Corporate Governance and Organizational Performance in the Nigerian Banking Industry

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Abstract
The concept of corporate governance emerged in response to the failures and widespread dissatisfaction with the way corporate organizations function. The Banking reforms in Nigeria brought about the consolidation of banks based on exploratory analysis, it was found that in the presence of several regulations, weak corporate governance was a contributing factor to the poor performance underlying the subprime crisis in the Nigerian banking sector. In Nigeria, it is evident that banks strongly influence economic development and the efficient allocation of funds resulting in a lower cost of capital to firms, a boost in capital formations, and an increase in overall productivity. Consequently, the passing of various acts which deregulated the banking industry heightened the importance of internal regulatory mechanisms of banks such as corporate governance. In particular, corporate governance is expected to affect bank’s valuation, cost of capital, performance, and risk taking behaviour. Given the importance of the industry, there is a need to safeguard depositors’ funds and shareholders investments through a continuous entrenchment of sound and effective corporate governance regime within the banking sector.

Keywords: Corporate governance, Organizational performance, stakeholders, Banking Industry, Nigeria.

1. Introduction
Empirical evidences in the corporate world suggest a positive association between corporate governance and organizational performance. In this regard, sub-optimal or outright failure of governance systems can therefore be argued to be a major contributor to the collapse of many of the well-established organizations that abound in the world’s corporate landscape. This failure, which translates into an inability of organizations to meet the expectations of their various stakeholders, has often been traced to weaknesses in the internal controls infrastructures and operating environments, and a lack of commitment to high ethical standards. These weaknesses are sometimes deliberately or intentionally induced by organizational designers and controllers, and at other times they may be a result of the naive assumption that those entrusted with managerial responsibilities will always act in a way that suggests or promotes enlightened self-interest, which should ultimately have positive implications for all stakeholders (Donaldson & Preston, 1995). However, evidences emerging from some of the recently collapsed organizations the world over, hitherto assumed to be run professionally or on sound principles, succinctly demonstrates the point that there is indeed a lack of good corporate governance culture among corporate organizations, with its attendant effect of enormous financial losses to both the stakeholders and the society as a whole.

Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Consequently, corporate governance is all about running an organization in a way that guarantees that its owners or stockholders receive a fair return on their investment, while the expectations of other stakeholders are also met (Magdi & Nedareh, 2002). It addresses the need for organizational stewards or managers to act in the best interest of the firm’s core stakeholders, particularly, minority shareholders or investors, by ensuring that only actions that facilitate delivery of optimum returns and other favourable outcomes are taken at all times. This is typically facilitated by creating an operational base which promotes the observance of codes of conduct that entrenches accountability, transparency, fairness, ethical behaviour, responsibility and other values designed to act as safeguards against institutional corruption and the mismanagement of scarce organizational resources. The policies, rules, processes, practices, programs and institutions used in administering, directing and controlling the operations and affairs of an organization generally constitute the elements and instruments of its corporate governance. Therefore, the elaborateness, clarity, formality and the degree of compliance with these elements and plans reflect the extent to which an organization is likely to experience good corporate governance. The main responsibility for corporate governance rests with the Board of Directors of a firm. The board is usually made up of executive (full time) and non-executive (part-time and independent) members. The board’s responsibilities include setting the company’s strategic goals, providing leadership towards putting the set goals into effect, supervising the management of the firm and reporting to shareholders on their stewardship. The board also sets financial policy and oversees its implementation, using financial controls systems. The board’s actions are subject to laws, regulations and the
shareholders’ review at general meetings. While the key facilitators of corporate governance are clearly members of the board, it is however apparent that other stakeholders, particularly management and employees, equally have significant roles to play (in varying degrees) in achieving effective corporate governance. As the board needs to secure the active cooperation of managers in order to be effective in instituting and ensuring appropriate behaviour, so do employees on their part need to offer support by insisting on, and complying with, only board-approved actions taken by managers. In this way, a cooperative relationship between these core of organizational stakeholders helps drive the corporate governance process in the right direction.

