AN EMPIRICAL ANALYSIS OF CORPORATE GOVERNANCE COMPLIANCE IN NIGERIA DEPOSIT MONEY BANKS

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Abstracts
The separation of ownership and control has given rise to an agency problem whereby management operates the firm in their own interest rather than the share holders. This creates opportunities for managerial shirking or empire building which may lead to outright expropriations of resources by directors. This paper utilizes documentary data from the annual reports and accounts of the banks operating in the Nigerian money deposit banks, the annual report of the Nigerian Deposit Insurance Corporations (NDIC), Central Bank of Nigeria (CBN) and the FACT Book of the Nigerian Stock Exchange (NSE). The data generated were analyzed using Chi-Square statistical tools in order to establish the relationship between corporate governance and compliance in Nigeria Deposit Money Banks. The study found that there is adequate corporate governance provisions in Nigeria which money deposit banks are expected to comply with. It is concluded that there is need for greater oversight functions by the regulatory authorities to ensure total compliance. The study recommends among others that audit committee should always be strengthened and board should be mainly composed of non-executive directors to prevent corporate failure. This will ensure implementation of strategies for economic growth and sustainable development.

Key words: Board, profitability, failure, agency, efficiency, stakeholders.

Introduction

The central Bank of Nigeria code of Corporate Governance (2006) observes that specifically for financial sector, poor corporate governance was identified as one major factor in all known instances of financial distress in the country. The thrust of corporate governance lies in putting place structures that would make management and board accountable. This indeed is the motivation of this study. The concept of corporate governance is a multifaceted one and it cuts across several disciplines including macro-economics, organizational theory, information theory, accounting, finance, psychology, sociology and politics.

The rising number of corporate failures, scandals and crises such as Enron, WorldCom, Global Crossing, HIH Insurance, Ansett, Pan Pharmaceuticals, Lever Brothers, Cadbury, and Mainstream Bank, has precipitated the growing interest on the governance structures of firms by academics, practitioners, the investment community, regulatory agencies, policy makers, national and multilateral government bodies and host of other stakeholders. Exemplar studies and legislations on the related issue of corporate governance include Dockery and Herbert (2000); La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000); Yakasai (2001); Detomasi (2002); Fort and Schipani (2003); Jandik and Rennie (2004); Bai, Liu, Lu, Song and Zhang (2005); Sanda, Makailu, and Garba (2005); Barako and Tower (2006); Achua (2007); Okike (2007); Cadbury (1992); and Sarbanes Oxley Act, 2002.

The Enron's fall was brought about

by the joint effects of conflicts of interest on the part of its senior managers and lack of oversight by its board and advisers (Deakin & Konzelmann, 2004). The Cadbury crises arose from significant and deliberate overstatement of financial statements over the years (Onu, 2007). The Afribank case was outright cooking of the books of the bank by the internal directors and external directors (Onu, 2007; Jetuah, 2007). Thus, while these business failures, scandals and crises were not only a big disappointment with respect to their sizes and the level of respect and integrity with which they viewed, they also had perverse effects on the level of investor confidence in company audit and the capital market (Deakin & Konzelmann, 2004) and (Cohen & Holder-Webb, 2006). Furthermore, they raised concerns over the effectiveness of corporate governance mechanisms put in place by the owners of the affected firms and corporate accountability.

One of the corporate governance mechanisms that has received considerable attention in the literature is the use of a monitoring board appointed by the company's shareholders (see John & Senbet, 1998; Abdullahi, 2006; Kyereboah-Coleman & Biekpe,2006a, 2006b; Nguyen & Faff, 2006). However, the collapse of Enron and other world class multinationals demonstrate the limits of the monitoring board; it is also a testimony to the complexity of the monitoring task (Deakin & Konselmann, 2004). Furthermore, it has brought to the fore the need for a deeper understanding of the theoretical framework underlying the formulation of corporate governance policies and practices. The main purpose of this paper, therefore, is to provide an orientation in corporate governance for academics and practitioners as a basis for improving the rigour of research and practices respectively.

A number of studies on Corporate Governance (CG) have been carried out over the last few decades, more than ever before, as a result of some corporate scandals involving a number of giant firms in both the developed and developing economies of the world. The separation of ownership and control has given rise to an agency problem whereby management operates the firm in their own interests, rather than those shareholders (Fama and Jensen, 1983). This creates opportunities for managerial shirking or empire building which in the extreme may lead to outright expropriation of resources by directors (Keasey and Short, 1997); (Basel, 1999); (Wilson, 2002) and (CBN, 2006).

Focusing on the emerging CG problems, extensive research regarding the relationship between shareholders and directors has been conducted in order to deal with the agency problem. Most of the studies conducted used board characteristics such as board size, board composition, power separation and the composition of audit committee (John and Senbet, 1998); (Albrecht, Albrecht and Albrecht, 2004); (Sharma, 2004) and (Faber, 2005). However, CG studies can for the sake of convenience be grouped into five. Studies which have attempted to examine the relationship between board structures and firm's financial performance/value, studies on the relationship between board structures and board efficiency and effectiveness, studies on the relationship between board structures and corporate fraud, studies which attempt to study CG itself to account for variations in CG practices in different set-ups, economies and countries of the world and studies on CG and ICS.

