**AN APPRAISAL OF THE APPLICATION OF CORPORATE GOVERNANCE PRINCIPLES OF COMPOSITION, DUTIES AND DISCLOSURE REQUIREMENTS OF DIRECTORS UNDER NIGERIAN LAW**

BY

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**DEPARTMENT OF COMMERCIAL LAW AHMADU BELLO UNIVERSITY, ZARIA NIGERIA**

**DECEMBER, 2014**

1

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**BY**

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**A DISSERTATION SUBMITTED TO THE SCHOOL OF POSTGRADUATE STUDIES, AHMADU BELLO UNIVERSITY, ZARIA, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A DOCTOR OF PHILOSOPHY IN LAW – PhD**

# DEPARTMENT OF COMMERCIAL LAW, AHMADU BELLO UNIVERSITY, ZARIA

**DECEMBER, 2014**

# DECLARATION

I declare that the work in this Dissertation entitled “**An Appraisal of the Application of Corporate Governance Principles of Composition, Duties and Disclosure Requirements of Directors Under Nigerian Law”** has been carried out by me in the Department of Commercial Law. The information derived from the literature has been duly acknowledged in the text and a list of references provided. No part of this Dissertation was previously presented for another degree or diploma at this or any other institution.

Samuel Aondoawase APINEGA

Signature Date

# DEDICATION

This Dissertation is dedicated to my wife Mrs. Theresa N. Apinega and all my children

# CERTIFICATION

This Dissertation entitled “**An Appraisal of the Application of Corporate Governance Principles of Composition, Duties and Disclosure Requirements of Directors Under Nigerian Law**” by Samuel Aondoawase APINEGA meets the regulations governing the award of the degree of Doctor of Philosophy in Law -PhD of the Ahmadu Bello University and is approved for its contribution to knowledge and literary presentation.

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Dean, School of Postgraduate Studies Prof. A. Z. Hassan Signature Date

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# LIST OF ABBREVIATIONS

AC - Appeal Cases

ALLFWLR - All Federation Weekly Law Report APC - Administrative Proceedings Committee BCC - British Company Cases

BCLC - Butterworth Company Law Cases CAC - Corporate Affairs Commission CAMA - Companies and Allied Matters Act CBN - Central Bank of Nigeria

CEO - Chief Executive Officer

CFO - Chief Finance Officer

Ch. - Chancery

Ch.D - Chancery Division

CLR - Commonwealth Law Reports CLRQ - Commercial Law Report Quarterly CSA - Canadian Securities Administrators DLR - Dominion Law Reports

DTI - Department of Trade and Industry

EFCC - Economic and Financial Crimes Commission

ISAR - International Standard of Accounting and Reporting

K.B - Kings Bench

LR - Law Report

NACR - Nigerian Appeal Cases Report

NASDAQ - National Association of Securities Dealers Automated Quotation NED - Non-Executive Directors

NWLR - Nigerian Weekly Law Report

NYSE - New York Stock Exchange

OECD - Organization for Economic Cooperation and Development SEC - Securities and Exchange Commission

U.K - United Kingdom

UNCTAD - United Nations Conference on Trade and Development USA - United States of America

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# ABSTRACT

*Corporate organizations are engine of growth and development. They contribute to economic and social development of individuals, society and the nation in general as they produce goods and render services that improve the social and economic life of the people. In carrying out their businesses, they provide investment opportunities to the public and other social responsibility projects as well as contribute to national gross domestic product. Based on the above factors the survival of corporate organizations is of interest to both government and individuals hence the need for promoting good corporate governance. Corporate collapses have however, occurred around the world including Nigeria with devastating social and economic effects of loss of income, employment and revenue due to corporate governance lapses. The Nigerian Companies and Allied Matters Act like companies statutes in other countries of the world was found to be insufficient in stemming the increasing rate of corporate collapses around the world including Nigeria due to corporate governance abuses. The introduction of codes of corporate governance in Nigeria and around the world was meant to complement companies’ statutes in order to improve corporate governance. The Nigerian Securities and Exchange Commission Code of Corporate Governance was meant to apply essentially to all public companies that are listed on the stock exchanges in Nigeria. The Code has made far reaching provisions in respect of composition, duties and disclosure requirements of directors with the objective of ensuring that directors perform their duties and responsibilities in such a way that corporations are protected from abuses that resulted to their failures. The issue for consideration was whether the Companies and Allied Matters Act and the Securities and Exchange Commission Code of Corporate Governance in Nigeria have provided sufficient legal regime that would protect companies from directors’ abuses in performing their duties and responsibilities. Consequently, the objective of the research was to find out whether the Companies and Allied Matters Act together with the Securities and Exchange Commission Code of Corporate Governance in Nigeria have sufficiently addressed issues of corporate governance relating to composition, duties of directors and disclosure requirements. The research adopted a doctrinal research methodology which relied principally on existing statutes, subsidiary legislation and literature on corporate governance and made analyses which resulted to formation of opinions and findings. The study reveals that the category of persons prohibited from being directors on the basis of past fraudulent conduct is narrow which will continue to provide a leeway for some fraudulent persons to become company directors; It was also found that the SEC Code has failed to provide sanctions for failure to comply with the Code therefore making the Code to lack enforcement power thus making compliance to be voluntary and haphazard which will not achieve the desired best practices in the Nigerian business environment. It was further shown that the narrow scope and ambiguous definition of the concept of ‘connected persons’ to directors cannot achieve the objective of preventing conflict of interest transactions under the current corporate governance regime. The research therefore recommended among other things, the amendment of the Companies and Allied Matters Act to make the definition of fraudulent persons to be elastic enough to cover other areas beyond company affair. Fraudulent conduct should be made elastic enough to cover other areas like civil and public service; the SEC Code should be made mandatory for compliance by public companies and clear sanctions should be prescribed for failure to comply in order to enhance faster application and entrenchment of good corporate governance in Nigeria. It was further recommended that a clear definition of ‘connected persons’ to directors with an extended scope be made to cover other persons such as father, mother, brothers and sisters, father in-law and mother in-law who are more likely to promote the interest of directors in material transaction with the company.*

# CHAPTER ONE

* 1. **GENERAL INTRODUCTION**

# Background to the Study

Corporate organisations are the drivers of every nation‟s industrialization, commerce, employment and general economic development. Companies are business ventures that are established to produce goods or provide services for consumption by individuals, organisations and government. They are regarded as the engine of growth and development1. Companies provide investment outlets for the public to invest with the expectation to receive returns on their investments and improve their economic strength. In order to carry on their activities, companies employ people in various levels of the workforce who are remunerated in form of salaries, wages and allowances. Those who receive financial benefits from companies use their money to improve their standard of living by taking care of themselves, their families, accessing health care, sending their children to good schools and payment of taxes to the government. Companies also engage in corporate social responsibilities in their host communities to improve the social wellbeing of the people. Some companies provide scholarship; others build schools and other philanthropic activities. In addition companies provide taxable revenue to the government. Companies pay corporate tax while employees and investors pay taxes on income derived from companies. The revenue derived from these taxes by the government is used for government operation and provision of infrastructures that would become factors of economic and technological development in the country. Based on the above premise the performance of companies is of interest to not only government but also individuals. Several classes of people have stake in the company and would not want their stake to be destroyed due to the collapse of the company.

1Oso, L and Semiu, B (2012). The Concept and Practice of Corporate Governance in Nigeria: The Need for Public Relations and Effective Corporate Communication. J Communication, 3 (1) p.1

The experience of the great depression between 1929 and 1939, points to the devastating consequence of corporate failures. The great depression has been acclaimed as the deepest and longest-lasting economic downturn in the history of the Western industrialized world. In the United State of America, it began soon after the stock market crash of October, 1929, which sent Wall Street into a debacle and wiped out millions of investors. Over the next several years, consumer spending and investment dropped, causing steep declines in industrial output and rising levels of unemployment as failing companies laid off workers2. By 1933, when the great depression reached its nadir, some 13 to 15 million Americans were unemployed and nearly half of the country‟s banks had failed3.

In a similar vein the financial crisis that affected almost every nation‟s economy in the world otherwise popularly called the financial meltdown between 2007 and 2008 was triggered by the bursting of the United States of America housing bubble which peaked in about 2005 - 20064. Easy availability of credit in the United States fueled by large inflows of foreign funds led to a housing construction boom and facilitated debt financed consumer spending. Lax lending standards made it easy for loans of various types to be obtained and consumers assumed an unprecedented debt load5. However, as housing prices declined major global financial institutions that had borrowed and invested heavily in mortgages reported significant losses. Defaults and losses on other loan types also increased significantly as the crisis expanded from the housing market to other parts of the economy. Total losses were estimated in trillions of United States Dollars globally6

2 The Great Depression – facts &summary history.com. [http://www.history.com/topics/great-depression.](http://www.history.com/topics/great-depression) Accessed on 18/3/2014 at 8:27 Pm P. 1 of 4

3 Ibid

4Lahart, J (2007) Egg Cracks Differ in Housing Finance Shells. [http://online.wsj.com/article.](http://online.wsj.com/article) The Wall Street Journal. Retrieved July 2008

5President Bush‟s Address to Nation.[http://www.nytimes.com2008/09/24/business/economy.](http://www.nytimes.com2008/09/24/business/economy)

6International Monetary Fund Loss Estimates[.http://www.imf.org/external/pubs/ft/weo/2009/01/pdf](http://www.imf.org/external/pubs/ft/weo/2009/01/pdf)

The United States financial crisis inquiry commission reported its findings in January, 2011 and concluded that “the crisis was avoidable and was caused by widespread failures in financial regulation… dramatic breakdowns in corporate governance including too many financial firms acting recklessly and taking on too much risk… and systemic breaches in accountability and ethics at all levels.”7It is against this backdrop that all stakeholders including government desire that corporations not only survive but operate in the best interest of all stakeholders and the economy in general. This is the hallmark of corporate governance.

Over the years, different issues relating to corporate governance practices have been on the agenda of the inter-governmental working group of experts on International Standards of Accounting and Reporting at its various sessions. During the International Standard of Accounting and Reporting (ISAR) intersession period of 2003/04, the issue of corporate governance and transparency continued to receive unmatched levels of attention.8 Concerns about corporate governance have grown over time. In recent years, there has been the recognition of a need for changes in the way that public companies are governed due to a number of spectacular and well-publicized corporate failures. In the United States of America, many organizations in the savings and thrift industry had to be rescued from financial collapse in the 1980s and recently in the 2000s, witnessed the mega collapse of Enron and World Com, two mega corporations in the United States of America. In the United Kingdom, a number of companies collapsed unexpectedly in the 1980s and 1990s. These included Polly Peck International, the Bank of Credit and Commerce International, British and Commonwealth, the Mirror Group News

7 Financial Crisis Inquiry Commission – Press Release – January 27, 2011 [http://www.fcie.gov/files/news-](http://www.fcie.gov/files/news-pdfs/2011-0127) [pdfs/2011-0127](http://www.fcie.gov/files/news-pdfs/2011-0127)

8 Report by the United Nations Conference in Trade and Development (UNCTAD) Secretariat on Review of the Implementation Status of Corporate Governance Disclosures and the Role of such Disclosures in Adding Sustainable Value. TD/B/com.2/ISAR/25, 2004 p.3.

International and Barrings Bank.9 In each case, there appeared to be serious accounting or financial reporting irregularities and inadequate internal controls and risk management. In some cases, creative accounting and inadequate financial regulations were identified as the cause of the corporate failures.10

In a similar vein in Nigeria, it has been noted that corporate governance lapses were significantly responsible for the collapse of over 70 percent of defunct companies in Nigeria over the last two decades.11Some of the companies that crumbled due to corporate governance questions include Intercontinental Bank, Oceanic Bank, Bank PHB, Afribank, Spring Bank, Lion of Africa Insurance, SocieteGenerale Bank Nigeria, Mtel, Kaduna Textile Mills, Nigeria Airways, Concord group.12 “A survey by the Securities and Exchange Commission (SEC) (in Nigeria) reported that … specifically for the financial sector, poor corporate governance was identified as one of the major factors in virtually all known instances of financial institution‟s distress in the country.”13 In many cases of corporate collapses directors have been linked as perpetrators of unethical business practices and corporate governance abuses. The Central Bank of Nigeria (CBN) had listed the reasons for the collapse of Savannah Bank and SocieteGenerale Bank of Nigeria as the ineffectiveness of the board, false and unreliable returns to the regulatory authorities.14 The revocation of the Peak Merchant Bank license by the CBN was predicated on the ground of over bearing influence of the chairman, significant insider abuses, reckless granting of credits and a host of other reasons.15 While the CBN removal

9 Coyle, B.(2009) *The Institute of Chartered Secretaries and Administrators (ICSA) Study Text in Corporate Governance*, 6th Edition (ICSA Information and Training Ltd. London), p.10.

10 Ibid

11Why the Rising Business Failure in Nigeria? [http://www.myfinancialintelligence.com/banking-and-](http://www.myfinancialintelligence.com/banking-and-finance.%20p.%202of%205) [finance. p. 2of 5.](http://www.myfinancialintelligence.com/banking-and-finance.%20p.%202of%205)Accessed on 14/4/2013

12Ibid

13 Introduction, paragraph 1.3 Central Bank of Nigeria Code of Corporate Governance for Banks in Nigeria Post Consolidation, 2006.

14Osuagwu, G. O. (2013). “Implications of Corporate Governance on the Performance of Deposit Money Banks in Nigeria” *Arabian Journal of Business and Management Review* (OMAN Chapter) vol. 2 No. 2 p. 107

15 Ibid

and replacement of chief executive officers of Oceanic Bank, Intercontinental Bank, Union Bank, Afribank and Finbank was reported to be as a result of deep rooted mismanagement and the existence of large cases of insider lending to directors and their relations, unsecured and bad debts.16The incessant collapse of companies has no doubt brought the failure of good corporate governance into public glare. Investors are becoming increasingly sensitive to the corporate governance framework of companies. There is a general perception that strong corporate governance and transparency are necessary for going concerns as it is a major indicator of a well-managed and resilient business.17

There are several stakeholders to corporate governance who have interests, either directly or indirectly that need to be protected by effective performance of companies. These stakeholders similarly have roles and duties to perform to promote good corporate governance. They consist of Directors, Shareholders and Employees, who have direct interests and duties in the company. Other stakeholders include creditors, suppliers, customers and the community/general public who have indirect interests in the company through their transaction with it. All these stakeholders have their respective roles to play to ensure that the company is properly managed for the company‟s interest and that of all its stakeholders. The concern of this research is with respect to the directors‟ issues of corporate governance.

The board of directors is the main stay of corporate governance in the company. Its primary responsibility is to ensure good corporate governance in the company.18 This means that the principal objective of the board is to ensure that the company is properly managed by overseeing the effective performance of management.19 Accordingly, the

16 Ibid

17Ibid

18Section 2.3 SEC Code of Corporate Governance in Nigeria, 2011.

19Section 2.2 Ibid

success or failure of a company depends largely on the board of directors. It is against this backdrop that the Nigerian SEC like many other countries has developed the Code of Corporate Governance in 2011 which it considered as an improved version from the earlier code of 2003. The SEC Code was made with the aim to align with international best practices. It has indeed made far reaching provisions in addition to the statutory provisions for the purpose of enhancing the quality of the board of directors in Nigeria. The requirements for an effective board of directors range from its composition to duties and disclosure responsibilities. The directors are expected to perform their duties and disclosure responsibilities individually and collectively and therefore become accountable for their actions or inactions.

# Statement of the Research Problem

The incessant corporate failures and malfeasance in Nigeria were due to poor corporate governance culture. The Companies and Allied Matters Act indeed proved to be an insufficient legislation to stem corporate governance abuses. The introduction and production of the Securities and Exchange Commission Code of Corporate Governance was meant to complement the Companies and Allied Matters Act to provide for efficient and effective legal regime for corporate governance system in Nigeria. The issue for consideration now is whether the Nigerian SEC Code of Corporate Governance has sufficiently covered issues of corporate governance especially in the area of composition and duties of board of directors as well as disclosure requirements for effective and efficient corporate governance in Nigeria.

In view of the foregoing, this research has formulated the following research questions:

* + 1. Whether the provisions of the Companies and Allied Matters Act and SEC Code of Corporate Governance on board of directors of public companies in Nigeria have set standards that can entrench corporate best practices.
    2. Whether boards of directors under the corporate governance system in Nigeria can constitute effective and competent board that will achieve good corporate governance in Nigerian companies.
    3. Whether there are limitations in the legal regime for corporate governance in Nigeria that need to be reviewed and improved upon in order to provide for more effective board of directors of public companies in Nigeria.
    4. Whether there has been an improvement in the application of corporate governance principles enunciated in the SEC Code of Corporate Governance in Nigeria.

# Aim and Objectives of the Research

The aim of this research is to show or prove that the Companies and Allied Matters Act and the Securities and Exchange Commission Code of Corporate Governance have not sufficiently addressed issues of corporate governance relating to company‟s board composition, duties of directors and disclosure requirements.

1. In furtherance of the aim of the research, the main objective of the dissertation was set to identify the limitations in the Companies and Allied Matters Act and Securities and Exchange Commission Code of Corporate Governance that would need to be addressed to improve corporate governance in respect of board composition, duties of directors and disclosure requirements.
2. In addition, the research was set to show that companies in Nigeria applied discretionally the requirements of the Securities and Exchange Commission Code of Corporate Governance in the aspects of board composition, duties and disclosure of material information
3. The dissertation would consequently provide recommendation to address the limitations discovered in the Companies and Allied Matters Act and the Securities and Exchange Commission Code of Corporate Governance as they relate to board composition, duties of directors and disclosure requirements for effective corporate governance.

# Scope of the Research

This dissertation is limited to the consideration of issues relating to the composition of company board of directors, duties of directors as well as the role of directors in making or ensuring the required disclosure of material information needed for an effective and efficient corporate governance regime in Nigeria. In this regard, the Companies and Allied Matters Act and the Securities and Exchange Commission Code of Corporate Governance were used as the base line among others for measuring the application of corporate governance in Nigeria as it relates to board composition, duties of directors as well as disclosure requirements.

# Research Methodology

The approach adopted in carrying out this research is principally doctrinal methodology. For the purpose of legal analysis, primaryand secondary sources of materials constitute very important reference materials. The primary sources of materials that have been considered include statutes and codes of corporate governance from local and foreign jurisdictions as well as judicial pronouncement on the subject. They are considered as primary sources because they form the basis upon which actions and opinions are formed. They are the origin of every legal subject.

The secondary sources of materials that were used are published and unpublished works of scholars in the field of the research. These include books, journal articles, seminars papers, monographs, dissertations on cooperate governance, and available

newspaper, magazine articles and internet materials. In making use of the materials mentioned above, the research adopted a theoretical analysis of the materials and sources of information by comparing and contrasting them with a view to forming opinions and arriving at conclusions.