2. Literature Review
Corporate governance has been part of research into the business profession since Adam Smith’s (1776) seminal publication of an inquiry into the nature and causes of the wealth of nations and undoubtedly given impetus through Berle and Means’s (1932) classic publication of the separation of corporate ownership from control. Corporate governance is aimed at reducing conflicts of interest, short-sightedness of writing costless perfect contracts and monitoring of controlling interest of the firm, the absence of which firm value is decreased (Denisand McConnell, 2003). Good corporate governance can also be considered as the diligent way in which providers of corporate financial capital guarantee appropriate rewards in a legal and ethically moral way. There are both internal and external ways of achieving this (Jensen, 1993). The first is through the structure of ownership (shareholding concentration and voting rights), and board of directors or supervisory board in some regulatory regimes (who monitor firms and are supposed to work in the interest of shareholders). The second is through the market for corporate control (takeover threats), regulatory intervention, and product and factor markets. Corporate governance codes that serve as templates of achieving value to shareholders (and stakeholders) have been written in several countries.

2.1 Conceptual framework
Corporate governance, as a concept, can be viewed from two perspectives: the narrow view and the broad perspective. The narrow view is concerned with the structures within a corporate entity or enterprise receives its basic orientation and direction. The broad perspective is regarded as being the heart of both a market economy and a democratic society (Oyejide and Soyibo, 2001), the narrow view perceives corporate governance in terms of issues relating to shareholder protection, management control and the popular principal-agency problems of economic theory. In contrast Sullivan (2000), a proponent of the broader perspectives, uses the examples of the resultant problems of the privatization crusade to prove that issues of institutional, legal and capacity building as well as the rule of law are at the very heart of corporate governance.

Oyejide and Soyibo (2001) 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 (1999) 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 (OECD, 1999) also defined corporate governance as a system on the basis of which companies are directed and managed. Furthermore, Arun and Turner (2002) contend that there exist narrow approaches to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interest. However, Oman (2001) 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 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 (Macey and O’Hara, 2001). Arun and Turner (2002) joined 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 banks. They posit that, the nature of the banking firm is such that regulation is necessary to protect depositors as well as the overall financial system.

The adoption of various economic reforms programmes in Africa in the 1980’s in which privatization of government-owned enterprise forms a major plank, has heightened the corporate governance debate in the continent. The bitter experience of Asian financial crisis of the 1990’s underscores the importance of effective corporate governance procedures to the survival of the macro-economy. This crisis demonstrates in no unmistakable terms that “even strong economies, lacking transparent control, responsible corporate boards, and shareholder rights can collapse quite quickly as investor’s confidence collapse” and emphasizes the need to ensure effective corporate governance with a view to ensuring the development of market-based economies and democratic societies based on the rule of law (Soyibo et al,2002). For the financial industry, the retention of
public confidence through the enthronement of good corporate governance remains of utmost importance given the role of the industry in the mobilization of funds, the allocation of credit to the needy sectors of the economy, the payment and settlement system and the implementation of monetary policy.

As seen from the above, corporate governance is not a concept that could be subjected to a watertight definition. The 1992 Cadbury Report saw it as “systems by which companies are directed and controlled.” Without disputing the validity of this definition, the concept extends beyond systems for directing and controlling a company and is also “concerned with holding the balance between economic and social goals and between individual and communal goals the aim is to align as nearly as possible the interests of individuals, corporations and society.” Thus, the concept implicates rules and regulations that ensure that a company is governed in a transparent and an accountable manner, such that the enterprise survives and meets the expectations of its shareholders, creditors and stakeholders of which society forms a large part of. The overall effect of corporate governance should be the strengthening of investors’ confidence in the economy of a particular country, sub-region, or region.

Recent occurrences in the international corporate environment have refocused the world’s attention to concerns for effective domestic corporate governance initiatives that would ensure credibility on how companies conduct business in our post modern globalised world. The much celebrated Enron and the WorldCom saga in the United States, the Vivendi and the recent Parmalat scandals in Europe are the most recent of such disturbing failures of credible business practice. Nigeria has also had its share of inelegant business practices that have resulted in failed corporate giants that once stood firm, without any overt sign of trouble. Thus, within Nigeria’s domestic corporate setting, the effect of the unwholesome international corporate governance climate engendered a renewed emphasis on effective corporate governance standards. The recent launch of Code of Best Practices on Corporate Governance in Nigeria (Corporate Governance Code) lays credence to this emphasis.