A number of studies have been conducted on CG in Nigeria, most of which are well documented in accounting and finance literature. These studies include that of Adenikinju and Ayorinde (2001), who used data obtained from listed firms on the Nigeria Stock Exchange (NSE) to examine the

relationship between firm performance, insider ownership and ownership concentration. Consequently, in an attempt to address the limitations underlying the study by Adenikinju and Ayorinde (2001), Sanda, Mikailu and Tukur (2005) using data obtained from 101 firms listed on the Nigerian Stock Exchange (NSE) from the 1999 database of Lagos-based stock broking firm and the Fact Book of the NSE for 2000 examined the relationship between director shareholding, board size and firm financial performance in Nigeria.

The accounting and finance literature contains quite number of studies that extend the CG questions beyond the level of boards to control mechanisms; which affect corporate effectiveness, efficiency and resulting performance. In addition, some of these studies examine the determinants of internal control effectiveness and their effect on certain variables, such as: earning quality, CG, financial misappropriation, audit fees and external auditors' scope of substantive test. For example, Jeffrey, Ge, and McVay (2005) using a sample of 261 firms that disclosed material weaknesses from August 2002 to November 2004 in the UK, find that material weaknesses in internal control are more likely for firms that are smaller, less profitable, more complex, growing rapidly, or undergoing restructuring.

The aim of this paper is to analyze the state of Corporate Governance in the Nigerian banking industry, with a view to understanding the environment within which the banks operates.

Corporate governance in banking has also received particular attention among investors, depositors, regulators, and rating agencies the world over. Researches carried out indicated that weak corporate governance mechanisms was one of the main causes of banking crises from Asia, East and Central Europe, Latin America, to Nigeria. Monumental corporate scandals across the world brought untold hardships to depositors and investors alike, where life-savings, investments, and pensions were lost to fraud and highly risky economic decisions. In Nigeria, poor corporate governance in the banking industry, as it was the case with the Asian countries, took its toll with the liquidation of many banks, resulting in personal savings, pensions and gratuities, trust funds and huge investments trapped, with attendant consequences of mass job loss.

According to NDIC (2004), the banking sector as the major holder of the nation's financial assets, presents the largest potential risk for financial and reputation losses for the operations of firms and prosperity of any nation in the event of a corporate governance failure. Failures in corporate governance can cause enormous financial losses, not only to individual banks and their shareholders, but also to the society as a whole. It has been argued that the retention of public confidence through the enforcement of 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 policies.

In addition, the fact that there has been very little research – empirical or theoretical – on the banks corporate governance as revealed by Ariff (2005) makes more research in this area of study significant, particularly in developing countries like Nigeria. This is important as most researchers have agreed on the fact that banks are significantly different from other corporations, and therefore the approach to their corporate governance should be different too (Shleifer, 1996). In view of the aforementioned this paper attempts to find out the level of compliance to internationally accepted codes of corporate

governance among DBMs in Nigeria. Specifically, it will try to establish the quality of the board of directors, and executive management of DMBs in Nigeria as well as to measure the level of transparency and accountability among DMBs in Nigeria.

To this end we will test the following hypotheses:

Ho1: There is no significant relationship between corporate governance and the quality of board and executive management of banks.

Ho2: There is no significant relationship between corporate governance and transparency, accountability, and shareholder protection in banks.

The paper is restricted to the study of the 23 Deposit Money Banks quoted on the Nigerian Stock Exchange, NSE, existing as at 31 December 2008, using secondary data from their annual reports for a period of five years, 2004 to 2008. The banking sector is the most active on the Nigerian Stock Exchange and as at December 2008 there were 24 quoted DMBs with total capitalization of 3.365 trillion and total assets of N15.92 trillion (CBN statistical Bulletin, 2008). This period is significant because it is the height of banking reform that is expected to generate all anticipated efficiencies including the impact of corporate governance on the banking after consideration.

The remainder of this paper is divided into 4 sections. Section two is on the literature review, conceptual framework and theories in corporate governance in banking while three deals with methodology of the research. Section four analyses and presents the data collected and section five concludes and summarizes the paper as well as offers appropriate recommendations in corporate governance compliance for deposit money banks in Nigeria.

Literature review

Conceptual of Corporate Governance (CG)

There is no generally accepted definition of Corporate Governance (CG) which enjoys consensus of opinion in all settings and countries of the world. The concept is thus defined and understood differently in different parts of the world, depending on the relative power of owners, managers and providers of capital. In order words, a number of scholars have viewed CG differently from their own perspectives (Rediker and Seth, 1995); (Short, 1996); (Keasey and Short, 1997); (Shleifer and Vishny, 1997); and (Cai, Keasey and Short, 2006). For example, Maher and Anderson (1999) and Craig (2005) view CG from two contrasting angles: the shareholder and the stakeholder model. CG in its narrowest sense (i.e. shareholder model) is used to describe the formal system of stewardship of the board to the shareholders. In contrast, in its widest sense (i.e. stakeholder model) CG is used to describe the network of relationships between an organization and its various stakeholders.

Similarly, the Cadbury Committee (1992) as cited in Alexandra, Reed and Lajoux (2005) defines CG as the system by which companies are directed and controlled. The nature of CG, therefore, going by this definition consists of two dimensions: direction and control. The direction side of CG emphasizes the responsibility of the board to attend to strategic positioning and planning in order to enhance the performance and sustainability of the company. The control side of the definition, on the other hand, emphasizes the responsibility of the board to oversee the executive management of the company in the execution of the plans and strategies.

