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CORPORATE GOVERNANCE AND BANK SECTOR CRISIS IN NIGERIA: RESCUE INTERVENTION OR A MACABRE DANCE WITH THE ECONOMY?

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ABSTRACT

Hopes have been dashed and several families reduced to economic rubbles. From *Société Générale* to Savannah bank, International Bank for Africa to All States Trust Bank; the story is the same and sadly remained so till date – the Nigerian Banks are failing leading to catastrophic loss of investments and erosion of confidence in the banks. In response, imperative wave of mergers and acquisitions swept through the banking industry as boundaries between financial sectors and products blurred dramatically. The Central Bank of Nigeria (CBN) on its part, unveiled new banking guidelines designed to consolidate and restructure the industry through mergers and acquisition. But despite the attempts, the CBN disclosed that after the consolidation in 2006, 741 cases of attempted fraud and forgery involving N5.4billion were reported thus questioning the effectiveness of the regulations and interventions in those banks. In light of the above, this paper examined the relationships that exist between governance mechanisms and financial performance in Nigerian banks. Appraisal and expository methodology were used to find that the CBN interventions in the bank crisis have yielded little results? The Paper recommends mandatory compliance with the code of corporate governance for banks and warns that the current intervention by the CBN through the Asset Management Corporation of Nigeria (AMCON) offends the contractual principle of privity and scares away investors.

Keywords: Corporate Governance, Bank Crisis, Rescue Intervention, Nigeria.

1. INTRODUCTION

The consequences that followed the global financial crisis in Nigeria are yet to settle. From loss of investments to loss of jobs, the Nigerian economy was left gasping for breath after what turned out to be a deceitful and unreliable assurances by regulators of the economy including the Central Bank of Nigeria that Nigeria was immune from the global financial meltdown even as financial regulators in other part of the world were scrambling to assess the changes and master the turbulence.[1] In line with these changes, the fact remains unchanged that there is the need for countries to have sound resilient banking systems with good corporate

[1]Sandeep, A., Patel, A. B. & Lilicare, B., 'Measuring Transparency and Disclosure at Firm-Level in Emerging Markets' *Journal of Finance,* (2002) Vol. 24, No.4, pp. 537- 553.

governance. This will strengthen and upgrade the institution to survive in an increasingly open environment.[2]

Given the fury of activities that have affected the efforts of banks to comply with the various consolidation policies and the antecedents of some operators in the system, there are concerns on the need to strengthen corporate governance in banks. This will boost public confidence and ensure efficient and effective functioning of the banking system.[3] According to Heidi and Marleen,[4] banking supervision cannot function well if sound corporate governance is not in place. Consequently, banking supervisors have strong interest in ensuring that there is effective corporate governance at every banking organization. As opined by Mayes, etcetera,[5] changes in bank ownership during the 1990s and early 2000s substantially altered governance of the world's banking organization. These changes in the corporate governance of banks raised very important policy research questions - how do these changes affect bank performance?

It is therefore necessary to point out that the concept of corporate governance of banks and very large firms have been a priority on the policy agenda in developed market economies for over a decade. Further to that, the concept is gradually warming itself as a priority in the African continent. Indeed, it is believed that the Asian crisis and the relative poor performance of the corporate sector in Africa have made the issue of corporate governance a catchphrase in the development debate.[6]

Several events are therefore responsible for the heightened interest in corporate governance especially in both developed and developing countries. The subject of corporate governance leapt to global business limelight from relative obscurity after a string of collapses of high profile companies. Enron, the Houston, Texas based energy giant and WorldCom the telecom behemoth, shocked the business world with both the scale and age of their unethical and illegal operations. These organizations seemed to indicate only the tip of a dangerous iceberg. While corporate practices in the US companies came under attack, it appeared that the problem was far more widespread. Large and trusted companies from Parmalat in Italy to the multinational newspaper group Hollinger Inc., Adephia Communications Company, Global Crossing Limited and Tyco International Limited, revealed significant and deep-rooted problems in their corporate governance. Even the prestigious New York Stock Exchange had to remove its director (Dick Grasso) amidst public outcry over excessive compensation.[7]

In developing economies, the banking sector among other sectors has also witnessed several cases of collapses, some of which include the Alpha Merchant Bank Ltd, Savannah Bank Plc, Societe Generale Bank Ltd, All States Trust Bank Plc, African International Bank Plc (all in Nigeria), The Continental Bank of Kenya Ltd, Capital Finance Ltd, Consolidated Bank of Kenya Ltd and Trust Bank of Kenya among others.[8]

In Nigeria, the issue of corporate governance has been given the front burner status by all sectors of the economy. For instance, the Securities and Exchange Commission (SEC) set up the Peterside Committee on corporate governance in public companies. The Bankers'

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[2]Qi, D., Wu, W., Zhang, H., 'Shareholding Structure and Corporate Performance of Partially Privatized Firms: Evidence from listed Chinese Companies' *Pacific Basin, Finance Journal,* (200) Vol. 8 Pp 587-610.

[3]Soludo, C. C., 'Consolidating the Nigerian Banking Industry to Meet the Development Challenges of the 21st Century'. Being an Address to the special Meeting of Bankers Committee, Held on July 6 2004.

[4]Heidi, V. B. & Marleen, W., *Voluntary Disclosure on Corporate Governance in the European Union..* (2004) University of London Press.

[5]Mayes G. D., Halme L and Aarno, L,. *Improving Banking Supervision*, (2001) New York, Palgrave, Macmillan.

[6] Berglog, E and Ernst-Ludwig Von-Thadden (1999): 'The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries', (1999), Conferences Paper, Annual World Bank Conference on Development Economics, Washington D.C.

[7] La Porta, R., Lopez-De-Silanes, F. and Shleifer, A., 'Corporate Ownership Around the World' *Journal of Finance*, (1999) Vol. 54, pp.471-498.

[8]Akpan, N., 'Internal Control and Bank Fraud in Nigeria', (2007) *Economic Journal,* Vol. 95, pp.118–132.

Committee also set up a sub-committee on corporate governance for banks and other financial institutions in Nigeria. This is in recognition of the critical role of corporate governance in the success or failure of companies.[9] Corporate governance therefore refers to the processes and structures by which the business and affairs of institutions are directed and managed, in order to improve long term share holders' value by enhancing corporate performance and accountability, while taking into account the interest of other stakeholders.[10] It is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that will foster good corporate performance.

This paper agrees with the acknowledgement by Jensen and Meckling[11] that the principal-agent theory is the general starting point for any debate on the issue of corporate governance. A number of corporate governance mechanisms have been proposed to ameliorate the principal-agent problem between managers and their shareholders. These governance mechanisms as identified in agency theory include board size, board composition, chief executive officer pay performance sensitivity, directors' ownership and share holder right.[12] They further suggest that changing these governance mechanisms would cause managers to better align their interests with that of the shareholders thereby resulting in higher firm value.

Although corporate governance in developing economies has recently received a lot of attention in the literature,[13] yet corporate governance of banks in developing economies as it relates to their financial performance has almost been ignored by researchers.[14] Even in developed economies, the corporate governance of banks and their financial performance has only been discussed recently in the literature.[15]

The few studies on bank corporate governance narrowly focused on a single aspect of governance, such as the role of directors or that of stock holders, while omitting other factors and interactions that may be important within the governance framework. Feasible among these few studies is the one by Adams and Mehran[16] for a sample of US companies where they examined, the Effects of Board Size and Composition on Value. Another weakness is that such research is often limited to the largest, actively traded organizations- many of which show little variation in their ownership, management and board structure and also measure performance as market value.

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[9]Ogbechie, C., 'Corporate Governance A Challenge For Nigerian Banks'. Available at www.Businessdayonline.com Accessed 07 July, 2013.

[10]Jenkinson, T. and C. Mayer, 'The Assessment: Corporate Governance and Corporate Control, *Oxford Review of Economic Policy*, (1992) Vol. 8, No.3 pp. 138- 156.

[11]Jensen, M. and Meckling W., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* (1976) in Putterman L,. *The Economic Nature of the Firm.* Cambridge University Press, (1986).

[12]Gompers, P., Ishii, L and Metick, A., 'Corporate Governance and Equity Prices' *Quarterly Journal of Economics,* (2003) Vol.118, pp.107-125.

[13]Lin, C. 'Private Vices in Public Places: Challenges in Corporate Governance Development in China', (2001) OECD Development Center, Discussion Paper 634-01; Goswami, O. 'The Tide Rises, Gradually: Corporate Governance in India, (2001) OECD Development Centre Discussion Paper No 96; Oman, C. P. (2001), Corporate Governance and National Development, (2001) OECD Development Center Technical Papers, Number 180 pp. 362-388; Malherbe, S. and Segal, N. 'Corporate Governance in South Africa', (2001) OECD Development Centre Discussion Paper. Issue 44, Carter, Colin B., and Jay W. Lorsch, Back to the Drawing Boards: Designing Corporate Boards for a Complex World, (2004) Boston, Harvard Business School Press; Staikouras, C., Maria-Eleni, K., Agoraki, A., Manthos, D. and Panagiotis, K., The Effect of Board Size and Composition on Bank Efficiency. Available at http://www.efmaefm.org/0EFMAMEETINGS/EFMA. Accessed 13 May 2013; and Bebchuk, L., Cohen, A. and Ferrell, A., 'What Matters in Corporate Governance?' *The Review of Financial Studies*, (2009) Vol. 22, No. 2, pp.783-807.

[14]Caprio, G., Laeven, L. & Levine, R., 'Governance and Bank Valuation', *Journal of Financial Intermediation*, (2007) Vol.16, pp 584-597.

[15]Macey, J. R. and O'Hara, M., 'The Corporate Governance of Banks', *Economic Policy Review, (*2001) Vol. 16, No2 pp 89- 102.

[16]Adams, R. and Mehran, H., 'What Do Boards Do? Evidence from Board Committee and Director Compensation', (2003) *EFA 4005, SSRN.*

In Nigeria, among the few empirically feasible studies on corporate governance are the studies by Sanda and Mukailu and Garba[17] and Ogbechie[18] that studied the corporate governance mechanisms and firms' performance. In order to address these deficiencies, this paper examined the role of corporate governance in the financial performance of Nigerian banks. Unlike other prior studies, this article is not restricted to the framework of the Organization for Economic Cooperation and Development principles, which is based primarily on shareholder sovereignty. It analysed the level of compliance of code of corporate governance in Nigerian banks with the Central Bank's post consolidated code of corporate governance. Finally, while other studies on corporate governance neglected the operating performance variable as proxies for performance, this paper employed the accounting operating performance variables to investigate the relationship if any, that exists between corporate governance and performance of banks in Nigeria.

Banks and other financial intermediaries, including those in Nigeria, are therefore at the heart of the world's financial crisis. The deterioration of their asset portfolios, largely due to distorted credit management, was one of the main structural sources of the crisis.[19] To a large extent, this problem was the result of poor corporate governance in countries' banking institutions and industrial groups. Schjoedt[20] observed that this poor corporate governance, in turn, was very much attributable to the relationships among the government, banks and big businesses as well as the organizational structure of businesses.