The financial sector with special reference to banking has come under the searchlight in recent years not only because of its strategic role as mediator of funds between the surplus and the deficit units but also as a result of the problem rocking the industry in terms of failure and eventual bankruptcy. The banking sector basically serves as the nerve centre of any modern economy, being the repository of people’s wealth and supplier of credits which lubricates the engine of growth of the entire economic system. The failure experienced in the sector over the years can be captured by the number of failed banks, the debt and extent of required capitalization, the proportion of non-performing credits, loss of depositor’s funds and the general impact on the economy all of which underscores the importance of the sector.

While the targeted end result of banking business are to be achieved through adherence to laid down rules and regulations, the causes of the unhealthy deviation from set rules have been found to include, inadequate Supervision Weak Management and offensive government policies. Ogunleye (2002) classified the causes of bank failure into Institutional, Economic and Political factors as well as regulatory and Supervisory inadequacies. Ebhodaghe (1995) attributed bank failure to economic downturn, inhibitive policy environment and management problems.

The impact of ill health in the banking sector left nobody untouched ranging from the government, the regulatory authorities the bankers as well as the general public. It is in this spirit that predicting the potential of failure in the sector becomes imperative if these actors/players are to be rightly guided in their decision making ventures. A good manager therefore must be conversant with such tools that will enable him measure performance and trend over time for the achievement of the desired organizational and decision making objectives especially in an unstable economic environment like ours. In this connection therefore, the use of bankruptcy prediction model for determining the current and potential business failure proves handy and appropriate. This will afford effective resource management instead of distress classification that amounts to medicine after death.

In recent years, there has been great concern on the management of banks’ assets and liabilities because of large-scale financial distress. The experience of many countries indicates that regulation and supervision are essential for stable and healthy financial system and that the need becomes greater as the number and variety of financial institutions increase. The banking sector has been singled out for the special protection because enforcement of rules and regulations, but also judgments concerning the soundness of bank leads to healthy banking industry. To maintain confidence in the banking system, the monetary authorities have to ensure banks play by the rule. The Deposit insurance scheme and prudential guidelines were evolved to improve the assets quality of banks, reduce bad and doubtful debt, ensure capital adequacy and stability of the system, and protect depositors funds (Oladipo 1993). In Nigeria, the rising cases of bank distress have also become a major source of concern for policy makers. It is not surprising to find banks to have nonperforming loans that exceed 50 per cent of the bank’s loan portfolio. For instance, the Nigeria Deposit Insurance Corporation (NDIC) in its 1996 annual report put the number of distressed banks loans, N40 billion or 79 per cent of which were classified as nonperforming credits. The recent deregulation of the financial system embarked upon from 1986 allowed the influx of banks into the banking industry. As a result of attractive interest rate on deposits and loans, credits were
given out indiscriminately without proper credit appraisal (Phillip, 1994). The resultant effects were that many of these loans turn out to be bad. For instance, in the merchant banks between 1989 and 1992, the ratio of classified assets to total loans and advances rose from 14.7 per cent to 37 percent and peaked at 63.9 per cent in 1994. For commercial banks, the ratio rose from 47.4 per cent in 1989 to 50.9 per cent in 1990 and fell to 38.10 per cent in 1994(NDIC Report, 1995). Asset quality degenerated, as classified assets increased from N11.91 billion in 1990 to N18.82 billion in 1992, moved to N46.9 billion in 1994 and further to N94.8 billion in 1999. It is in realisation of the consequence of deteriorating loan quality on the banking sector and the economy at large that this paper is motivated. The regulation and supervision of banks is expected to bring order to the chaotic situation that had developed in financial sector since the late 1980s.

2.2 Theoretical and Empirical framework
An understanding of corporate governance proceeds from an examination of a number of theories that attempt to explain the basis and rationale behind this management imperative. These theories principally include the Agency, Stakeholders, Stewardship, Resource-dependency, Transaction cost and Complexity theories. The agency theory is a theory that explains the relationship between principals (such as shareholders) and agents (such as a company’s executive). In this relationship, the principal delegates or hires an agent to perform a task. The theory attempts to deal with two specific problems; first, that the goals of the principal and agent are not in conflict, and second, that the principal and agent reconcile different tolerance for risk (investorword 2014).

The Stakeholders theory is a theory of organizational management and business ethics that addresses morals and values in managing an organization. In the traditional view of the firm, the shareholders or stockholders are assumed to be the owners of the company, and the firm has a binding fiduciary duty to put their needs first, and to increase value to them. Stakeholder’s theory however argues that there are other parties involved such as employees, customers, suppliers, financiers, communities, governmental bodies, political groups, trade associations and sometimes competitors as they all have capacity to affect the workings of an organization (Edward 2014).