As part of the secondary source of data, the research further employed empirical information and data from a random compilation of the annual reports and accounts of some companies that are listed on the Nigerian Stock Exchange. These data were obtained and analyzed in conjunction with primary and secondary data to form the basis for the conclusions that were arrived at in the dissertation.

# Literature Review

In putting together this study, several literatures were used as foundation. Materials such as text books and journal articles were reviewed. The aim is to borrow ideas that would add value to this research. The approaches adopted for the literature review are in three main ways;

1. Conceptual literature;
2. Theoretical framework and
3. Empirical literature.

The intention is to examine the available literature in different perspectives as they relate to this research and identify their areas of contribution and limitation to this study.

# Conceptual Literature

* + - 1. **Meaning of Corporate Governance**

The key word in the research topic is „‟corporate governance‟‟. Accordingly, it is necessary to define what is referred to as corporate governance. The concept of “corporate governance” is subject to many definitions depending on the perspective of the

person based on the background and the objective the definition is intended to achieve. It has been posited that corporate governance is not a concept that could be subjected to a watertight definition. Consequently “several definitions and perceptions of corporate governance proliferate academic literature. This is largely due to divergent economic, social and ethical world views about the concept of corporate governance. Thus, scholars and governance pundits define the concept according to their economic, political and cultural perception.”20 Corporate governance is said to be a nebulous concept, thus “the lack of consensus in the definition of corporate governance resulted in researchers from different background (finance, economics, sociology, and psychology) coming up with their respective theoretical views, all aimed towards aiding understanding of the complex nature of the concept.”21 The existence of irreconcilable and divergent definitions has made a single and general acceptable definition not achievable. However, since purposeful attempts have been made to define corporate governance, some of the definitions considered by this author as major shall be considered.

The initial attempt to define the term “corporate governance” was by Adrian Cadbury22who stated that “corporate governance is the system by which companies are directed and controlled”. The report in what appears to be an explanation of details of the systems of control stated further that:

boards of directors are responsible for the governance of their companies. The shareholders‟ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company‟s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to

20Osuagwu, G. O. (2013) Implications of Corporate Governance on the performance of Deposit Money Banks in Nigeria.Arabian Journal of Business and Management Review (OMAN Chapter) vol. 2 No. 10. P. 110

21Lawal, B. (2012) Board Dynamics and Corporate Performance: Review of Literature, and Empirical Challenges.International Journal of Economics and Finance[.www.ccsenet.org/ijef.p.23.](http://www.ccsenet.org/ijef.p.23) Accessed on 15/3/2014

22Report of the Committee on the Financial Aspects of Corporate Governance. Gee (a Division of Professional Publishing Ltd) London, 1992 Paragraph 2.5

shareholders on their stewardship. The board‟s actions are subject to law, regulations and the shareholders in general meetings.23

It is observed that the emphasis of the Cadbury Report was on the control side of things - the monitoring of, accounting for, and the implementation of sound board policy rather than on the formulation of policy and development of strategies which are the starting points of good corporate governance.This definition is rather restrictive as it laid emphasis on the aspect of company management because essentially it is the directors that direct and control the company. Section 244(1)24refers to directors as “persons duly appointed by the company to direct and manage the business of the company”. It must be noted however, that management of company had been going on before the issue of corporate governance emerged. Corporate governance therefore goes beyond direction and control (management of companies). The background and perspective of Adrian Cadbury was the accounting and financial considerations. This is reflected in the objective of the committee that is “to help to raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes is expected of them.”25Corporate governance certainly goes beyond management of companies to include measures put in place to ensure that companies are managed properly.

The Organization for Economic Cooperation and Development (OECD) is an international organization that was formed to promote policies designed *inter alia* “to achieve the highest sustainable economic growth… thus to contribute to the development of the world economy; to contribute to sound economic expansion in member as well as

23Paragraph 2.5 ibid; see also Gareth, A.D. (2004) “Themes and Variations: The Convergence of Corporate Governance Practice in Major World Markets”. *Denver Journal of International Law and Policy,Spring.* p. 1

24 Companies and Allied Matters Act (CAMA) Cap C20 Laws of the Federation of Nigeria (LFN), 2004

25Adrian Cadbury. Op. Cit. Paragraph 2.8

non-member countries in the process of economic development.”26 In 1999 the OECD developed a set of principles of corporate governance in response to a call by its council meeting at ministerial level to develop, in conjunction with national governments, other relevant international organizations and the private sector, a set of corporate governance standards and guidelines.27 The said OECD principles have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike.28 In its preamble, the Principles see corporate governance as involving “a set of relationships between a company‟s management, its board of directors, its shareholders and other stakeholders‟‟29. Thus, corporate governance provides the structure through which the objectives of the company are set, and how the means of attaining those objectives and monitoring performance are determined.

This definition is limited in the sense that in as much as the structure is important for providing the basis, it has not covered the aspect of making the various stakeholders to actually participate and be effective in carrying out their respective responsibilities. For instance, shareholders have roles to play in the company structure. In fact, they are considered as one of the major organs through which the company acts.30 But the reality is that shareholders have been observed for a long period ago to be unable to participate effectively in company affairs because of the overbearing influence of the board of directors, who exercise control over the mechanism of the general meeting where shareholders are supposed to perform their responsibilities.

Another definition worth mentioning states that corporate governance is “a system of checks and balances between the board, management and investors to produce an

26Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, 2004, OECD Publication service, 2 rueAndre-fascal, Paris France, p. 2

27Ibid. p. 9

28ibid

29 Preamble to the OECD Principles of Corporate Governance, ibid

30Section 63(1), CAMA op. cit

efficiently functioning corporation, ideally geared to produce long-term value”31This definition shows that corporate governance deals with the relationship among various stakeholders with respect to the control of corporations. In the said definitions, corporate governance addresses the relationship between the owners of a company- the shareholders who are the principals and those who manage the company‟s operations- the executives hired to run the company as agents of the principals,32 and that it also encompasses the weight given to various factors in connection with the process of making strategic decisions, the adequacy and transparency of disclosure, the reliability of financial reporting and compliance with laws and regulations.33

This definition has neglected the role of other stakeholders in the company like employees, customers and the community where the company is located. But there is no gainsaying that these stakeholders play significant roles to ensure that the company is properly managed and that their interest is recognized and protected.

Another dimension of the definition of corporate governance is the emphasis on economic perspective. The proponents of this ideology are Mathiesen, Gookey and Chambers.It has been canvassed that “corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals”34 This definition presupposes that “the governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society”35 this definition appears to place greater emphasis on economic efficiency through which corporate governance system should aim to

31Garrett, A.D (2004) Themes and Variations: The Convergence of Corporate Governance Practices in Major World Markets. Op.cit. p.1

32 Ibid

33 Ibid

34Chambers, A and Weight, C. (2008) *Corporate Governance Handbook,* 4th Edition. Tottel Publishing West Sussex, p.193

35Ibid.

optimize economic results that would benefit immediate stakeholders while at the same time recognizing the general interests of other stakeholders. In further accentuation of the economic factor of corporate governance, Mathiesen contends that:

corporate governance is a field in economics that investigates how to secure or motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. It is often limited to question of improving financial performance, for example, how the corporate owners can secure or motivate that the corporate managers will deliver a competitive rate of return. (Sic)36

This definition postulates that the main objective of corporation governance is to promote shareholder value. That is to say, corporate managers are obliged to have regard to the enhancement of investors‟ investment over time to ensure increase in value of shares or yield on shares of the company.Probably it is this economic ideology that exacerbated Gookey at an annual meeting of the International Corporate Governance Network in July 2003 to say that “corporate governance is only about reducing the cost of capital: if we can‟t establish that beyond peradventure then we are wasting our time. This is not a moral crusade.”37

Chambers and Weight are rather mild in their economic objective of corporate governance but still emphasized it. They state that “corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals.”38 In explaining what they really imply by their definition, they went further to say that “the governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The

36Smerdon, R, (2007) *A Practical Guide to Corporate Governance.*Op.cit. p. 2

37 Ibid, p.3

38Chambers, A and Weight C (2008).*Corporate Governance Handbook.* Op.cit. p.193

aim is to align as nearly as possible the interests of individuals, corporations and society.”39

The economic perspective of the definitions above is principally concerned with maximization of economic results. This has been the bane of corporate governance in many companies that have collapsed. The fact that business enterprises are established for profit making and maximization, the process must not neglect ethical standards. If morality is thrown overboard as vehemently canvassed by Gookey then there will be exploitation of the weak stakeholders that will result to chaos.

The definitions above have been reiterated by other authors like Amupitan,40Badi,41and Coyle.42Amupitan came to the conclusion that “there is no doubt that the whole essence of corporate governance is not just managing the affairs of a company, but how to make those company executives responsible and accountable,”43 He stated that the central issue arising there from is accountability. There must be some safeguards which will ensure that directors are accountable not only to the shareholders but also to creditors and other stakeholders. The emphasis of this definition on accountability is too generalistic and impracticable. Directors cannot be answerable to all stakeholders in company management. They can only take into consideration the interest of all stakeholders in formulating strategic policies and goals of the company to enable the company operate smoothly.

39ibid

40Amupitan, J. O. (2008) *Corporate Governance: Models and Principles*. Hiltop Publishers. Ibadan & Abuja, Pp. 2-6

41Badi, N.V. (2012), *Corporate Governance*. Vrinda Publications (p) Ltd, Delhi-India Pp. 13-15

42Coyle, B. (2009). *The ICSA Study Text in Corporate Governance*, p. 4

43Amupitan, J.O (2008) Op. Cit p. 7

In Nigeria too, there are definitions of corporate governance proffered by some authors. Lemo44 states that:

“Corporate governance is a body of rules of the game by which companies are managed and supervised by the board of directors in order to protect the interest and financial stakes of shareholders that are far removed from the management of the firm”

It is a system by which corporations are governed and controlled with a view to increasing shareholders value and meeting expectation of other stakeholders. Demaki and Momoh *et al* have also quoted the definition by Mensah who states that “Corporate governance is an institutional arrangement which provides the discipline and checks over excesses of controlling managers.”45 The focus of these definitions is on the board of directors as corporate managers. They are expected to discharge their responsibilities in accordance with set rules and standards in such a way that would be beneficial to financial stakeholders while taking into consideration the interest of other stakeholders as well.

Inamreiterates the fact that “corporate governance is a nebulous concept but it is safe to say that it is all about the manner in which corporations are directed, controlled and held to account. It is concerned with effective leadership of corporations to ensure that they deliver on their promise as the wealth creating organ of society and that they do so in a sustainable manner.”46Ifeanyi*etal*while admitting the validity of the definition of corporate governance as “a system by which companies are directed and controlled” contend further that the concept is also “concerned with holding the balance between

44Lemo, T. (2010). Keynote Address of the 34th Conference of ICSAN, Sheraton Hotels & Towers, Banquet Hall, 22nd and 23rd September, Lagos. This definition was quoted by: Demaki, G. O (2011) Proliferation of Codes of Corporate Governance in Nigeria and Economic Development. Business and Management Review vol. 1(6) p. 2 Available online at http:/[www.businessjournals.org/bmr.Accessed](http://www.businessjournals.org/bmr.Accessed) on 15/3/2014. See also Momoh, O. A. and Ukpong, M. S. (2013) Corporate Governance and its effects on the Nigerian Insurance Industry. European Journal of Globalisation and Development Research.Vol.8 No. 1 p. 481 Journals Bank.com (2013). Accessed on 15/3/2014

45 Ibid

46Inam, W (2006) Regulatory and Institutional Challenges of Corporate Governance in Nigeria post Banking Consolidation. Nigerian Economic Summit Group (NESG) Economic Indicators. Vol. 12 No. 2 p. 2

economic and social goals and between individual and communal goals (and) the aim is align as nearly as possible the interests of individuals, corporations and society.” By way of explanation, he went on to say that “the concept implicates rules and regulations that ensure that a company is governed in a transparent and 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.”47 This definition takes cognizance of divergent interests of a wide spectrum of stakeholders in the company who expect the managers of the company to be transparent and accountable in such a way that their respective interest in the company will not be jeopardized. The definition postulates the need for rules and regulations to guide the actions of those entrusted with company management.

The definitions of corporate governance stated above by Nigerian authors concentrate more on the role of corporate managers without adducing the position of other stakeholders in promoting corporate governance practices. Even though directors as corporate managers have greater responsibility in ensuring corporate governance practices, other stakeholders like shareholders, creditors, employees, regulators and public have roles to play in order to entrench good corporate governance by companies.

From the above definitions, the key constituents of corporate governance that are common are: corporation (company) and stakeholders (the principal players). A corporation is a juristic person distinct and separate from its owners and managers. 48 However a corporation being an abstraction is bound to operate through natural persons in diverse capacities as directors, shareholders, managers and other employees. It is these relationships between a company and these natural persons that create some

47Ifeany, D. N; Olagunju, A, David, A. O. (2011) Corporate Governance and Bank failure in Nigeria: issues, challenges and opportunities. Research Journal of Finance and Accounting vol. 2 No.2 Online. [www.iiste.org.](http://www.iiste.org/)

48 Section 37 and 38(1) Companies and Allied Matters Act (CAMA) Cap. C20, Vol. 3 Laws of the Federation of Nigeria (LFN), 2004

responsibilities and duties between the company and the operators, as well as relationships among the operators themselves. These relationships expect to protect the interests of each party with the aim of producing beneficial outcomes. It is in this respect that corporate governance plays a key role in setting out a system by which roles and responsibilities in a company are performed properly. By the term “performed properly” It means that the result of what the corporation does is to the benefit of the interested parties and does not do harm to the commonweal. If management is about running business, governance is about seeing that it is run properly. It therefore entails that the definition of corporate governance includes a procedure that will make a company operate effectively and beneficially. The procedure may involve laws, regulations, principles and accepted business practices.

This work postulates that the term “corporate governance” is an all-encompassing concept that envisage a functional system that involves the interplay among stakeholders directly and indirectly to achieve value and balance the interests of all stakeholders in the corporation. The principal stakeholders are certainly the shareholders, board of directors and managers. Other stakeholders include employees, suppliers, customers, creditors and the community.

Accordingly, the view taken in this study is that corporate governance suggests a system of corporate management whereby every stakeholder in the company is given the opportunity and encouraged to perform duties and take actions that would enhance better corporate performance and protection of the interest of the company and all its stakeholders. The duties and actions of stakeholders could be statutory, regulatory, contractual or moral obligations. The aspect of protection of the interests of all stakeholders in the company is very essential to provide equitable beneficial outcomes. Even though the company has its separate personality, the truth still remains that it is established for the ultimate economic and social welfare of its stakeholders. It is expected

that no person or group of persons should advance their interest at the detriment of others. It is believed by the researcher of this work that the ultimate aim of corporate governance is to ensure that all interests in the company are equitably attended to.

# Meaning of Director

The term „director‟ is a noun which is derived from the adjective word „direct‟. The meaning of „direct‟ include: to control or be in charge of something; show the way; and give order.49 Accordingly, „director‟ has been defined as: “one of a group of managers who run a company”50. In consonance with the word „direct‟ a company director in running a company shall be one of the persons who is in charge of a company by showing the way and giving orders as to how the company should be run. In the same vein, section 24451 defines directors of a company registered under the Act as “persons duly appointed by the company to direct and manage the business of the company.” What makes a director is the responsibility to direct and manage the affairs of the company. Section 63 (3)52 gives credence to this assertion by affirming that; “except as otherwise provided in the company‟s articles, the business of the company shall be managed by the board of directors”.

The meaning of company director has however been extended to cover persons who are not duly appointed by the company to direct or manage the company. They are deemed to be directors by their involvement and influence in the way the company is directed and managed. Such a person or persons are referred to as shadow directors. A shadow director is referred to a “person on whose instructions and directions the directors are accustomed to act.”53 This inclusive definition of directors is apt in the sense that the

49 Hornby, A.S *Oxford Advanced Learners Dictionary of Current English*, 7th Edition (Oxford University Press, London.) p.400

50 Ibid p.411

51 Companies and Allied Maters Act (CAMA) Cap C20 Laws of the Federation of Nigeria (LFN) 2004; see also section 37 SEC Code of Corporate Governance in Nigeria , 2011

52Companies and Allied Matters Act. Ibid

53Sections 245 and 567. Ibid

idea of directorship is to direct, which includes to be in charge, show the way or give order. The shadow director assumes these attributes since in the ultimate it is his directions and instructions that the company is managed or run. The duly appointed directors are mere puppets in this regard. A shadow director is therefore subject to the full regime of duties of directors.

In some other situations the articles of association of a company may allow directors to appoint another person to sit in for the director when he (the latter) cannot attend meeting. The person whom the substantive director appoints to represent him is referred to as alternate director. The Companies and Allied Matters Act does not contain any provisions relating to alternate directors as such but they are recognized as directors and mentioned in the Securities and Exchange Commission Code of Corporate Governance in Nigeria.54 The recognition of the position alternate directors is derived from common law which is applicable in Nigeria as a matter of company practice with judicial approval. In *Baffa v. Odili*,55 the court clearly recognized alternate director by proffering its meaning thus: “an alternate director where the articles of association of the company allow for one is appointed by a director to act in his place during his absence. This amounts to a temporary delegation of functions by the directors which subsist until it is revoked”56 Alternate directors are regarded as directors in the fullest sense as a matter of law in relation to discussion taken at board meetings at which they were present.57

Another way a person is regarded as a director is where the company holds him out as director even though he is not duly appointed.58 In such a circumstance, the company would be compelled to bear the consequence of the actions of the person the

54 Section 37, Code of Corporate Governance in Nigeria, 2011 on the Definition of „Director‟

55 (2001) 15 NWLR (pt. 737), p.715

56 Ibid, pp.715-716

57Smerdon, S. (2007) *A Practical Guide to Corporate Governance* 3rd Edition (Sweet and Maxwell London) p.75

58 Section 250, CAMA op. cit

company had held out as director.59 This is commonly referred to as director by estoppel. Section 26060 validates the acts of a director by estoppel despite the defect of the means by which he is considered as director. An estoppel director is not duly appointed as director61. However, his act binds the company because it is the representation of the company that creates impression in the minds of the third party that the person is a director of the company with whom he had transacted business.

From the above analysis it is submitted that a person is a company director by whatever name called62 provided he performs the functions of a director either directly or indirectly by directing or managing the affairs of the company. The means by which a person becomes a director does not really make a difference in determining his liability as a director. A director by whatever name is liable for his actions and inactions. The basis for holding all kinds of directors responsible for their role in company management is to warn everyone who intends to interfere with the management of a company to prepare to bear the consequence of his actions. The fact that it is only the names of those who are duly appointed as directors that appear on the company‟s documents, when it comes to determining liability of directors the organization net is extended to cover undocumented directors such as shadow directors to account for the roles they have played in the company. Apart from the duly appointed directors, other types of directors are deemed as directors by operation of the provisions of the Nigerian Companies and Allied Matters Act.

# Theoretical Framework

In legal perspective, a theory refers to a principle or doctrine that provides the basis for interpretation of law, formulation of policies and opinion. The application of a theory in a particular situation determines the type of outcome that would be experienced.