Sanda, Mikailu and Tukur (2005) on their own part see CG as the ways in which all parties interested in the well being of the firm attempt to ensure that managers and other insiders take necessary measures to safeguard the interest of all stakeholders. However, the major weakness of this definition is its

identification of the function of CG with the management alone without incorporating the board, which is an important player in CG. On its part, the Basel Committee (1998) views CG from a banking perspective, as the manner in which the business and affairs of a bank are governed by the board of directors and senior management, which provides the structure through which the objectives of the bank are set and the means of attaining those objectives and monitoring performance.

From the above discourse, it is evident that views differ on the content and boundaries of CG. For some, the essence is the exercise of power by shareholders or stakeholders, while for others it is the formal structure of relationships that involves the control and direction of companies. However, what is clear from the above definitions is that in directing and controlling the affairs of a company, the board has to ensure that it takes due care of the interests of the stakeholders of the company. The typical arrangements and processes that constitute a CG system such as board composition and functioning, risk management and auditing are all merely the means to ensure that the corporation act in a manner that is fair, accountable, responsible and transparent to all stakeholders. Conclusively, what is evident from the various definitions reviewed is that CG is the set of structures, processes, cultures and systems through which objectives are set, and the means of attaining the objectives and monitoring performance are determined and companies are directed and controlled. The four (4) components of CG as suggested by Klapper and Love (2002) are Board Composition (BC), Board Size (BS), Power Separation (PS) and the Composition of Audit Committee (CAC).

Codes of Corporate Governance

Codes of good governance are a set of best practices' recommendations regarding boards issued to address deficiencies in a country's governance systems by recommending a set of norms aimed at improving transparency and accountability among top managers and directors. The codes of good governance were issued mainly by the stock market or by managers' Associations. Thus, Directors' and Investors' Associations and the government do not normally play a key role in developing national governance practices (Fernandez-Rodriguez, Gomez-Anson and Cuero-Garcia, 2004).

In most legal systems, codes of good governance have no specific legal basis, and are not legally binding. Thus, enforcement is generally left to the board of directors and external market forces. It is only in a few countries (e.g. Nigeria-in the case of the CCG for banks, Germany and the Netherlands in Europe) that the law attaches explicit legal consequences to the codes. Even if, compliance with code recommendations is traditionally voluntary (i.e. based on the "comply or explain" rule), empirical evidence shows that publicly quoted companies tend to comply with the codes more than non-quoted firms (Conyon and Mallin, 1997; and Gregory and Simmelkjaer, 2002). Consequently, Fernandez-Rodriguez et al., (2004) study, suggests that the market reacts positively to announcements of compliance with the codes.

The content of codes has been strongly influenced by corporate governance studies and practices. This is because, they touch fundamental governance issues such as fairness to all shareholders, accountability by directors and managers, transparency in financial and non-financial reporting, the composition and structure of boards, the responsibility for stakeholders' interests, and compliance with the law (Gregory and Simmelkjaer, 2002). Since, the core of codes of good governance lies in the recommendations on the board of directors.

However, following the dominant agency theory (Alchian and Demsetz, 1972; and Fama and Jensen, 1983) governance codes encourage the board of directors to play an active and independent role in controlling the behavior of top management. In particular, scholars and practitioners (Lorsch and Maclver, 1989; Demb and Neubauer, 1992; Charan, 1998; and Conger, Lawler III and Finegold, 2001) recommend for increasing number of non-executive and independent directors; the splitting of chairman and CEO roles; the creation of board committees (nomination, remuneration and the audit committee) made up of non-executive independent directors; and the development of an evaluation procedure for the board. The introduction of these practices is considered a necessary factor in order to avoid governance problems, and to increase board and firm performance.

State of Corporate Governance in Nigerian Banks

In Nigeria, a 2003 survey by the securities and exchange commission, (SEC), reported that corporate governance was at a rudimentary stage, as only 40% of quoted companies, including banks, had recognized codes of corporate governance in place (CBN, 2005). Today, most of the banks have corporate governance documents – and compliance departments – in addition to codes of conduct and ethics circulated to all their network of branches for compliance and yet the regulatory authorities and external examiners have continued to highlight serious exceptions on their activities.

Soludo (200) identified "weak corporate governance" among others, as responsible for the demise of all the liquidated banks and some operating ones. A critical review of the banking system over the years has shown that one of the problems confronting the sector had been that of poor corporate governance. The Nigerian banking system was characterized with weak corporate governance, evidenced by inaccurate reporting and non-compliance with regulatory requirements, declining ethics and gross insider abuse, resulting in huge non-performing insider-related credits (CBN, 2004).

The CBN (2004) report also revealed that many owners and directors abused or misused their privileged positions or breached their fiduciary duties by engaging in insider activities. Such abuses included granting of unsecured credit facilities to owners, directors, and related companies that in some cases were in excess of their banks' statutory lending limits in violation of the provisions of the law.

Various NDIC on site Examination reports (2001-2004) of the banks in operation continued to reveal that some of the banks had continued to engage in unethical and unprofessional conduct of the past. The reports showed that the banks have continued with willful violation of banking laws, rules, and regulations. This is because the meager financial penalties the regulatory/supervisory authorities impose on the banks for such infractions have encouraged the banks to violate flagrantly such laws, rules and regulations. Apparently, the banks have continued to falsify the insider-related returns they submit to the regulatory authorities monthly. In fact, the regulatory authorities seem to have lost confidence in the financial statements of the banks as most of them were still guilty of lack of transparency in their financial reporting. Ogunleye (2005) stated that banks in Nigeria not only engaged themselves in undesirable practices in financial reporting, but were also going against the standard practice of accounting in income recognition, and balance sheet classification by falsifying their records. Some of the directors were inept as they lack the required qualification and experience while boardroom

squabbles have been a regular feature of such boards, sometimes attracting headlines in the national dailies. With this serious shortcoming on the board of directors, which is an important corporate governance mechanism, it will be difficult, if not completely impossible, to entrench good corporate governance in such banks.