The Stewardship theory posits that managers, left on their own will indeed act as responsible stewards of the assets they control. This is an alternative view of agency theory, in which managers are assumed to act in their own self interest at the expense of shareholders. The Resource-dependency theory on the other hand focuses on how the external resources of an organization affect the behaviour of the organization. The procurement of external resources is an important tenet of both the strategic and tactical management of an organization (Webmaster 2007). The Transaction cost theory suggests that firms organize exchanges internally that might otherwise be conducted in markets due to the costs associated with an exchange (transfer) of a good or service in the market (costly negotiating and monitoring cost that may accompany exchanges conducted within the market). It is a theory accounting for the actual cost of outsourcing of products or services, including transaction costs, contracting costs, coordination costs and search cost. The inclusion of all costs is considered when making a decision and not just the market prices (The Economist 2014). Consequently the complexity theory is the study of complex systems, such that behaviour of dynamical system are brought under review to test their sensitivity to initial conditions (Wikipedia 2014).

However over the last decade, the Asian financial crises, Enron, WorldCom, Tyco, Adelphia, Arthur Anderson, Lehman Brothers, Freddy Mac and Fanny Mae in the USA have come to represent the classic faces of failure attributable to corporate governance shortcomings. On account of the same problem, other important institutions, including Goldman Sachs (in USA); Marconi and Northern Rock (in UK); Parmalat (in Italy); Yukos (in Russia); and, Intercontinental Bank, Oceanic Bank, Union Bank, Bank PHB, Spring Bank (in Nigeria), were found to be virtually on the threshold of failure just before their various national governments intervened to bail them out of imminent collapse. In the wake of these developments, corporate governance frameworks have been formulated by a variety of regulatory agencies and national governments over the last decades across different countries, including the USA - the Sarbanes-Oxley Act (2002); in the UK - the UK Companies’ Act (2006) and similar policy guidelines issued by the Financial Reporting Council and the Financial Services Authorities; the UN’s Bank of International Settlement’s Basel Committee guidelines on Corporate Governance; the OECD Principles of Corporate Governance (1999 & 2004); in Nigeria the Securities and Exchange Commission (SEC) Code of Best Practices for Public Companies (2003), Code of Corporate Governance for Banks and Code of Corporate Governance for Licensed Pension Operators (Nwadioke, 2009). These well-documented guidelines have provided the main instruments used in regulating the operations of firms. In spite of the soundness and widespread subscription to these corporate governance codes, financial scandals and prospects of organizational failure still continue to be of deep concern to stakeholders. The OECD provisions for instance is considered to be adequate in addressing issues of executive remuneration, risk management, board practices and exercise of shareholder rights. However, weakness in corporate governance appears to be a function of ineffective implementation of the codes (OECD, 2009). Pursuance of good corporate governance would therefore mainly stem from the political will of organizational managers to adhere to specified best-practices.
The rewards of good corporate governance include reduction of waste on non-productive activities such as shirking, excessive executive remuneration, perquisites, asset-stripping, tunnelling, related-party transactions and other means of diverting the firm’s assets and cash flows. It also results in lower agency costs arising from better shareholder protection, which in turn engenders a greater willingness to accept lower returns on their investment. The firm ultimately ends up enjoying higher profits as it incurs lower cost of capital. Importantly, firms become more attractive to external financiers in direct proportion to a rise in their corporate governance profile. Consequently, managers become less susceptible to making risky investment decisions, and focus more on value-maximizing projects that generally facilitate organizational efficiency. The ultimate outcomes of these corporate governance benefits are generally higher cash flows and superior performance for the firm (Love, 2011). Most of the studies on the link between corporate governance and firm performance confirm causality (Abor & Adjasi, 2007). However, the evidence indicates between a strong and very weak relationship. Black (2001), for instance found a strong correlation between corporate governance and firm performance, as represented by stock valuation. Love (2011, pp 50-58) documented several other studies that have demonstrated these varying positive relationships to include Bebchuk, Cohen and Ferrell (2006), Black and Khana (2007), Brown and Caylor (2009), Bruno and Claessens (2007), Chhaochharia and Laeven (2007), El Mehdi (2007), Gompers, Ishii and Metrick (2003), Klapper and Love (2004), Kyereboah-Coleman (2007), Larcker, Richardson and Tuna (2007), Nevona (2005) and Wahab, How and Verhoeven (2007). Some other studies have however argued against a positive relationship between corporate governance and firm performance (Ferreira & Laux, 2007; Gillan, Hartzell & Starks, 2006; Pham, Suchard & Zein, 2007). This lack of unanimity continues to make the discussion a current issue. Findings from past studies on the selected corporate governance variables in the literature are as follows:

a) Reliability of financial reporting: The accuracy and reliability of the financial reports issued by management affects the perception of the firm by all other stakeholders and prospective investors. In spite of the experience at Enron and WorldCom, the financial reporting of publicly quoted firms are generally perceived to be more transparent and credible, because they are usually subjected to stiffer or more rigorous scrutiny, than what obtains in private firms. And, this therefore makes the financial reporting component of corporate governance even more difficult to assure in privately held firms. Audit committees and external auditors are the main instruments available for ensuring this corporate governance variable. There is however scant evidence of empirical research findings around this particular variable.

b) Existence of code of corporate governance: The growing concern about the need to institutionalize corporate governance mechanisms in firms has elicited the issuance of codes of governance by different regulatory agencies and voluntary industry associations. However, clear evidence of the exact extent to which Nigerian firms have adopted these codes or developed their own company-specific governance procedures is still unknown largely because of dearth of readily available data.

c) Audit committees: Although results of Klein (2002) and Anderson, Mansi and Reeb (2004) showed a strong association between audit committee and firm performance, Kajola (2008) found no significant relationship between both variables. This lack of consensus presents scope for deeper research on the impact of this corporate governance variable.

d) Board size: There is a convergence of agreement on the argument that board size is associated with firm performance. However, conflicting results emerge on whether it is a large, rather than a small board, that is more effective. For instance, while Yermack (1996) had found that strong organizational performance declines with board size, and this finding was corroborated by those of Mak and Kusnadi (2005) and Sanda, Mikailu and Garba (2005) which showed that small boards were more positively associated with high firm performance. However, results of the study of Kyereboah-Coleman (2007) rather indicated that large boards enhanced shareholders’ wealth more positively than smaller ones.

e) Separation of office of board chair and CEO: Separation of office of board chair from that of CEO generally seeks to reduce agency costs for a firm. Kajola (2008) found a positive and statistically significant relationship between performance and separation of the office of board chair and CEO. Yermack (1996) equally found that firms are more valuable when different persons occupy the offices of board chair and CEO. Kyereboah-Coleman (2007) proved that large and independent boards enhance firm value, and the fusion of the two offices negatively affects a firm’s performance, as the firm has less access to debt finance. The results of the study of Klein (2002) suggest that boards that are structured to be more independent of the CEO are more effective in monitoring the corporate financial accounting process and therefore more valuable. Fosberg (2004) found that firms that separated the functions of board chair and CEO had smaller debt ratios (financial debt/equity capital). The amount of debt in a firms’ capital structure had an inverse relationship with the percentage of the firm’s common stock held by the CEO and other officers and directors. This finding was corroborated by Abor and Biekpe (2005), who demonstrated that duality of the both functions constitute a factor that influences the financing decisions of the firm. They found that firms with a structure separating these two functions are more able to maintain the optimal amount of debt in their capital structure than firms with duality. Accordingly, they argued
that a positive relationship exists between the duality of these two functions and financial leverage. Separation of these two offices is however sharply challenged by Donaldson and Davis (1991), who found that shareholders’ returns are maximized when there is duality.

3. Corporate Governance in Nigeria
Recently, Nigeria has laid a solid foundation for corporate governance by sponsoring series of legislative, economic and financial reforms that intended to promote transparency, accountability and the rule of law in the economic life of the country. Managerial inefficiency and accounting scandals alert the legislators’, government and management of banks and big corporations to the danger involved in the absence of constraints governing corporate governance. This has in turn reinforced interest in consolidating the foundation and principles of corporate governance in the Nigerian economy. Over the years, Nigeria as a nation has suffered a lot of decadence in various aspects of her national life, especially during the prolonged period of military dictatorship. The political and business climate had become so bad in recent times, thus necessitating the entrenchment of corporate governance regimes in all aspect of national life.