In some countries (for example Iran and Kuwait), banks were part of larger family-controlled business groups and are abused as a tool of maximizing the family interests rather than the interests of all shareholders and other stakeholders. In other cases where private ownership concentration was not allowed, the banks were heavily interfered with and controlled by the government even without any ownership share.[21] Understandably in either case, corporate governance was very poor. The symbiotic relationships between the government or political circle, banks and big businesses also contributed to the maintenance of lax prudential regulation, weak bankruptcy codes and poor corporate governance rules and regulations.[22]

In Nigeria, before the consolidation exercise of 2004/2005, the banking industry had about 89 active players whose overall performance led to sagging of customers' confidence. There was lingering distress in the industry, the supervisory structures were inadequate and there were cases of official recklessness amongst the managers and directors, while the industry

[17]Sanda, A.U, A.S Mukaila and T. Garba., 'Corporate Governance Mechanisms and Firm Financial Performance in Nigeria', Final Report Presented to the Biannual Research Workshop of the AERC, Nairobi, Kenya, (2005) pp 24-29.

[18]Ogbechie C., 'Corporate Governance A Challenge For Nigerian Banks'. Available at www.Businessdayonline.com accessed 13 June 2013.

[19]Fries, S., Neven, D. and Seabright, P., 'Bank Performance in Transition Economies'. *European Bank for Reconstruction and Development;* (2001) Vol.18. pp. 108-114; Kashif, Rasid 'A Comparison of Corporate Governance and Firm Performance in Developing (Malaysia) and Developed (Australia) Financial Market'. A PhD Thesis submitted to the Centre for Strategic Economic Studies, Faculty of Business and Law, Victoria University, Melbourne (2008); and Sanusi, L. S., 'The Nigerian Banking Industry: What Went Wrong and the Way Forward'. A Convocation Lecture Delivered at the Convocation Square, Bayero University, Kano, on Friday 26 February, 2010 to mark the Annual Convocation Ceremony of the University).

[20]Schjoedt, L., 'Governance Structure, Ownership and Managerial Tenure: Innovations Impact of Firm Performance', *Journal of Finance,* (2000) Vol. 52, No.2, pp. 737-753.

[21]Williamson O., *Corporate Control and Business Behavior: An inquiry into the Effects of Organizational Form on Enterprise Behavior,* (1970) Prentice-Hall, Englewood Cliffs, New Jersey; Zahra SA., 'Governance, Ownership and Corporate Entrepreneurship: the Moderating Impact of Industry Technological Opportunities. *Academy of Management Journal,* (1996) Vol. 39 pp. 1713-1735; and Yeung B., 'Comment.' in *Concentrated Corporate Ownership.* Morck RK (ed.) University of Chicago Press: (2000) 292-294.

[22]Das, A. and S. Ghosh, 'Corporate Governance in Banking System: An Empirical Investigation', *Economic and Political Weekly*, (2004, March 20), pp. 1263-1266; and Bai, C., Liu ,Q., Lu, J., Song, F., and Zhang, J. 'Corporate Governance and Market Valuation in China', (2003) Working Paper , University of Hong Kong.

was notorious for ethical abuses.[23] Poor corporate governance was identified as one of the major factors in virtually all known instances of bank distress in the country. Weak corporate governance was seen manifesting in form of weak internal control systems, excessive risk taking, override of internal control measures, absence of or non-adherence to limits of authority, disregard for cannons of prudent lending, absence of risk management processes, insider abuses and fraudulent practices remain a worrisome feature of the banking system.[24] This view is supported by the Nigeria Security and Exchange Commission (SEC) survey in April 2004, which shows that corporate governance was at a rudimentary stage, as only about 40% of quoted companies including banks had recognised codes of corporate governance in place. This, as suggested by the study may hinder the public trust particularly in the Nigerian banks if proper measures are not put in place by regulatory bodies.

The Central Bank of Nigeria (CBN) in July 2004 unveiled new banking guidelines designed to consolidate and restructure the industry through mergers and acquisition. This was to make Nigerian banks more competitive and be able to play in the global market. However, the successful operation in the global market requires accountability, transparency and respect for the rule of law. In section one of the Code of Corporate Governance for banks in Nigerian post consolidation (2006), it was stated that the industry consolidation poses additional corporate governance challenges arising from integration processes, Information Technology and culture. The code further indicate that two-thirds of mergers world-wide failed due to inability to integrate personnel and systems and also as a result of the irreconcilable differences in corporate culture and management, resulting in Board of Management squabbles.

Despite all these measures, the problem of corporate governance still remains unresolved among consolidated Nigerian banks, thereby increasing the level of fraud.[25] Akpan[26] further disclosed that data from the National Deposit Insurance Commission report (2006) shows 741 cases of attempted fraud and forgery involving N5.4 billion. Soludo[27] also opined that a good corporate governance practice in the banking industry is imperative, if the industry is to effectively play a key role in the overall development of Nigeria.

The causes of the recent global financial crises have been traced to global imbalances in trade and financial sector as well as wealth and income inequalities.[28] More importantly, Caprio, Laeven & Levine[29] opined that there should be a revision of bank supervision and corporate governance reforms to ensure that deliberate transparency reductions and risk mispricing are acted upon.

Furthermore, according to Sanusi[30] the banking crises in Nigeria, has been linked with governance malpractice within the consolidated banks which has therefore become a way of life in large parts of the sector. He further opined that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management.

The boards of directors were further criticized for the decline in shareholders' wealth and corporate failure. They were said to have been in the spotlight for the fraud cases that had resulted in the failure of major corporations, such as Enron, WorldCom and Global Crossing.

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[23] Akan N. *supra* n 8.
[24]Soludo, C. C. 'Towards the Repositioning of The Central Bank of Nigeria for the 21st Century'. A keynote Address Delivered at the Annual Dinner of the Chartered Institute of Bakers of Nigeria, Held at the Muson Centre, Onikan, Lagos, 5 November 2004.
[25]Akpan N. *supra* n 8.
[26] *Ibid.*
[27] Soludo C. *Supra* n 25.
[28]Goddard, J., 'The Diversification and Financial Performance of Us Credit Unions', *Journal of Banking & Finance*, (2007) Vol. 32 No.9, 1836-1849.
[29]Caprio, G., Laeven, L. & Levine, R., 'Governance and Bank Valuation', *Journal of Financial Intermediation*, (2007) Vol.16, pp 584-597.
[30]Sanusi, L. S. s*upra* n 19.

The series of widely publicized cases of accounting improprieties recorded in the Nigerian banking industry in 2009 (for example, Oceanic Bank, Intercontinental Bank, Union Bank, Afri Bank, Fin Bank and Spring Bank) were related to the lack of vigilant oversight functions by the boards of directors, the board relinquishing control to corporate managers who pursue their own self-interests and the board being remiss in its accountability to stakeholders.[31] Inan[32] also confirmed that in some cases, these bank directors' equity ownership is low in other to avoid signing blank share transfer forms to transfer share ownership to the bank for debts owed banks. He further opined that the relevance of non- executive directors may be watered down if they are bought over, since, in any case, they are been paid by the banks they are expected to oversee.

As a result, various corporate governance reforms have been specifically emphasized on appropriate changes to be made to the board of directors in terms of its composition, size and structure.[33] It is in the light of the above problems, that this article studied the effects of corporate governance mechanisms on the financial performance of banks in Nigeria and also reviewed the annual reports of the listed banks in Nigeria to find out their level of compliance with the CBN (2006) post consolidation code of corporate governance. The paper also finds out if there is any statistically significant difference between the profitability of the healthy and the rescued banks in Nigeria as listed by CBN in 2009. Finally, it went further to investigate if the banks with foreign directors perform better than those without foreign directors. Part 2 of the paper presents a review of related literatures and theoretical framework of the topic in discuss by examining among other things; the Historical Overview of Corporate Governance, Corporate Governance of Banks, Elements of Corporate Governance in Banks, Corporate Governance Mechanisms, Linkage Between Corporate Governance and Firm Performance, the Role of Internal Corporate Governance Mechanisms in Organisational Performance, Regulatory Environment, Governance Standards and Principles around the World. Part 3 of the paper examines Corporate Governance and the Current Crisis in Nigerian Banks. In doing this the paper looked at the Global Financial Crisis and previous empirical studies on Corporate Governance and Performance. Perspective of Banking Sectors in Nigeria and State of Corporate Governance in Nigerian Banks vis–a-viz the recent CBN rescue intervention through the Asset Management Corporation Act of Nigeria 2010 (the AMCON Act). In Part 4, the paper offers suggestions and recommendations for reform and warns that over-regulation of banks in Nigeria has the negative effect of eroding investors' confidence in the banks and could scare away investors and borrowers from accessing funds from deposit banks. The borrower is hunted by the fear that AMCON, a total third party lurks around the corner to interfere with his loan contracts and facilities in the name of regulation.

2. LITERATURE REVIEW AND THEORITICAL FRAMEWORK

Corporate governance is a uniquely complex and multi-faceted subject. Devoid of a unified or systematic theory, its paradigm, diagnosis and solutions lie in multidisciplinary fields i.e. law, economics, accountancy, finance among others.[34] As such it is essential that a comprehensive framework be codified in the accounting framework of any organization. In any

[31]Uadiale, O. M., 'The Impact of Board Structure on Corporate Financial Performance in Nigeria', *International Journal of Business and Management*, (2010) Vol. 5, No.10, pp 155-166.

[32]Inam, W., 'Regulatory and Institutional Challenges of Corporate Governance in Nigeria Post Banking Consolidation', *Nigerian Economic Summit Group, Economic Indicators*, (2009) Vol. 12 No. 2, pp 114-129.

[33]Abidin, Z. Z., Nurmala Mustaffa Kamal, N. M., & Jusoff, K., 'Board Structure and Corporate Performance in Malaysia', *International Journal of Economics and Finance,* (2009) Vol. 1 pp. 150-164. Available at http://www.ccsenet.org/journal.html. Accessed 20 February 2013.

[34] Cadbury, A., 'Overview of Corporate Governance: A Framework for Implementation', (2002) *The World Bank Group; Washington. D.C: V-VI.*

organization, corporate governance is one of the key factors that determine the health of the system and its ability to survive economic shocks. The health of the organization depends on the underlying soundness of its individual components and the connections between them.

According to Morck, etcetera,[35] among the main factors that support the stability of any country's financial system include: good corporate governance; effective marketing discipline; strong prudential regulation and supervision; accurate and reliable accounting financial reporting systems; a sound disclosure regimes and an appropriate savings deposit protection system.