The chairman and the MD/CEO in some of the banks have often dominated the boards where important meetings by statutory committees like those of audit, risk management, and compensation, are held only at their behest. As a result important issues that bother on the survival of the bank such as external auditors and examiners reports, and corporate governance compliance issues, take the back burner.

Nigerian Money Deposit Banks Industry

The genesis of banking can be traced back to as early as 2000 BC in Babylon, when a functional system of banking was established. Bankers and banks were given different names in different places. It is speculated that the word 'bank' must have been coined from Banco San Giorgio, which was established in Genoa in 1407. The bank of Amsterdam, basically established in 1609 to cater for the banking needs of Amsterdam businessmen, was a pioneer of modern banking by its introduction of a certificate of deposit and receiving all forms of coins. The roles of Goldsmiths in Britain and the effect of the gold rush of 1848 in the United States were also significant in the evolution of modern banking (Olalusi, 1997).

In the late nineteenth century, there were a lot of trading activities along the Nigerian coastal areas. Therefore, banking evolved to support these activities. In August 1891, the Chairman of Elder Dempster Company initiated the setting up of a branch of African Banking Corporation. The purpose of this was to boost the British shipping business operated by the company. The bank was given the privilege of importing silver coins from Britain for use in Nigeria as from January, 1892. Elder Dempster Company took over the bank on payment of 1000 pounds sterling and the bank became incorporated on 1st March 1893 as the Bank of British West Africa (BBWA). The bank was biased in favor of Elder Dempster Company, so there were a lot of agitations by British traders. This development led to the establishment of a second bank in 1899 known as Anglo African Bank, which later became bank of Nigeria. The BBWA was merged with the new bank (i.e. Bank of Nigeria) in 1912 (Ndekwu, 1994). In 1917, another bank known as the Colonial Bank was set up. This bank, which later became Barclays Bank Nigeria Limited (and now known as the Union Bank (Nigeria) PLC). This bank posed a formidable competition for BBWA. In 1948, the British and French Bank was established. Later in 1961, it changed its name to United Bank for Africa Limited, now PLC. In fact, the First Bank, Union Bank and United Bank for Africa (UBA) are the three largest banks in Nigeria today, among the twenty five banks comprising the Nigerian banking industry (Ndekwu, 1994; and Olalusi, 1997).

During the period 1929 to 1952, a number of indigenous banks were established. The Agbonmagbe Bank Ltd, (now known as Wema Bank) was set up in 1938, followed by African Continental Bank (ACB), which was set up in 1948. During the period, February 1951 and May 1952, 18 indigenous banks were registered. All of them failed without any exception within a short period. The failure was attributed to lack of banking expertise and non-prudent lending policies (Ndekwu, 1994; and Olalusi, 1997).

From independence in 1960 to 1985, there were a total of 40 banks in Nigeria, made up of 12 merchants' banks and 28 commercial banks. Due to deregulation, however, the

number of operating banks in the country increased phenomenally from 40 in 1985 to 66 in 1988, 100 in 1990 and 120 in 1992. Equally, the banks braches increased from 1316 in 1985 to 1698 in 1988, 1944 in 1990 and 2027 in 1992. Thus within a period of 7 years (1985-1992) the Nigerian banking industry witnessed a growth that has not been recorded in the first 25 years of the country as an independent nation. However, by December 2002, there were a total of 90 licensed banks, 282 community banks, 74 primary mortgage institutions and 6 development banks.

The recent banking sector reforms commenced with the announcement of a 13-point reform agenda by the CBN on July 6, 2004. A major element of the reform programme was the requirement for banks to achieve a minimum shareholders' fund of N25 billion by the end of December, 2005. Banks were specifically required to achieve this through fresh capital injection or through merger/acquisition arrangements with other banks (CBN, 2005). At the expiration of the deadline on 31st December 2005, twenty-five banks emerged from seventy five banks out of the eighty nine banks that existed at the end of December 2004. Fourteen banks, which had negative shareholders' fund and, therefore, insolvent had their licenses revoked by the CBN. As at the end of December 2007 there were a total of 25 banks, 1,287 other financial institutions, comprising of 750 community banks, 7 Microfinance Banks, 112 Finance Companies, 91 Primary Mortgage Institutions, 322 Bureaus De-Change and 5 Development Finance Institutions operating in the country (CBN, 2007).

Theoretical framework

Theories and models which explain CG studies are well documented in the accounting and finance literature. In this regard, three contrasting models (namely exclusive Vs inclusive model, conformance model and enterprise Vs regulatory model) and four theories (namely the stewardship theory, the theory of the firm, the stakeholder theory and the agency theory) are found to provide the theoretical framework for studies on CG (Collier and Roberts, 2001; Goodpaster, 2004; and Rossouw, 2005).