For a developing country such as Nigeria corporate governance is of critical importance. In its recent history, the lack of corporate governance has led to economic upheavals. Two examples illustrate the point being made. In the late 1980 and early 1990s the country witnessed a near collapse of the financial sector through the phenomenon of failed banks and other financial institutions. In consequence, the Failed Banks (Recovery of Debt) and Financial Malpractice in Banks Act was promulgated to facilitate the prosecution of those who contributed to the failure of banks and to recover the debt owed to the failed banks.

Secondly, the privatization and commercialization programme of the Nigerian Government was a reaction to the failure of corporate governance in state owned enterprises (SOE). According to El-Rufai (1998), data obtained from various government department estimates reveal that in 1998, Nigerian PEs [Public Enterprises] enjoyed about N265 billion in transfers, subsidies and waivers, which could have been better invested in our education, health and other social sectors. There is virtually no public enterprise in Nigeria today that functions well. While they were created to alleviate the shortcomings of the private sector and spearhead the development of Nigeria, many of them have stifled entrepreneurial development and fostered economic stagnation. Public enterprises have served as platforms of patronage and the promotion of political objectives, and consequently suffer from operational interference by civil servants and political appointees. The Nigerian experience in the recent years has shown many examples that clearly establish the poor levels of corporate governance in public enterprises and private, including the banking industry. In view of the importance attached to the institution of effective corporate governance, the Federal government of Nigeria, through her various agencies have come up with various institutional arrangements to protect the investors of their hard earned investment from unscrupulous management/directors of listed firms in Nigeria. These institutional arrangements was provided in the “Code of Corporate Governance for Best Practices”

The Central Bank of Nigeria in its continuing efforts to enhance corporate governance in the Nigerian banking system also came up with the Corporate Governance Code which is intended to promote international best practice in the corporate governance of Nigerian banks. The Code draws upon international best practice, in particular the Organisation of Economic Corporation and Development (OECD) principles of Corporate Governance and the guidance issued by the Basel Committee on Banking Supervision in their publication: Enhancing Corporate Governance for Banking Organizations. However, it is worthy to note that the interest in corporate governance is not limited to governmental or banking institutions, as some private forums and associations have also been established to enhance the adoption of the concept of corporate governance. Thus the major focus of corporate governance regime as championed by the regulatory institutions in Nigeria are good board practices, control environment, transparent disclosure, well defined shareholder rights and board commitment. The banking sector on the other hand also draws its policy framework from the four pillars of corporate governance, which includes accountability, fairness, transparency and independency (Omeiza Micheal, 2009). Consequently Weil et al (2002) concluded that although, corporate governance in Nigeria can be generally viewed as a variety of ways involving the mechanisms by which those saddled with the responsibilities of managing businesses, firms and public enterprises, are held accountable for corporate conduct and performance.

3.1 Evolution of Corporate Governance in the Nigerian Banking Industry
In the Nigerian Banking industry, the consolidation regime was introduced in order to guarantee enhanced services and deepening of financial intermediation on the part of the banks. On July 6th 2004, the Central Bank of Nigeria introduces a reform in the financial system by increasing the capital base of banks to N25billion. The reform led to the withdrawal of public sector funds amounting to N74 billion. The reform also led to mergers and acquisition of banks, which reduced the number of banks in Nigeria from 89 to 25. The consolidation exercise equally, led to a review of the existing code for the Nigerian banks, which in turn led to the development in 2006,
the Code of Corporate Governance for Banks in Nigeria. This development was made to complement and enhance the effectiveness of other existing policies in the Nigerian Banking Sector.

A brief historical perspective into the activities of the banking sector in Nigeria showed that distress syndrome was first observed around 1989 when there was mass withdrawal of deposit by government agencies and other public sector institutions which revealed the financial weakness of certain banks like the National bank of Nigeria and the Commercial trust bank Limited which was bedevilled by boardroom cries and inside abuse (Osuka, Bernado & Chris Mpamugoh). From about that period, there were consistent bank failures and financial crisis during the next two decades that followed, which raised a number of questions on the consistency of the Corporate Governance practices in the banking system, although there were several attempts made at arresting the deteriorating situation.