59 Ibid.

60CAMA. Ibid.

61Sections 250, and 244 (4) Ibid.

62 Section 567 CAMA. Op. cit.

Accordingly, the system of corporate governance employed in the management of companies depends on the type of theory adopted by the legal regime or the corporate operators. There are three principal theories as to what sound corporate governance should be. They are agency theory, stakeholder theory and enlighten shareholder theory. These theories were examined in this study and then determined the theory preferred for this work.

# Agency Theory

The agency theory was postulated by Jensen and Meckling.63 The theory is based on the separation of the ownership of a company and control over the company‟s actions, whereby shareholders own the company, but managers control it. The relationship between the owners and managers is apposite to that of agency in the sense that owners (as principal) appoint an agent (the managers) to manage the company on their behalf.64 It is therefore expected that the managers should always act in the best interest of the owners. It is in this regard that the shareholder value approach to corporate governance was emphasized. This theory requires boards to regard the enhancement of their owners‟ investments over time as the overriding objective.65 The intention should be to maximize the wealth of the company‟s shareholders, in form of share price growth, dividend payments, organic growth and successful growth by acquisition.

In 2005, the International Corporate Governance Network (ICGN) issued a statement on corporate governance principles. It said that the overriding objective of the corporation should be to optimize over time the returns to its shareholders. Corporate governance practices should focus board attention on this objective.66 It is generally acknowledged

63 Coyle B (2009). Op. cit. p.6

64 Jensen, M and Mechling, W. H. (1976) Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure. Journal of Financial Economics [.http://doi.org.](http://doi.org/) accessed on 15/3/2014. See also Lawal, B. (2012) Board Dynamics and Corporate Performance: Review of Literature, and Empirical Challenges. Op. cit p. 23

65Smerdon, R. (2007) op. cit. p. 19

66 Coyle, B. (2009) op. cit. p 22

that public companies are in business to earn profits for the benefit of their shareholders. Successful companies are therefore viewed as those paying dividends to shareholders and whose share price goes up.

The agency theory requires the agents to be accountable to their principals for their decisions and actions. Accountability means reporting back to the principals and giving an account of what has been achieved, and the principal having power to reward or punish an agent for good or bad performance.67 Greater accountability is therefore necessary to achieve performance levels that are in the best interest of the shareholders.

# Stakeholder Theory

The stakeholder or pluralist approach in a nutshell suggests that the goal of shareholder value should be synchronized with the needs of customers, suppliers and employees. In this regard, the origin of sound corporate governance is not just to meet the objectives of shareholders, but also to have regard for the interest of other individuals and groups with a stake in the company, including the public at large.68 This theory states that a company‟s management should make decisions that take into consideration the interest of all the stakeholders. This means trying to achieve a range of different objectives, not just the aim of maximizing the value of the company for its shareholders. This is because different stakeholders each have their own (different) expectations of the company which the company‟s management should attempt to satisfy.69

From a stakeholder view, corporate governance is concerned with achieving a balance between economic and social goals and between individual and communal goals. Sound corporate governance should recognize the economic imperatives companies face in competing markets and should encourage the efficient use of resources through sound

67 Ibid. p 7

68Coyle, B Ibid; See also Smerdon, R.*APracticalGuide to Corporate Governance*, op.cit., p.20.see also Lawal, B (2012). Op. cit. p. 23

69 Coyle, B. Ibid p. 10

investment. It should also require accountability from the board of directors to the shareholders for the stewardship of those resources within this framework; the aim should be to recognize the interest of other individuals, companies and society at large in the decisions and activities of the company.70 It is therefore the responsibility of firm managers to align these diverse interest groups by effectively analyzing the nature of their perceived interest disparities and the adoption of appropriate corporate strategies that help balance the act and improve performance.

The limitation of the stakeholder approach is that unlike the shareholder approach where company law provides certain rights to shareholders and some legal duties on the board of directors towards shareholders, the interest of other stakeholders are, not explicitly fortified by company legislation. The protection of other stakeholders can however, be enforced by other aspects of law, such as employment law, health and safety legislation, and environmental law.

The argument of the pluralist approach make sense in that cooperative and productive relationships will be optimized only if the directors are permitted or required to balance shareholders‟ interests within the interest of other stakeholders who are committed to the company.

# The Enlightened Shareholder Theory

The enlightened shareholder theory is apparently a hybrid view from the shareholder and stakeholder views. This approach opines that directors should consider the long term, not just the short term value, and they should also have regard to the interests of other stakeholders in the company, not just shareholders. Managers should be aware of the need to create and maintain productive relationships with a range of stakeholders having interests in their company.71

70Ibid, p.23.

71Ibid p. 23

The enlightened shareholder value approach has been formalized into the United Kingdom Companies Act72 in the provisions dealing with directors duties and in particular in the new duty to “promote the success of the company” under section 172, for the benefit of shareholders as a whole but having “regard (amongst other things) to” a number of stakeholder interests including employees, customers and the environment. What it means is that directors must first act in the way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members. In doing so, they must take into account, where relevant and so far as reasonably practicable, of other factors such as the impact of the company‟s activities on the community and the environment.

A similar provision in the Nigerian Companies and Allied Matters Act73 imposes a duty on the directors to act in “the best interest of the company as a whole” while performing their functions, should take into consideration “the interest of the company‟s employees in general, as well as the interest of its members”. Even though the Companies and Allied Matters Act has not mentioned the interest of the company‟s host community, the omnibus provision of “the best interest of the company as a whole” could be interpreted to cover the interests of other categories of persons whose activities if not taken into consideration would affect the smooth operation of the company. A practical example is the operation of oil companies in the Niger Delta region in Nigeria. The host communities where oil companies carry on petroleum drilling activities have complained of oil spillage resulting to damage of their ecosystem and environmental degradation. The Ogoni people in Rivers State of Nigeria have been fighting against oil companies operating in their area and in some instances resulted to suspension of operation of those

72 2006

73Section 279(3) and (4), op.cit.

companies due to violence, vandalization of companies‟ installations and hostage taking of expatriates. These activities are not to the best interest of those oil companies.

It is therefore important for a company to identify the areas that its activities and operations affect the host community and take into consideration while formulating its policies. This approach will help companies to address issues that are capable of stultifying their activities and operations from outside the company.

The Hermes Pensions Management Limited, the United Kingdom largest pension fund management company and a long-time activist fund expressed that:

In summary, a company‟s primary consideration should be the generation of long-term shareholder value, and this should be based on appropriate financial disciplines, competitive advantage and within a framework which is economically, ethically and socially responsible and sustainable.74

It is believed that in achieving enhanced shareholder value; corporations should behave in a socially responsible manner which has regard to all who have a stake in the company. Those who have stake in the company should not be limited to the principal stakeholders like shareholders and directors, but include employees, creditors, suppliers, customers, the community and indeed the government.

In the cumulative analysis, it can be said that corporate governance is concerned with equitable protection and provision of the interest of all stakeholders in the company. The interest of some may however be greater than others: the important thing is that let it be recognized and delivered. This must form companies‟ strategy policy to operate smoothly.

This research has noted from the three theories above, that the board of directors are the drivers of corporate governance. They have the responsibility of ensuring good corporate governance in the company. Accordingly, the success or failure of a company

74Hermes Principles. Published in October, 2002, Quoted by Smerden, R.*A Practical Guide to Corporate Governance*, op.cit, p.21.

depends largely on the board of directors. The approach adopted by the company‟s board of directors in formulating strategic policies and setting of goals will determine whether the company will offer successful outcomes.

There is no doubt that in the contemporary time, a company that neglects the interest of any stakeholder will face some resistance. There is growing awareness of society in general towards social, ethical and environmental issues. There are increasing number of social and environmental activist groups and non-governmental organizations in Nigeria that engage in creating awareness and fighting the cause of such concerns.A company that fails to take into consideration these issues is bound to encounter confrontation from activist in those areas. This could affect the image of the company and if not addressed by the company it could also affect the smooth operation and business of the company.Directors therefore, have the responsibility of ensuring that their companies behave like good citizens by obeying existing laws in all aspects of their operations so that the interests of all stakeholders in the company would be considered. In view of the fact that enlightened shareholder value appears to be developing into statutory company law, and the fact that company activities have effect in one way or the other on all its stakeholders including the environment, the enlightened theory provides a better perspective of corporate governance. It is in this regard that the responsibilities of directors in corporate governance become the subject for consideration in this research.

Many writers have written on corporate governance issues of board of directors. The texts and materials that have been accessed are hereunder considered.It is intended to firstly consider the Nigerian text entitled: *Status and Duties of Company Directors.75* This book concentrates entirely on the duties of directors. At the time it was written, the duties of directors essentially consisted of common law duties and fiduciary duties which were governed by principles of equity. The author admitted that “as yet in this country, there is

75Olawoyin, G.A.(1977) *Status and Duties of Company Directors*, University of Ife Press, Ile-Ife,

no codification or statutory definition of the duties of company directors”.76 He even felt that “the codification of directors‟ duties is nevertheless considered impracticable”.77

However, without any argument, the Nigerian Companies and Allied Matters Act78have now not only explicitly codified those common law and equitable principles of directors‟ duties but with additional duties.79 This development alone would necessitate a different perspective on the directors‟ duties having become statutory requirements. The standard of what is expected of directors must therefore be considered on the basis of what the statute has provided.

While this book might be very useful for historical analysis of the duties of directors, it is obviously outdated as far as company law in Nigeria is concerned. The book was written in 1977 before the Companies and Allied Matters Act (CAMA) was enacted in 1990. Moreover, this book was written before the issue of corporate governance emerged and took a centre stage in corporate affairs at national and international scenes. The discussions in the book were essentially on substantive company law. For instance, the standard of care at that time was a „reasonable care‟ to be measured by the care an ordinary man of the director‟s knowledge and experience might be expected to take in the circumstances.80 But section 282 (1)81 prescribes the degree of care to be that which a reasonably prudent director would exercise in comparable circumstances. This work will evaluate the statutory standard of director‟s duties to discover the current position.

Another issue worth mentioning is that at the time Olawoyin wrote his book, there

was no emphasis on business qualification of any kind needed to become a director of any company. Accordingly, a director was not bound to bring any special qualification to his

76 Ibid, p. 32

77 Ibid,

78 Cap. C20 Laws of Federation of Nigeria, 2004

79Section 279, 280, 282 and 283. Ibid

80Olawoyin, G-A. op. cit Pp. 214, 217 and 219

81CAMA op. cit.

office.82 But now the issue of directors‟ qualification has become a corporate governance issue which is reflected in codes of corporate governance of many countries including Nigeria.83 Other issues such as attendance of meetings by directors, and the degree to which the board of directors can monitor the executive management have now been considered differently from what was obtainable before the advent of corporate governance.

In view of the above, this research examines the current position of the duties of directors based on the statutory provisions and the emerging view point on the interpretation of the standard of those duties. In addition, since this work is focused on the aspects of corporate governance, it brought out corporate governance issues as they relate to the duties of directors.

Another Nigerian text worthy of note is “Corporate Governance: Models and Principles.”84 This book is a standard work on the historical models of corporate governance practiced by several countries of the world.

The worthy achievement of Amupitan‟s book is in the area of identification of several models of corporate governance around the world. The models that have bearing with this research are the Berle and Means Model, Disclosure Model and Stakeholders Model under chapters 2, 8, and 9 respectively.

The Berle and Means model is considered as the traditional model of corporate governance which emphasized two major structures, to wit, ownership (shareholders) and control (directors or managers of corporations)85 This model is prominent in corporate environment where there is dispersed ownership rather than concentrated ownership of

companies. The book found that with the bank reforms and privatization in Nigeria,

82Olawoyin, G.A. op. cit. p. 215

83 Sections 4.4; 5.3 (a); 5.4 (b); 13.2 and 13.4 SEC Code of Corporate Governance in Nigeria, 2011; A. 3 Supporting Principles; A. 4.2 United Kingdom Combined Code, 2008; 2.8.1 Code of Corporate Practices and Conduct of South Africa 2002.

84Amupitan, J. O. (2008) Corporate Governance: Models and Principles, Hilltop Publishers.

85 Ibid p. 47

dispersed ownership has become prominent.86 The problem with dispersed ownership is the separation of ownership from management which creates a gap in between. It is against the problem of dispersed ownership that corporate governance reforms were introduced. This research move from this stand point to consider the reforms introduced under the current corporate governance regime in Nigeria.

The disclosure model and stakeholder model discussed in Amupitan‟s book take more of historical perspective than the nature and effect of the codes of corporate governance. At the time the book was written, there were only two codes of corporate governance in Nigeria that is, the Securities and Exchange (SEC) / Corporate Affairs Commission Code of Best Practices on Corporate Governance in Nigeria, 2003 and Code of Corporate Governance for Bank in Nigeria post consolidation, 2006. This explains why the book made reference to them only. However, there is now the SEC Code of Corporate Governance in Nigeria, 2011 which is a review of the previous SEC/CAC Code. This new SEC Code which postdates Amupitan‟s book has been considered and indeed forms the fulcrum of the analysis of this research work. Amupitan‟s book since it predates the new SEC Code, it could not identify the limitations of the code, but this research shall do that especially in relation to international best practices.

A renowned book of repute on company law is the P*rinciples of Modern Company Law.87* In its part three, the book considered corporate governance in relation to the board and shareholders. The discussion of corporate governance issues in Gower‟s book is based on the United Kingdom legal system.

Gower‟s consideration of the composition of board of directors stops at an overview of the background upon which the Cadbury committee was set and what it seemed to have achieved, particularly on the relevance of non-executive directors. He

86 Ibid pp. 62 and 63

87 Gower and Davies *Principles of Modern Company Law* (ed) Davies, P.L. (2008) 8th Edition, Sweet & Maxwell, London.

pointed out that prior to the Cadbury report “the executive directors were the dominant force within the company, with the CEO as the embodiment of managerial authority who normally chose non-executive directors that did little or nothing other than attend reasonable number of board and committee meetings.88 Accordingly, he described as the thrust of the committee‟s proposal “the putting in place a board structure which would render such dominance by a single person less likely, through the introduction of various counter-balances to the executive management of the company”89 The Cadbury report therefore proposed an increase in the proportion of one-third to one-half of listed companies.90 This was later implemented and entrenched in the subsequent combined codes.

To buttress his arguments, Gower expressed the main points in the combined code as they relate to the composition of the board. He reiterated the requirement of the combined code that the board should consist of a balance of executive and non-executive directors, and “to ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and non- executive directors”91

The book also identifies three board committees which clearly deal with the three sensitive governance matters. These committees are the nomination, remuneration and audit committees.92 The functions and roles of these committees under corporate governance were not expatiated by the author. This research therefore addressed them by exponenting and underpinning the significance of the three committees in corporate governance.

88 Ibid. p. 402

89 Ibid. p. 403

90 Ibid. Pp. 404-405

91 Ibid p. 407 See also A. 3 Main Principle and Supporting Principle, United Kingdom Combined Code. 2008.

92 Gower and Davies, op. cit p. 407

Another issue of board composition pointed out by Gower is the separation of roles and powers between the CEO and the chair of the board, so that no one individual should perform the two functions.93 He commented that the “role of the chair is nowhere specified or indeed hardly recognized in statutory company law”94 This research shows that under Nigerian company law, the role of the chair is statutorily recognized, even though it is conceded that the role of the chair is more expansive under corporate governance requirements.

One aspect that is not included in Gower‟s discussion of the composition of board of directors is the issue of „size‟ of the board. Board size has become a corporate governance issue because it impacts on the effectiveness of the board as a whole. The combined code made reference to it that “the board should not be so large as to be unwieldy. The board should be of sufficient size…”95 It is deemed expedient in this work to analyze the importance of size to board composition in relation to corporate governance.

With regard to the duties of directors, Gower and Davies have substantially discussed the subjects involved, however, with reference to the United Kingdom Companies Act. This research on the other hand made the discussion with particular reference and focus on the Nigerian company statute. Any references that were made to company legislation of other jurisdictions were only for the purpose of comparative analysis or to buttress arising issues.

Another book worthy of note in company law is *Charlesworth’s Company Law.96*Chapter 18 of the book is titled “Corporate Governance” with a single topic “the

93 Ibid p. 408; See also A. 2.1 Combined Code op. cit

94 Gower and Davies Ibid p. 408

95 A. 3 Supporting Principle, Combined Code op.cit

96Morse, F etal, (eds) (2005) *Charlesworth’s Company Law*, 7th edition, Thomson Sweet & Maxwell, London.

Revised Combined Code on Corporate Governance”.97 It is apparent that the book and indeed this chapter on corporate governance were written based on the United Kingdom Combined Code.

This text also pointed out the salient issues from the Combined Code on the board of directors. While underscoring the role of the board as the head of the company to provide entrepreneurial leadership,98 he made specific reference to the Combined Code on some aspects of board composition.

On the issue of „chairman and chief executive,‟ he made reference to principle A. 2,99 which “provides that there should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility of running the company‟s business and that no one individual should have unfettered powers of decision”.100 There are provisions in this respect in the Nigerian Code of corporate Governance. This research rather focused on the Nigerian SEC Code to accentuate the Nigerian position.

Another issue is on „board balance and independence‟ under the Combined Code which states “that the board should include a balance of executive and non-executive directors (NEDs) (and in particular independent NEDs).”101 He also reiterated the fact that the mix of executive and non-executive directors should be in such a way that no individual or small group of individuals can dominate the board‟s decision making.102 Even though he mentioned the fact that the board should not be unwieldy without discussing the relevance of board size to corporate governance is an indication that size is an important issue under corporate governance. This dissertation included the

examination of board size.

97Ibid, Content p. xii and Pp. 392 and 394

98Ibid, p. 394; See also A. 1 Main Principle, Combined Code, op cit.

99Combined Code, op cit

100*Charlesworth’s Company Law,* op cit. p. 395

101Combined Code. Op cit. see also *Charleswoth’s Company Law,* Ibid. p. 395

102*Charlesworth Company Law*, Ibid. p. 395

Charlseworth‟s text also makes reference to the combined code requirement for the establishment of the remuneration and audit committees of the board.103 He proceeded to explain the requirements and roles of the two committees based on the combined code. Charlesworth did not consider the relevance of the nomination committee; and so did not consider it under his discussion of corporate governance. This research discovers that the importance of the nomination committee to provide and entrench transparency in the appointment of directors cannot be overlooked in corporate governance, because that is the starting point in the process of putting a sound structure for good corporate governance.

On the issue of the duties of directors Charlesworth‟s discussion was concentrated on the fiduciary duties established by common law principles with impressive case law development. His analysis makes little references to statutory provisions even of the United Kingdom company law jurisdiction under which he wrote despite the fact that the duties of directors have now been codified into many company statutes. This is due to the fact that at the time Charlesworth‟s book was published in the year 2005 the processes of modernizing company law in the United Kingdom had already reached advance stage when the company law review proposed statutory list of duties to replace the equitable ones.104 The United Kingdom Companies Act was eventually enacted in 2006 just one year after the publication of Charlesworth‟s book in 2005. This explains why his book does not contain the statutory duties of directors.