First, in the exclusive model of CG, the directors are regarded as the agents of shareholders, and in that capacity they have to direct and control the company to the benefit of the shareholders alone. Thus, the responsibility of the directors does not extend to other stakeholders such as creditors, bankers, relevant tax authorities, employees, the general public, etc. (Collier and Roberts, 2001). In contrast, the inclusive model focuses on the responsibility of directors to a coalition of stakeholders (Goodpaster, 1993; and Collier and Roberts, 2001). From the above discussion, it can be seen that while the exclusive model takes care of the interest of all stakeholders, including government for tax and other purpose.

Second, the conformance Vs performance model views CG as consisting of two dimensions, i.e. direction side of CG emphasizes the responsibility of the board to attend to strategic positioning and planning in order to enhance the performance and sustainability of the company. The control side, on the other hand, emphasizes the conformance responsibility of the board to oversee the executive management of the company in the execution of the plans and strategies of the company. This responsibility results in the board giving account of the performance of the company to stakeholders and regulatory bodies (Rossouw, 2005). Although the model emphasizes on the strategic positioning function of CG, what is needed is a sound balance between performance and conformance.

Third, the enterprise Vs regulatory model assumes that governance can either be

made based on management policies or based on statutory provisions. There is therefore the need for a distinction of the basis of governance. On the enterprise level, governance refers to the way in which the company directs and controls its own affairs, while governance on the regulatory level refers to the regulatory environment within which corporations function (Rossouw and Van-Vuuren, 2004). In Nigeria, for example, regulatory governance consists of the control over companies that are exerted from the outside by the CBN, SEC, NDIC, CAC, NSE and other regulators, all of which combined to form the landscape of regulatory governance. The purpose of such control over the operations of companies is not only to lay down ground rules for key role players, but also to provide protection to all stakeholders.

However, an effective regulatory regime within which corporations operate can provide stakeholders with the peace of mind that their interests will not be taken for granted, and that their rights and interests will be protected through laws, regulations, listings requirements and professional codes. Stakeholders can be given the assurance that corporations will adhere to certain standards of behavior. In cases where corporations do not adhere to such standards, the regulatory regime provides stakeholders with the opportunity to seek recourse. In Nigeria, for example, such provisions are provided under CAMA (1990) S.63 (5), S.280 (4), S.284, S.286, S.408, S.311, 314 and S.315.

There exist a number of theories on corporate governance but only two will be considered.

The Agency Theory

The Agency Theory is developed from the principal-agent relationship in a typical neo-classical firm where the owners, the shareholders, (the principal), rely on the managers (the agent) to run the affairs of the firm in order to get return on their investments. The theory posits that due to information asymmetry the agent (managers) is likely to pursue interests that may hurt the shareholder (principal). According to Levine (2004), the agency theory suggests that regulatory and legal systems provide a framework in which a complex nexus of agency problem and conflicting interests among owners and managers shape bank behavior. Therefore, a major corporate governance challenge for the banks is the principal-agent problem and how it can undermine financial stability when the incentives of bank management and directors are not aligned with those of the owners of the bank.

The theory was initially developed on the assumption that the shareholders are the sole stakeholders and corporate governance was necessary to realize return on investment. According to Sanda, Aminu and Tukur (2005), the main strength of the agency theory is that it establishes the relationship between the owners of the firm and the managers, defining corporate objectives. On the other hand, its major drawbacks are the failure to recognize other stakeholders in the agency relationship and the assumption that all firms operate under the same structures. In Nigeria, information asymmetry and the opacity of the banks that have exacerbated the principal-agent relationship will put the theory to test. Giving another dimension to the theory, different from that of Sanda et al (2006), Ciancanelli and Jose (2000), opined that the agency theory as it relates to the neo-classical firm could not applied to the bank because it is based on certain assumptions, which did not apply to the bank. These assumptions make it unsuitable for analyzing governance in banks because regulations intended to prevent systematic risk limit the disciplinary power of market forces. They hold that the existence of other stakeholders in a typical bank, in addition to information asymmetry, suggests

that the banking system is qualitatively different from the nature of the firm implied by the agency theory. Therefore to apply the agency theory to banks, they concluded, is to assume that banks operate in the same type of competitive markets and are structured managerially by the same forces as all other firms. They concluded that although agency theory is of limited use in the analysis of bank governance because they are structured differently and do not operate under the same competitive environment with other firms, the "agency problem" remains an important conceptual tool. Therefore the theory is only limited to the context of defining the principal-agent relationship that exists between the shareholders and managers.

The Shareholder Theory

The other side of the principal-agent relationship that recognizes the shareholder as the principal and managers as the agents is the stakeholder theory. Rogers (2005) held the opinion that the stakeholder theory regards the firm as belonging not simply to shareholders but to all stakeholders. The proponents of this view see corporate governance as not simply a shareholder-manager relationship, but to first regard the corporation as a coalition of stakeholders. Gugler (2001) asserted that the stakeholder theory also recognizes the agency problem that exists in banks, but instead of restricting it to maximizing shareholders' value by the managers; it widens the scope to recognize the various relationships among employers, depositors, creditors, and regulators, who all have a stake in the bank. According to this view, it is wrong to assume that firms are driven solely on shareholders' value maximization because managers may be altruistic about employee empowerment. They argue that the theory, though based on the structure of the neo-classical firm, is even more applicable to banks today because of their opaqueness, liquidity, gearing and the role regulation plays on its activities.

One argument against the stakeholder theory is that it can allow managers and individual stakeholders to exploit blurred corporate objectives and paralyze decision-making. On the other hand, in banks, corporate governance is expected to strike a balance between financial and non-financial stakeholders and recognize the needs, and in particular the potential value-added, of stakeholders other than shareholders, thereby addressing the agency problem that exists not only between shareholders and managers, but between other stakeholders as well.