The most recent bank distress in the Nigerian economy can be traced to the global financial crisis which began in the United States of America and the United Kingdom when the global credit market came to a standstill in July 2007 (Avgouleas, 2008). The crisis, which had been brewing for a while, really started to show its effects in the middle of 2008. Around the world, stock markets were at the lowest ebb as share prices were falling, large financial institutions were collapsing and governments around the world had to come up with rescue packages to bail out their financial systems. Analysis of the financial crisis within the period in question was shown to have been related to Corporate Governance issues. As a direct consequence, the Nigerian government introduced new policy framework in form of corporate governance to stem the tide of bank failures and distress in Nigeria. The CBN in conjunction with other supervisory institutions decided to place emphasis on the monitoring of credit risk and provide incentives on prudent management of banks to aid transparency in the banking system, so that the Nigerian economy can forge ahead.

Corporate Governance in the banking system has assumed heightened importance and has become an issue of global concern because it is required to lead to enhanced services and deepening of financial intermediation on the part of the banks and enables proper management of the operations of banks. To ensure this, both the board and management have key roles to play to ensure the institution of corporate governance. Governance and performance are expected to be mutually reinforcing in bringing about the best corporate governance. Transparency and disclosure of information are key attributes of good corporate governance which banks must cultivate with new zeal so as to provide stakeholders with the necessary information to judge whether interest are being taken care of.

3.2 Corporate Governance and Banks Performance
It has been argued that the governance structure of Nigerian banks has little or no relationship to their financial performance due to the presence of external regulators at both the state and federal level. Consistent with this statement, Simpson and Gleason (1999) posits that there was no relationship between the structure of banks’ board of directors and subsequent failure. Further, Prowse (1997) argues that the change in corporate control in commercial bank is the result of regulatory intervention. As evidence by the recent crisis, it is apparent that regulatory forces were not effective in promoting a safe and fair allocation of bank resources.

It is important to demonstrate that even in the presence of regulation, weak corporate governance was a contributing factor to the poor performance underling the subprime crisis and to poor loan quality. Prior research suggests that banks strongly influence economic development and the efficient allocation of funds resulting in a lower cost of capital to firms, a boost in capital formations, and an increase in productivity (Levine, 2004). The passing of various acts which deregulated the banking industry heightened the importance of internal regulatory mechanisms of banks such as corporate governance. In particular corporate governance is expected to affect bank’s valuation, cost of capital, performance and risk taking behaviour (Polo, 2007).

Agency theory as posited by Jensen and Meckling (1976) suggests that strong corporate governance leads to better performance and accounting outcomes. Elyasiiani and Jai (2008) reports that bank’s financial performance is positively associated with the stability of ownership by institutional investors. Although the institutional holdings of banks may be lower than other firms, evidence suggests that institutional holding promote good financial performance. Institutional investors such as pension funds, investment trusts, and mutual funds own large blocks of public company stock. Due to these large investments they often play an active monitoring role of corporate managers (Shleifer and Vishny, 1997). Other empirical findings suggest institutional investors promote short term financial performance at the expense of long-term financial performance (Coffee, 1991; Bushee, 1998).

Banking supervision cannot function well if sound corporate governance is not in place, and consequently, banking supervisors have strong interest in ensuring that there is effective corporate governance at every banking organization. In any economy, well-functioning banks promote economic growth. When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms and accelerates capital accumulation and productivity growth. In addition, banks play important roles in governing firm to which they are major creditors and in which they are major equity holders (Caprio, Leaven and Levine, 2004). Thus, if bank
managers face sound governance mechanisms, this enhances the likelihood that banks will raise capital inexpensively, allocate society’s savings efficiently, and exert sound governance over the firm they fund.

Generally banks occupy a delicate position in the economic equation of any country such that its performance invariably affects the macro economy of the nation. Poor corporate governance will definitely contribute to bank failures, which can pose significant public costs and consequences due to their potential impact on any applicable deposit insurance systems and the possibility to broader macroeconomic implications, such as contagion risk and the impact on payments systems. In addition, poor corporate governance leads markets to lose confidence in the ability of a bank to properly manage its assets and liabilities including deposits, which could in turn trigger a bank run or liquidity crisis (Inam 2006).

The economics and functions of banks differ from those of industrial firms. Because of these differences, banks are subject to stringent prudential regulation of their capital and risk. Moreover, these differences are reflected in corporate governance practices observed in the banking sector and in theoretical works on the “good corporate governance of banks”. With respect to corporate governance practices, a particularly striking and almost unique feature of banks has been the prevalence of remuneration schemes that provide high-powered incentives, not only for executive directors (officers), i.e., members of the management board in a two-tier system, but also for senior managers at lower levels, and even for more junior employees in some functions, in particular the trading and sales function.