Given the insufficient statutory analysis as observed above, this research considered not only the traditional fiduciary duties of directors but shall go further to examine the statutory duties with particular reference to the Companies and Allied Matters Act which is the primary company legislation in Nigeria.

103Ibid Pp. 397-299; See also principles B. 1 and C. 3 Combined Code.Op cit.

104*Charlesworth Company Law,* Ibid. p. 395

*The ICSA Study Text in Corporate Governance****105*** is a land mark text on the subject of corporate governance in general. The text is written based on the United Kingdom code of corporate governance and with the background of English company law. This study drew analogies from it to apply to local situations of corporate governance on relevant issues.

The notable issues of interest in the text are as follows: the text advocate that an individual appointed to the board of a public company should possess personal qualities such that investors should trust his or her honesty and integrity.106 But it followed immediately by lamenting that “in practice, this requirement is generally overlooked107. The text did not proceed to recommend appropriate steps to be taken in order to ensure that the right calibers of persons are appointed as directors.

On the issue of size and balance of the board composition, the text comment that even though the size of the board will vary from one company to another, the ideal size is one that balances.108 It has not defined what balance means, however, it is of the view that no one individual should have excessive powers; and that there should be a significant number of independent directors on the board; independence is provided by non- executive directors109.A further discussion on what amounts to a balance board becomes pertinent.

The aspect of the duty of care and skill which is incorporated into company statutes has not been adequately discussed in the text. It has failed to analyze the statutory provisions and current trend of interpreting the standard of the duty especially that of the non-executive directors now that there is growing view that the standard of the study of care and skill is higher than it was perceived earlier than now. The research studied the

105Coyle, B. *The ICSA Study Text in Corporate Governance*, Op. cit

106Ibid p. 76

107 Ibid

108Ibid p. 77

109 Ibid

two opposing views of the standard of care and skill and takes a position based on the statutory provision and the popular opinion as is appropriate in the Nigerian context.

Another significant work on corporate governance is by Smerdon entitled: *A Practical Guide to Corporate Governance****110***.This text is also written based on the background of English Companies Act and the United Kingdom codes of corporate governance, particularly the combined code on corporate governance111.What the text seem to have done is an analysis of the Combined Code. Much of the code principles were restated and then comments made on them. This has made the text typically English oriented. Therefore there is the need to see whether those United Kingdom principles of corporate governance are good and relevant idea to Nigeria.

The text recognized the importance of board size as epitomized by the Higgs Review.112 It has stated the average size of twelve members for United Kingdom 100 bigger companies of whom six are usually non-executive directors, while five are executive directors and one is the chairman.113 The text went on to reveal that a review found a welcome trend towards smaller boards. Some commentators have suggested that the ideal decision-making body is between eight and ten members.114 This is the situation in the United Kingdom. This research conducted study on the size of board of directors among companies in Nigeria in order to see whether they are appropriate in terms of size.

The text defined the duty of care and skill based on the United Kingdom Companies Act of 2006. It stated expressly that it also has to be remembered that the duty of care may well be construed in the light of other contemporary statement relating to the duties of directors and in particular non-executive directors, for example, the 2003 Higgs Review of the role and effectiveness of non-executive directors. Many of the

110Smerdon, R.(2007) *A Practical Guide to Corporate Governance.* Op.cit 111United Kingdom Combined Code on Corporate Governance, 2006 112Smerdon, R. op.cit p.52

113ibid

recommendations of the Higgs review have found their way into the Combined Code, and it is submitted that the principles and provisions of the Combined Code are also used in construing the modern duties of care, skill and diligence.115 However, this research examines the directors‟ duty of care and skill on the basis of the provisions of the Companies and Allied Matters Act.116

*Corporate Governance Handbook****117*** is also a notable work on corporate governance. This book like the other ones mentioned above stems majorly from the United Kingdom background, even though it has briefly considered corporate governance arising from the United States of America. Its principal legal regime is the United Kingdom Combined Code. Its discussion on the American corporate governance depended on Sarbanes-Oxley Act of 2002.

The book has not made succinct discussion on the composition of directors. Its reference as to qualification of directors is merely a recommendation for training of directors by the institute of directors to obtain chartered director qualification.118 The work did not consider other aspects of acquiring knowledge and experience. This research is set to look beyond the formal training of directors in a classroom.

Secondly, the work did not consider the caliber of persons that would constitute an effective board of directors. It has however, discussed in details the remuneration and audit committees stressing their membership, skill and responsibilities.

Also of importance is the issue of the standard of skill and care. The text merely noted that the UK Companies Act 2006 has replaced the traditional subjective standard of skill and care by a new objective standard119 without analytical discourse on such an important subject. However, in this research both the subjective and objective standards

115Ibid, p.94

116Cap. C20 LFN 2004

117Chambers, A. and Weight, C. (2008) *Corporate Governance Handbook*. Op.cit

118Ibid Pp.59-60

of directors duty of care and skill have been analyzed to arrive at the prevailing view on the issue.

This book also failed to discuss on the nomination committee of the board of directors. The importance of the nomination committee cannot be over emphasized because it is seen as a committee that entrench transparency in the appointment of directors and chief executives. This research has filled that gap by incorporating a meaningful discussion on the nomination committee.

The book entitled “Corporate Governance120 is a recent work. It is written based on Indian corporate law and environment. It has discussed various aspects of corporate governance at random. There is no specific discussion on the roles and duties of directors under corporate governance, which is the main focus of this research. The aspects of corporate governance are merely stated by itemizing them without any analytical discourse.

The book noted interestingly that “over recent years there has been a need for more alignment in laws and regulatory requirements around the globe to create more international standards in corporate governance as companies and groups trade across many jurisdictions and are subject to multi-regulators.”121 Unfortunately, it could not proceed further to identify the international standards on corporate governance. This is the aspect that this research has addressed by identifying the aspects of corporate governance that are assuming or have assumed international recognition as best practices across all types of corporate governance.

The specific subject that Badi‟s book has discussed which is directly related to this research is the composition of board of directors.122 The mixture of executive and non-executive directors together with independent directors is stated based on Indian

120Badi, N. V. (2012*) Corporate Governance*. Op.cit

121 Ibid p. 34

122 Ibid p. 50

corporate governance system. For example, the percentage of the number of independent directors to consist of the board is different from other jurisdictions. Given the significance of independent directors under corporate governance around the world, the Nigerian position has been analysed based on corporate governance in Nigeria.

The book has identified the audit committee as the only committee that is mandatorily required in India.123 However, in many other jurisdictions of the world, corporate governance reforms have required in addition to the mandatory statutory audit committee, the establishment of other committees that are considered to promote good corporate governance. This aspect of board committees that have not been given attention in Badi‟s book has been discussed in this research.

Other issues of director‟s corporate governance like disclosures and remunerations of directors have been scantly mentioned in Badi‟s book,124but they were discussed in greater detail with their implications in this research.

There are also three well researched articles with the same topic: Globalization and New Perspective in Corporate Governance125written by three separate set of authors. The articles postulate the general fundamentals of the concept of corporate governance and its global nature. They have appreciably considered the concept, principles and development of corporate governance from the global and local levels. However they have not gone into any specific issues arising from the roles of stakeholders in ensuring and promoting corporate governance. Such issues pertaining to company directors have not been covered by the articles. The issues of composition of directors their duties and responsibilities that form the fulcrum of this research were not treated in the articles.

123 Ibid p. 51

124 Ibid pp. 53 to 55

125Oji, E.A et al (2005) Globalization and New Perspective in Corporate Governance. (eds) Guobadia, D.A and Azinge, E.In*Globalization, National Development and the Law. Nigerian Institute of Advanced Legal Studies, Lagos.*p.142 See also Ikpotor, T.R, p.180 and Oluwagbami, D.A and Udombana N.J .p190. infra

Therefore the consideration of these aspects by this study added value to existing local literature on corporate governance.

The article entitled “The concept and Practice of Corporate Governance in Nigeria; The need for Public Relations and Effective Corporate Communication”126 reiterated the definitions of several authors and reports such as the Cadbury Report and the OECD Principles of Corporate Governance. Many of the definitions contained in the article have been considered in this study under conceptual literature review. From the array of the definitions the authors came to the conclusion that “it is very clear that corporate governance has come to stay, it stands as inevitable for the survival of business corporations in Nigeria and beyond. It is the cornerstone upon which the corporate goal and sustainability can be achieved and any company that acts otherwise does so at its own peril.”127

The above article also identified basic and commonly accepted principles of corporate governance. These principles are summarized under five topics:

* + - * 1. Rights and Equitable Treatment of Shareholders
        2. Interest of Stakeholders
        3. Role and Responsibilities of the Board of Directors
        4. Integrity and Ethical Behaviour
        5. Disclosure and Transparency.128

These principles are those that have been postulated by the OECD.129 The article did not show how these principles apply in Nigeria. However, this research has considered the application of corporate governance principles in Nigeria. Another point worthy of note in the article is the issue of corporate governance failure in Nigeria,

126Oso, L and Smiu, B (2012) J Communication 3(1)

127 Ibid p.4

128 Ibid p. 5

129OECD Principles of Corporate Governance, 2004. Op cit

particularly in the banking industry. The authors reiterated the assertion that poor corporate governance and unethical practices have been identified as one of the major causes of distress in the nation‟s banking industry.130 The article further referred to an Audit Report which showed gross abuse by chief executives of some banks, reckless use of depositors‟ funds, poor corporate governance, and “that corporate governance in many bank failed because the boards ignored this concept, including being misled by executive management … and not having the qualifications to enforce corporate governance in bank management.”131

The article restricted itself to the role of public relations and effective corporate communication as a means of promoting good corporate governance practices. It went on to underscore the fact that corporate communication is an instrument for engaging the various stakeholders and eliciting social support. One of its functions is that the managers of corporate organisations should be in regular contact with the various stakeholders. This is to enable them monitor public opinion, and collect and analyse relevant information which forms inputs into the decision making process of an organisation.132 This research has discussed other mechanisms of improving corporate governance such as disclosure requirements and qualification of directors which are outside the scope of the article mentioned above.

Lawal, in his article “Board Dynamics and Corporate Performance: Review of Literature, and Empirical Challenges”133 directed his discussion on the role of board of directors, board dynamics and firm performance. He acknowledged the postulations of other writers that the “board is the “heart” of corporate governance where the outcome of

130Oso, L et al (2012) op. cit p. 10; Adewakun, A (2010) Poor Corporate Governance, bane of Nigerian Bank. Nigeria Tribune, 29th September, 2010 p. 15

131Oso, L (Ibid) p. 10 Yusuf A. (2010) Audit Report that Exposed the Rot in the Banking Sector. <http://economicconfidential.et/new/financial/monetary>accessed on 16th May, 2012

132Oso, L et al ibid p. 12

133Lawal, B (2012) Board Dynamics and Corporate Performance: Review of Literature, and Empirical Challenges. International Journal of Economics and Finance vol. 4 No. 1 [www.ccsenet.org/ijef](http://www.ccsenet.org/ijef) accessed on 15/3/2014

a firm is often determined, and that the central objective of corporate governance resides on the ability of board to monitor the management”.134 He argued that “the effectiveness of the board of directors as shareholders‟ monitoring mechanism can only be efficient if bounded with appropriate size, composition and leadership configuration. To this end, most code for best practices and corporate governance guidelines tend to focus critically on these board dynamics as the cornerstone to achieving the much needed board effectiveness.”135

The article discussed the key aspects of board size, composition and leadership in general perspective without linking them to any particular corporate governance system or regime. These elements of corporate governance provided a good background to this research on those issues, and were therefore examined in relation to the Nigerian corporate governance system. The empirical analyses of board dynamics that are stated in the article are based on United States of America documented literature. This research considered documented information in Nigeria to obtain data for analysis.

Another article reviewed in this research is the “Proliferation of Codes of Corporate Governance in Nigeria and Economic Development.”136 The central subject of discussion in this article is the issue of multiplicity of corporate governance codes in Nigeria. The author identified four (4) different codes of corporate governance in Nigeria namely:

1. Securities and Exchange Commission (SEC) Code of Corporate Governance 2003, addressed to public companies listed in the Nigerian Stock Exchange (NSE)

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134 Ibid. p. 24

135 Ibid

136Demaki, G. O. (2011) Proliferation of Codes of Corporate Governance in Nigeria and Economic Development. Business and Management Review vol. 1(6) http//[www.businessjoournals.org/bmr.](http://www.businessjoournals.org/bmr) Accessed on 14/3/2014

1. Central Bank of Nigeria (CBN) Code, 2006 for Banks established under the provision of the Bank and Other Financial Institutions Act (BOFIA)
2. National Insurance Commission (NAICOM) Code, 2009, directed at all insurance, reinsurance, broking and loss adjusting companies in Nigeria
3. Pension Commission (PENCOM) Code, 2008, for all licensed pension operations.137

The author omitted to mention the recent SEC Code of Corporate Governance in Nigeria, 2011 which is a review of the 2003 code with significant improvements. This recent SEC Code forms the basis of this research.

The article pointed out that “although all the Nigerian Codes contain the under listed key elements of corporate governance, there are disparities in the content of their provisions and enforcement mechanisms. The key elements of corporate governance are:

* 1. Composition of board of directors
  2. Independent directors
  3. Multiple directorship
  4. Board of directors committees
  5. Accountability and transparent reporting
  6. Mandatory and self-regulatory requirements of the provisions of the codes.138

This means that a company that is listed on the stock exchange and operates in the banking, pension or insurance sectors must be regulated by two codes, that is, the SEC Code and the specific industry code. The problem of compliance where the two codes conflict arises.

The article in its conclusion underscored the fact that “in a world of global capital

market, Nigeria cannot isolate itself from international standard practice of corporate

137 Ibid p. 4

138 Ibid pp. 4-5

governance. It must view its corporate governance codes in international context.”139 The article, however, did not examine any of the codes in Nigeria in relation to international standard practice. This research has filled that gap by making considerable references to codes of other countries to determine the standard of corporate governance in Nigeria.

The article “Corporate Governance and Bank failure in Nigeria: issues, challenges and opportunities”140 is also focused on the banking sector. The article has stressed the importance of corporate governance as a means by “which financial resources available to an organisation are judiciously used to achieve the overall corporate objective of an organisation, it keeps the organisation in business and creates a greater prospect for future opportunities.141 The article came to the conclusion that “poor corporate governance may contribute to bank failures, which can pose significant public costs and consequences due to their potential impact on the applicable deposit insurance system and the possibility to broader macroeconomic implications, such as contagion risk and the impact of payments systems.”142 The author pointed out that I Nigeria‟s recent history “the lack of corporate governance has led to economic upheavals and that 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.”143 He gave few examples of Savannah Bank, Onwuka Interbiz and Peak Merchant Bank.

This article triggered the researcher‟s thought of studying the root of corporate governance, that is, the board of directors to see their role and how improvement could be made to promote higher standard of corporate governance in Nigeria. This research believes that if the boards of directors‟ issue of corporate governance are reasonably

139 Ibid p. 6

140Nworji, I. D; Olagunju, A and Adeyanju, O. D. (2011) Corporate Governance and Bank Failure in Nigeria: issues, Challenges and Opportunities. Research Journal of finance and Accounting. Vol. 2 No. 2 [www.iiste.org](http://www.iiste.org/)

141 Ibid unpagenated

142 Ibid

143 Ibid

addressed, it will provide impetus in corporate governance observance which in-turn will promote economic growth and development as a result of proper management of companies.

Corporate Governance and its effects on the Nigeria Insurance industry,144 is an article that is directed at the insurance industry. The article enumerated the factors that necessitate a code for corporate governance in the insurance industry to include, fraudulent and self-serving practices among members of the board, management and staff; ineffective board oversight functions; and conflict of interest.145 The article, however, did not examine these factors as they concern corporate governance issues in the insurance industry. These issues are discussed in this research under the SEC Code of Corporate Governance in Nigeria, 2011. The SEC Code is a general code that applies to all companies that are listed on the stock exchange in Nigeria irrespective of which sector the company operates, including insurance companies. The article admits the fact that “the board of directors is the focal point of the corporate governance system. It should ultimately be held accountable and responsible for the actions of the insurer which would promote prudent behaviour in the insurer”.146 It is against this backdrop that this research embarked on the study of duties and responsibilities of company directors in general which were not considered in the article so as to provide a broader perspective of corporate governance issues beyond the insurance industry.

Another article is entitled “Implication of Corporate Governance on the Performance of Deposit Money Banks in Nigeria.147 The article observed that “poor corporate governance was identified as one of the major factors responsible for the entire

144Momoh, O. A. and Ukpong, M. S. (2013) Corporate Governance and its Effects on the Nigerian Insurance Industry.European Journal of Globalisation and Development Research. Vol. 8 No. 1 Journals Bank.com

145 Ibid p. 483

146 Ibid p. 485

147Osuagwu, G. O. (2013) Implications of Corporate Governance on the performance of Deposit Money Banks in Nigeria. Arabian Journal of Business and Management Review (OMAN Chapter) vol. 2 No. 10

distress situation experienced in the Nigerian banking industry and the concomitant loss of about 75 banks.”148 The author proceeded to state emphatically that “the NDMB (Nigeria Deposit Money Bank) failed to observe effectively the underlying principle that guide the application of corporate governance in the industry.”149 The article indicates that despite the existence of corporate governance regulatory agencies like the Central Bank of Nigeria and the Securities and Exchange Commission in Nigeria, Nigeria Deposit Money Banks “are yet to comply with corporate governance codes. This resulted in the quantum of failed banks in the industry.”150 The article recommends that “the existing banking ethics, rules and regulations need to be strengthened in order to develop sound, reliable and dependable banking systems as well as carrying out real banking business in Nigeria.”151

The article provided a road map to this research which embarked on appraisal of the rules and regulations contained in the SEC Code of Corporate Governance recently issued in 2011 in order to point out their weakness as would affect companies including banks. This is because the article did not examine the rules and regulations to discover their weaknesses and limitations that need to be strengthened. One important report that is important to this research is “Corporate Governance Country Assessment: Nigeria.”152 The Corporate Governance Report on the observance of standards and codes of Nigeria was based on law and practice against the Organisation for Economic Cooperation and Development (OECD) Principles of Corporate Governance, focusing on the companies listed on the Nigeria Stock Exchange (NSE)153

The report made key findings. Some of them are as follows: it stated that most

basic shareholder rights are protected by the Companies Act, however, in practice certain

148 Ibid p. 115

149 Ibid

150 Ibid

151 Ibid p. 116

152 Corporate Governance Assessment, Country Assessment: Nigeria World-Bank, December, 2008.

153 Ibid p. 1

problems have emerged, for instance, “some companies reportedly select meeting locations that are difficult for shareholders to access, or do not send out meeting information on time.”154 On the issue of related party transaction protections, the report observed that the rules may not cover all indirect transactions between the company and its board members.155 This research analysed critically the concept of related party transaction or connected persons under the CAMA and SEC Code to buttress this observation in the report. This also made a survey of some companies that are listed on the Nigerian Stock Exchange to find out how the companies are applying the principles of corporate governance enshrined in the SEC Code of Corporate Governance in Nigeria.