Corporate governance has been looked at and defined variedly by different scholars and practitioners. However they all have pointed to the same end, hence giving more of a consensus in the definition. Coleman and Nicholas-Biekpe[36] defined corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole. However, Mayer[37] offers a definition with a wider outlook and contends that it means the sum of the processes, structures and information used for directing and overseeing the management of an organization. The Organization for Economic Corporation and Development[38] has also defined corporate governance as a system on the basis of which companies are directed and managed. It is upon this system that specifications are given for the division of competencies and responsibilities between the parties included (board of directors, the supervisory board, the management and shareholders) and formulate rules and procedures for adopting decisions on corporate matters.

In another perspective, Arun and Turner[39] contend that there exists a narrow approach to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interests. However, Shleifer and Vishny,[40] Vives[41] and Oman[42] observed that there is a broader approach which views the subject as the methods by which suppliers of finance control managers in order to ensure that their capital cannot be expropriated and that they can earn a return on their investment. There is a consensus, however that the broader view of corporate governance should be adopted in the case of banking institutions because of the peculiar contractual form of banking which demands that corporate governance mechanisms for banks should encapsulate depositors as well as shareholders.[43] Arun and Turner[44] supported the consensus by arguing that the special nature of banking requires not only a broader view of corporate governance, but also government intervention in order to restrain the behaviour of bank management. They further argued that, the unique nature of the banking firm, whether in the developed or developing world, requires that a broad view of corporate governance, which encapsulates both shareholders and depositors, be adopted for

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[35] Morck, R.; Shleifer, A. and Vishny, R., 'Alternative Mechanism for Corporate Control'. *American Economic Review.* (1989) Vol. 79, pp.41- 56.

[36] Coleman, A. and Nicholas- Biekpe, N., 'Does Board and CEO Matter for Bank Performance? A Comparative Analysis of Banks in Ghana', *Journal of Business Management, University of Stellenbosch Business School (USB), Cape Town, South Africa* (2006) Vol.13, Pp.46- 59.

[37] Mayer, C., 'Corporate Governance in the UK', A Paper Presented at The Conference on Corporate Governance: A Comparative Perspective, held in University of Oxford on 16 October 1999.

[38] OECD Principles of Corporate Governance. Ad-Hoc Task Force on Corporate Governance, 91999) OECD, Paris

[39] Arun, T.G and Turner, J. D., 'Corporate Governance of Banking Institutions in Developing Economies: The Indian Experience', *Paper presented in the conference on 'Finance and Development' organized by IDPM, The University of Manchester, 23 July 2002.*

[40] Shleifer A. and R. Vishny, 'A Survey of Corporate Governance', *Journal of Finance,* (1997) Vol. 52, pp 246- 253

[41] Vives, X, *Corporate Governance: Does it Matter,* in Xavier Vives (ed.) *Corporate Governance: Theoretical and Empirical Perspectives*, Cambridge: Cambridge University Press (2000).

[42] Oman, C. P., 'Corporate Governance and National Development', (2001) *OECD Development Center Technical Papers, Number 180 pp. 362-388*

[43] Macey, J. R. and O'Hara, M., 'The Corporate Governance of Banks', *Economic Policy Revie,* (2001) Vol. 16 No.2 pp 89- 102.

[44] Arun, T.G and Turner, J.D. *supra* n 39

banks. They posit that, in particular, the nature of the banking firm is such that regulation is necessary to protect depositors as well as the overall financial system.

This paper therefore adopts the broader view and defines corporate governance in the context of banking as the manner in which systems, procedures, processes and practices of a bank are managed so as to allow positive relationships and the exercise of power in the management of assets and resources with the aim of advancing shareholders' value and shareholders' satisfaction together with improved accountability, resource use and transparent administration.

3. HISTORICAL OVERVIEW OF CORPORATE GOVERNANCE

The foundational argument of corporate governance, as seen by both academics as well as other independent researchers, can be traced back to the pioneering work of Berle and Means.[45] They observed that the modern corporations having acquired a very large size could create the possibility of separation of control over a firm from its direct ownership. Berle and Means' observation of the departure of the owners from the actual control of the corporations led to a renewed emphasis on the behavioral dimension of the theory of the firm.

Governance is a word with a pedigree that dates back to Chaucer. In his days, it carries with it the connotation of 'wise and responsible', which is appropriate. It means either the action or the method of governing and it is in the latter sense that it is used with reference to companies. Its Latin root, '*gubernare'* means to steer and a quotation which is worth keeping in mind in this context is: 'He that governs sits quietly at the stern and scarce is seen to stir'.[46] Though corporate governance is viewed as a recent issue but nothing is new about the concept because, it has been in existence as long as the corporation itself.[47]

Over centuries, corporate governance systems have evolved, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England. Similarly, much of the security laws in the United States were put in place following the stock market crash of 1929. There has been no shortage of other crises, such as the secondary banking crisis of the 1970s in the United Kingdom, the U.S. savings and loan debacle of the 1980s, East-Asian economic and financial crisis in the second half of 1990s.[48] In addition to these crises, the history of corporate governance has also been punctuated by a series of well-known company failures: the Maxwell Group raid on the pension fund of the Mirror Group of newspapers, the collapse of the Bank of Credit and Commerce International, Baring Bank and in recent times global corporations like Enron, WorldCom, Parmalat, Global Crossing and the international accountants, Andersen. These were blamed on a lack of business ethics, shady accountancy practices and weak regulations. They were a wake-up call for developing countries on corporate governance. Most of these crisis or major corporate failure, which was a result of incompetence, fraud, and abuse, was met by new elements of an improved system of corporate governance.[49]

[45] Berle, S.S & Means, G.C., *The Modern Corporation and Private Property,* (1932) New York, Macmillan..

[46]Cadbury, A., 'Report of the Committee on the Financial Aspects of Corporate Governance', Gee Publishing, (1992) London.

[47] Imam, Mahmood Osman, 'Firm Performance and Corporate Governance through Ownership Structure: Evidence from Bangladesh Stock Market', Paper presented in 2006 ICMAB Conference.

[48] Flannery, M. J., 'Financial Crisis, Payment Systems Problems, and Discount Window Lending, *Journal of Money Credit and Banking,* (1996) Vol. 28. No. 4 Pp. 58-65.

[49] Iskander, Magdi R., and Chamlou, Nadereh, 'Corporate Governance: A Framework for Implementation', (2000) Washington. D.C, The World Bank Group.

4. THE FUNDAMENTAL VALUES OF CORPORATE GOVERNANCE AND BANKS

Corporate governance is a crucial issue for the management of banks, which can be viewed from two dimensions. One is the transparency in the corporate function, thus protecting the investors' interest (reference to agency problem), while the other is concerned with having a sound risk management system in place (special reference to banks).[50] The Basel Committee on Banking Supervision[51] states that from a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management. This thus affect how banks:

i) "Set corporate objectives (including generating economic returns to owners);
ii) Run the day-to-day operations of the business;
iii) Consider the interest of recognized stakeholders;
iv) Align corporate activities and behaviours with the expectation that banks will operate in safe and sound manner, and in compliance with applicable laws and regulations; and protect the interests of depositors."

The Basel Committee on Banking Supervision further enumerates basic components of good corporate governance to include:

a) The corporate values, codes of conduct and other standards of appropriate behaviour and the system used to ensure compliance with them;
b) A well articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured;
c) The clear assignment of responsibilities and decision making authorities, incorporating hierarchy of required approvals from individuals to the board of directors;
d) Establishment of mechanisms for the interaction and cooperation among the board of directors, senior management and auditors;
e) Strong internal control systems, including internal and external audit functions, risk management functions independent of business lines and other checks and balances;
f) Special monitoring of risk exposures where conflict of interests are likely to be particularly great, including business relationships with borrowers affiliated with the bank, large shareholders, senior management or key decisions makers within the firm (e.g. traders);
g) The financial and managerial incentives to act in an appropriate manner, offered to senior management, business line management and employees in the form of compensation, promotion and other recognition;
h) Appropriate information flows internally and to the public.

On a theoretical perspective, corporate governance has been seen as an economic discipline, which examines how to achieve an increase in the effectiveness of certain corporations with the help of organizational arrangements, contracts, regulations and business legislation. It is not a disputed fact that banks are crucial element to any economy; this therefore demands that they have strong and good corporate governance if their positive effects were to be achieved.[52]

King and Levine[53] and Levine[54] emphasized the importance of corporate governance of banks in developing economies and observed that: first, banks have an overwhelmingly

[50] Jensen, M. and Meckling., W., *supra* n. 11.
[51] Basel Committee on Banking Supervision, 'Sound Practices for the Management and Supervision of Operational Risk: Bank for International Settlement', Basel, February 2006.
[52] *ibid*
[53] King, R. G. and R. Levine, 'Finance, Entrepreneurship and Growth Theory and Evidence', *Journal of Monetary Economics,* (1993) Vol. 32, pp. 513-522.

dominant position in the financial system of a developing economy and are extremely important engines of economic growth. Second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for majority of firms. Third, as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for the economy's savings.

Banking supervision cannot function if there does not exist what Hettes[55] calls 'correct corporate governance' since experience emphasizes the need for an appropriate level of responsibility, control and balance of competences in each bank. Hettes explained further on this by observing that correct corporate governance simplifies the work of banking supervision and contributes towards corporation between the management of a bank and the banking supervision authority.

Crespi, Cestona and Salas[56] contend that corporate governance of banks refers to the various methods by which bank owners attempt to induce managers to implement value-maximizing policies. They observed that these methods may be external to the firm, as the market for corporate control or the level of competition in the product and labor markets and that there are also internal mechanisms[57] such as a disciplinary intervention by shareholders (what they refer to as proxy fights) or intervention from the board of directors. Donald Brash the Governor of the Reserve Bank of New Zealand when addressing the conference for Commonwealth Central Banks on Corporate Governance for the Banking Sector in London, June 2001 observed that:

> "… Improving corporate governance is an important way to promote financial stability. The effectiveness of a bank's internal governance arrangements has a very substantial effect on the ability of a bank to identify, monitor and control its risks. Although banking crises are caused by many factors, some of which are beyond the control of bank management, almost every bank failure is at least partially the result of mis-management within the bank itself. And mis-management is ultimately a failure of internal governance. Although banking supervision and the regulation of banks' risk positions can go some way towards countering the effects of poor governance, supervision by some external official agency is not a substitute for sound corporate governance practices. Ultimately, banking risks are most likely to be reduced to acceptable levels by fostering sound risk management practices within individual banks. An instilling sound corporate governance practice within banks is a crucial element of achieving this."

[54] Levine, R., 'A Financial Development And Economic Growth: Views and Agenda', *Journal of Economic Literature,* (1997) Vol.35, pp 688-706.

[55] Hetteš, F., 'Corporate Governance in the Banking Act: National Bank of Slovakia', *BIATEC* (2002) Vol.5, Pp 42-60.