The performance of the individual banks which makes up the banking sector is a function of the decisions of the management governing these banks. In other words, corporate governance has a major role to play in the development of the banking sector. This is in line with the argument of Block, Jang and Kim (2006) and Claessens (2006) that the concern over corporate governance stems from the fact that sound governance practices by organizations, banks inclusive results in higher firm’s market value, lower cost of funds and higher profitability.

4. Importance and benefits of corporate Governance

Corporate Governance is majorly to ensure a strong and reliable banking industry where there is safety of depositors’ money and also to develop the required flexibility to support the economic development of the nation by effectively performing its functions. Corporate governance also aims to create an atmosphere whereby Nigerian banks will comply with the laid down rules and regulations without compromise. This will in the end lead to transparency in the banking institutions, proper risk management, adoption of best practices in carrying out duties, strong internal control system, restoration of public confidence, rapid economic growth and in all prevent bank distress which might eventually lead to bank failure.

Corporate governance has become more prominent today than ever before. Rosell, (2002) identify several reasons for the increased interest in corporate governance, and among those reasons is the takeover wave of the 1980s and the 1997 east asia crisis. Yoshikawa & Phan (2001) noted that intensifying global competition and rapid technological changes result in lower price/cost margins which in turn force banks to focus on maximizing asset efficiency and shareholder value if they want to access funds to fuel growth opportunities. Aggarwal et al. (2007) asserts that good governance helps banks to have favourable access to capital markets although this benefit holds little value to banks in under-developed capital markets or for banks with limited growth opportunities. Better governance restricts controlling shareholders’ expropriation of minority and this loss of private benefits is even more in countries with low investor protection. Hence, countries that have weak protection for investors are expected to have worse corporate governance and hence enhanced firm level governance can lead to a marked improvement in firm value.

Corporate failures have come about as a result of bad corporate decisions made by its leaders in attempts to expropriate rents. The enactment of good corporate governance across the globe justifies the importance Nigerian Banks adopting sound corporate governance policies. Furthermore, effective corporate governance reduces “control rights” shareholders and creditors confer on manager, increasing the probability that banks generate and also enable managers to invest in positive net present value projects (Shleifer and Vishny, 1997). Effective corporate governance has been identified to be critical to all economic and banking transactions especially in emerging and transition economies (Dharwardkar et al.,2000). At varying levels of agency interactions, market institutional conditions that reduce informational imperfections and facilitate effective monitoring of agents impinge on the efficiency of investment. Likewise, corporate governance has assumed the centre stage for enhanced corporate performance.

Corporate performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization, it keeps the organization in business and creates a greater prospect for future opportunities. Consequently, good governance can be compared to trusteeship and as such, it is more than creating checks and balances, but rather accentuates customers’ satisfaction and shareholders’ value.
5. Conclusion and recommendation

In view of the above analysis it can be concluded that, Corporate Governance is necessary to achieve the proper functioning of banks and that Corporate Governance can prevent bank distress only if it is well implemented. This implies that to prevent bank distress through adequate corporate governance, emphasis should not only be about the government setting rules and regulations but actually ensuring that the laid down rules and regulations are strictly adhered to within the banking sector.

Given the susceptibility of banks to distress within the economy, corporate governance serves as a useful tool to stem the tide of distress, based on its emphasis on conformity with prudential guidelines of the government.

The Central Bank and other regulatory agencies should encourage (and consequently ensure that) all banks have approved policies in all their operation areas and have in place strong inspection division (and other enforcement mechanisms) to practically implement these policies.

The management staffs have important roles to play in ensuring that there exists a sound internal control system in their banks and that laid down procedures are reviewed regularly. This will help to frustrate the activity of the fraudsters. It is also important to stress the need for all banks to comply with statutory requirements of rendering returns for effectiveness of all the policy measures which the government, monetary and supervisory bodies might design to curb distress in the financial industry.

The compensation policies for managers and executives should be disclosed and made readily available to shareholders.

The increasing homogenous industry behaviour and bandwagon effect observed should be discouraged. Banks should emphasize their unique strategies and abandon the herd behaviour they are noted for.

References


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