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Corporate Governance in Nigerian Banking Sector: A Review of Literature

Umeora, Chinweobo Emmanuel, Ph.D.
Professor of Banking and Finance, Chukwuemeka Odumegwu Ojukwu University, (Formerly Anambra State University) Nigeria.

Abstract: *The study carried out a literature review of corporate governance in the Nigerian banking sector. The objective was to take a bird's eye view of the practice of corporate governance in Nigeria. The method of the study was theoretical and discursive of development in theory and processes of corporate governance in Nigeria. Literature has been reviewed along the lines of theoretical framework, theoretical and empirical literature. All works point to the importance of corporate governance in the running of the corporate firm. It was recommended that firm managers (agents) obey the code of corporate governance in banking. They should go beyond the code by imbibing more voluntary ethical practice.*

Key words: *Corporate Governance, Agency Theory, Financial Intermediation, Reporting System, Stakeholders, Systemic Failure*

Section 1: Introduction

Corporate governance in banking attracted a lot of attention in recent decades. The widely held view is that the financial system, especially the banking sector, is an active player in promoting economic growth and development in all nations (Obialor, 2008). In other words financial intermediation of banks in any economy is not in doubt. Prominent among these roles are facilitating production of goods and services for satisfaction of societal needs, empowering consumers and producers to get credit facilities such as loans and overdrafts. Consumers get credit also to enable them make purchases of good and services provided by producers. Banks also provide effective payment system including international payments. Shittu (2012) confirms this when he stated that the role of financial intermediation has been exemplified by several studies. Furthermore, he observed that financial intermediation provides more than cost mitigation. Jaksa and Mandac (2015) agreed by saying that banks, as dominant financial intermediaries, are most important member of financial intermediation. However, there are some economists who hold the contrary view that financial intermediation is neutral (Jaksa and Mandac, 2015).

We can then guess that the importance of the banking sector in any economy cannot be overemphasized. The critical role of the banking sector intermediation can only be achieved when stability is also achieved. This will sustain confidence and trust of the public especially the investing public. The degree of confidence of the investing public in the banking system will largely depend on the performance of banking institutions. This performance refers to the demands for their maturing obligations, which if not met by banks, may not only adversely affect the banking sector but the entire economy. The effect may often turn systemic resulting in banking crisis and failures. Adedipe (2004) recounts that Nigeria experienced this in the late 1990s when twenty seven (27) banks were liquidated following irreversible failures. Similar scenario played out on less devastating level in 2008/2009 following the Global Financial Crisis (also called meltdown) when three banks were liquidated and sold out. Three were acquired by Assets Management Corporate of Nigeria (AMCON).

Over the past three decades, developments in the Nigeria's financial sector have reinforced the need for strict adoption of effective corporate governance especially in the banking sector. Failures and distress continue to plague the banking sector thereby underscoring the imperative for greater concern for corporate governance in the banking sector. According to Yusoff and Idris (2012) corporate governance has become indispensable in the management and running of all organizations in the present global and complex business environment. Banks are not exempt in this global and complex business environment. Corporate Governance has many definitions. Anya (2003) quoting the Organization for Economic Co-operation and Development (OECD, 2001) defines corporate governance as the system by which business corporations are directed and controlled. Yusoff and Idris (2012) corroborate by saying that corporate governance can be taken to refer to private and public institutions, including laws, regulations and acceptable practices which when taken together govern the relationship, in a capitalist economic system, between corporate managers and entrepreneurs on the one hand and investors in the corporation on the other hand. For Rezaee (2009), corporate governance is a process through which shareholders induce management of a corporation to take actions in their interest and thereby providing a degree of confidence conducive for financial markets to function effectively. Chow (1999) explains that the objectives of good corporate governance are to ensure transparency, accountability, adequate disclosures and effectiveness of reporting systems.

Effective corporate governance has become imperative to stem the rate of business failures such as World.com and Enron debacle. The effects of bank failures on economic growth and sustainable economic development for developing countries such as Nigeria are devastating. Public confidence in the financial system is eroded. People's savings are lost. Shareholders, employers, suppliers and consumers are all adversely affected. This calls for establishment of corporate governance that will promote ethical values, professionalism and proper management practices. Thus, Mayer (2007) in Fatimoh (2011) states the corporate governance is important towards ensuring transparency, accountability and fairness in running an organization.