Methodology

This paper adopted historical and survey methods for data collection to determine the extent of corporate governance compliance of DMBs in Nigeria. The period of the study covered is from 2001 to 2005.

The population of the study consists of all the thirty-six DMBs quoted on the Nigerian Stock Exchange, NSE, as at 31 December 2005 (NSE, 2005). 20 banks were selected as the sample to represent the entire population of 36 quoted DMBs, or 56%. This is due to complete data by the sampled banks. The data used in this study was mainly from primary and secondary sources. Primary data were collected using questionnaire. To achieve an objective assessment of compliance on key corporate governance mechanisms we developed and administered two distinctly different set of questionnaires to two set of stakeholders – the MDs/CEOs of the DMBs, on one hand, and the customers, shareholders, and regulators, on the other. The questionnaires were developed using corporate governance parameters that addressed the formulated hypotheses, using yes/no option. One hundred and ten questionnaires were administered: 20 to each

of the MDs/CEOs of the DMBs, and 30 to each of the other three categories of the stakeholders.

Secondary data used were extracted from the financial statements of the DMBs as contained in the NSE Factbook as at 31 December 2005, the annual reports of the sample size DMBs and shareholding statements from the NSE Factbook. Other sources of data included CBN annual reports and accounts, NDIC Annual Reports, Bank of International Settlements (BIS) and World Bank and IMF Research Working Paper Series, Economic Journals, and other references obtained from the library.

Chi-square statistical tool was used to establish the relationship between observed and expected frequencies of the primary data and test the two hypotheses. This is because it is suitable for two variables drawn from individual samples each of which is categorized into yes or no (Asika, 2005).

The Chi-square test used to test the formulated hypotheses of the study was represented by the following formula:

X2= ?(O-E)2
E

Where:

O=Observed value

E=Expected value

Results and Discussions

Two different set of questionnaires were administered on the MDs/CEOs of the surveyed banks and three other important stakeholders: the shareholders, customers, and regulators. One hundred and ten questionnaires were administered as shown below:

Table 1: Distribution of Questionnaire

Respondents	Number of questionnaires administered	Number of questionnaires returned	%
MDs/CEOs	20	11	55
Shareholders	30	19	63
Customers	30	26	87
Regulators	30	14	47
Total	110	70	64

Source: Primary Research Data

Table 1 above gives a summary of the breakdown of questionnaires administered and responded to by the four categories of the respondents. It shows that the customers of the banks had the highest response of 26, representing 87 per cent, while the regulators had the lowest response of 14, or 47 per cent. Response from the MDs/CEOs of the banks was 11, representing 55 per cent, which was satisfactory, considering the reluctance bank staff often show in disclosing the activities of their banks. One explanation of this could be their desire to convince their customers, investors, creditors, and industry watchers of their banks' compliance to codes of corporate governance.

The impressive response of 87 per cent from the customers could be from their ubiquitous nature and the increase in branch network by the banks, while the low response from the regulators category was from the dearth of CBN, NDIC, and NSE staff in survey locations. The shareholders also responded well by returning 19, or 63 per cent of the questionnaires with most questions correctly answered. Increase in the banking and investing culture of the Nigerian public could be one reason for this high response.

Analysis of Responses from the DMBsTable 2 Corporate Governance Compliance Responses – MDs/CEOss

Corporate Governance Parameter	Yes	%	No	%	Total
Does the bank have written policies, codes, or manuals, approved by the board of Directors setting out bank's approach to corporate governance?	11	100	-	-	11
Does the Board conduct self -evaluation or reviews of its activities and have the ability and funding to hire external consultants to perform its oversight functions?	11	100	-	-	11
Is the Board independent of Management and have access to accurate, relevant, timely information?	11	100	-	-	11
Is there separation between CEO and Chairmanship position?	11	100	-	-	11
Does the Board meet at least four times within a financial year?	7	64	4	36	11
Total	51	93	4	7	55

Source: Primary Research Data

Table 2 above highlights the response of the MDs/CEOs of the surveyed banks to five fundamental questions that centered on the quality of board of directors and executive management in corporate governance. All the respondents answered in the affirmative on all but one question: the minimum number of times they hold board meetings. Only seven or 64 per cent of them hold board meetings at least four times in a year; because it is the minimum times required it becomes compliance issue. This could be attributed to family dominance on the boards or simply the MD/CEO and the Chair have overbearing dominance on the entire board. This infraction could go undetected or unsanctioned by the regulatory/supervisory authorities due to weak enforcement mechanisms. Generally, responses from bank staff on the activities of their banks are low and un-encouraging, but as explained, the desire of the banks' MDs/CEOs to win the confidence of their customers, investors, and creditors could have motivated the high response of 55 per cent positive return of the questionnaires.

