per Share

The earnings per share ratio (EPS ratio) measure the amount of a company's net income that is theoretically available for payment to the holders of its common stock. This is considered as the widely used financial performance benchmark (Graham, Harvey & Rajgopal, 2004) results on earnings per share is such that can affect investors decision of a company’s stock.EPS is also the linchpin undergirding strategic decision-making like share valuations, management performance incentive schemes, and merger and acquisition negotiations(Johannes de Wet, 2014)

Most investors are familiar with the valuation multiple, the P/E ratio, which has EPS as the denominator and the continued relevance of EPS and EPS growth in modern-day share valuation methodology is still widely acknowledged. Adkins et al attribute the obsession with EPS to the fact that EPS neatly summarizes the earnings generated for shareholders and the shareholder’s view appeals to investors and management alike

Tobin Q

Another type of measurement is the market-based measurement Tobin Q which is categorized as long-term. Tobin’s Q can be as a traditional measure of expected long-run firm performance (Bozec, Dia & Bozec, 2010). The employment of market value of equity may represent the firm’s future growth opportunities which could stem from factors exogenous to managerial decisions and this is indicated by the companies’ level (Shan & McIver, 2011; Demsetz & Villalonga, 2001).

In addition, a high Tobin Q ratio shows success in a way that the firm has leveraged its investment to develop the company that is valued more in terms of its market-value (Kapopoulos & Lazaretou, 2007). Moreover, market-based expectations for firm

performance may result in management incentive to modify their holdings on the basis of their expectations of the future performance of the firm (Sánchez-Ballesta & García-Meca, 2007). When the company's market-based performance is higher than that of Tobin's Q, it shows that the company has succeeded in achieving its planned high performance (Nuryanah & Islam, 2011) but if it is less than Tobin's Q, then the company needs to revisit its plans to enhance its short-term performance.

Review of Empirical Studies

Several studies have been carried out on the relationship between related-party transactions and financial performance of companies, although, majority of these studies were carried out in developed countries, specifically, European countries. Cheung, Rau & Stouraitis (2006) examined transaction between 232 publicly-listed firms in Hong Kong and their controlling shareholders and directors where expropriation might occur and shows their incidence and valuation effect. Using data obtained from a sample of 328 connected transactions of these listed companies within 1998-2000. It was shown that on average, firms announcing connected transactions earn significant negative excess returns. Chien and Hsu (2010) investigated the effect of related party transaction on firm performance of public companies listed on Taiwan stock exchange within years 1996-2006. Multiple regressions were used to test the relationship between the variables. The result revealed that related party sales, interest revenue and interest expense though negative, were statistically significant and the other variable were negative and insignificant. Aharony, Wang and Yuan (2010) determined the related party transactions and the incidence of tunneling by firms that made a first-time issue of common shares to the public on the Shanghai Stock Exchange during the period 1999–2001. They find evidence of tunneling practices among Chinese companies, through non-repayment by Chinese parent companies of net outstanding corporate loans made to them by their newly listed subsidiaries. Pouzaly and Venouty (2013) investigated the relationship between related party transactions and the company's financial performance presented in Italy during the period 2008-2011. Their regression test results indicate that there is no correlation between the related party transactions and the company's financial performance. Gina (2012) ascertained the status of related party disclosures of a sample of Indian companies for the financial years 2002- 2006. Using content analysis, the study showed that Indian companies disclosed more than the required minimum level of related party disclosure as required in the Indian accounting standard. They found no association between related party disclosure with market capitalization, industry affiliation and foreign listing for year 2006. Pozzoli1 and Venuti (2013) ascertained the relation between RPTs and companies' financial performance, and thus verify whether there is an association between these kinds of transactions and earnings management using Italian listed companies for the period of 2008-2011. The results are not correlated and that there is no evidence of a cause-effect relation. Pozzoli and Venuti (2014) investigated the relationship between related party transactions profit or loss and financial performance [based on return on assets] of 185 Italian listed companies within the period of 2008-2011. Pearson Correlation analyses was used to test the relationship between the variables and it was discovered that there is no evidence of any significant correlation between the variable .Financial performance was found to have a negative relation to profit or loses from related party transactions. Roudaki and Bhuiyan (2014) found that almost half of the failed finance firms in New Zealand were engaged in related party transaction and that the RPT engaged firms had interlock directors. They also found that that the type of audit firm has a positive relation to related party transaction. Widari, Subroto and Faud (2016) assessed and analyzed the information content of transaction information of related parties of four hundred and nine (409) listed companies in Indonesia in 2014 using multi-linear regression model, found that related party transaction does not affect the abnormal return of stock. Hadi (2017) investigated the related party transactions and financial performance of the companies listed in Tehran Stock Exchange. Ordinary least squares regression method was used with the software EVIEWS 7. The research results showed a significant relationship between related-party transactions and financial performance of companies listed in Tehran Stock Exchange. Umobong (2017) examined related party transactions and firm's financial performance. Data were obtained from Nigerian Stock Exchange. It was found that related party transactions have not significantly affect return on equity and earnings per share of the firms.