[56] Crespi, R., Garcia-Cestona, M. A. and Salas, V., 'Governance Mechanisms in Spanish Financial Intermediaries', (2002) *Universitat Autònoma de Barcelona- 28-02.*

[57] Carse the Chief Executive of the Hong Kong Monetary Authority, also observed in 2000 that: "Corporate governance is of course not just important for banks. It is something that needs to be addressed in relation to all companies. Sound corporate governance is particularly important for banks. The rapid changes brought about by globalization, deregulation and technological advances are increasing the risks in banking systems. Moreover, unlike other companies, most of the funds used by banks to conduct their business belong to their creditors, in particular to their depositors. Linked to this is the fact that the failure of a bank affects not only its own stakeholders, but may have a systemic impact on the stability of other banks. All the more reason therefore is to try to ensure that banks are properly managed" [Adapted from: Carse, D;, 'The state of the banking industry in Hong Kong', Speech to the Hong Kong Foreign Bank Representatives Association, Hong Kong, 6 May 2000]. Available at http://www.bis.org/review/r030 on 09/10/. Accessed 20 July 2013.

4.1 THE ELEMENTS OF CORPORATE GOVERNANCE IN BANKS

Different authors and management specialists have argued that corporate governance requires laid down procedures, processes, systems and codes of regulation and ethics that ensures its implementation in organization.[58] Some suggestions that have been underscored in this respect include the need for banks to set strategies which have been commonly referred to as corporate strategies for their operations and establish accountability for executing these strategies. El-Kharouf,[59] while examining strategy, corporate governance and the future of the Arab banking industry, pointed out that corporate strategy is a deliberate search for a plan of action that will develop the corporate competitive advantage and compounds it.

In addition to this, the BCBS[60] contends that transparency of information related to existing conditions, decisions and actions is integrally related to accountability in that it gives market participants sufficient information with which to judge the management of a bank. The Committee advanced further that various corporate governance structures exist in different countries hence, there is no universally correct answer to structural issues and that laws do not need to be consistent from one country to another. Sound governance therefore, can be practiced regardless of the form used by a banking organization. The Committee therefore suggests four important forms of oversight that should be included in the organizational structure of any bank in order to ensure the appropriate checks and balances. They include: Oversight by the board of directors or supervisory board; oversight by individuals not involved in the day-to-day running of the various business areas; direct line supervision of different business areas, and; independent risk management and audit functions.

In summary, they demonstrate the importance of key personnel being fit and proper for their jobs and the potentiality of government ownership of a bank to alter the strategies and objectives of the bank as well as the internal structure of governance hence, the general principles of sound corporate governance are also beneficial to government-owned banks. The concept of good governance in banking industry empirically implies total quality management, which includes six performance areas.[61] These performance areas include capital adequacy, assets quality, management, earnings, liquidity, and sensitivity risk. Klapper and Love[62] argued that the degree of adherence to these parameters determines the quality rating of an organization.

4.2 CORPORATE GOVERNANCE MECHANISMS

One consequence of the separation of ownership from management is that the day to today decision-making power (that is, the power to make decision over the use of the capital supplied by the shareholders) rests with persons other than the shareholders themselves. The separation of ownership and control has given rise to an agency problem whereby there is the tendency for management to operate the firm in their own interests, rather than those of shareholders'.[63] This creates opportunities for managers to build illegitimate empires and, in the extreme, outright expropriation. Various suggestions have been made in the literature as to how

[58] Altunbas, Y., L. and Molyneux, P., 'Bank Ownership and Efficiency', *Journal of Money*, *Credit and Banking,* (2009) Vol. 33.No. 4. Pp. 926–954.

[59] El-Kharouf, F. W., 'Strategy Corporate Governance and the Future of the Arab Banking Industry', *The Arab Bank Review,* (2009) Vol. 2 No. 2 October, pp. 265- 278.

[60] Basel Committee on Banking Supervision, 'Sound Practices for the Management and Supervision of Operational Risk', *Bank for International Settlement Basel,* February.2003.

[61] Klapper, L.F and I. Love, 'Corporate Governance, Investor Protection and Performance in Emerging Markets', World Bank Policy Research Paper 2818, April 2002.

[62] i*bid.*

[63] Jensen, M. and Meckling, *supra* n 50 and Fama, E.F. and Jensen, M., 'Separation of Ownership and Control', *Journal of Law and Economics,* (1983) Vol.26, Pp. 301-325.

the problem can be reduced.[64] Some of the mechanisms based on Shleifer and Vishny,[65] and their impediments to monitor and shape banks' behaviour are discussed below:

4.3 SHAREHOLDERS

Shareholders play a key role in the provision of corporate governance. Small or diffuse shareholders exert corporate governance by directly voting on critical issues, such as mergers, liquidation, and fundamental changes in business strategy and indirectly by electing the boards of directors to represent their interests and oversee the myriad of managerial decisions. Incentive contracts are a common mechanism for aligning the interests of managers with those of shareholders. The Board of directors may negotiate managerial compensation with a view to achieving particular results. Thus small shareholders may exert corporate governance directly through their voting rights and indirectly through the board of directors elected by them. However, a variety of factors could prevent small shareholders from effectively exerting corporate control. There are large information asymmetries between managers and small shareholders as managers have enormous discretion over the flow of information. Also, small shareholders often lack the expertise to monitor managers accompanied by each investor's small stake, which could induce a free-rider problem.

Large (concentrated) ownership is another corporate governance mechanism for preventing managers from deviating too far from the interests of the owners. Large investors have the incentives to acquire information and monitor managers. They can also elect their representatives to the board of directors and thwart managerial control of the board. Large and well-informed shareholders could be more effective at exercising their voting rights than an ownership structure dominated by small, comparatively uninformed investors. Also, they could effectively negotiate managerial incentive contracts that align owner and manager interests than poorly informed small shareholders whose representatives, the board of directors, can be manipulated by the management. However, concentrated ownership raises some corporate governance problems. Large investors could exploit business relationships with other firms they own which could profit them at the expense of the bank. In general, large shareholders could maximize the private benefits of control at the expense of small investors.

4.4 DEBT HOLDERS

Debt purchasers provide finance in return for a promised stream of payments and a variety of other covenants relating to corporate behaviour, such as the value and risk of corporate assets. If the corporation violates these covenants or default on the payments, debt holders typically could obtain the rights to repossess collateral, throw the corporation into bankruptcy proceedings, vote in the decision to reorganize, and remove managers. However, there could be barriers to diffuse debt holders to effectively exert corporate governance as envisaged. Small debt holders may be unable to monitor complex organization and could face the free-rider incentives, as small equity holders. Also, the effective exertion of corporate control with diffuse debts depends largely on the efficiency of the legal and bankruptcy systems.

Large debt holders, like large equity holders, could ameliorate some of the information and contract enforcement problems associated with diffuse debt. Due to their large investment, they are more likely to have the ability and the incentives to exert control over the firm by monitoring managers. Large creditors obtain various control rights in the case of default or

[64] Jesen, M. And Meckling, *supra* n 50, Shleifer and Vishny *supra* n 40, and Hermalin, Benjamin E., and Michael S Weisbach, 'The Effects of Board Composition and Direct Incentives on Firm Performance', *Financial Management,* (1999) Vol. 20, pp. 101-112.

[65] Shleifer and Vishny *supra* n 40.

violation of covenants. In terms of cash flow, they can renegotiate the terms of the loans, which may avoid inefficient bankruptcies. The effectiveness of large creditors however, relies importantly on effective and efficient legal and bankruptcy systems. If the legal system does not efficiently identify the violation of contracts and provide the means to bankrupt and reorganize firms, then creditors could lose a crucial mechanism for exerting corporate governance. Also, large creditors, like large shareholders, may attempt to shift the activities of the bank to reflect their own preferences. Large creditors for example, as noted by Myers[66] may induce the company to forego good investments and take on too little risk because the creditor bears some of the cost but will not share the benefits.

According to Oman,[67] corporate governance mechanisms including accounting and auditing standards are designed to monitor managers and improve corporate transparency. Furthermore, a number of corporate governance mechanisms have been identified analytically and empirically. These, according to Agrawal and Knoeber,[68] may be broadly classified as internal and external mechanisms.

4.5 LINKAGE BETWEEN CORPORATE GOVERNANCE AND FIRM PERFORMANCE

Better corporate governance is supposed to lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision-making. In expectation of such an improvement, the firm's value may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty.[69]

Good governance means little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. As investors and lenders will be more willing to put their money in firms with good governance, they will face lower costs of capital, which is another source of better firm performance. Other stakeholders, including employees and suppliers, will also want to be associated with and enter into business relationships with such firms, as the relationships are likely to be more prosperous, fairer, and long lasting than those with firms with less effective governance.

Implications for the economy as a whole are also obvious. Economic growth will be more sustainable, because the economy is less vulnerable to a systemic risk. With better protection of investors at the firm level, the capital market will also be boosted and become more developed, which is essential for sustained economic growth. At the same time, good corporate governance is critical for building a just and corruption-free society. Poor corporate governance in big businesses is fertile soil for corruption and corruptive symbiosis between business and political circles. Less expropriation of minority shareholders and fewer corruptive links between big businesses and political power may result in a more favourable business environment for smaller enterprises and more equitable income distribution.[70]

[66] Myers, S., 'A Determinants of Corporate Borrowing', *Journal f Financial Economics,* (1997) Vol.5, pp 147-175.

[67] Oman, C. P., 'Corporate Governance and National Development, (2001) *OECD Development Center Technical Papers, Number 180 pp. 362-388.*

[68] Agrawal, A. & Knoeber, C. R, 'Firm Performance and Mechanism To Control Agency Problems Between Managers and Shareholders', *Journal of Financial and Quantitative Analysis,* (1996) Vol. 31, pp. 377-397.

[69] Imam, Mahmood Osman, 'Firm Performance and Corporate Governance through Ownership Structure: Evidence from Bangladesh Stock Market', Paper presented in 2006 ICMAB Conference.

[70] Iskander, Magdi R., and Chamlou, Nadereh, 'Corporate Governance: A Framework for Implementation', (2000) Washington. D.C, The World Bank Group.

According to a survey by McKinsey and Company cited in Adams and Mehran,[71] 78% of professional investors in Malaysia expressed that they were willing to pay a premium for a well-governed company. The average premium these investors were willing to pay generally ranged from 20% to 25%. Many scholars have attempted to investigate the relationship between good governance and firm performance in a more rigorous way.

4.6 REGULATORY ENVIRONMENT FOR BANKS IN NIGERIA

The special tasks of providing the general public with a payment system and funding their operations with deposits are the main reasons why banks are regulated, i.e. there is a need for a safety net to protect depositors from the risk of bank runs and failures.[72] As mentioned earlier on, the subject of corporate governance and the more specific issue of board independence have suffered neglect both in the academia and public policy in Nigeria. Before the introduction of a code of corporate governance, there were three main legislations that influenced the operations of enterprises: The Companies and Allied Matters Act 1990 prescribes the duties and responsibilities of managers of all limited liability companies; the Investment and Securities Act (ISA) 2009 requires Securities and Exchange Commission to regulate and develop the capital market, maintain orderly conduct, transparency and sanity in the market in order to protect investors; the Banks and other Financial Institutions Act 1991 empowers the Central Bank of Nigeria to register and regulate Banks and other Financial Institutions.