# Empirical Literature

A major study carried out on corporate governance as a whole was done by the Organization for Economic Cooperation and Development (OECD). The work was carried out in both OECD and non-OECD countries.156 The Commission of the European Communities also participated in the work of the OECD. The objective of the work was to strengthen the fabric of corporate governance round the world to make corporate criminality difficult as rules and regulations are adopted in accordance with the principles. The outcome of the study identified some common elements that underlie good corporate governance. The principles built on these common elements were formulated to embrace the different models of corporate governance that exist. The principles apply mutatis mutandis to both two tier board structure and unitary board system.

The principles identified by the study are stated as follows:

154 Ibid. p. 2

155 Ibid p. 3

156 The original member countries of the OECD are, Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became members subsequently through accession, Japan, Finland, Australia, New Zealand, Mexico, Czech Republic, Hungary, Poland, Korea and the Slovak Republic – OECD Principles of Corporate Governance, 2004

1. Ensuring the basis for an Effective Corporate Governance Framework. This entails that the corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2. The Rights of Shareholders and key Ownership Functions. By this the corporate governance framework should protect and facilitate the exercise of shareholders‟ rights.
3. The Equitable Treatment of Shareholders. Under this the corporate governance framework should ensure the equitable treatment of all shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
4. The Role of Stakeholders in Corporate Governance. The import of this is that the corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
5. Disclosure and Transparency. This means that corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
6. The Responsibilities of the Board. This principle requires that, the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board‟s accountability to the company and the shareholders.

The OECD Principles of Corporate Governance have become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. The Principles have advanced corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non-OECD countries. The development of codes of corporate governance round the world with common principles and requirements on key aspects could be attributed to this source of inspiration. Those common elements are generally considered as international best practices. It is necessary to find out the position of the Nigeria SEC Code of Corporate Governance provisions on some key elements of good corporate governance.

Other studies related to this research under corporate governance were limited to the issue of independent directors at company board of directors. Many codes of corporate governance round the world recommend greater role of outside independent directors. However, some studies have found a negative correlation between independence and corporate performance. A comprehensive study by Bhagat and Black reviewed other studies along with their own research and found among other things, that there is no evidence that greater board independence leads to better firm performance.157 A study by Klein found that the audit, nomination, and compensation committees traditionally dominated by outsiders, have little if any, effect on firm performance. Evans and Evans their part found that the presence of independent directors on the board or on compensation committee had no effect on chief executive officer (CEO) pay level.158

Clarke admits that the important element of the concept of and rationale for independent directors remain curiously obscure and unexamined. As a result the empirical

157Clarke, D.C. (2007) Three Concepts of the Independent Director. [http://scholarship.law.gwu.edu/cgi.](http://scholarship.law.gwu.edu/cgi) Accessed on 14/4/2013, p. 5 of 40; Lawal, B (2012) Board Dynamics and Corporate Performance op. cit see also Osuagwu, G. O. (2013) Implications of Corporate Governance on the Performance of Deposit Money Banks in Nigeria. Op. cit. p. 112

158 Clarke, D. C. (2007) Ibid 5-6 of 40

findings that exist may be misapplied, and judicial gap filling may be harder than imagined when legislative intent cannot be divined (sic) or is contradictory.

On the other hand it has been found that independent directors are one of the most critical pillars of corporate governance. Singh states that “it is widely accepted that the presence of independent directors in the boardroom improves the quality of corporate governance. Accordingly, corporate governance mechanisms all over the globe… focus on independent directors.”159 In further support of this proposition, Lawal reported the findings of Jackling and Johl who examined a sample drawn from 180 top Indian firms that greater outside directors represented on corporate board is positively associated with improved firm performance.160 It was contended that outsiders dominated board are said to be more effective when it comes to carrying out specific tasks such as replacing poor performing chief executive officers, external linkage and strategy initiatives.161 In view of the existing contradictory perspectives about the independent directors, this research made contribution to the debate and takes a realistic position.

On the issue of board size, from empirical perspective studies have reported conflicting findings. Some researchers found that there was no relationship between board size and firm performance. However, positive nexus were reported in some studies with respect to board size driving improved firm performance.162 In the overall analysis, Lawal concluded that “majority of documented evidences have demonstrated that small boards are more efficient and effective and are thus more likely to provoke improved corporate performance.”163 He however, cautioned rightly that the size of board in terms of quantity

159 Singh, S.K (2012) Corporate Governance & Independent Directors: An Analysis. [http://www.thefreelibrary.com.](http://www.thefreelibrary.com/) Accessed on 14/4/2013, p.6 of 12

160Lawal, B (2012) op. cit. p. 25; Momoh, O. A. and Ukpong, M. S. Corporate Governance and its Effects on the Nigerian Insurance Industry. Op. cit. p. 482

161 Ibid

162 Ibid p. 26; Ouagwu, G. O. (2013) op. cit. p. 113

163 Ibid

is materially insignificant compared to the quality. This is because it is quality that determines the effectiveness of corporate deliberations and decision making.

Other empirical studies were conducted in respect of chief executive duality. This is with respect to one person heading both the management and the Board. The contention has been that chief executive duality creates imbalance in corporate power distribution as heavy concentration of management and control resides with one person which tend to jeopardise board effectiveness. This imbalance makes it inevitably difficult for the corporate board to provide appropriate monitoring or even institute punitive measure against erring chief executive officer due to absence of independence.164 On this issue also empirical evidence have shown divergent findings ranging from positive to negative and mix findings in respect of how chief executive duality affects firm performance.165 Despite inconsistences of findings, the support for separation of the position of chief executive officer (CEO) and that of the board chair outweighed other propositions. This has resulted to most corporate governance guidelines round the world to recommend the separation of the two leadership positions in the company.

This study also adopted an empirical approach to determine the level of application of standard requirements of corporate governance enshrined in the SEC Code of Corporate Governance in Nigeria.

# Justification

The subject of corporate governance has gained global attention in recent years due to its worldwide importance. Different countries both developed and developing economies including Nigeria have evolved corporate governance measures that extend the scope of responsibility of those entrusted with the task of running business with other

164 Ibid

165 Ibid

people‟s money. The board of directors is the company‟s organ that is vested with the statutory mandate to manage the affairs of companies. The board of directors therefore plays a key role in corporate governance system.

It is in view of the crucial position of the board of directors in a company that motivates this research to consider not just every aspects relating to directors but to choose the very fabric of what makes a competent and effective board of directors. This is to say, the success of a company depends on the quality of its board of director. Thus, the issue of composition of the board of directors their duties and responsibilities which are the main subjects of this work is apt for consideration. The composition of the board of directors involves some critical issues like size, qualification, suitability and committees. The extent of the skill and care directors‟ exhibit largely depends on the level of their qualification and experience.

Much of these critical issues mentioned above have not been sufficiently covered by even the principal companies‟ statute in Nigeria that is, the Companies and Allied Matters Act. The Code of Best Practices on Corporate Governance in Nigeria also has been shown to be inadequate in its framework on the said issues. Similarly, the limitations identified in the reviewed several text literatures are meant to be covered by this research. Thus, this research supplement existing literature specifically on the issues of composition of board of directors, and their duties and responsibilities with particular reference to Nigerian context; since majority of literature generally on corporate governance have foreign origin and background.

It is therefore desirable to put a proper understanding of what constitute an effective company board of directors, so that companies can avail themselves of the requirements identified in this work for their guidance. In addition, it becomes necessary for company directors whether individually or collectively, to know the new trend of corporate governance standards required of them in the performance of their duties as

directors. Failure to appreciate the standard might make some directors or boards to perform below acceptable standard and that can affect the ultimate performance of the company itself. On the part of the directors themselves they may become liable to the company which, might decide to sue them and claim damages for negligence. To avoid these unpleasant situations, this research has accentuated the proper current position on the directors‟ duties and responsibilities to be of use to stakeholder in company management.

# Organizational Layout

This work is divided into six chapters. The purpose is to consider the research in components of related subject for coherent presentation and comprehension.

Chapter one gives the general background of the concept of corporate governance and its several stakeholders. The chapter contains the objectives of the study, research methodology based on doctrinal approach that entails an analysis of laws and literature to form opinions and make findings. The statement of the research problem was identified and research questions were raised to form the focus of the research. The literature review under this chapter was done under three components of conceptual theoretical and empirical literature. A justification for the work also falls under this chapter.

Chapter two, deals with the international dimension of corporate governance. Accordingly, the historical steps taken on the international scene in the development and reformation of corporate governance systems through production of principles and codes comes under this chapter. The specific aspects of the international elements of best standards of corporate governance for board of directors have been considered because the work centers on the board of directors. The factors responsible for the common international standards of corporate governance have also been considered in this chapter. The chapter proceeds to consider corporate governance reforms in Nigeria, with specific attention on the Companies and Allied Matters Act and the Securities and Exchange

Commission Code of Corporate Governance in Nigeria, 2011. This shows the response in Nigeria to the global gale of corporate governance reforms.

Chapter three concentrates specifically on the composition of board of directors. The various nitty-gritty of board composition such as the structure, like the positions of the chairman and chief executive officer as well as the mix of executive and non- executive directors will be examined under the Nigerian law in relation to other jurisdictions. The issue of board size which has become a global corporate governance issue is also considered under this chapter. For every board of directors, the caliber of directors is terms of character integrity, quality and suitability determines the kind of board a company has. These essentials determine an effective board and so will be given due consideration in this chapter. In addition, boards of directors are required by company law and regulatory rules to establish board committees to carry out specific functions and responsibilities that would promote and entrench good corporate governance in the company. This chapter therefore identifies and examines the three committees that have gained international prominence. They are the mandatory audit committee, nomination committee and remuneration committee.

In chapter four, the main issue of discussion is the responsibilities of directors in corporate governance. Under this the role of directors as managers of companies will be accentuated and the manner in which they are to carry out their managerial responsibility. The ethical requirements of openness, honesty, transparency, independence, accountability and fairness will form necessary elements. While performing their managerial responsibility, directors have been vested with specific duties under the statute and of general nature. Those duties have significant relevance to corporate governance and will be considered in that perspective.

Chapter five focuses on the disclosure requirements of directors under corporate governance. The companies‟ statute and regulatory rules require that some information

about the company and its directors be disclosed, that is, made public so that any investor dealing with the company would do so on an informed basis. The issue of disclosure is an important one under corporate governance and corporate regulators do not take it lightly. In view of that, the elements and items of disclosure requirements will be identified and discussed respectively. The intention is to see how disclosure can promote good corporate governance in the company.

The sixth chapter of the dissertation considered the application of principles of corporate governance that have been enunciated by the Securities and Exchange Commission Code of Corporate Governance. The specific aspects of the Code‟s provisions that are discussed in this chapter are the composition and structure of the board of directors. Some data were obtained to show companies‟ board size, executive duality (separation of the positions of board chairman and chief executive officer), board mix of executive and non-executive directors, as well as the presence of independent directors and board committees. The chapter further considered the application of directors‟ responsibilities. The issues of directors‟ report, board and committee meeting with directors‟ attendance, and the nature of preparation of the financial statement were shown how companies applied them. The application of disclosure requirements also come under this chapter. It is shown whether companies disclose their directors‟ profile, risk management system, directors‟ interest in their companies‟ shares, contracts and related party transactions. The issues of corporate social responsibility and whether the chief executive officer and chief finance officer signs the financial statement were also indicated.

The final chapter, which is chapter six, is the concluding part of the research. It contains the summary, findings and recommendations. The work will close with a concluding remark thus bringing the research to its completion.

# CHAPTER TWO

* 1. **INTERNATIONAL REFORM INITIATIVES ON CORPORATE GOVERNANCE AND THE NIGERIAN RESPONSE**

# International Historical Measures for Corporate Governance Reforms

In their attempt to respond to corporate governance challenges of growing incidence of corporate failures, countries around the world have employed various mechanisms to improve corporate governance systems. The variation in approach by different countries has resulted in a number of legislative and semi-voluntary codes of conduct of business practices to be adopted. The structure of corporate governance and the emphasis of the various codes also differ in some respect giving rise to different models. The regulatory enforcement approach by countries in matters of corporate governance has been found to fall under two separate measures. There is the rules-based regime and the principles-based regime. Some of the major economies of the world will be epitomized to adumbrate the differences in the corporate governance models.

# The United Kingdom Approach

The United Kingdom has been acknowledged as the protagonist of good corporate governance. The Report of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Report) which was published in 19921 was later described as a landmark in thinking on corporate governance.2 The report included a code of best practice to be complied with by United Kingdom companies. Since then a number of other reports issued in the United Kingdom have provided further thought on governance practices. These included the Greenbury Reports in 1995 which focused on disclosure of directors‟ pay; the Hampel Report of 1998, covered a number of governance issues, such as the composition of the board and the role of directors, the role of shareholders

1 Gee ( a division of Professional Publishing Ltd) London 1992

2 Coyle,B (2002) *The ICSA Study Text in Corporate Governance.* Information and Training Ltd. London, p.11

(particularly institutional shareholders), communication between the company and its shareholders, financial reporting, auditing and internal controls. As a result of the increasing corporate governance scandals in the United States of America, exemplified by Enron, WorldCom and Tyco collapses, the United Kingdom Treasury and the Department of Trade and Industry took proactive steps by commissioning some studies. One of those studies was a review to be conducted by Mr. Derek Higgs of the role and effectiveness of non-executive directors which reported in January 2003.3 The report contained strong criticism of the lack of true independence of many non-executive directors; lack of rigour in the way in which non-executive directors were recruited; the narrowness of the pool and the lack of proper induction procedures, appraisal and further professional development.4 As a result of the Higgs review a heavily revised combined code was published by the Financial Reporting Council in July 2003, which reflected Higgs views particularly on the subject of director independence, that at least half of the board must be independent.5

In the same year 2003, a report on Combined Code Guidance for Audit Committees chaired by Sir Robert Smith under the auspices of the Financial Reporting Council was submitted.6 The guidance was designed to assist company boards in making suitable arrangements for their audit committees, and to assist directors serving on audit committees in carrying out their role.7 The revised combined code was issued in 2003 which incorporated many of the recommendations from the previous reports, particularly the Higgs Report and Smith Report on the areas of the role and effectiveness of non- executive directors, and guidance for audit committees.8The United Kingdom Combined

3Smerdon, R. *A Practical Guide to Corporate Governance,* op cit. p.7

4Ibid. p 8

5Ibid.

6Ibid p. 7

7Ibid p. 733

8 Ibid, pp11-12, See also Garrett A.D.(2004) *Themes and Variations: The Convergence of Corporate Governance Practices in Major World Markets*, op.cit p.12

Code of 2003 was fully revised in 20069 which covers most areas of corporate governance and now updated to 2008 combined Code.10

The United Kingdom has pioneered a flexible model of regulation of corporate governance, known as the “comply or explain” approach. Compliance with the combined code is made voluntary. This is a principle-based code that lists a number of recommended practices which publicly listed companies in the United Kingdom have to either apply those principles or, if they choose not to, then explain in a designated part of the annual report why they decided not to comply. The idea behind this position is that companies are not the same in size and have peculiarities in matters of corporate governance. If a company has good reasons to deviate from the sound rule, they should be able to convincingly explain to its shareholders that it is in the best interest of the company as a whole. The “comply or explain” rule for listed companies applies to all provisions of the code. The U. K. Combined Code is not a rigid set of rules; rather it is a guide to the components of good board practice. While it is expected that companies comply wholly or substantially with its provisions, it is recognized that noncompliance may be justified in particular circumstances if good governance can be achieved by other means. This “comply or explain” approach has been the position of the U.K. Code since 1992.

# The United States of America Approach

The United States of America appeared to show little concern for better corporate governance throughout the 1990s, although there were some activist institutional shareholders such as *Calpers*.11 The situation changed dramatically, however, with the collapse of the energy company Enron, followed by a number of other corporate collapses

9 Smerdon, R.A *Practical Guide To Corporate Governance*, op. cit. p. 8

10Coyle, B. *The ICSA Study Text in Corporate Governance*, op. cit Apppendix1 p. 303

11 Ibid, p.12

and governance scandals. The United States of America Senate subcommittee investigated the role of directors in the collapse of Enron in 2002 and found out some intriguing governance abuses in the company. The company had unprecedented outrageous remuneration packages for senior executives. For example, in one financial year, the company paid out cash bonuses of almost $975 million. It was discovered that executives of Enron were permitted to run off balance sheet partnership with the company which earned hundreds of millions of dollars at Enron‟s expense; and non-executive directors had financial ties with Enron, including payments for consultancy services in some cases.12 The company‟s auditor, Arthur Andersen, was accused of applying lax standards in their audits because of a conflict of interest over the significant consulting fees generated from Enron. In 2000, Arthur Andersen earned $25 million in audit fees and

$27 million in consulting fees. As a result of the shady relationship with the company, Andersen attempted to cover up many improprieties in its audit by shredding supporting documents after investigations of Enron by the Securities and Exchange Commission became public.13 Consequently, recommendations for change were proposed by the New York Stock Exchange14 for serious actions to be taken to address corporate governance issues in United States‟ companies.

The United States has taken a different approach to corporate governance from that adopted in Europe as epitomized by the United Kingdom. As stated earlier, in the United Kingdom, the emphasis is mainly on voluntary compliance with the code and the application of principles. While in the United States the emphasis has been on statutory regulation. The United States approach resulted in the promulgation of its Sarbanes-Oxley Act in 2002.15 The Act was intended to address the corporate governance challenges that

12Ibid p. 76

13Healy, P M and Palepu, K. G.(2003) The Fall of Enron, *Journal of Economic Perspective. Vol.17 No.2 Spring*. p. 15

14 Coyle, B *The ICSA Study Text in Corporate Governance*, op. cit.p.12

15 Ibid. p.295

became manifest from the Enron collapse in 2002. The Act has now become the law regulating corporate governance in the United States of America. The Act itself contains various specific requirements, and directs the American Securities and Exchange Commission (SEC) to issue rules implementing its measures relating to corporate governance. The requirements of the Sarbanes-Oxley Act, and some SEC rules are made mandatory and must be complied with by United States of American companies.