Anya (2003) opines that corporate governance requires clear cut understanding of the respective roles the board and Top Management and their relationships with other stakeholders. The various relationships should be characterized by candour, fairness and need to maintain good corporate citizenship with the community where it operates and with the government.

In 2006 following ₦25billion recapitalization, the Central Bank of Nigeria (CBN) issued what was felt to be a code of corporate governance to twenty five banks that emerged after the recapitalization that ended on 31st December, 2005. Prominent provisions of the code are summarised below:

i. No government or its agencies should own more than 10% direct or indirect stake in any bank. No private investor can hold more than 5% without approval from the CBN.
ii. No two members of the same extended family should be on the board of a bank at the same time.

iii. No person can hold the position of Chairman and Managing Director/Chief Executive Officer at the same time.
iv. Board membership for life was abolished and no member can serve for more than fourteen consecutive years.
v. The Board should have at least four committees and the Chairman cannot head any of them.
vi. External consultants should assess performance of the board annually. Auditors cannot serve as consultants.
vii. Appointment to top positions in banks must be with approval of CBN.
viii. Any board member whose credit is non performing for more than one year will cease to sit on the board.
ix. A strong Audit Committee should be put in place.
x. Banks are encouraged to have joint auditors. (Source: Nigeria Business Day February, 2006).

In spite of these seemly stringent requirements the spectre of systemic crisis and failures, have not disappeared in the banking sector.

In the light of the above background, this study examines the operations of corporate governance in the Nigerian banking sector. Thus, the objective is to carry out a review of relevant literature on the efficacy of corporate governance in Nigeria banking sector. The study is essentially theoretical. It examines the existing literature, make conclusion based on literature reviewed. Thus, the study has the limitation of being a qualitative opinion paper contrary to quantitative empirical paper most popularly done these days. The work is arranged in four sections. Section 1 is the matter discussed this far. Sections 2 is the review of related literature. Sections 3 deals with analysis and comments of the researcher based on the works reviewed. Section 4 deals with conclusion and recommendations.

Section 2: Review of Related Literature

In this section, we review conceptual issues related to corporate governance. Theoretical framework, theoretical as well as empirical literature are also reviewed.

Conceptual Issues: Here we review some concepts used in the study

a. Corporate Governance: We have tried in the previous section to explain the term corporate governance. By way of recap, we state again that corporate governance is all about ensuring good business behaviour. It deals with the way in which the agent oversees the running of a firm, and how board members are accountable to shareholders and stakeholders (Ogbechie, 2006). It covers every aspect of the organization ranging from how resources are generated up to how they are utilized. According to Raut (2009), corporate governance deals with a set of processes, customs, policies, laws and institutions regarding the way a company is directed, administered or controlled. It also includes the different relationships existing among the stakeholders.

b. Underlying Concepts of Corporate Governance:

Some of the underlying concepts are: honesty/probity which relate to giving true and not misleading statements. Accountability means that the directors on whose shoulders corporate governance falls are responsible to shareholders and stakeholders. Responsibility means directors accept credit or blame for consequences of their actions in running the company. Transparency means disclosure of relevant information to shareholders. According to Obialor (2008) transparency will deal with quality of information and accounting standards. Quality of information entails that financial institutions give information that is true and fair view of the state of affairs of a bank. Accounting standards concern the accounting and reporting requirements which must conform with the rules of accounting profession and internationally accepted minimum standards for banking services.

c. Agency Relationship: Agency law is a situation where the principal engages another person as agent to act for him. Under corporate governance, directors act as agent for owners of a company, which are the shareholders. Directors have a fiduciary duty to the company and must exercise their powers in utmost good faith.

d. Whistle Blowing: The Code of Corporate Governance for banks stipulates that every bank shall have a whistle blowing policy (KPMG Newsletter, 2014). The policy must institute a mechanism for encouraging shareholders and stakeholders to report any unethical actions in banks to the CBN. This gives rise to the existence and protection of squealers. These are staff who leak secrets of unethical activities or practices in the company to regulatory authorities. Usually such staff are seen as “black sheep” by management and can be victimized. Code of proper corporate governance insists that such staff should be protected since their loyalty is indeed to the company and society.

e. Risk Management: The Code of Corporate Governance for banks lays the responsibility for preparing a bank’s risk management actions on the Board of directors. The Board is also required to occasionally review the effectiveness of the implementation of a bank’s risk management and control every year.