Analysis of Responses from Other Stakeholders

Table 3: Corporate Governance Compliance Responses – Shareholders

Corporate Governance Parameter	Yes	%	No	%	Total
Does the bank disclose to you the extent to which it complies with its corporate governance policies and those issued by the CBN?	4	21	15	79	19
Do you have the right to be informed and participate in decisions and changes to extraordinary transactions?	16	84	3	16	19
Do general shareholders meetings follow processes and practices that treat all shareholders fairly?	8	42	11	58	19
Do all shareholders have opportunity to obtain redress for violation of their rights?	10	53	9	47	19
Is the Management Team of your Bank effective?	11	58	8	42	19
Total	49	52	46	48	95

Source: Primary Research Data

Table 3 above contains responses from some of the shareholders of the banks on their rights and the protection of those rights; and how effective the management teams of their banks are. Most of them, representing an average 60 per cent, were of the opinion that the banks guaranteed and protected their rights as shareholders. On the other hand, only an insignificant 4 or 21 per cent responded in the affirmative on their banks' disclosure to corporate governance compliance. This is worrisome because unless the MDs/CEOs carried the shareholders along on their compliance to corporate governance issues it would continue to be a grey area for the shareholders.

Block holding and family ownership could be some of the reasons why other small shareholders were not carried along on the level of corporate governance compliance of the banks. The implications of this were not far-fetched. This group of shareholders would continue to dominate and hold sway on critical decisions affecting the corporate existence of the banks at the expense of the minority shareholders. This, in the end, could be a major cause for distress, the consequences of which would be loss of depositors and investors' funds, among others.

Fifty-eight per cent, or 11 of the respondents think the management teams of their banks are effective. It is difficult to establish the parameters based on which the respondents passed the confidence votes. The shareholders' perception of effective management could be from the monetary/financial perspective in terms of profitability, declared cash dividend, or bonuses, rather than corporate governance issues as insider abuse, boardroom squabbles, poor training for board members, weak internal control/risk management system, and sit-tight syndrome, among others.

Table 4 Corporate Governance Compliance Responses – Customers

Corporate Governance Parameter	Yes	%	No	%	Total
Do you have access to all relevant information about the Bank through website?	17	65	9	35	26
Does the bank require you to submit audited financial statements periodically?	22	85	4	15	26
Are you satisfied with the services you receive from your bank?	12	46	14	54	26
Do you receive advance notice of all charges on loans and advances?	14	54	12	46	26
Total	65	63	39	37	104

Source: Primary Research Data

Response from customers is in Table 4 above. As explained, the ubiquitous nature of the customers, one-on-one administration of the questionnaires, and the proliferation of brick and mortar branches could be responsible for the impressive response of 87 per cent. The questions administered on the customers were on transparency and accountability and averagely, 68 per cent of them responded in the affirmative in terms of disclosure and accessibility to information, and getting advance notice on bank charges. However, only 12, or 46 per cent of the respondents are happy with the services they receive from their banks. Care was taken by the researcher to identify only those customers that are exposed enough to appreciate what was expected of them through the personal administration of questionnaires.

Table 5 Corporate Governance Compliance Responses – Regulators

Corporate Governance Parameter	Yes	%	No	%	Total
Do you receive accurate and timely financial reports from the banks?	6	43	8	57	14
Are you satisfied with the level of compliance on examiners' reports by the banks?	5	36	9	64	14
Has there been a significant improvement on violations of banking laws, rules, and regulations by the banks?	8	57	6	43	14
Has the level of corporate governance of the banks improved?	6	43	8	57	14
Total	25	45	31	55	56

Source: Primary Research Data

Response from the regulators, as contained in Table 5 above, was low because only 14 questionnaires, representing 47 per cent, out of the thirty administered were completed and returned. The questions centered on the integrity and promptness of all categories of returns, response to routine and special examination reports, and the general state of corporate governance compliance of the banks. There are strong indications that the examination issues that featured prominently in various NDIC and CBN reports described in chapter two of this report are still prevalent among the banks. For example, only a paltry 5, or 36 per cent of the respondents were satisfied with the level of compliance on examiners' reports by the banks, and a mere 43 per cent, or 6, think that the banks submit accurate and timely reports to the regulatory authorities.

As the regulators are the most important of the three independent respondents, their assessment of the banks' compliance to codes of corporate governance is very important. This is more so because other stakeholders rely on such assessment to make critical investment decisions. The major implication on this would be the erosion of customer and investor confidence, which could eventually affect banking habit, and by extension, the economy at large as, for example, the level of cash outside the system would increase. It could therefore be assumed that the higher the level of corporate governance compliance of

the banks the higher their performance, and therefore their ability to impact on the economy.

Fifty seven per cent of the respondents, representing eight, which are the highest rating, were of the opinion that over time there has been a significant improvement on violations of banking laws, rules, and regulations by the banks. This could be because of improvement in enforcement and oversight functions on the part of the regulatory authorities or simply the desire of the banks to improve their compliance level to boost the confidence of their shareholders and other stakeholders.

Hypotheses Testing

As indicated in earlier, the Chi-square method was used to analyze responses from the respondents to enable us test our hypotheses. The Chi-square statistical tool was represented by the following formula:

$$X2 = \frac{\Sigma(O-E)2}{E}$$

Where:

O=Observed value

E=Expected value

The two formulated hypotheses of the study are given below:

Hypothesis One: There is no significant relationship between corporate governance and the quality of board and executive management of the banks.

To test this hypothesis, the data responded to by the MDs/CEOs of the DMBs as contained in Table 6, which tested the quality of the board of directors and executive management of the banks, was used. This will give the following observed frequency (O) Table 6 below:

Table 6 Observed Frequency (O) Table

Corporate Governance Parameter	O	E	O-E	(O-E)2	(O-E)2/E
Corporate Governance codes approved by the Board	11	11	0	0	0
Board independent of Management	11	11	0	0	0
CEO separate from Chairmanship	11	11	0	0	0
Minimum of four Board meetings in a year	7	11	4	16	1.4545
	65	50		TOTAL	1.4545

Source: Primary Research Data

Chi-Square (X2) value: 1.4545.