For instance, sections 302 and 90616, provide that chief executive officers (CEO) and chief finance officers (CFO) of companies must certify each annual or quarterly financial report under oath. The essence of these provisions is that they must certify their company‟s integrity and take direct responsibility for the accuracy of their company‟s financial statements. The requirement applies not only to United States companies but also to foreign companies with United States listing. Accordingly, the above mentioned section 302 in its subsection (a) directs the Unite States Securities and Exchange Commission (SEC) to adopt rules requiring CEO and CFO certification. The SEC has therefore designed form 20-F which is broadly worded in order to deepen the potential liability of the certifying officers.17

Another significant provision of the Sarbanes-Oxley Act is the restrictions placed on the types of non-audit work that can be carried out by the audit firm for a client company under sections 201 and 202. This is in response to the Arthur Andersen – Enron consultancy service relationship that made Andersen to compromise his auditing duties to the company. Section 404 of Sarbanes-Oxley Act mandates the SEC to prescribe rules requiring each annual report to contain an internal control report which shall state the responsibility of management for establishing and maintaining an adequate internal

16Sarbanes – Oxley Act, 2002, United States of America

17Smerdon, R. (2007) *A Practical Guide to Corporate Governance,* op cit. p.578; Chambers, Aand Weight,

C. (2008) Corporate *Governance Handbook*, op.cit. p.38; and Coyle, B.*The ICSA Study Text in Corporate Governance*. Op cit. p.295.

control structure and procedures for financial reporting; and contain an assessment as at the end of the most recent fiscal year of the effectiveness of the internal control structure and procedure for financial reporting.18 This is aimed to check and detect fraudulent financial dealing of the company. In furtherance of ensuring financial prudence section 407 requires companies to disclose in its periodic reports whether its audit committee has at least one “financial expert” and if not, why not.19 The SEC has introduced rules defining what requirements must be met to be a suitable “financial expert” for audit committee purposes as new item 16A of form 20F.20

“Legislative measures for corporate governance are considered by some commentators to be unnecessary on the grounds that rules are often broken, and the forcible imposition of rules is unlikely to be effective unless directors and managers work (according) to a voluntary code of business ethics.”21 For instance, section 401(a)22 provides that “the company must disclose in its financial reports filed with the SEC the material facts and circumstances of its off-balance sheet partnerships with the company.” Enron had permitted her executives to run off-balance sheet partnership with the company which earned hundreds of millions of dollars at Enron‟s expense.23 Enron used several controversial special purpose entities which were designed primarily to achieve financial reporting objectives without actually breaching extant law. Special purpose entities are shell firms created by a sponsor, but funded by independent equity investors and debt financing.24

One of such special purpose entity transaction was with Chewco, a special purpose entity that was controlled by an Enron executive. Enron wanted to buy out a

18Chambers. A and Weight, C*. Corporate Governance Handbook*, ibid. p. 390

19Smerdon, R. A *Practical Guide to Corporate Governance,* op cit p. 583

20Ibid. pp. 583-584 and Coyle, B. *The ICSA Study Text in Corporate Governance*. Op cit p. 296

21 Coyle, B. Ibid p.298

22 Sarbanes-Oxley Act, 2002 of the United States of America

23Coyle, B. *The ICSA Study Text in Corporate Governance*. op cit p. 76

24Healy, P. M. and Palepu, K.G. *The Fall of Enron*. Op cit p. 10

partner‟s stake in one of its many joint ventures; however, Enron did not want to show any debt for financing the acquisition of the joint venture on its balance sheet. Enron therefore entered into a special purpose entity transaction with Chewco, a special purpose entity that was controlled by an Enron executive which raised debt that was guaranteed by Enron, acquired the joint venture stake for $383 million. The transaction was structured in such a way that Enron did not have to consolidate Chewco or the joint venture into its financials, enabling it effectively to acquire the partnership interest without recognizing any additional debt on its book.25 Enron did not disclose sufficiently its relationship with the special purpose entities so they could not know that the entities were actually using Enron‟s stock and financial guarantees to carry out those businesses. Worse still the company allowed several key employees, including its chief financial officer Andrew Fastow, to become partners of the special purpose entities.26 This is a blatant conflict of interest for which the employees profited excessively.

The above incidences tend to support the argument that rules can be circumvented and some other ways of channeling money to individuals could well be found that is not in breach of the law and would not require disclosure.27

# Corporate Governance Reform in Canada

In Canada the significant factor that impacts on securities regulation is the lack of a single, national agency regulating securities. Instead, there are several provincial and territorial governments, each of which has its own legislation and securities regulatory agencies responsible for the regulation of securities in Canada.28 Corporate governance issues therefore become complicated in Canada by the lack of harmonization among the various provinces, and by bickering among the various provincial securities regulators. In

25Ibid. p. 11

26Ibid.

27 Coyle, B. op. cit. p.298

28 Mc Dermott, R. and Farrel, S. (2004) Corporate Governance in Canada. McMillan Binch LLP, http:/[*/*www.mcmillanbinch.com](http://www.mcmillanbinch.com/) p.1, visited on 10/11/2011

British Columbia and Alberta, for example regulators favour a principles-based regulatory regime, while in Ontario, regulators favour a rules-based scheme patterned after the United States laws, such as the Sarbanes-Oxley Act.29 In consequence of the above, the efforts of the Canadian securities administrators to lead governance reform in Canada have slowed as regulators from the various jurisdictions have differing views about approaches to reform. However, the Ontario Securities Commission, because the Toronto Stock Exchange where the largest Canadian Public Companies are listed is located within its jurisdiction, wields more power than other regulators in Canada. Accordingly, the Ontario Securities Commission has been playing a leading role in corporate governance reforms.30 Among the new recommendations initiated by the Commission are that a majority of board member should be independent and that those directors should meet regularly.31 The new changes define independent directors as those individuals considered to be free from any other relationship which could reasonably be perceived to materially interfere with their ability to act with a view to the best interests of the issuer”.32Other changes recommended for the chair to be an independent director; creation of compensation committee and nomination committee; review of board performance and individual directors; and a clear description of the position of the directors and chief executive officer.33

The changes advocated by the Ontario Securities Commission are geared more in line with governance expected of public companies in the United States. This means that Canada‟s model of corporate governance leans more in favour of rules-based regulations of corporate governance.

# Response to Corporate Governance in Germany

29 Garrett, A. D. Themes and Variations: The Convergence of Corporate Governance Practice in major world markets, op.cit p. 8

30Mc Dermott, R and Farrel, S*. Corporate Governance in Canada,* op. Cit. p. 1

31 Garrett A.D, op cit. See also McDermott, R. et al, ibid. p. 2

32 Garrett Ibid. p. 8

33 Ibid. p. 9 see also McDermott, R. et al ibid p.2

Like other countries, Germany also responded to corporate governance challenges in its country. The main issue with Germany‟s corporate governance was the two-tiered structure of the board of directors. Boards of directors of public companies in Germany have two levels-the management board and the supervisory board comprised of outside directors. These are separate groups of people, such that members of one group cannot be members of the other.34 These directors represent both capital and labour. The two-tiered structure received criticism over the years on issues of interlocking directorates, conflict of interest, labour-management factors on the board, restricted information to the board for fear of labour representatives on the board thus depriving the board of certain information.35

In July 2002, Germany enacted the Transparency and Publicity Act; an Act based on the recommendations made by the German Corporate Governance Commission whose Corporate Governance Code was first published in February 2002.36 The Act covers disclosure, transparency and accounting issues. On an annual basis, the management board must now file a Compliance and Disclosure Statement, which is a representation both as to compliance during the year and compliance at the time of filing, with the principles in the Corporate Governance Code.37 If the company has failed to comply with certain provisions of the German Corporate Governance Code, the company must specifically disclose these provisions with which it failed to comply. Certain provisions of the code restate mandatory provisions from German corporate law, while other provisions are precatory and simply give guidance as to best practices.38

34 Ibid. p.9 See also Gower and Davies,(*2008).Principles of Modern Company Law* (ed) Davies P.L. 8th edition, Sweet & Maxwell, London , Pp. 399 & 400

35 Garret, A. D. *Themes and Variations: The Convergence of Corporate Governance Practices in Major world Markets, o*p. cit p. 9

36 Ibid

37 Ibid p.10

38 Ibid

Even though Germany has adopted the United Kingdom regulatory approach of “comply or explain” it is hereby observed that by restating some mandatory provisions from German laws, companies in Germany cannot apply the “comply or explain” scheme wholly. Those provisions are mandatory because they are by themselves laws independent of the corporate governance code. It is the other guidance provisions in the code that are voluntary and companies can exercise their discretion either to comply or explain. In essence, a company can deviate from the provisions of the Code only to the extent that the Act itself expressly permits.

The Corporate Governance Code establishes three categories of corporate governance principles. The first category merely reiterates the mandatory rules of German law. Companies are obliged to comply with these rules independent of the Code. The second and third categories of provisions set out internationally recognized best-practice standards for responsible transparent governance. These practices are structured as “recommendations” and “suggestions”. Companies can deviate from recommendations, but are obliged to disclose their non-compliance, but companies need not disclose deviation from suggestions.39 For example, the management board is statutorily bound to inform the supervisory board comprehensively and without delay of all issues important to the company with regard to planning, business development, risk situations and risk management. The supervisory board must provide management boards with detailed specifications of their information and reporting duties.40 Also, to ensure transparency, it is mandatory for management board members to disclose any conflict of interest to the supervisory board and to other members of the management board. Relevant transactions between the company and members of the management board require supervisory board

39Shearman and Sterling.(2002) *Corporate Governance in Germany, Supplement-Corporate Governance*. [www.corporate-governance-code.de](http://www.corporate-governance-code.de/) Pp.6 and 10, visited on 25/11/2011; Foreword, German Corporate Governance Code (as amended on May 26, 2010) p. 2. deutsche-boerse.com. visited on 31/8/2012 40Shearman and Sterling, Corporate Governance in Germany, ibid. p. 7

approval.41 On the composition of the supervisory board to ensure its independence, the Code recommends that not more than two former management board members can serve on the supervisory board and supervisory board members must not exercise directorships or similar positions or advisory tasks for competitors‟ companies.42

# Transformation of Corporate Governance in Japan

The concept of “family” is extremely important in the Japanese capital market. Due to cross shareholdings, there are interrelationships among many companies in Japan. These families (Keiretsus) are tied together through a common ownership structure. The situation being that majority of companies listed on the Tokyo Stock Exchange do not have independent directors. This ownership structure results in shareholders even large shareholders being fairly stable and passive. Corporations in Japan focus on the importance of consensus in decision making. Despite a substantial shareholding, these shareholders may not exert control in the same ways as might major shareholders in the United States.43 Another unusual factor in Japan that affects the area of corporate governance has been the lack of hostile takeovers. Unlike in other markets where there may be bidding wars or hostile takeovers, the Japanese focus on consensus will not motivate companies to “window-dress” for a potential bidding war.44 Finally, the Japanese government plays a strong role in corporate governance, as the government shows willingness to intervene to assist troubled companies. 45

Japan started to transform governance practices slowly; in 2000, the Tokyo Stock Exchange wrote to all companies listed upon it and requested that they revise their corporate governance practices to take into account shareholder‟s interests to a greater

41Ibid 42Ibid.

43 Garret, A D. Themes and Variations… op. cit p.10

44 Ibid

45 Ibid

degree. The Tokyo Stock Exchange also established a permanent corporate governance committee to advise the Exchange and listed companies.46

On May 22, 2002, the Legislative Assembly (Diet) passed revisions to Japan‟s Commercial Code. The revisions, effective from April 1, 2003, included a number of changes affecting the operation of board of directors in Japan. The boards of large companies, those most likely to be recipients of foreign investment, are now allowed to either operate using a single-tier structure like boards of directors in the United States or maintain their traditional Japanese style structure47. Those opting for the new system must establish three committees of the board of directors; a nomination committee, an audit committee and a compensation committee. A majority of the members of each of the committee must be outside directors.48

A striking point worth mentioning under the Japanese corporate governance regulation is that companies are allowed to choose between the hitherto traditional Japanese style of corporate governance and the new United States style. Under the previous law, a firm‟s board of directors traditionally composed of members who were responsible for both supervision and executive responsibilities. There was actually no distinction between monitoring and executive duties.49 Naturally, people are not willing to easily change from their normal way of behaviour or activities especially when such change will affect their personal interest. This may inform the reason why less than thirty percent of companies listed on the Tokyo Stock Exchange have independent directors.50However, as a result of the change in the law, even firms that are not changing their governance system are separating some monitoring and operational

46 Ibid

47McCarty. W and Toda, M. (2005) Corporate Governance in Japan: Can You See the Changes?*The Josai Journal of Business Administrationvol. 2 No.1 Josai University*, p.2, libir.josai.ac.jp. visited on 31/8/2012

48 Ibid, p.11 see also, Revised Corporate Governance Principles, Japan Corporate Governance Forum (October 26, 2001) p. 2

49McCarty, W and Toda, M*. Corporate Governance in Japan*, op. cit p.3

50 Garret, A D. Themes and Variations… op. cit. p.10

activities.51Despite the attempts to change, Japan is still viewed as lacking in the transparency and disclosure rules necessary to provide a high level of investor confidence.52

# The New Trend of Corporate Governance in Mexico

In Mexico, businesses are majorly owned and operated by families. Therefore control resides with the families that own the controlling interest in the voting classes of stocks.53 Accordingly, both public and private corporations share similar characteristics of being closely held by the family. This business model in Mexico had led to several instances of corporate fraud. Jonathan Davis, president of Mexico‟s National Banking and Securities Commission, disclosed that 80 of the approximately 150 listed companies are being investigated for irregular operations.54 For example, on January 5, 2005 the United States Securities and Exchange Commission accused Salinas Pliego, a TV Azteca executive, of having profited $109 million from a transaction among Unefon S A (TV Azteca‟s phone unit), Nortel Networks Corporation and Codisco.55 The shares of TV Azteca, a Mexican television network are listed on both Mexican Stock Exchange and New York Stock Exchange.

Foreign investors continued to demand better corporate governance from Mexico. It is responding by making reforms to its corporate governance law to provide for greater transparency regarding corporations and their operations. Coupled with the global trend

of corporate governance reforms, on June 9, 1999 a new Best Practice for Corporate

51 McCarty, W and Toda, M op. cit.p.3

52 Garret, A D. Themes and Variations… op. cit. p.10

53Aguilar, L. A*. Corporate Governance: Does Mexico finally get it?*<http://www.metrocorpcounsel.com/articles/6275/corporategovernance>p. 1 of 4 visited on 4/9/2012

54Ibid.

55Ibid.

Governance for Mexico was introduced which incorporated the basic principles of corporate governance generally recognized in the United States and Europe.56The Code was the first of its kind in Latin America.57 The Code was prepared jointly by the Mexican Stock Exchange, the Mexican Bankers‟ Association, the Mexican Institute of Finance Executive and the Mexican Institute of Public Accountants, as well as representatives from the industrial, retail and service sectors. It was then submitted to the National Banking and Securities Commission so that the securities authorities could issue the necessary regulatory provisions on disclosure of information regarding conformity to the practices suggested therein.58The code addressed governance issues relating to the structure and functions of boards of directors, auditing of the company and oversight of internal controls and finance, planning, transparency and disclosure in the provision of relevant information to shareholders.59 Compliance with the code is voluntary. Mexico has followed a principle-based rather than rules-based approach to governance. Accordingly, companies must file a report annually with the „Bolsa‟ (Stock Exchange) identifying any areas of the code with which they have not complied with and explain the reasons for the non-compliance.60

The new trend in Mexico now is that most companies have started to establish audit committees and draft charter for those committees and in many instances; they follow the charters used by United States companies as models.

# International Best Standards of Corporate Governance for Board of Directors

The initial international effort at developing formal Principles of Corporate Governance was the OECD principles of corporate governance in 1999 and later revised

56 Creel,C and Garcia-Cuellar, S. Overview of Recent Corporate Governance Reforms in Mexico. <http://www.globalcorporategovernance.com/n-latinamerica>Visited on 4/9/2012

57Corporate Governance Code for Mexico, p. 1 of 14 [www.ecgi.or/codes/document/mexico-code-en.pdf](http://www.ecgi.or/codes/document/mexico-code-en.pdf) visited on 4/9/2012

58Ibid.

59 Sections 1.1, 1.2, and1.3 iii, Mexico‟s Code of Best Corporate Practices.

60Aguila, L. A. Corporate Governance: Does Mexico Finally Get It? Op. cit p. 2 of 4

in 2004. Since then they have formed the basis for corporate governance initiative in both OECD and non-OECD countries alike. The Principles were intended to assist governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions in the process of developing good corporate governance.61 Based on this background, in 2002 the Emerging Markets Committee of the International Organization of Securities Commission (IOSCO) recommended the OECD principles as a benchmark.**62**

In view of the fact that countries round the world derived their source of inspiration from the OECD principles of corporate governance, there are common principles or provisions that cut across the various codes of corporate governance of countries irrespective of the model of approach adopted by the countries. This trend is to a larger extent driving corporate governance perspectives towards the same direction. In effect corporate governance guidelines or requirements are being created to meet international recognizable standards.

The board of directors being a very strategic organ in company management irrespective of the type of board structure, whether it is a two-tier or one-tier system has far reaching provisions in various corporate governance principles and codes. The OECD principles state that “the corporate governance frame-work should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board‟s accountability to the company and the shareholders”.63 The United Kingdom Combined Code on its part provides that “every company should be headed by an effective board, which is collectively responsible for the success of the company”,64 while

61 Preamble, OECD Principles of Corporate Governance 2004

62 Coyle, B *The ICSA Study Text in Corporate Governance,* op cit. p.280

63 Principle VI, OECD. Op cit

64 Principle A1. The United Kingdom Combined Code on Corporate Governance, 2008

Principle 165 has this to say that “the board should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity for the corporation and to act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility”. The emphasis on the board leadership responsibility is similarly underpinned that “the board is accountable for the performance and affairs of the company”.66

In Germany, a dual board system is prescribed by law, which comprise of the management board and the supervisory board. The German Corporate Governance Code (as amended on May 26, 2010)67 has epitomized the task and responsibilities of the board that “the management board develops the enterprise‟s strategy, coordinates it with the supervisory board and ensures its implementation”.68 In order for the supervisory board to be able to effectively supervise the management board the Code requires “the supervisory board to be composed in such a way that its members as a group possess the knowledge, ability and expert experience.”69 Corporate governance in Canada also places the onerous task of supervising management on the board of directors.70 The Revised Corporate Governance Principles in Japan likewise provides that “the board of directors should supervise the management of the company”71

In all these Codes the board is required to fulfill certain functions such as reviewing and guiding corporate strategy, major plans of action, monitoring the effectiveness of the company‟s governance practices and making changes as needed. The board is therefore to set the company‟s strategic aims, retain effective control, and comply with laws and regulations. In essence, apart from the legal duties of directors, the

65 Principles for Corporate Governance in the Common Wealth (CACG Guidelines)

66 Section 2.1.1 King II Report on Corporate Governance Code of Corporate Practices and Conduct, South Africa.

67deutsche-boerse.com. Accessed on 31/8/2012

68Section 4.1.2 German Corporate Governance Code, 2010

69Section 5.4.1. ibid.

70Binch, M. (2004) Corporate Governance in Canada. The Globe White Page Boardroom Adviser Series p.5

71Principle 1(2) Revised Corporate Governance Principles, 2001

board has the powers of both monitoring the behavior of management and positively contributing to strategic policy-making.