Theoretical Framework and Theoretical Literature

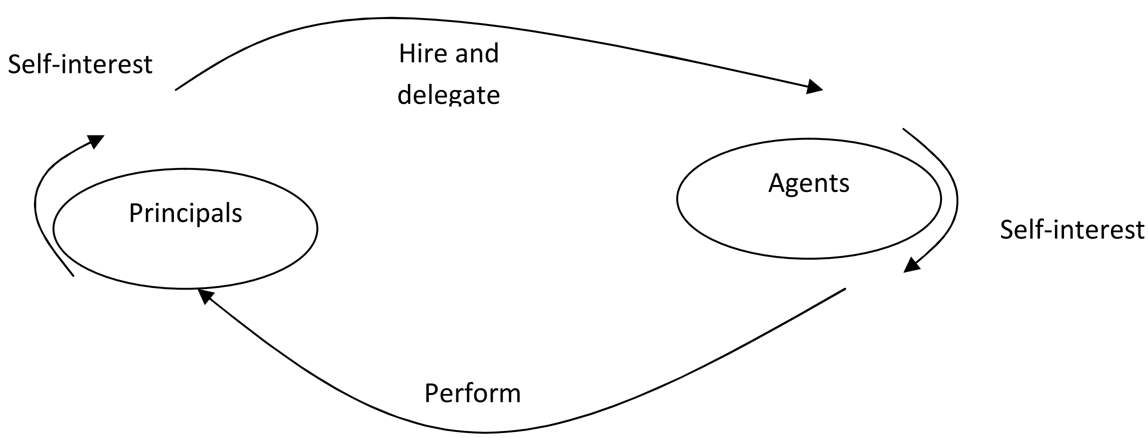
This study is anchored on Agency theory as its framework. According to the theory, as captured by Donaldson and Davis (1991), Agency theory states that owners are principals and the managers are agents. According to OECD (2001) principals or owners are not in position to run the business themselves and so have to rely on the directors as managers who now act as agents for them. Following from this, Jensen and Meckling (1976) in Donaldson and Davis (1991), observe an agency loss in this arrangement. Agency loss is the extent to which returns to the owners fall short of what they could get if the owners were directly controlling the firm. The theory also observes that agents may choose to undertake activities more for their own personal interest than for the company. According to Eisenhardt (1989) also in Donaldson and Davis (1991), the agency theory provides mechanisms to reduce agency loss. Some of the mechanisms include incentive schemes; ownership shares purchase at reduced price and bonuses for exceeding set targets. The agency theory is thus used to explain that agents need good corporate governance to act for the benefits of principals in form of shareholders and stakeholders.

We now review some theoretical literature. Malek (2004), in a study of Theory and Practice of Corporate Governance, observes that corporate governance is concerned with the relationships existing among various corporate stakeholders. He recalls Roe (1994) who states that the America corporate governance system resulted from economic evaluation and its democratic philosophy. The US government deliberately weakened the powers of corporate managers of banks by denying them rights to become corporate shareholders. Malek (2004) further exposed the neoclassical view of corporate governance especially Modigliani and Miller (1958) who hypothesize that if the investment policy of the firm is assumed and known to the market; its total market value would be independent of the mix of financing-whether by equity or debt. The result is that investment and financing decisions of the firm remain independent of each other. A further result of this is that corporate governance structure of firm would not add to value creation for shareholders.

In contrast to the neoclassical view, Malek (2004) also recounts the alternative view of Williamson (1988) who states that debt and equity are not only alternative financing process but also show alternative governance structure. Corporate governance structure will differ on types of assets. Assets that can be redeployed can be financed by debt while non-redeployable projects can be financed by equity.

Yusoff and Idris (2012) writing on Insight of Corporate Governance theories observe a nexus of contracts among individual factors of production which have necessitated the emergence of agency theory. The firm is a legal fiction where conflicting objectives and contractual relationships emerge between legal entity, employees, suppliers, customers and creditors. According to Deegan (2004), by these contracts each party acting in his own self-interest motivated to maximize the organizational value, reduce agency costs and adopt accounting methods that most efficiently reflect performance of the entire legal entity. The Agency model (theory) assumes that people can access complete information and investors have significant knowledge effects of corporate governance activities, whether or not the board has knowledge of preferences of investors. In agency theory, efficient market is considered a way out of the problem including efficient market for corporate governance.