These legislations had evident gaps and they were by no means comprehensive in terms of corporate governance provisions. Taking note of the deficiencies of the existing legislations, the Securities and Exchange Commission in partnership with the Corporate Affairs Commission set up in June 2002 a Committee to develop a draft code of corporate governance. The code, launched in November 2003 made a number of recommendations for improving corporate governance in general, but gives a more detailed account of ways to promote board independence. Amongst other recommendations of the code is that the Audit Committee should comprise at most one executive and at least three non-executive directors (NED). Members of that committee must be able to read and understand financial reports. There is a recommendation that the post of CEO should be separated from that of the Chairman, unless it is absolutely necessary for the two to be combined, in which case the Code recommends that a strong, non-executive director should serve as Vice-chairman of the board.

Other provisions of the code related to strengthening board independence include the recommendation that non executive director (NED) should chair the audit committee, in addition to the requirement that a non executive director should have no business relationship with the firm. They also include a recommendation that provides that the non-executive directors should be in the majority, and that a non-executive director should chair the remuneration committee, the membership of which should comprise wholly or mainly of outside directors. However, it is observed that the code is silent about other equally important committees like the appointment committee which is for regulating board independence. Moreover the code lacks legal authority, as there is no enforcement mechanism and its observance is entirely voluntary.[73] Recognising the potential problem to effective governance that family affiliation of board members could cause, the committee recommended that in order for the board to be truly independent, (outside) directors should not be connected with the

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[71] Adams R and Mehran H., 'Corporate Performance, Board Structure and their Determinants in the Banking Industry', (2008) *Federal Reserve Bank of NY Staff Report No 330.*
[72] Freixas, X., Parigi, B. and. Rochet, J.C. 'The Lender of Last Resort: A 21st Century Approach', (2003) Working Paper No.298, European Central Bank.
[73] Nmehielle, V. O. and E. S. Nwauche, 'External-Internal Standards in Corporate Governance in Nigeria', (2004) Public Law and Legal Theory Working Paper NO. 115, The George Washington University Law School.

immediate family of the members of the management.

As mentioned above, by excluding certain vital means of strengthening board independence it would appear that Nigeria's code of corporate governance does not take full account of such provisions in codes of corporate governance developed much earlier on in other countries such as the United Kingdom and USA. In the United States, the Sarbanes-Oxley Act 2002 has come into being, heralding the start of new far-reaching measures aimed at strengthening corporate governance and restoring investor confidence.[74] Building on the progress made in the reports by Cadbury,[75] Greenbury,[76] and Hempel,[77] the United Kingdom in 2003 started to implement the New Combined Code, an outcome of the Company Law review and a report by the Higgs Committee. In both countries the new set of regulations have recognized the importance of non-executive directors and made special provisions aimed at promoting their independence and corporate governance.

5. CORPORATE GOVERNANCE AND THE NIGERIA BANKING MECHANISM: SYTHESIS OF CRISES AND RESILIENCE

Although the consolidation process in the Nigerian banking sector created bigger banks, it however failed to overcome the fundamental weaknesses in corporate governance in many of these banks. The huge surge in capital availability occurred during the time when corporate governance standards at banks were extremely weak. In fact, failure in corporate governance at banks was indeed a principal factor contributing to the financial crisis.

According to Sanusi[78] it was well known in the industry that since consolidation, some banks were engaging in unethical and potentially fraudulent business practices and the scope and depth of these activities were documented in recent CBN examinations. Governance malpractice within the consolidated banks has therefore become a way of life in large parts of the sector, enriching a few at the expense of many depositors and investors. Sanusi further opined that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management. In addition, the audit process at all banks appeared not to have taken fully into account the rapid deterioration of the economy and hence of the need for aggressive provisioning against risk assets.

As banks grew in size and complexity, bank boards often did not fulfil their functions and were lulled into a sense of well-being by the apparent year-over year growth in assets and profits. In hindsight, boards and executive management in some major banks were not equipped to run their institutions. Some banks' Chairmen/CEOs were seen too often have an overbearing influence on the board, and some boards lacked independence; directors often failed to make meaningful contributions to safeguard the growth and development of the bank and had weak ethical standards; the board committees were also often ineffective or dormant.

The Central Bank of Nigeria published details of the extent of insider abuse in several of the banks and it was revealed that CEOs set up Special Purpose Vehicles to lend money to themselves for stock price manipulation or the purchase of estates all over the world. For instance, one bank borrowed money and purchased private jets which the Apex bank later discovered were registered in the name of the CEO's son. In another bank, the management set up 100 fake companies for the purpose of perpetrating fraud.

[74] Jensen, M.C. and Fuller. J., 'What's a Director to Do?', *Research Paper No. 02-38*, (2002) Harvard NOM.
[75]Cadbury, A., *Report of the Committee on the Financial Aspects of Corporate Governance,* (2002), Gee Publishing, London.
[76] Greenbury Committee Report, *Report on Directors Remuneration*, (1995), London: Gee Publishing.
[77] Hempel, R., *Committee on Corporate Governance: Final Report.,* (1998), London, Gee Publishing.
[78] Sanusi *supra* n

Sanusi also disclosed that 30% of the share capital of Intercontinental bank was purchased with customer deposits. Afribank used depositors' funds to purchase 80% of its IPO. It paid N25 per share when the shares were trading at N11 on the NSE and these shares later collapsed to under N3. The CEO of Oceanic bank controlled over 35% of the bank through SPVs borrowing customer deposits. The collapse of the capital market wiped out these customer deposits amounting to hundreds of billions of naira. Therefore, a lot of the capital supposedly raised by these so called 'mega banks' was fake capital financed from depositors' funds.[79] Based on this, we can conclude that the consolidation process was a sham and the banks never raised the capital they claimed they did.[80]

5.1 SHAREHOLDER'S ACTIVITIES

Baysinger and Butler[81] found little evidence that corporate governance resolutions initiated by shareholders lead to better firm performance. Smith and Watts,[82] reported a positive performance effects for the Shareholder's activities of the California Public Employees' Retirement System. Huson, Malatesta and Parrino[83] showed that financial institutions could be fairly effective in pushing target companies to take steps to comply with their corporate governance proposals. They also find that any short-term valuation effects resulting from activities are dependent on the specific type of governance issue targeted. Gillan[84] find that shareholder proposals by individuals have small, positive announcement effects, while proposals by institutional investors have a small but significant negative effect on stock prices. Overall, the empirical literature on shareholder's activities in the United States seems to indicate that it has a negligible impact on corporate performance.[85]

In other studies, Frankel, Johnson and Nelson[86] showed a negative relationship between earnings and auditor's independence, but Ashbaugh, Lafond and Mayhew[87] and Larcker and Richardson[88] dispute their evidence arguing that the study dwelt more on intrinsic factors. Agrawal and Chadha[89] find no relation between either audit committee independence nor the extent auditors provide non-audit services with the probability a firm restates its earnings. Furthermore, several studies have examined the separation of CEO and chairman, positing that agency problems are higher when the same person holds both positions. Using a sample of 452 firms in the annual Forbes magazine rankings of the 500 largest U.S. public firms between 1984 and 1991, Yermack[90] shows that firms are more valuable when the CEO and board chair

[79] Sanusi *supra* n.

[80] www.centbank.com. Accessed 20 June 2013.

[81] Baysinger, B. D. & Butler, H.N., 'Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition', *Journal of Law, Economics, and Organization,*(1985) Vol. 1, pp. 101-124.

[82] Smith, Clifford W. and Ross L. Watts, 'The Investment Opportunity Set and Corporate Financing, Dividend, and Compensation Policies', *Journal of Financial Economics,* (1992) Vol.32, pp. 263- 292.

[83] Huson, M., P. Malatesta, R. Parrino, 'Managerial Succession and Firm Performance', (2004) *Journal of Financial Economics,* Vol. 74, pp. 237-265.

[84] Gillan, S.L., 'Recent Developments in Corporate Governance: An Overview', (2006) *Journal of Corporate Finance,* Vol.12 pp.381-402.

[85] Black, B., H. Jang, and W. Kim, 'Does Corporate Governance Affect Firm Value?' (2003) *Working paper 327,* Stanford Law School.

[86] Frankel, R., Johnson, M and Nelson, K, 'The Relation between Auditors' Fees For Non-Audit Services and Earnings Management', *Accounting Review,* (2002) Vol. 77 pp. 71 – 95.

[87] Ashbaugh, H., R. Lafond, and Mayhew, B., 'Do Non-audit Services Compromise Auditor Independence? Further Evidence', *Accounting Review* (2003) 78 (July): Pp. 611-639.

[88] Larcker, D., and S. Richardson., 'Fees Paid To Audit Firms, Accrual Choices, and Corporate Governance', *Journal of Accounting Research* (2004) 42 (June): pp. 625-638.

[89] Agrawal, A., and Chadha, S., 'Corporate Governance and Accounting Scandals', *Journal of Law and Economics*, (2005) Vol.10, No.4, Pp 56- 78.

[90] Yermack, D., 'Higher Market Valuation of Companies with a Small Board of Directors', *Journal of Financial Economics,* (1996) Vol.40, pp. 185–211.

positions are separate. Core, Holthausen and Larcker[91] also find out that CEO compensation is lower when the CEO and board chair positions are separate.

Gompers, Ishii and Metrick[92] used Investor Responsibility Research Center data, and concluded that firms with fewer shareholder rights have lower firm valuations and lower stock returns. They classified 24 governance factors into five groups: tactics for delaying hostile takeover, voting rights, director protection, other takeover defenses, and state laws. Most of these factors are anti-takeover measures so this index is effectively an index of anti-takeover protection rather than a broad index of governance.

Mallin[93] in USA studied the possible link between the corporations' financial performance and its commitment to ethics. The emphasis of the paper was on attempting to find a link between overall financial performance and an emphasis on ethics as an aspect of corporate governance. Mallin, found that 26.8% of the 500 largest US public corporations are committed to ethical behaviour towards stakeholders, or emphasize compliance with codes of conduct. The financial performance of these corporations ranked higher than that of those corporations, which did not behave in this way. The statistical significance of the difference was highly significant.

Spong and Sullivan[94] in their study on corporate governance of banks outlined that the previous studies by Pfeffer and Salancik,[95] Ogus,[96] Pearce and Zahra,[97] Vafeas,[98] Weisbach,[99] Daily and Dalton,[100] Mehran,[101] Daily and Ellstrand,[102] Rosenstein and Wyatt,[103] Klein,[104] Weir and Laing,[105] Bhagat and Bolton,[106] Bhagat and Black[107] and Sanda, Mukaila and Garba;[108] all

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[91] Core, J., Holthausen, R.and Larcker, D., 'Corporate Governance, Chief Executive Compensation, and Firm Performance, *Journal of Financial Economics* (1999) Vol. 51 (March): Pp371-406.