With the specific mandate of ensuring that managements of companies do their work properly for the interest of the company, the board of directors must be very prudent in order to discharge its responsibilities. They must do what is necessary to verify management information and perform their duties in a vigilant manner. The failure to discharge director‟s responsibilities is most likely to be actionable against the directors and the Courts might be more inclined to define the scope of the duties of directors in board decisions based on the current notion of best practices. In *Re Walt Disney Co. Derivative Litigation*,72 Chancellor William B Chandler III observed that Disney‟s directors were “taken on a wild ride, and most of it was in the dark” and that “there are many aspects of defendants‟ conduct that fell significantly short of the best practices of ideal corporate governance;” that “the actions (and the failures to act) of the Disney board that give rise to this law suit took place ten years ago” before “the Enron and WorldCom debacles, and the resulting legislative focus on corporate governance” and that applying 21st century notions of best practices in analyzing whether those decisions were actionable would be a misplace.” Future decisions will develop and clarify the extent to which “21st century notions of best practices will be used by Courts to define the scope of the duties of directors in board decisions made today.

# General Factors Responsible for Common International Standards of Corporate Governance

# The Effect of International Organizations

Global organizations are significantly impacting the convergence of core governance principles. Among these organizations are the International Corporate Governance Network, Organization for Economic Cooperation and Development (OECD), the United Nations, the Export Import Bank, the International Organization of

72(2005) No. 15452 Del. Ch.

Securities Commission, the International Accounting Standard Board, the Institute of Internal Auditors, the American Society of Corporate Secretaries in cooperation with its sister organizations in other countries.73

There are several examples of international cooperation among various government agencies and membership organizations working toward corporate governance convergence. As a case in point, in 1995, the International Corporate Governance Network was formed by a group of institutional investors, such as pension funds and financial institutions, to provide a forum for exchange on international corporate governance information. It published guidelines in 1999 that have been relied on by many institutional investors in forming their own international corporate governance principles. Similarly, in 1999 the OECD produced Principles of Corporate Governance which became an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non OECD counties.74 The International Organization of Securities Commissions has also released pronouncements on transparency and disclosure, auditor independence and the board‟s role in the oversight of outside directors (non-executive directors). The International Accounting Standard Board and the United States Financial Accounting Standard Board are at work on global accounting standards; the accounting rulemaking bodies of other countries are also focused on implementing changes with accepted norms of international accounting.75

# The Effect of United States of America‟s Influence

73 Garret, A.D. (2004) Themes and Variations: the Convergence of Corporate Governance Practices in Major World Markets. Op.cit p. 6

74Foreword, OECD Principles of Corporate Governance, 2004 p. 3

75 Garret, A D. Op. cit p. 6

To some degree, United States government regulations on the subject of corporate governance have an extraterritorial effect, even where the effect was unintended. For example, Regulation FD76 is intended to level the playing field between analysts, institutional investors and individual investors. The Commission believed that companies provided more information or earlier information to analysts and institutional investors than to individual investors. Regulation FD requires that companies communicate material information contemporaneously to these groups. As companies from other countries woo United States of America investors, they must take cognizance of the requirements of Regulation FD. Similarly, as United States companies deal with investors abroad, those companies will act as they have been trained to act by their United States- based attorneys.

The Sarbanes-Oxley Act also has an extraterritorial effect. For instance, Sections302 and 906 of the Act, which require official certification of financial statements by chief executive officers and chief finance officers of annual or quarterly report filed to the US Securities and Exchange Commission is made applicable to foreign companies that have listed their securities or issued securities to the public in the United States of America.77 The implication is that such foreign companies are required to comply with the provisions of the Sarbanes-Oxley Act. The effect is that those companies are influenced to behave like United States companies thus impacting on their corporate governance culture in their countries of origin.

Before the enactment of the United States Sarbanes-Oxley Act in 2002, sometime in the 1990s there was a notion that United States standards were seen as global standards.78 This made corporate managers in countries like Japan to make concerted

76 U.S. Securities and Exchange Commission (SEC), Final Rule, 2000

77Smerdon, R. *A Practical Guide to Corporate Governance*. Op.cit. pp. 566. See also Chambers, A and Weight, C. *Corporate Governance Handbook*. Op. cit. p. 387

efforts not to lag behind the “global standard” in any aspect of management, not only in the field of corporate governance practices.79 In consequence thereof, the revised Commercial Code of Japan was drafted to follow the system adopted in the United States of America.80 For instance, the Japanese Code now recommends a board structure with committee system whereby three committees (nomination, compensation and audit committees) consisting mainly of outside directors.81 On the whole the Revised Commercial Code shows a tendency to bring into Japan the shareholder-oriented corporate governance which is practiced in the U.S.

In a similar vein, corporate governance reforms in Canada were seen to have been influenced by United States initiatives such as the Sarbanes-Oxley Act. The Canadian Securities Administrators (CSA), a forum for developing a harmonized approach to securities regulation across the country introduced a series of national instruments and policies which affect the corporate governance of Canadian public companies known as the CSA Rules.82 The said Rules closely follow Sarbanes-Oxley Act and the consequential rules and guidelines established by the United States Securities and Exchange Commission and the United States Stock Exchanges. The CSA Rules contain similar issues such as certification of financial statements. The chief executive officer and chief financial officer have to certify the accuracy of annual and interim financial statements.83 Another significant issue is the CSA Rules provision on the composition, authority and responsibilities of audit committees, including the requirement that public companies have an audit committee composed of independent directors who are financially literate.84 This is similar to section 40785 and the Securities and Exchange

79Ibid

80McCarty, W and Toda, M. (2005) *Corporate Governance in Japan*. Op cit p. 5

81Principle 6, Revised Corporate Governance Principles of Japan.

82McDermott, R and Farrell, S.(2004) *Corporate Governance in Canada*, Op. cit p. 2 83Ibid, see also sections 302 and 906 Sarbanes-Oxley Act of United States 84McDermott et al. *Corporate Governance in Canada*, Op. cit. p. 2

Rules which require companies‟ audit committee members to be independent directors one of them must be a financial expert.

# The Effect of Multiple Listing Standards on Convergence.

Another factor playing a significant role in the global convergence of corporate governance principles is the listing of certain global companies with the stock exchange of different countries. Each major stock exchange requires that the companies whose stock is traded on the exchange comply with certain listing requirements, many of which directly address issues of corporate governance. Consequently all the companies quoted on the same stock exchange will have the same standard of rules to comply with. As companies seek to comply with multiple listing standard in various countries, those companies may influence global corporate governance in much the same way that global accounting standards have been influenced by multinationals.86

A good example is seen in the Mexican television network, TV Azteca which is listed on both the Mexican Stock Exchange and New York Stock Exchange. When the United States Securities and Exchange Commission (SEC) discovered fraudulent activities in TV Azteca, it took steps for the investigation of the company. The United States SEC on January 5, 2005 accused a TV Azteca executive, Salinas Pliego, of having profited $109 million from a related party transaction which the company failed to disclose.87 Both the Mexican Banking and Securities Commission and the United States SEC imposed financial penalties on the company. As a result of the incident, TV Azteca established a new audit committee which consisted of three independent directors, dissolved its related party transaction committee and adopted a Code of Ethics covering all directors, officers and employees.88 It can be seen that the company was a Mexican company but for the fact that it was listed on the New York Stock Exchange, the action of

86 Garret, A. D Op.cit p. 5

87Aguilar, L. A. Corporate Governance: Does Mexico Finally Get It? p. 1 of 4 Op. cit

88Ibid pp. 1-2 of 4

the United States SEC compelled it to take steps towards improving its corporate governance.

Closely related to the above is the effect of cross-border mergers and acquisitions. As a company in the acquisition mode examines various target companies in a particular market, it will be more interested in the well-governed target company. The due diligence process that occurs in connection with an acquisition involves, among other things, examining the governance of the target company. A company that wants to present itself to be an attractive target may implement widely-recognized touchstones of good governance to increase its price.

In this situation also, the Mexican market provides a practical example. It has been observed that the greatest challenge facing improved corporate governance in Mexico is the tension between families that desire to retain control of their companies and their companies‟ needs for external financing. However, it is believed that as foreign investors find opportunities to invest in corporations with better corporate governance practices and greater protection for their interests, Mexican companies will come under increasing pressure to continually improve their corporate governance standards and processes to comply with the measures advocated in the Code of Best Corporate Practices.89

It has been shown in the preceding discussion how corporate governance practices around the world are increasingly moving towards the same perspective in several areas. However, the convergence of corporate governance practices will never be complete for some reasons, although certain core principles will be recognized in virtually every country as fundamental to a market economy. Those factors that impair complete convergence of corporate governance are hereunder pointed out.

# The Philosophical Approach to Governance

89Ibid. p. 4 of 4

One impediment to complete convergence is the varying philosophical approach to governance regulations, some countries approach corporate governance in a manner that differs substantially from the approach adopted by others, for example the approach adopted by the United States of America is law-based or rules-based approach to corporate governance. This is exemplified by the United States passage of the Sarbanes- Oxley Act in 2002. The legislation, regulations, and stock exchange listing requirements relating to governance are extremely detailed. Failure to comply with these highly specific rules may result in penalties.

The idea behind the law-based approach to corporate governance is to ensure compliance. As a statute it becomes mandatory for every person who is affected by the Act to observe its provisions and the rules and regulations made pursuant to it. Such rules and regulations become delegated legislation where there is noncompliance there will be corresponding enforcement which may include levying of appropriate penalties. The law- based approach to corporate governance provides a uniform standard and perception to corporate governance issues.

Conversely, in some of the world‟s other markets, the approach is a principles-based approach. The chief advocate of this principles-based approach is the United Kingdom,90which operates a comply or explain system. A simple explanation of the difference between the two approaches is illustrated by the different concepts conveyed by the terms “law” and “guidelines.” The result is a different mindset with respect to

corporate governance in the United States, which applies a rule or law-based approach, where what is not prohibited is permitted, compared to a principles-based approach where greater discretion is vested in a company‟s management to make decisions regarding governance activities.

A principles-based approach to governance is one in which guidelines are clear, but compliance with them is voluntary. Some countries have adopted a “comply or explain” approach, which requires corporations not only to disclose whether they have complied

90The U K Combined Code on Corporate Governance, 2008

with the governance guidelines, but also require explanation of any reasons for non-compliance. Typically, the compliance or non- compliance disclosure is made in a filing with either the stock exchange or a government agency.91

The principle-based approach to corporate governance is simply based on the fact that principles are wider in concept than rules. It is easier to break rules than principles in the sense that what is not prohibited by law is permitted and it is a fact that law cannot cover exhaustively every aspect of activity. Corporate operators look for loopholes in the law to take advantage of for their own interest. Enron was said to have taken full advantage of accounting limitations in managing its earnings and balance sheet to portray a rosy picture of its performance.92 Enron used a lot of structured finance transactions that required establishing special purpose entities which do not have clear accounting rules for suchtransactions. Mechanical conventions were used to record those transactions, thereby creating divergence between economic realities and accounting numbers.93 It was commented that “Enron debacle… was a case of corrupt management that was seeking technicalities behind which to perpetrate investor fraud.94 On the other hand because principles are broader than rules, they require persons to adopt different methods suitable to their peculiar situation to achieve the same objective. This is a case of the end justifying the means. The principles-based approach takes into consideration company differences in the areas of operation, business and location as factors that may warrant companies to behave differently. It is in this regard that the discretion is given to companies to approach corporate governance issues differently, however, with the same aim of achieving the same objective of good corporate governance.

# The Effect of Corporate Structure and Ownership Dispersion

91Garret, A D. Op. cit p. 2

92Healy. P. M. and Palepu, K. G. (2003). *The Fall of Enron*. Op. cit. p. 9

93Ibid.

94Holcomb, J. M. (2004) Corporate Governance: Sarbanes-Oxley Act, Related Legal Issues, and Global Comparisons. Op. cit, p. 226

The type of corporate structure practiced in some countries can lead to different results in the corporate governance arena, in Germany, for example, there is a two-tiered board structure consisting of a management board called the „*Vorstand’* and a supervisory board of outside directors called the „ *Aufsichtsrat*.‟95 Members of the *Vorstand* (management board) cannot at the same time, be members of the *Aufsichsrat* (outside directors). The existence, at the highest level in the corporation, of a board of independent, outside directors arguably abrogates the need in Germany for some of the corporate governance principles gaining traction in the United States, such as requiring independent audit or compensation committees.

Ownership dispersion also differs from country to country, creating different governance concerns in some other countries than those that exist in the United States. In the United States and United Kingdom, ownership dispersion is high, while in France, Canada and Germany, ownership dispersion is low.96The commonplace family or bank ownership structure in Canada, Germany, Japan and Mexico may make investors in those cultures more comfortable with control of the corporation resting

in a limited number of individuals having a high percentage of ownership. Differences in thenumber of individual investors may also lead to apposite results in various countries. Institutional investors can be expected to be active to monitor firm performance because of the expertise they possess. Further, their large ownership stakes motivate them to engage in active monitoring. Consequently, in a country where institutional investors are not prominent there will be less pressure on companies to implement and strengthen corporate governance structures.

From the totality of the above discussions under this chapter, it is abundantly clear that corporate governance concerns have assumed a global dimension. Though countries have adopted different approaches in addressing corporate governance system based on their inherent culture, and legal background, there are generally recognizable core

95Foreword, German Corporate Governance Code. Op.cit

96Garret, A D. Op.cit p. 3

requirements that have become international standard to be entrenched in all countries. Since most countries want to belong to the international community of nations and have a place in the global market, as being fostered by various international organizations, intergovernmental agencies, the necessity of creating generally acceptable standard of corporate practices is most likely to be strengthened.

The unfortunate thing is that the developing nations would have to be running with the developed nations at the pace set by the developed nations. It is indeed a marathon by persons of unequal strength. The normal effect of overdose would be overbearing on the local economies of developing nations since they are not ripped for such economic measures postulated by the developed nations.

# Corporate Governance Reforms in Nigeria

# Corporate Governance under the Companies and Allied Matters Act

Corporate governance has been generally associated with the recent evolution of formalized codes and principles of best practices. However, in actual sense the idea of corporate governance had been in existence since the emergence of public companies where ownership is dispersed and separated from management, whether it was recognized under that concept or not.97 The notion of corporate governance of ensuring proper management of companies has been reflected in the Nigerian Companies and Allied Matters Act (CAMA).98 The management of companies is vested in the board of directors.99 They are therefore required to observe good corporate governance. The CAMA has made provisions relating to the board of directors that are aimed at making the directors to observe good practices of corporate management. These provisions are mentioned hereunder.

97 Amupitan, J. O. Corporate Governance: Models and Principles. Op. cit. pp. 2-3

98 Companies and Allied Matters Act. Op.cit

99 Section 63(3) Ibid

Section 254100provides for “Restraint of fraudulent persons” from being directors. These are persons who are convicted of any offence in connection with the promotion, formation or management of a company; or have been guilty of any offence to defraud creditors of the company or any fraud in relation to the company. The intention of this provision is to prevent people who do not possess the character of integrity and ethical values from being entrusted with other people‟s money to manage. Against this backdrop corporate governance has been defined as based on the principles of integrity, fairness, transparency, accountability and commitment to values.101

The limitation of this provision is that it is only concerned with fraud in relation to companies. It does not cover persons who commit fraud in other sectors like the public and civil service as well as inter personal relationship. Since fraud is an issue of character, a fraudulent person can commit fraud everywhere he/she is. A fraudulent person in the civil/public service or a „419‟ person who swindles individuals is likely to commit fraud if he is made a company director. There is need for this provision on restraint of fraudulent persons to include fraud committed by a person everywhere.

Section 262102 provides for “removal of directors”, that a company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding in its articles or in any agreement between it and him.” This section has made directors to be accountable to the shareholders who should have the power to check the conduct of directors. It is in this regard that corporate governance has been considered as concerned with how powers are shared and exercised by different groups.103 The intention is to provide for checks and balances in the affairs of company.

100 Ibid

101 Badi, N. V. (2012) *Corporate Governance*. Op.cit. Pp. 14-15

102 CAMA. Op. cit

103 Coyle, B. *The ICSA Study Text in Corporate Governance*. Op. cit. p. 4

The problem has always been how shareholders could effectively exercise this statutory power under corporate governance structure of dispersed ownership where in many cases shareholders have apathy in attending general meeting. Directors on their part also have dexterously developed some methods of controlling the conduct of general meeting in their favour.

The provision of section 263104 is on the issue of “proceedings of directors” meetings. Subsection (2) of section 263 above in particular states that “any question arising at any meeting shall be decided by a majority of votes, and in case of an equality of votes, the chairman shall have a second or casting vote.” This requirement for decision making process of the board of directors exemplifies corporate governance principle of democratization. This is to prevent a situation of an individual or small group of individuals dominating the board‟s decision taking, and thereby promoting personal interest to the detriment of the company and shareholders or other stakeholders.

The bane of this provision is the lack of provision in the CAMA on the composition of the board of directors. The CAMA has failed to provide on the kind of persons to constitute a board. Directors who can vote objectively are those who are independent in character and judgment without any relationship with other directors. The CAMA has not gone further to require the members of the board of directors be independent of one another to reduce the tendency of connivance on issues of common interest.

The issue of “notice of meeting” has been appreciably captured under section 266(1) and (2).105 The subsections provide that “every director shall be entitled to receive notice of the directors‟ meeting… There shall be given 14 days‟ notice in writing to all directors…” The aspect of corporate governance envisaged by this provision is the supply

104 CAMA. Op. cit.

105 Ibid

of accurate, timely and clear information to the directors in respect of the meeting. Section 218 of CAMA further consolidates this requirement by providing for the content of notice of meeting to ensure full information. It states that “the notice of a meeting shall specify the place, date, and time of the meeting, and the general nature of the business to be transacted thereat in sufficient detail… and where the meeting is to consider a special resolution, shall set out the terms of the resolution.” When notice of meeting is given timeously, they will be able to study the issues for discussion and where necessary seek independent professional advice in order to discharge their responsibilities as directors.

Section 267 and 268106 makes provision for “remuneration of directors”. Section 267(1) states that “the remuneration of the directors shall, from time to time, be determined by the company in general meeting...” while, section 268(1) provides that “a managing director shall receive such remunerations… as the directors may determine.” It means that the remuneration of non-executive directors is determined by the general meeting while that of the managing director and indeed that of the executive directors is fixed by the board of directors. The idea of these provisions is prevent the directors from being involved in the determination of their remunerations to avoid manipulation.

The above provisions cannot prevent completely the directors from engaging in the determination of their remunerations. In practice, the board of directors set their remunerations and present to the general meeting for approval. In most cases the general meeting simply approves same without question. It has been contended that “setting remuneration in this way is a classic case where the risk of “mutual back scratching” arises: directors may not scrutinize too closely the remuneration of a fellow director in the expectation of similar treatment in return when their cases are considered.‟‟107 The hyper levels of executive remuneration have been a matter considerable public criticism in

recent years because of the unsatisfactory negotiating process through which executive salaries are fixed.108 The CAMA does not exclude other executive directors from participating in the board meeting where the remuneration of another is being considered. This is why the need for remuneration committee made up of independent non-executive directors is advocated as an international best practice.