Acceptance Decision:

The computed value of X2 (1.4545), with 5% significance level and a degree of freedom (DF) of 3 is 7.815. The Decision Rule is that if the computed value of X2 which is 1.4545, is greater than the computed critical value, which is 7.815, we reject the null hypothesis and accept the alternative.

From the above, the value of X2 is less than the computed critical value that is it falls within the acceptance region as indicated in the diagram above. We therefore accept the null hypothesis that there is no significant relationship between corporate governance and the quality of board of directors and executive management.

The results above indicate that although the banks claimed to be corporate governance compliant, some of them do not hold regular meetings. This is in tandem with some of the findings of the NDIC on-site examination report (2004). The violation of the minimum number of meetings by the boards of the banks is also another major finding which violation affected their compliance. As public companies, the banks are under obligation to be transparent in all their activities. The continued manipulation of annual general meetings by the executives and block

shareholders as the study discovered has also impaired the compliance of the banks to codes of corporate governance. This manipulation could result in appointing or renewing the term of inept and non-performing executives, which could in turn affect the quality of the entire board.

The implication of this would be the continued dominance of the banks by block shareholders and family associates, eroding depositor and investor confidence.

Hypothesis Two: There is no significant relationship between corporate governance and transparency, accountability, and shareholder protection in banks.

This will give the following observed frequency (O) table:

Table 7 Observed frequency (O)

Corporate Governance Parameter	O	E	O-E	(O-E)2	(O-E)2/E
Disclosure of corporate governance compliance	4	19	15	225	11.8421
Right to information on changes to extraordinary transactions	16	19	3	9	0.47368
Fair treatment of shareholders on shareholders meetings	8	19	11	121	6.36842
Redress on violation of shareholder rights	10	19	9	81	4.26315
Relevant information through bank website	17	26	9	81	3.11538
Demand for customers' audited financial statements	22	26	4	16	0.61538
Advance notice on all bank charges on loans and advances	14	26	12	144	5.53846
	91	154		TOTAL	32.21657

Source: Primary Research Data

Chi-square value: 32.21657

Acceptance Decision:

The computed value of X2 (32.21657), with 5% significance level and a degree of freedom (DF) of 6 is 12.832. The Decision Rule is that if the computed value X2, which is 32.21657, is greater than the computed critical value, which is 12.832, we reject the null hypothesis and accept the alternative.

From the above, the value of X2 is greater than the computed critical value that is it falls outside the acceptance region. We therefore reject the null hypothesis and accept the alternative that there is significant relationship between corporate governance and transparency, accountability and shareholder protection in the banks.

The implication of this is that since most of the shareholders of the banks are not privy to their state of corporate governance compliance there is strong need for transparency and accountability. Again, the connivance between the block holders of the banks together with the top executives especially in influencing Annual General Meetings (AGMs) through manipulations tends to further make the opinions of the minority shareholders irrelevant. The implication of this is that risky decisions that could be determined to the corporate existence of the bank would be voted for at AGMs.

The study also found out that most of the banks were guilty of misdemeanors and infractions of the past such as non-performing loans, over charge, violations of statutory limits, false and inaccurate financial reports, among others. These violations were serious enough to undermine the corporate governance of the banks and jeopardize their corporate existence.

The claim by the banks to be complaint, contrary to reports from the regulatory authorities and the minority shareholders does not augur well for the banks as banking is all about trust, integrity, and confidence.

From the foregoing findings, which are the violations of important corporate

governance mechanisms, it can be concluded that corporate governance has not made an impact on the quality of the board and executive management of the banks and neither has it enhanced their transparency and accountability or entrenched shareholder rights protection because they have not been compliant.

Conclusion and recommendations

The major challenge in corporate governance in banking in Nigeria today is enforcement. The issue is not that of complete absence of relevant regulations – but that of being ineffective, non-compliant, or unenforceable.

The regulatory authorities, namely the CBN, NDIC, and NSE should have common representatives to attend the annual general meetings of the banks. The representatives would serve as independent observers and submit a report on the proceedings at the end of the annual general meetings.

The introduction of independent directors on the boards of the banks would check the activities of the boards, particularly those of the block holders and family connections. This will strengthen the boards and check collusion between the executive and the chair. The popular structure of having non-executive directors on the boards of the banks has been ineffective as most of them are passive players and more often than not toe the line of the executives.

The CBN and NDIC should de-emphasize financial penalties for late, inaccurate, or false financial reports. Instead, serious penalties like the suspension of the bank from clearing, withdrawal of drawing facilities, or the suspension of the MD/CEO of the bank are more effective options.

The CBN should enforce the Pre-qualification for Appointments to Board and Top Management positions of banks amendments of BOFIA (1999) to the letter so that only people with relevant experience, proper qualifications and proven credible records serve as executives of banks in Nigeria. This will go a long way in enhancing the quality of the board of directors and executive management of the banks.

The state of corporate governance compliance of each bank should be indicated in its Annual Report as issued by its external examiners in the form of a 'Corporate Governance Compliance Certificate', CGCC, as an appendix. The shareholders of the bank, and indeed the public, would know the level of corporate governance compliance of their banks. This will burst strategic local and foreign investment that will guarantee economic growth which is the beacon of irreversible and sustainable development.

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