[92] Gompers, P., Ishii, L and Metick, A., 'Corporate Governance and Equity Prices', *Quarterly Journal of Economics* (2003) Vol.118, pp.107-125.

[93] Mallin, Christine, 'The Relationship between Corporate Governance, Transparency and Financial Disclosure' *International Review Journal,* (2002) Vol.10, No.4 pp. 253-255.

[94] Spong, K., and Sullivan, K., 'Corporate Governance and Bank Performance', *Strategic Management Journal*, (2007) Vol. 12, pp.155–160.

[95] Peffer, J. and Salancik, G.R., *The External Control of Organisation: A Resource Dependency Perspective,* (1978) New York: Harper and Roe.

[96] Ogus, A. I., *Regulation, Legal Form and Economic Theory. Clarendon Law Series,* (1994) Oxford University Press.

[97] Pearce, J.A. and Zahra, S.A., 'Board Composition from a Strategic Contingency Perspective', *Journal of Management Studies*, (1992) Vol.29, No.4, 414-438.

[98] Vafeas, N., 'Board Meeting Frequency and Firm Performance', *Journal of Financial Economics,* (1999) Vol. 53, pp. 113-132.

[99] Weisbach, M.S., 'Outside Directors and CEO Turnover', *Journal of Financial Economics,* (1988) Vol. 20, pp. 431-450.

[100] Daily, C.M. & Dalton, D.R., 'The Relationship Between Governance Structure and Corporate Performance in Entrepreneurial Firms', *Journal of Business Venturing,* (1992) Vol.7, No. 5, pp 375-386.

[101] Mehran, Hamid, 'Executive Compensation Structure, Ownership, and Firm Performance, *Journal of Financial Economics,* (1995) Vol.38, pp. 163-84.

[102] Dalton, D., Daily, R., Ellstrand, C. and Johnson, M., 'Meta-analytic Reviews of Board Composition, Leadership Structure, and Financial Performance', *Strategic Management Journal* (1998) Vol.19 Pp 269-280.

[103] Rosenstein, S and J.C Wyatt, 'Outside Directors, Board Effectiveness and Shareholders Wealth', *Journal of Financial Economics,* (1997) Vol. 26, pp 175-191.

[104] Klein, E., 'Firm Performance and Board Committee Structure', *Journal of Law and Economics*, (1998) Vol. 41, No.2, pp. 275- 293.

[105] Weir, C., Laing, D., and McKnight, P.J., 'An Empirical Analysis of the Impact of Corporate Governance Mechanisms on the Performance of UK Firm', (2001) Working Paper. Available at http://www.ssrn/ awwfc.com. Accessed 15 June 2013.

[106] Bhagat, Sanjai and Bolton, Brian, 'Corporate Governance and Firm Performance', Working Paper No.17-2005, University of Colorado.

[107] Bhagat, Sanjai, and Bernard Black, 'The Non-Correlation Between Board Independence and Long-Term Firm Performance', *Journal of Corporation Law,* (2002) Vol. 27, Pp. 231-254.

on board composition and performance, focused majorly on corporate governance of firms while non looked at the effect of board composition on banks' value. Furthermore, apart from the studies by Sanda et al and Attiya and Robina[109] as reviewed in board composition studies, all the other studies listed above, focused on developed market.

Studies by Lipton and Lorsch,[110] Jensen,[111] Hermalin and Weisbach 2002,[112] Mak and Li,[113] Mak and Yuanto,[114] Klein[115] (1998); Agrawal and Knoeber,[116] Adams and Ferreira,[117] Adams and Mehran[118] and Coles, Daniel and Naveen[119] among other studies on board size and performance have been criticized by Bolton[120] to consider just a single measure of governance. Bolton further expressed that this studies are also restricted to the Organization for Economic Cooperation and Development (OECD) framework only. As further observed, most prior studies on corporate governance and performance make use of the market based performance measure and not accounting performance measures. In order to cover the lapses in prior studies, this study will build on the studies by Brown and Caylor,[121] Sandeep et al,[122] Coleman and Nicholas-Biekpe[123] to analyze the relationship between corporate governance and financial performance of banks in Nigeria.

5.2 THE PERSPECTIVE OF BANKING SECTOR REFORMS IN NIGERIA

The last two and a half decades has witnessed several significant reforms and developments in the Nigerian financial services sector. As a result of the various financial sector reforms carried out since the late 1980s, the nation's banking system has undergone remarkable changes in terms of the number of institutions, ownership structure, as well as depth and breadth of the market. The reforms had been influenced largely by challenges posed by deregulation, globalization, technological innovations and adoption of supervisory and

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[108] Sanda, A.U, A.S Mukaila and T. Garba, 'Corporate Governance Mechanisms and Firm Financial Performance in Nigeria', (2005) Final Report Presented to the Biannual Research Workshop of the AERC, Nairobi, Kenya, pp 24-29.

[109] Attiya Y. and Robina, Iqbal (2007): Relationship between Corporate Governance Indicators and Firm Value: A Case Study of Karachi Stock Exchange. *MPRA Paper* No. 2225

[110] Lipton, M. and J.W. Lorsch, 'A Modest Proposal for Improved Corporate Governance', *Business Law Review* (1992) Vol. 48, No.1 pp.59–77

[111]Jensen, M., 'The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems', *Journal of Finance,* (1993) Vol.48, pp 831-840.

[112] Hermalin, B & Wesibach, M., 'Boards of Directors as Endogenously Determined Institutions: A Survey of the Economy Literature', *Economy Policy Review,* (March, 2002) *Pp.48- 62.*

[113] Mak, Y.T. and Li., Y., 'Determinants of Corporate Ownership and Board Structure: Evidence from Singapore, *Journal of Corporate Finance,* (2001) Vol.7, pp 235-256.

[114] Mak, Y.T. & Yuanto, K., 'Board Size Really Matters: Further Evidence on the Negative Relationship between Board Size and Firm Value', *Journal of Corporate Finance,* (2003) Vol.5, pp 145-166.

[115] Klein, E., 'Firm Performance and Board Committee Structure', *Journal of Law and Economics*, (1998) Vol. 41, No.2, pp. 275- 293

[116] Agrawal, A., and Chadha, S., 'Corporate Governance and Accounting Scandals', *Journal of Law and Economics*. (2005) Vol.10, No.4, Pp 56- 78.

[117]Adams, R and Ferreira, D., 'A Theory of Friendly Boards', *The Academy of Management Review*, (2003) Vol.22, No.3, 609-611.

[118] Adams, R. and Mehran, H., 'What Do Boards Do? Evidence from Board Committee and Director Compensation', (2002) *EFA 4005, SSRN.*

[119]Coles, J., Daniel, L. and Naveen, L., '*Boards: Does One Size Fit All?'* (2004). Available at www.papers.ssrn.com/sol3/papers.cfm accessed 15 July 2013.

[120] Bolton, P., 'Corporate Governance and Development', *Review of Financial Studies,* (2006) Vol.19, No.3, Pp.829-840.

[121] Brown, L. D. and Caylor, M.L, 'Corporate governance and firm performance', Georgia State University, (2004) Working Paper 146-04.

[122]Sandeep, A., Patel, A. B. & Lilicare, B. (2002): Measuring Transparency and Disclosure at Firm-Level in Emerging Markets. *Journal of Finance,* Vol. 24, No.4, pp. 537- 553.

[123] Coleman, A. and Nicholas- Biekpe, N., 'Does Board and CEO Matter for Bank Performance? A Comparative Analysis of Banks in Ghana', *Journal of Business Management,* University of Stellenbosch Business School (USB), Cape Town, South Africa, (2006) Vol.13, Pp.46- 59.

prudential requirements that conform to international standards. In 2001 for example, the Universal Banking Scheme was introduced, following further liberalization of the nation's financial sector. Its adoption was borne out of the need to create a more level-playing field for the financial sector operators than hitherto, encourage greater efficiency through economies of scale, and foster competition. Soludo[124] further asserts that as at the end of 2004, there were 89 universal banks operating in Nigeria, comprising institutions of various sizes and degrees of soundness. Structurally, the sector is highly concentrated, as the ten largest banks in the system account for about 50 per cent of the industry's total assets/liabilities. Many of the banks in the system are small in size and unable to compete with the bigger ones. Some of the small banks, apart from being closely held, were plagued by high incidence of non-performing loans; capital deficiencies; weak management and poor corporate governance. Also, when compared with the banking sectors in emerging economies, the nation's banking sector according to Soludo, was described as fragile, poorly developed and extremely small.

A critical look at the nation's banking system no doubt, indicates that the sector faces enormous challenges that call for an urgent attention. That consideration informed the implementation of a banking sector reform currently being undertaken by the CBN. The reform policies basically, complement banking liberalization earlier-on undertaken in the system, and include a broad range of measures aimed at improving the regulatory and supervisory environment as well as restructuring and developing the banking sector entities. The reforms agenda according to Soludo:[125]

> "… Is a pre-emptive and proactive measure to prevent an imminent systemic crisis and collapse of the banking industry, and permanently stop the boom and … the cycles which have characterized the history of our banking industry. More fundamentally, the reforms are aimed at ensuring a sound, responsive, competitive and transparent banking system appropriately suited to the demands of the Nigerian economy and the challenges of globalization."

Specifically, the objectives of the banking reform, which is part of the general agenda of the Government overall economic reform programme (National Economic Empowerment and Development Strategy (NEEDS), include: Creation of a sound banking system that depositors can trust; Creation of banks that are investor-friendly and that can finance capital intensive projects; Enhancement of transparency, professionalism, good corporate governance and accountability.

The main thrust of the reform package, which was anchored on a thirteen-point agenda, was to consolidate and recapitalize banks by increasing their shareholder's funds to a minimum of N25 billion (about US$190 million) which took effect from December 31st, 2005.[126] Other highlights include: the adoption of risk-focused and ruled based regulatory framework; the adoption of zero tolerance in the regulatory framework, especially in the area of data/information reporting; enforcement of dormant laws, especially those relating to the vicarious liabilities of banks' Board members in cases of bank failure; revision and updating of relevant laws, and drafting of new ones relating to the effective operations of the banking system etc. The reforms had in turn prompted a regulatory induced restructuring in the form of consolidation that would engender the alignment and realignment of banks and banking groups in determined moves, which translated into the merger of some banks and the acquisition of

[124]Soludo, C. C., 'Towards the repositioning of The Central Bank of Nigeria for the 21st Century', A keynote Address Delivered at the Annual Dinner of the Chartered Institute of Bankers of Nigeria, Held at the Muson Centre, Onikan, Lagos, 5 November 2005.
[125]Soludo (2004b) *supra.*
[126] Alashi, S. O., 'Banking Crisis: Causes, Early Warning Signals and Resolutions', *NDIC Quarterly,* (2005) Vol. 12, No. 4, December. Pp. 22-27.

others.[127] The emergence of mega banks no doubt, would expose banks to new challenges, which if not properly addressed could adversely affect the operations of the payment system and its credibility. Also, the nature of the business of banks, particularly its opacity could make the risk exposure of banks even more difficult to assess in a consolidated banking system. These developments make it compelling for operators to demonstrate far greater commitment to professionalism and good corporate governance practices in banking institutions. Essentially, the way banking institutions are governed under the new dispensation would have implications for the achievement of the overall objectives of the policy on consolidation.