A number of studies explicitly model the expropriation of minority shareholders by the controlling shareholders Aharony, Wang and Yuan (2010); Chen, Cheng .and Xiao Xinrong (2011); Ge, Drury, Fortin, Liu and Tsang (2010) thus analyzes the creation of business groups (a collection of multiple firms under the control of a single family) and finds that, in several countries, single individuals or families control a large number of firms; an organization typically referred to as a family business group. The controlling shareholders, who have a small fraction of total stake in Taiwan companies, always take control in discretion of allocating financial resources. Baek, Kang & Lee (2006) in India, found that Indian investors and creditors were aware of the propensity among group-affiliated firms to transfer financial resources to other group companies that are inefficient and to transfer funds through inter-corporate loans if they were incapable of raising capital

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METHODOLOGY

Research Design

This study adopted Ex-Post facto research design. This is appropriate because the study aims at measuring the relationship between one variable and another in which the variables are not manipulated. This involves the use of financial accounts of organizations to generate the financial analysis that will determine the significant difference.

Population and Sampling Techniques of the Study

The population of the study made up of Conglomerate firms quoted on the Nigerian Stock Exchange.

The researcher used 5 Conglomerate firms quoted on the Nigerian Stock Exchange as the sample for the study using the stratified random sampling and the simple random sampling method. The selection based on those firms that disclosed information as it concerns their related party transaction. They firms include: A.G Leventis Nigeria plc, John Holt plc, Chellarams Plc, SCOA Nigeria Plc, Transnational Corporation Plc and UACN Plc

Method of Data Analysis

The Analysis of Variance model was employed in estimating the parameters of the model. The Analysis of variance model was chosen since it will enable the researcher determine the relationship between financial ratios and the performance of the company and also to test the hypotheses. The analysis was done through the E-View 9.0

This study tested the relationship between related-party transactions and the financial performance of Conglomerate firms proxied by some performance indicators (earnings per share, and Tobin Q). Given the number of independent variables, a multi regression model was used to analyze the data.

Model Specification

The model was stated below:

$EPS_{it} = \beta_0 + \beta_1 RPTs_{it} + \varepsilon_t$

$Tobin\ Q_{it} = \beta_0 + \beta_1 RPTs_{it} + \varepsilon_t$

Where:

RPTs = Related-Party Transactions

EPS = Earnings per Share

TOBINQ = Tobin Q

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

it = Time Period

$\beta_{0,}$ = Constant of regression equation

$\beta_{1,}$ = Regression Coefficients

DATA PRESENTATION AND ANALYSIS

Data Presentation

Table 1: Descriptive statistics

	RPTS	EPS	TOBIN_Q
Mean	2.92E+09	0.307778	4.561889
Median	3.48E+09	0.280000	2.833000
Maximum	4.87E+09	0.570000	10.85600
Minimum	4.32E+08	0.150000	1.321000
Std. Dev.	1.71E+09	0.124276	3.421696
Skewness	-0.362424	0.932099	0.847142
Kurtosis	1.604124	3.278635	2.297870
Jarque-Bera	0.927704	1.332328	1.261345
Probability	0.628857	0.513675	0.532234
Sum	2.63E+10	2.770000	41.05700
Sum Sq. Dev.	2.33E+19	0.123556	93.66400
Observations	9	9	9

Source: Researcher's computation using E-View 9.0

Table 4 shows the mean (average) for each of the variables, their maximum values, minimum values, standard deviation and Jarque-Bera (JB) Statistics (normality test). The results provided some insight into the nature of the Nigerian conglomerate firms that were used in this study.

It was observed that on the average over the ten (10) years periods (2010-2019), the sampled quoted conglomerate in Nigeria were characterized by positive earnings per share (EPS) and Tobin Q =0.3078; 4.5619 respectively. Also, the large difference between the maximum and minimum value of the related party transactions (RPTs) show that the sampled quoted conglomerate firms in this study are not dominated by firm with large RPTs.

However, the Jarque-Bera (JB) which test for normality or the existence of outliers or extreme values among the variables shows that most of the variables are normally distributed at 5% level of significance. This means that any variables with outlier are not likely to distort our conclusion and are therefore reliable for drawing generalization. This

also implies that the least square estimate can be used to estimate the pooled regression model.

Testing of Hypotheses

Hypothesis 1

H_o: Related-party transactions have no significant effect earnings per share of Conglomerate firms in Nigeria.

Table 2: Panel Least Square (PLS) Regression Analysis testing the effect of RPTs on EPS

Dependent Variable: EPS
Method: Least Squares
Date: 09/17/20 Time: 22:09
Sample: 2010 2019
Included observations: 9

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.090439	0.052838	1.711629	0.1378
RPTS	2.28E-11	1.19E-11	1.921762	0.1030

R-squared	0.869100	Mean dependent var	0.307778
Adjusted R-squared	0.825467	S.D. dependent var	0.124276
S.E. of regression	0.051919	Akaike info criterion	-2.817070
Sum squared resid	0.016173	Schwarz criterion	-2.751329
Log likelihood	15.67682	Hannan-Quinn criter.	-2.958940
F-statistic	19.91833	Durbin-Watson stat	2.431760
Prob(F-statistic)	0.002243		

Table 2 reveals an adjusted R^2 value of .825. The adjusted R^2, which represents the coefficient of multiple determinations imply that 83% of the total variation in the dependent variable earning per share (EPS) of conglomerate firms in Nigeria is jointly explained by the explanatory variable related party transaction (RPTs). The adjusted R^2 of 83% did not constitute a problem to the study because the F-statistics value of 19.918 with an associated Prob.>F = 0.002 indicates that the model is fit to explain the relationship expressed in the study model and further suggests that the explanatory variable is properly selected and used. The value of adjusted R^2 of 83% also shows that 17% of the variation in the dependent variable is explained by other factors not captured in the study model. This suggests that apart from RPTs, there are other factors that mitigate EPS of conglomerate firms in Nigeria. The results in table 2 illustrated that RPTs has a positive but not statistically significant with EPS measured with a beta coefficient (β_1) and t- value of 2.28 and 1.92 respectively and p-value of 0.103 which is not statistically significant at 5%:

Decision

Based on the empirical evidence that suggests that related party transactions has a no significant but positive effect on earnings per share of conglomerate firms in Nigeria at 5% level of significance, thus, the null hypothesis of the study is accepted.

Hypothesis 2

Ho. Related party transaction has no significant effect on Tobin Q of Conglomerate firms in Nigeria.