Abdullah and Valentine (2009) state that with globalization and greater deterritorialization, there is less government control. This has given rise to greater need for corporate governance in managing organizations. They illustrate their agency model as in the diagram below:



Source: Abudullal and Valentine (2009) Fundamental and Ethics Theories of Corporate Governance.

The diagram is self explanatory and shows direction of delegation of authority from owners (principals) to managers (agents) and vice versa. Self interest is common to both sides.

Empirical Literature Review

We now review some empirical works on corporate governance in Nigeria. Anya (2003) did a study on Corporate Governance as an effective tool for combating financial and economic crimes. The paper is a theoretical discussion and observed that the government in Nigeria has always desired to attract foreign direct investment into the country. But this desire has not been fully achieved because of the incidences of financial and economic crimes. It is felt that promoting effective corporate governance is one of the most effective ways of reducing the ills. He concludes that good corporate governance is fundamental to enhance value and efficacy of investments. Proceeds from corporate investments yield more into the corporate purse when good corporate governance with appropriate structures and mechanisms are in place.

Obialor (2008) also used discursive method to examine corporate governance as an imperative for financial sector stability in Nigeria. He concludes by saying good corporate governance requires judicious and prudent management of resources ad adherence to adoption of good governance practices. He further observes that corporate governance enhances strength and stability of financial sector. The main objective of good corporate governance is to ensure a healthy banking system.

KPMG (2014) Newsletter of December concludes that Nigerian banks need to adopt more robust corporate governance practices and disclosures in their annual reports. They need to align with global best practices and eliminate perceived ambiguities. The newsletter informs that compliance with code of corporate governance is mandatory for all banks. As part of the compliance requirements, external auditors of banks are mandated to report annually to CBN the extent of banks' compliance with the Code of Corporate Governance.

Okoigbo (2011) did an empirical study on corporate governance based on selected listed companies in Nigeria. The study, using regression analysis, provides some empirical evidence of the relationship between corporate governance and firm performance in Nigeria. The study also observes that the concentration of directors-ownership relationship was negative and insignificant with firm's measures of performance. It was further discovered that Audit Committee independence has a negative but significant relationship with firm's performance based on profit margin and return on equity.

Abiola's (2012) study is on Corporate Governance in Nigeria's banking sector and relevance of internal auditors. His study affirms that internal auditing function is one of the pillars of corporate governance. However, one of his findings is that despite the ever increasing focus on corporate governance in both developed and developing countries, there is paucity of research on how internal auditors perform in the issue of corporate governance.

Fatimoh's (2011) empirical study is on impact of corporate governance on banking sector performance in Nigeria. The study adopts judgemental sampling technique to select four banks out of a population of twenty four banks. The paper finds out that weak corporate governance practices and agency problems contributed immensely to bank failures in Nigeria. It was also discovered that although compliance to code of corporate governance is mandatory on banks in Nigeria, close supervision and sanctions by regulatory authorities were ineffectively done.

Section 3: Analysis and Comments

The matter of corporate governance has become very important in financial discourse. In Nigeria, serious attempts have been made to adopt corporate governance in accordance with international best practices. Although corporate governance principles are for all corporate firms, emphasis has been on the financial sector especially the banking sector. The reasons for the emphasis on banking sector are not far-fetched. Such reasons pertain to the fact that investors need to be protected. Banks play prominent role in implementation of CBN's monetary policies. Furthermore, failures of banking sector result in disruption of a nation's entire economy. The effect often permeates to the social and political sectors. No wonder then, why banks are coerced into complying with corporate governance. In other words, banks play very important functions in the macroeocnomy.

Non compliance with corporate governance points to many lessons that we learn as they affect the society at large. We learn that failure of corporate governance points to failure of agency theory in that there is excessive self-interest seeking by the agents to the detriment of principals. We also experience the preponderance of insider abuses and emergence of creative accounting that encourages falsification of accounts.

Conclusion

Compliance with code of corporate governance is indispensable to banks. It should be emphasised that compliance should be beyond letters of the code. Banks should be more ethical and doing the proper thing.

Recommendations

We make some recommendations based on some issues raised in the study:

i. Regulatory agencies should be more active to enforce compliance and impose sanctions where and when necessary.
ii. Banks should adopt self regulation as a complement to corporate governance code which should be regarded as minimum benchmark requirement.

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