5.3 STATE OF CORPORATE GOVERNANCE IN NIGERIAN BANKS

Owing to the unique nature of banking, there are adequate corporate governance laws and regulations in place to promote good corporate governance in Nigeria. Some of the most important ones include: the Nigeria Deposit Insurance Corporation (NDIC) Act of 1988, the Company and Allied Matters Act (CAMA) of 1990, the Prudential Guidelines, the Statement of Accounting Standards (SAS 10), the Banks and Other Financial Institutions (BOFI) Act of 1991, Central Bank of Nigeria (CBN) Act of 1991, CBN Circulars and Guidelines, among others.[128] Also, there are some government agencies and non-governmental associations that are in the vanguard of promoting good corporate governance practices in the Nigerian banking sector. These organizations, apart from the CBN and NDIC, include the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE), Corporate Affairs Commission (CAC), Chartered Institute of Bankers of Nigeria (CIBN), Institute of Chartered Accountants of Nigeria (ICAN), Financial Institutions Training Centre (FITC) among others.

Basically, corporate governance in the nation's banking system provides the structure and processes within which the business of bank is conducted with the ultimate objective of realizing long-term shareholders' value while taking into account the interests of all other legitimate stakeholders. In meeting its overall commitment to all stakeholders, the various statutory and other regulations in the system impose the responsibilities with sanctions for breaches on bank directors to: Effectively supervise a bank's affairs by exercising reasonable business judgment and competence; critically examine the policies and objectives of a bank concerning investments, loan asset and liability management; monitor bank's observance of all applicable laws; avoid self-serving dealings and any other malpractices; and, ensure strict accountability.[129]

A critical review of the nations' banking system over the years, have shown that one of the problems confronting the sector has been that of poor corporate governance. From the closing reports of banks liquidated between 1994 and 2002, there were evidences that clearly established that poor corporate governance led to their failures. As revealed in some closing reports, many owners and directors abused or misused their privileged positions or breached their fiduciary duties by engaging in self-serving activities. The abuses included granting of unsecured credit facilities to owners, directors and related companies which in some cases were in excess of their banks' statutory lending limits in violation of the provisions of the law.[130]

The various corporate misconducts in the affected banks caused pain and suffering to some stakeholders particularly, depositors and some shareholders for no fault of theirs. A

[127] Craig, V. V., 'The Changing Corporate Governance Environment: Implications for the Banking Industry', *FDIC Banking Review,* (2005) Vol.16, pp. 131- 140.

[128] Adenikinju, O. and Ayorinde, F., 'Ownership Structure, Corporate Governance and Corporate Performance: The Case of Nigerian Quoted Companies', (2001) Unpublished Final Report presented at the AERC biannual research workshop, Nairobi, May.

[129] Umoh, P. N., 'An Overview of Risk Management Practices in the Nigerian Banking Industry', *NDIC Quarterly,* (2002) Vol. 12, No. 4, Dec. pp. 53- 59.

[130] Osota Oluranti, 'Insiders' Credit Problems In Insured Banks: Analysis and Prescription', *NDIC Quarterly,* (1992) Vol. 9, No. 4. December.45-53.

review of on-site examination reports of some banks in operation in recent times, continued to reveal that some banks had continued to engage in unethical and unprofessional conducts such as:

- Non-implementation of Examiner's recommendations as contained in successive examination reports;
- Continual and wilful violation of banking laws, rules and regulations;
- Rendition of inaccurate returns and failure to disclose all transactions thereby preventing timely detection of emerging problems by the Regulatory Authorities.[131]

Furthermore, some banks' examination reports revealed that many banks were yet to imbibe the ethics of good corporate governance. One of such issues bordering on weak corporate governance had been the prevalence of poor quality of risk assets. Apart from those of other debtors, large non-performing insider-related loans and advances in some banks had persisted due to the inability of the respective Boards and Management to take appropriate action against such insider debtors.

From the various reports reviewed, internal audit functions were, in some banks not given appropriate backing of the Board and Senior Management. As a result, there had been the prevalence of frauds and forgeries in some banks in the system. Lack of transparency in financial reporting had equally been noted in some banks' examination reports. The Boards of some banks were also noted to be ineffective in their oversight functions as they readily ratified management actions even when such actions could be seen to violate the culture of good corporate governance. Many Board Committees were equally noted to have failed to hold regular meetings to perform their duties. From the forgoing, it is obvious that corporate governance in the system faces enormous challenges which if not addressed could have serious implications for the overall success of the bank consolidation exercise.[132] If operators in the banking sector will keep to the rules, as specified by the regulatory agencies and in individual banks' policies and transaction procedures all things being equal, financial sector stability could be guaranteed. However, when there is the possibility of flagrant abuse of the ethical and professional demands on operators as evidenced in some failed banks' closing reports and on-site examination reports of some of the banks in operation, the prospect of restoring public confidence in the Nigerian banking system may be difficult to guarantee.

5.4 THE IMPERATIVES OF GOOD CORPORATE GOVERNANCE IN A CONSOLIDATED NIGERIA BANKING SYSTEM

The hallmark of banking is the observance of high degree of professionalism, transparency and accountability, which are essential for building strong public confidence. Due to the systemic distress witnessed in the nation's banking system and its unpleasant consequences on all stakeholders as a result of inadequacies in corporate governance of banks in recent times, series of initiatives had been taken by the nation's regulatory/supervisory authorities to encourage sound corporate governance in the system. Some of the initiatives included enhancing the legal framework; enhancing the surveillance activities of the financial system; strengthening the roles of internal and external auditors; developing of a code of best practices of corporate governance in the system; issuance of guidelines and circulars on matters such as pre-qualification for appointment to board and top management positions in banks, insider related credits, etc. While all the above-mentioned efforts are in the right direction, it is equally important to indicate some imperatives of good corporate governance for banks so as to ensure the safety and soundness of emerging bigger banks in the post-consolidation era with a

[131] Oluyemi, S.A., 'Banking Sector Reforms and the Imperatives of Good Corporate Governance in the Nigerian Banking System', *NDIC Quarterly,* (2006) Vol. 15 No. 1, March pp. 22-29.

[132] Craig V.V. *supra* n 128

view to enhancing public confidence in the nation's banking system. Some of the imperatives as identified by Oluyemi:[133]

- *Raising Awareness and Commitment To The Value of Good Corporate Governance Practices among Stakeholders*

Awareness and commitment among banks' directors, shareholders, depositors and other stakeholders including regulators of the value of good corporate governance are very critical for ensuring the quality of corporate governance practices. Raising awareness means convincing people that good corporate governance is in their self-interest. Investors and all members of the public that have stake in the proper functioning of the banking system should be aware of their responsibility towards ensuring good corporate governance practices.

- *The Responsibilities of the Board*

The ultimate responsibility for effective monitoring of the management and of providing strategic guidance to the bank is placed with the board. The OECD Principles provide that "board members should act on a fully-informed basis, in good faith, with due diligence and care, and in the best interest of the company and shareholders". The formulation lays out the basic elements of a director's fiduciary duty. The need to act on a "fully-informed" basis demands a base level of experience and competence on a director's part.

The OECD Principles require directors to act "with due diligence and care". This standard, like others, is contextual; it arises from a blend of laws, regulation and appropriate private sector practices. This would require developing and disseminating voluntary codes of conduct for directors. Governance is a professional activity. Under the new consolidated banking environment, banks should make provision for an explicit code in their governing documents in order to ensure good corporate governance practices. Codes of conduct would no doubt; assist the Board of Directors in its performance by publicly detailing the minimum procedures and effort that make up "due diligence and care". At the minimum, all banks should issue an annual corporate governance report detailing establishment and actions of key committees, involvement of independent directors and related-party transactions considered by the board.

In a consolidated banking system, the importance of independence, both in fact and appearance is essential for the board to be able to fulfil its responsibilities. Having the right people on the board is just as important as having the right rules under which the board operates. Efforts must therefore be made by shareholders to identify competent individuals who possess an independent spirit, which allows board members to raise difficult questions and probe issues relating to management's decisions to ensure that the bank operates honestly and in the interest of all stakeholders. There is the need to prevent low level, inexperienced relative of controlling shareholders from finding their way onto boards as "straw men" which are there to cover for "shadow" directors that do not occupy board seats themselves but are real decision makers.

Under the new dispensation, bank directors must commit adequate time to be informed participants in their banks affairs and must devote sufficient time and energy to their duties. Board members have a responsibility to educate themselves about their bank's operations and seek advice of external experts as and when appropriate. Even if board members are independent, they can be ineffective as directors if they lack expertise or knowledge relevant to banking and its business. Therefore, board members must also be willing to educate themselves about their bank and the risk it faces.

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[133] Oluyemi *supra* n 132.

Although effective risk management has always been central to safe and sound banking practices, it has become even more important now than hitherto as a result of the ongoing consolidation which is bound to alter the size, complexity and speed of financial transactions in the merging banking system. It is therefore important to indicate that the ability of a bank to identify, measure, monitor and control risks under the emerging banking environment can make the critical difference between its survival and collapse. For a bank to effectively play its role under the emerging dispensation therefore, the deployment of an effective risk-management system with an active board and senior management oversight is imperative.

Another major issue that has generated interest and which should be of interest to all stakeholders in post-consolidated banking system is the appropriateness of the Chairman of the Board of Directors serving as Chief Executive Officer (CEO). This no doubt, could present potential conflicts resulting from a single individual functioning in these dual roles. To ensure the protection of shareholders' interest, a suitable governance structure that has been advocated is the one where the Chairman of the Board is not the same person as the CEO. A situation where a person takes on the role of the executive chairman thereby sitting in judgment over its activities, could lead to a gross abuse of power. The separation of the CEO and Chairman of the board positions would amount to recognizing the differences in their roles and would eliminate conflict of interest. Chairing the Board and heading the Management team are also different roles, usually calling for quite different capabilities. Apart from the traditional role of attending board meetings, a Chairman should restrict himself to overseeing top executive and management, stimulating strategy, ensuring that transparency and accountability are maintained.