Table 3: Panel Least Square (PLS) Regression Analysis testing the effect of RPTs on Tobin Q

Dependent Variable: TOBIN_Q
Method: Least Squares
Date: 09/17/20 Time: 22:10
Sample: 2010 2019
Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.112683	1.263045	4.839638	0.0019

RPTS	-1.15E-09	2.93E-10	-3.932591	0.0057

R-squared	0.763196	Mean dependent var	4.497100
Adjusted R-squared	0.695538	S.D. dependent var	3.232505
S.E. of regression	1.783633	Akaike info criterion	4.238507
Sum squared resid	22.26944	Schwarz criterion	4.329283
Log likelihood	-18.19254	Hannan-Quinn criter.	4.138927
F-statistic	11.28018	Durbin-Watson stat	1.666850
Prob(F-statistic)	0.006462		

Table 3 reveals an adjusted R^2 value of .696. The adjusted R^2, which represents the coefficient of multiple determinations imply that 70% of the total variation in the dependent variable Tobin Q of conglomerate firms in Nigeria is jointly explained by the explanatory variable related party transaction (RPTs). The adjusted R^2 of 70% did not constitute a problem to the study because the F- statistics value of 11.280 with an associated Prob.>F = 0.006 indicates that the model is fit to explain the relationship expressed in the study model and further suggests that the explanatory variable is properly selected and used. The value of adjusted R^2 of 70% also shows that 30% of the variation in the dependent variable is explained by other factors not captured in the study model. This suggests that apart from RPTs, there are other factors that mitigate Tobin Q of conglomerate firms in Nigeria. The results in table 3 illustrated that RPTs has a negative but statistically significant with Tobin Q measured with a beta coefficient (β_1) and t- value of -1.15 and -3.93 respectively and p- value of 0.005 which is statistically significant at 5%:

Decision

Based on the empirical evidence that suggests that related party transactions has a significant and positive effect on Tobin Q of conglomerate firms in Nigeria at 5% level of significance, thus, the null hypothesis of the study is accepted.

Discussion of Findings

This chapter has presented the results of tests designed to address the research questions and test the research hypothesis. In relation to research question one, Earnings Per Share (EPS) was seen to have no relationship with Related Party Transactions. Kohlbeck and Maydew (2010) in U.S companies Cheung, Rau and Stouraitis (2006) in Hong Kong companies found positive relationship that firms that disclose related party transactions have significantly lower valuation and subsequent returns than the non-related party firms. Aharony, Wang and Yuan (2010) found a positive relationship between related party transaction (sales) and earnings the Baek, Kang and Lee (2006)

Analysis of hypothesis two, showed that no relationship exist between related party transactions and net worth indicating that the existence of related party transaction does not affect the value of a firm. This is contrary to the findings of Kohlbeck and Mayhew (2010) using sensitivity analysis that RP firms have significantly lower valuations review and that the market assigns lower values to firms that engage in relatively simple RP transactions including loans. In contrast, complex transactions with investments are not valued negatively.

CONCLUSION AND RECOMMENDATIONS

Conclusion

This research contributes to the existing research on RPTs; the literature regarding the examined issue, the association between RPTs and financial performance is still limited, and in many cases emphasis is on selected companies in East Asian countries (China, In-donesia, Malaysia and Taiwan) and the United States of America. This study carries out this analysis on Nigerian conglomerates, and thus on a specific market within Western Africa. The findings revealed that related party transactions do not has significant effect on earnings per share of conglomerate firms in Nigeria. Meanwhile related party transactions have significant effect in determining the Tobin Q of conglomerate firms in Nigeria.

The results therefore, confirm that related party transaction significantly affect financial performance in one way or the other. In particular, the results show that RPTs and companies' financial performance results are not correlated for Nigerian conglomerates and that there is no evidence of a cause-effect relation. Related party transactions however, should be minimized to avoid the likelihood of transgressing into a fraud opportunity for management.

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