- *Internal Control – The Role of Internal and External Auditors*

The need for banks to continue to recognize internal and external auditors as an important part of the corporate governance process cannot be overemphasized. Adequate internal control system will help to discipline banks in their daily business by ensuring compliance with internal and external regulations as well as help the board to effectively evaluate the bank's risks and ultimately its future strategy. The Basel II Accord on Capital Adequacy reinforces the need for a strong and independent internal control system that provides the bank's governing bodies with timely and accurate data to enable them performs their necessary oversight and control functions. The accounting profession needs to rigorously work to rebuild its greatest assets i.e. public trust, in order to restore faith in the integrity and objectivity of the profession.

The current control/audit system, which is administratively or functionally dependent on the CEO and not the board as noted in some banks' examination reports could limit their effectiveness. The professional development and growth in experience of internal auditors and internal control officers will be critical to the further development of the banking sector. There is need for the effective functioning of the board of directors' audit committee. The job of the Audit Committee is critical because the directors cannot oversee the bank effectively without reliable audits. Under the new dispensation, the committee members should consist of independent directors who are adequately informed and knowledgeable about the activities of the bank.

Still in the search for strategies to ensure good corporate governance is an examination of the role of external auditors. A major challenge in the emerging consolidated banking system would be the need to continue to ensure their independence, such that no matter the position their clients take on accounting, reporting and regulatory compliance, the auditor's duty will always be towards public good. More than ever before, the external auditors of banks should be obliged to commit themselves to clarity with regard to their independence, professionalism and integrity. They must continue to adhere to all applicable standards, code of ethics and

legislation. As the conscience of the nation, external auditors must strive to rebuild confidence in the profession through the preparation and presentation of credible and reliable financial reports.

- *Information Disclosure And Transparency*

The quality of information provided by banks is fundamental to corporate governance in a consolidated banking system. Transparency would enable the financial markets, depositors and other stakeholders to form a fair view of a bank's value and to develop sufficient trust in the quality of the bank and its management. The more transparent the internal workings of the banks, the more difficult it will be for managers and controlling shareholders to expropriate bank's assets or mismanage the bank. The current information disclosure requirements in the industry are grossly inadequate to effectively bridge the information asymmetry between banks and investing public in a consolidated banking system. With consolidation, it is important that the accounting as well as disclosure requirements of emerging banks be reviewed. Apart from its effect on individual banks performance and market valuation, disclosure and transparency will also affect the country's ability to attract domestic and foreign investment.

Banks should be encouraged to disclose information that goes beyond the requirements of law or regulation. The new consolidated banking environment will call for timely and accurate information to be disclosed on matters such as the bank's financial and operating results, its objectives, major share ownership, remuneration of key executives, and material issues regarding employees and other stakeholders, and the nature and extent of transactions with affiliates and related parties. Transparency under the new banking environment will also call for sharing mistakes with the bank's board and shareholders. Since financial statements do not present all information that is material to investors, comprehensive disclosure should also be made to include non-financial information.

The quality of information disclosure depends on the standards and practices under which it is prepared and presented. Full adoption of international accounting standards and practices will facilitate transparency, and comparability, of information across banks. Banks must be made to disclose whether they follow the recommendations of internationally accepted principles and codes in their documents and, where they do not, such institutions should provide explanations concerning divergent practices.

5.5 CORPORATE GOVERNANCE AND THE BANKING SYSTEM: LESSON FROM OTHER JURISDICTION

5.5.1 MALAYSIA

The financial and banking system in Malaysia has always been considered as safe and sound and Bank Negara Malaysia (the Central Bank of Malaysia) is renowned for its pursuit of a high level of regulatory and supervisory standards.[134] Haniffa and Cooke[135] observed that the practice of corporate governance in the domestic banking system is not a new phenomenon. Even before the 1997 financial crisis, Malaysia had already adopted the Basel Core Principles of Effective Banking. It would be erroneous to say that both the regulators and the Board of Directors in the banking industry did not understand what good corporate governance entails and its importance in reducing the costs of banking crises. Yet the Asian financial crisis of 1997

[134] Haniffa, R.M., and Cooke, T.E., 'Culture, Corporate Governance and Disclosure in Malaysian Corporations', *Abacus,* (2002) Volume 38, No.3, pp.317-329.
[135] *Ibid.*

occurred. The lesson of experience from this crisis is that having an enhanced corporate governance regime is a necessary condition to avert crisis.[136]

A good corporate governance mechanism encourages the proper management of risk and also provides a framework of disclosure that allows the market to discern the risk choices of the banking institutions. To be effective it must entail greater transparency and market discipline. It is essential that there must also be a proper balance in the prudential regulatory framework that acts as a stick as well as a carrot; i.e. inflicting disincentives for departure from, and bequeathing incentives for conformity to prudential norms. Especially in an environment of heightened uncertainties, the experience of the 1997-banking crisis demonstrated that lapses in internal controls and the management of operational and market risks can be very costly to individual banking institutions.[137]

In the post crisis period, Bank Negara Malaysia has relentlessly encouraged both the banking and the corporate sectors to minimize this gap in the practice of the governance framework. All banks have adopted strict measures in enhancing of Board structures and composition; i.e. by appointment of independent directors, audit, nomination, remuneration and risk management committees. Bank examination by the Central Bank's inspectors includes the review and scrutiny of minutes and loans portfolio and financials. There is greater disclosure in the notes to their financial statements. Board members and top management of banking institutions are incrementally enhancing their effectiveness and cognizant of their accountability in their decision making process. Implanting new forms of corporate governance behaviour will require time for them to take root. Both monitoring costs and supervisory costs of engendering accountability have increased, however, and whether there are commensurate gains and benefits has to be tested.[138]

There are obvious gains from the costly lessons of experience from the 1997 crisis. The operational experience of Bank Negara Malaysia and other governmental regulatory authorities in rescuing banks in crisis and restructuring banking reforms in the post crisis period have been invaluable. In the midst of the banking crisis in 1998, the Malaysian government made three important policy decisions that contained the crisis and paved the way for the successful implementation of the restructuring and recapitalization processes in the banking sector. These three policy decisions as identified by Bank Negara Malaysia[139] as the turning point in resolving the financial crisis include:

- The Malaysian government closed the off-shore ringgit markets to serve the link between the domestic inter-bank market rates and the off-shore market rates; and then pegged the ringgit to the USD at RM3.80 to USD$1.00.
- The Malaysian government reduced the domestic interest rates and the reserve requirements of the banks to reduce the liquidity pressures that were adversely affecting the ability of the banking sector to mobilize and intermediate funds necessary for recovery of the economy.
- The Malaysian government redefined the classification of non performing loans from three months to six months; which gave the banking institutions and corporate sector the needed time and breathing space to work out feasible debt rescheduling and restructuring schemes.

[136] Sang-Woo, Nam and Lum . A., 'Relationship Banking and Its Role in Corporate Governance', (2004) ADBI Research Paper, ADB Institute

[137] Bai, C., Liu ,Q., Lu, J., Song, F., and Zhang, J., 'Corporate Governance and Market Valuation in China', (2003) Working Paper , University of Hong Kong.

[138] Haniffa, R. & Hudaib, M., 'Governance Structure and Firm Performance of Malaysian Listed Companies', *Journal of Business, Finance and Accounting*, (2006) Vol.33. No.7. pp.1034–1052.

[139] Bank Negara Malaysia, 'The Financial System in Malaysia- A Decade of Change', (1999) AXPL Press

Bank Negara Malaysia further explained that the rationale of the first policy action of the government was to stop the currency speculations and re-establish stability and equilibrium in the ringgit exchange rate. The impact of the second policy action was to inject liquidity into the banking system to alleviate the problems of illiquidity both in the financial and corporate sectors during the crisis period. The rationale of the third policy action was to minimize any potential insolvency problem by allowing both the banking and the corporate sectors to rework their debt restructuring schemes. As a package, the three policy actions of the government were considered a success in halting the precipitation of the crisis.

6. CONCLUSION

This study provides a picture of where banks stand in relation to the codes and principles on corporate governance introduced by the Central Bank of Nigeria. It further provides an insight into understanding the degree to which the banks that are reporting on their corporate governance have been compliant with different sections of the codes of best practice and where they are experiencing difficulties. Boards of directors will find the information of value in benchmarking the performance of their banks, against that of their peers. The result of this study will also serve as a data base for further researchers in this field of research.

This paper reveals that both board size and the proportion of outside directors are significantly but negatively related to financial performance in banks. From the analysis above, the paper conclude that there is no uniformity in the disclosure of corporate governance practices made by banks in Nigeria. Though they all disclose their corporate governance practices, but what is disclosed does not conform to any particular standard. The banks do not disclose in general how their debts are performing, by providing a statement that expresses outstanding debts in terms of their ages and due dates. This is however done for insider-related debts in some banks. The insider-related debts are expected to form an insignificant part of the debts of the banks and so may provide an adequate picture of the risk profile of the banks.

Disclosures on directors' remuneration do not provide sufficient details that would enhance any meaningful analysis. This makes it difficult for anyone to judge the adequacy or otherwise of directors' remuneration. Similarly, disclosures about employees are scanty. They do not provide sufficient details that would enable anyone to do any meaningful analysis for the assessment of the adequacy or otherwise of their remuneration, vis-à-vis the number in each category of staff. Despite the requirements of stock exchange and government regulators, certain bank managers still disclose selectively, especially when the monitoring and enforcement of disclosure requirements are not strict in Nigeria.

Furthermore, the paper conclude that a negative relationship exist between bank performance, board size and proportion of non executive directors. That is, a reasonably strong correlation exists between poor performance and subsequent increase in board size and independence. While a percentage increase in return on equity can be explained by directors' equity interest and the governance disclosure level.

7. RECOMMENDATIONS

Based on the findings of this article, the paper makes the following recommendations:

- Efforts to improve corporate governance should focus on the value of the stock ownership of board members, since it is positively related to both future operating performance and to the probability of disciplinary management turnover in poorly performing banks.

- Proponents of board independence should note with caution the negative relationship between board independence and future operating performance. Hence, if the purpose of board independence is to improve performance, then such efforts are misguided. However, if the purpose of board independence is to discipline management of poorly performing firms or otherwise monitor, then board independence has merit. In other to have proper monitoring by independent directors, bank regulatory bodies should require additional disclosure of financial or personal ties between directors and the company or its CEO. By so doing, they will be more completely independent. Also, banks should be allowed to experiment with modest departures from the current norm of a “supermajority independent” board with only one or two inside directors.

- Steps should also be taken for mandatory compliance with the code of corporate governance. Also, an effective legal framework should be developed that specifies the rights and obligations of a bank, its directors, shareholders, specific disclosure requirements and provide for effective enforcement of the law.

- In this article, all the disclosure items were given same weight which helps to reduce subjectivity; however, authority may place higher emphasis on certain elements of governance. Some aspect of governance may be considered to be a basic component or prerequisite to implementing others and thus should be given more weight.

- Finally, there is the need to set up a unified corporate body saddled with the responsibility of collecting and collating corporate governance related data and constructing the relevant indices to facilitate corporate governance research in Nigeria.