Other provisions in the CAMA that have made efforts to address corporate governance concerns are sections 277, 279 and 280109 in relation to, disclosure by directors of interest in contracts, duties of directors, and conflict of duties and interest respectively. The cumulative import of these sections is to ensure that directors perform their duties for the interest of the company without allowing their personal interest to interfere.

The fiduciary relationship of directors to the company is apposite to that of trustees and agents of the company110 which requires them to observe utmost good faith towards the company in dealing with it or on its behalf so that the best interest of the company would be upheld. It is in this respect that section 277(1) of CAMA has expressly provided that „‟ it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company, to declare the nature of his interest at a meeting of directors of the company‟‟. The aim is to ensure transparency and to ensure that the board takes independent decision on the contract by allowing only the disinterested directors to take decision.

In furtherance of the desire to make directors to carry out their duties with the sense of honesty and accountability, they are forbidden from allowing their personal interest to conflict with their duties.111 Thus, a director shall not in the course of

108Ibid. See also Coyle, B. (2009) *The ICSA Text in Corporate Governance*. Op. Cit. P. 194

109CAMA op. cit

110Section 283. Ibid

111Section 280(1) Ibid

managing the affairs of the company or utilization of the company‟s property, make any secret profit or achieve unnecessary benefits.112

In a similar vein, section 284(1) of CAMA prohibits a company from entering into a substantial property transaction with the director except such transaction is approved by the general meeting. The intention is to make the general meeting and not the board of directors to take objective and independent decision whether to approve or not approve the transaction. The problem with all these conflict of interest transactions is that the CAMA has provided on how the approving body is to conduct the decision making process. The CAMA does not however exclude the interested director from attending and participating in the decision making process of the body to consider the transaction. Where a director is also a shareholder he has the right to attend and participate in a general meeting as a shareholder. Since a director is not prohibited by CAMA from attending meeting where his/her interest is considered, he can take advantage of that and might be able to influence the decision in his favour.

Finally, the provision of section 290 of CAMA which make directors personally liable for failure to apply money or property for the purpose they were meant also has corporate governance intention. The provision is meant to caution directors to act prudently and for the purpose of achieving the company‟s objectives.

In spite of these corporate governance provisions in the CAMA, there have been several incidents where executive management and the board of corporate institutions were alleged to be reckless with investor‟s funds, neglected due processes and took biased decisions; and engaged in conducts that negate the principles of corporate governance. In the case of the defunct Oceanic Bank, the former group managing director, Cecilia Ibru, was alleged to have given out depositors‟ funds worth over N150 billion as loans to friends and relatives without collateral; including her nanny who got N13 billion loan to

112Section 280(2) Ibid

cater for personal needs.113 It has been stated that evidence from recent survey confirms that corporate governance lapses were significantly responsible for the collapse of over 70% of defunct companies in Nigeria over the last two decades.114

There is therefore no doubt that the CAMA did not offer sufficient corporate governance framework in Nigeria. This could inform the response by some corporate regulatory agencies in Nigeria particularly the Securities and Exchange Commission (SEC) to produce codes of corporate governance like many countries of the world. The objective is to make corporate governance codes to supplement CAMA provisions in order to provide for a better corporate governance framework.

# Corporate Governance Reforms under the SEC Code in Nigeria

Nigeria, like other nations around the world did not initially pay serious attention to corporate governance issues even though there had been several cases of corporate failures in the country. It is on record that weak corporate governance had been responsible for some corporate failures in Nigeria.115 For instance, Intercontinental Bank, Oceanic Bank, Bank PHB, Afribank, Spring Bank, Lion of Africa Insurance, SocieteGenerale Bank, Mtel, Kaduna Textile Mills, Nigeria Airways, Concord Group and many others crumbled on the basis of corporate governance questions.116 However, the aggravated corporate collapses in the 1990s in the United Kingdom and more recently in the United States of America stirred the hornet‟s nest and brought corporate governance to a global centre stage. As a result of this, improving corporate governance was recognized in most countries which led to the creation of codes of corporate governance with internationally recognized principles by regulatory institutions of several countries.

113League of Defunct Companies. Why the Rising Business Failure in Nigeria? [http://www.myfinancialintelligence.com/banking-and-finance. accessed on 14/4/2013](http://www.myfinancialintelligence.com/banking-and-finance.%20accessed%20on%2014/4/2013) p. 2 of 5

114Corporate Governance Lapse. Ibid p. 2 of 5

115 Introduction, Securities and Exchange Commission (SEC) Code of Corporate Governance in Nigeria, 2011

116 Why the Rising Business Failure in Nigeria? [http://www.myfinancialintellignece.com/banking-and-](http://www.myfinancialintellignece.com/banking-and-finance.p.2%20of%205) [finance.p.2 of 5](http://www.myfinancialintellignece.com/banking-and-finance.p.2%20of%205) accessed on 14/4/2013

Regulators acknowledged the fact that corporate governance reforms were vital for increased investment which actually strengthens the economy.117

It was in realization of the importance of good corporate governance and perhaps more particularly the global gale of formalizing standards of corporate behavior through the production of codes that the Securities and Exchange Commission in conjunction with the Corporate Affairs Commission also produced the code of corporate governance in 2003.118 Although, the main target of the code was the board of directors as leaders of corporate organizations, the responsibilities of other stakeholders including shareholders and professional bodies were equally given due attention.119

The key issues addressed in the 2003 Code were principally on the board of directors, shareholders and audit committee.120 These three important stakeholders in corporate governance have been internationally recognized as key players whose roles are very significant in entrenching good corporate governance. All known codes of corporate governance round the world make provisions with respect to the roles and responsibilities of the boards, shareholders and audit committee.121

On the issue of compliance with codes of corporate governance, experience from other jurisdictions has shown that many countries spearheaded by the United Kingdom encourage voluntary compliance122 and in the United Kingdom code any non-compliance must be satisfactorily explained to justify it. The 2003 Code reiterated this approach of voluntary compliance but cautioned that while voluntary compliance was generally

117 Aigbekaan, E.K. (2010). The Nigerian Capital Market and Corporate Governance Issues.*Journal of the Nigerian Securities and Exchange Commission. SEC News*, vol. 4, No. 6, p.22.

118 Code of Best Practice on Corporate Governance in Nigeria, 2003

119 Ibid, preface, p. ii

120 Parts A, B and C respectively. Ibid

121 Parts A, C and D, United Kingdom Combined Code on Corporate Governance, 2008; Section 2, 6 and 7, South African Code of Corporate Practices and Conduct, 2002; Sections 303A.02, 303A.07 (b) and 312 A 08 New York Stock Exchange Manual

122 Preamble to UK Combined Code, 2008 Germany‟s Transparency and Publicity Act 2002; and Mexico Best Practice Corporate Governance, 1999

encouraged, appropriate sanctions would be applied when it became necessary and applicable for non-compliance.123

The impact of the Code of Best Practice on Corporate Governance in Nigeria, 2003 was little felt, due to its scant provisions and its inefficacious enforcement by the regulatory authorities like the Securities and Exchange Commission and Corporate Affairs Commission. A cursory look at the provisions of the Code in respect of “chairman and chief executive officer‟s positions” at the board of directors, it can be seen that the only significant thing stated by the Code is the separation of the positions of chairman and chief executive officer. It recommends that the two positions be separated and held by different persons.124 On the responsibilities of the chairman, the 2003 Code merely stated without more that “the chairman‟s primary responsibility is to ensure effective operation of the board and should as possible maintain a distance from the day to day operation of the company which should be the primary responsibility of the chief executive officer and the management team.” The Code did not go further to state the functions of the chairman and the chief executive officer. This situation did not provide some benchmarks of what is expected of the chairman and the chief executive officer. It therefore became difficult to determine whether these two key officers of the company performed or not.

Another serious impediment that was the bane of effective enforcement of the 2003 Code of Corporate Governance was its failure to provide for companies to report to the Securities and Exchange Commission or the Corporate Affairs Commission about its compliance with the Code or not. In the absence of compliance report, it became difficult for the regulatory authorities to know the extent to which companies were complying with the Code. The situation was like the Code was made and left to the companies to

123 Preface, Code of Best Practice on Corporate Governance in Nigeria, 2003

124Section 2(b). Ibid

decide whether or not to comply with it. It was as a result of the above scenario that the Securities and Exchange Commission inaugurated the M. B Mahmoud Committee to review the 2003 Code in Nigeria to address its weaknesses and to improve the mechanism for its enforceability.125

The new code of corporate governance produced by the Nigerian SEC in 2011 actually improved on the previous 2003 and made far reaching provisions touching on the board of directors, relationship with shareholders and other stakeholders, risk management and audit, accountability and reporting, communication with shareholders and other stakeholders.126Some of the significant areas of improvement of the new Code can be seen firstly on the unambiguous provisions requiring companies to disclose their level of compliance with the 2011 Code of Corporate Governance. The Code provides that in their Annual Report to the SEC, public companies shall indicate their level of compliance with this Code127 The use of the word “shall” by the Code suggest some level of mandatory obligation on the part of companies to comply. The Code further reiterates the need for this disclosure under its section 34.14 thus “all public companies should state in their annual reports how they have applied this Code and the extent of their compliance. The emphasis given to disclosure of compliance shows the importance placed on it by the Securities and Exchange Commission. Such disclosure provides information both to regulatory authorities and investors to evaluate companies that are observing good corporate governance and those that are not doing so. For regulators, the disclosure provides information on the companies and the basis upon which they can enforce compliance. On the part of investors, disclosure provides information upon which they will be able to know those companies that are good or not good for investment.

125 Introduction, SEC Code of Corporate Governance in Nigeria, 2011

126 Part B, C, D, E and H respectively, Ibid.

127 Section 34.14 SEC Code of Corporate Governance in Nigeria 2011

Another notable area in which the new 2011 Code has improved on the old 2003 Code is on the composition of the board of directors. While it was provided in the old Code that “the Board should comprise of a mix of executive and non-executive directors headed by a chairman of the board…128 the new Code has gone further to categorically state that the majority of the board should be non-executive directors and that at least one of whom should be an independent director. These two requirements are in conformity with international standard of best practices of corporate governance which were lacking in the 2003 Code. The new Code has gone further to itemize the respective functions of the chairman and the chief executive officer.129 These provisions provide some level of yardstick to determine whether these two officers are able to perform or not judging from the minimum requirements prescribed by the Code of Corporate Governance.

Also importantly is the provision in the new Code on multiple directorships. The new Code requires prospective nominee to the Board to disclose their membership on other Boards while serving directors should notify the Board of prospective appointments on other Boards, and a clear prohibition of directors being members of boards of companies in the same industry to avoid conflict of interest and breach of confidentiality.130 These provisions were not found in the 2003 Code. The provision on multiple directorships is very important because if a director serves on too many boards, he may not be able to discharge his responsibilities effectively to all the companies. The disclosure of a nominee director on other boards will enable the board to determine his/her suitability for appointment. All these issues draw inspiration from the Organization for Economic Cooperation and Development (OECD) Principles of the Corporate Governance, 2004131and in consonance with the global trend of best practices.

128Section 1 (a) (b) Code of Best Practices, 2003

129Sections 5.1 and 5.2 SEC Code of Corporate Governance in Nigeria, 2011

130Section 6(a)(c) and (d) ibid

131 Topical OECD Principles are as follows:

Principle II- The Rights of Shareholders and key ownership functions

The SEC Code, 2011 has significantly captured the crucial and sensitive issues of corporate governance epitomized in many other codes in different jurisdictions more particularly the United Kingdom that has played the pioneer role of setting international standard for principles and codes of corporate governance. Some of those issues will be mentioned to buttress the point of international influence on the Nigerian code of corporate governance.

The SEC Code like codes of other countries has provided for the composition and structure of the board with specific reference to size, board mix of executive and non- executive directors in such a way that the number of non-executive directors should be more.132 The critical issue of independent non-executive directors is also found in the SEC code like others.133 The position and functions of the board chairman and chief executive officer have been clearly separated so that no one individual holds the two offices at the same time.134The reason behind this common approach is to ensure that no one has unfettered power or authority by over concentration of power in an individual.

Another issue of international concern is in relation to board committees. The board is required to set committees that would enhance corporate governance in the company. The growing trend among codes of corporate governance in most countries is the establishment of board committees like the remuneration and nomination committees in addition to the mandatory statutory audit committee for public companies.135 In line with this global trend the SEC code has recommended that “the board may in addition to

Principle III- The Equitable Treatment of Shareholders

Principle IV- The Role of Stakeholders in Corporate Governance Principle V- Disclosure and Transparency

Principle VI- The Responsibilities of the Board.

132 Section 4 SEC Code of Corporate Governance in Nigeria, 2011; section A,3 UK Combined Code, 2008; section 2.2 South African Code; section 303A.02 NYSE Manual

133 Section 5.5 Nigerian SEC Code; A.3 Main Principle, UK Combined Code; 2.2.1(c) South African Code. Section 3.3 A0.1 NYSE Manual

134 Sections 5.1 and 5.2 Nigerian SEC Code; see also section A. 2.1 UK Combined Code; section 2.3.1 South African Code

135 Section A. 4.1 (Nomination Committee), B.1 Supporting Principle (Remuneration Committee) and C.

3.1 (Audit Committee) UK. Combined Code 2008; Section 2.7.5 South African Code, 2002.

the audit committee required by the Companies and Allied Matters Act (CAMA) establish a Governance/Remuneration Committee and a Risk Management Committee and such other committees as the board may deem appropriate depending on the size, needs or industry requirements of the company”.136 This provision gives Nigerian companies ample opportunity to set committees that may become necessary in compliance with international best practices under the code. The relevance of these committees will be discussed in chapter three.

One other important issue is the remuneration of directors, which has been a problem round the world particularly in the United States of America and United Kingdom. There have been ferocious criticisms of the high remuneration packages of directors especially the chief executives and senior executives. In fact, in September 2002, the president of the United States of America Federal Reserve, Bill McDonough, attacked the high levels of remuneration for chief executives as morally dubious”.137 Consequently, most countries‟ codes now provide for remuneration of directors to be clearly set on company policy and should be linked to individual and company performance.138 It is in this regard that the Nigerian Code also makes specific provisions concerning remuneration of directors. The code requires every company to develop a comprehensive policy on remuneration for directors and senior management.139

Another issue worth mentioning which has gained international prominence is with respect to whistle-blowing. A whistleblower is an individual, usually an employee, who reports concerns about misconduct or misdemeanors by someone in an organization without the use of normal lines of reporting.140 Like codes of other countries, the Nigerian code has provided that “companies should have a whistle-blowing policy which should be

136 Section 9, SEC Code of Corporate Governance in Nigeria, 2011

137 Coyle, B. *The ICSA Study Text in Corporate Governance,*op.cit. p. 194

138 Sections B.1 and B.2 UK Combined Code, 2008; sections 2.5.5 and 2.5.10, South African Code.

139 Section 14, SEC Code of Corporate Governance in Nigeria, 2011

140 Coyle, B. *The ICSA Text in Corporate Governance,* op. cit. Glossary, p.420

known to employees, stakeholders such as contractors, shareholders, job applicants and the general public…”141 The British Standards Institute had also issued a code of practice for whistle-blowing arrangements (2008) covering the introduction, operation and review of whistle blowing arrangements within an organization.142

With all the above references and other provisions in the Nigerian SEC Code of Corporate Governance, 2011, it is abundantly clear that the Nigerian corporate governance system has tried to tow the path of international perspective of principles and general standards.

It is however, observed that in Nigeria, there are multiple Codes of Corporate Governance in existence. They are the Code of Best Practices on Corporate Governance in Nigeria which was jointly produced by the Securities and Exchange Commission (SEC) and Corporate Affairs Commission (CAC) in 2003,143 Central Bank of Nigeria (CBN) Code of Corporate Governance in Nigeria Post Consolidation, 2006 The Pension Commission (PENCOM) Code, 2008, the National Insurance Commission (NAICOM) Code, 2009 and SEC Code of Corporate Governance in Nigeria, 2011. The SEC, CAC, CBN, PENCOM and NAICOM are all government regulatory bodies in their respective sectors of the economy. The CBN Code of course applies only to institutions in the banking subsector. The Securities and Exchange Commission regulates the capital market especially with regards to dealing with securities of corporate organizations,144 while the CAC regulates incorporation and management of companies of Nigeria.145PENCOM on its part regulates the pension sector and its Code is directed at all licensed pension operators in Nigeria. NAICOM regulates the insurance industry with its code applicable to insurance companies in Nigeria.

141 Section 32.1 SEC Code of Corporate Governance in Nigeria; Section C. 3.4 UK Combined Code 2008.

142 Coyle, B. op.cit p.257.

143Preface, Code of Best Practices on Corporate Governance in Nigeria, 2003. p. 11

144 Section 13, Investments and Securities Act No. 29, 2007

145 Section 7 Companies and Allied Matters Act. Op.cit

While it may appear as if the Code of Corporate Governance of 2011 supersedes the 2003 Code of Corporate Governance by virtue of the fact that the 2011 Code was a review of the 2003 Code to address its weaknesses and improve the mechanism for its enforceability,146 there is no indication that the 2011 Code has repealed the 2003 Code. It means that the earlier 2003 Code is still in force. This is more so because the 2003 Code was made jointly by SEC and CAC which means that both of them could enforce the Code as their Code. However, the 2011 Code of Corporate Governance was produced by SEC alone. There is no indication that CAC was party to this latter Code. It means that SEC having been dissatisfied with the 2003 Code decided to produce her own Code which she can enforce. The CAC not being a party to it cannot enforce the 2011 Code. For all intent and purposes SEC has left CAC with the 2003 Code so that it is now having its own Code of Corporate Governance 2011. It means that the CBN, SEC, CAC PENCOM and NAICOM now have their respective Codes of Corporate Governance operating in Nigeria.

It has been observed that all the codes in Nigeria contain similar key elements of corporate governance which are, composition of board of directors, independent directors, multiple directorships, Board of directors committees, accountability and transparent reporting, and mandatory and self-regulatory requirements of the provisions of the Codes.147 There is however disparities in the Code requirements on these key elements. For example, on the composition of board of directors, the SEC/CAC Code of 2003 stipulates the minimum of 5 and maximum number of 15 directors, the SEC Code of 2011 provides for minimum of 5 directors without stating the maximum, the CBN Code, 2006 has no minimum but maximum number of 20 directors. The NAICOM Code, 2009

146Introduction, SEC Code of Corporate Governance in Nigeria, 2011.p. 2

147 Demaki, G .O. (2011).Proliferation of Codes of Corporate Governance in Nigeria and Economic Development. Business and Management Review vol. 1(6) pp. 4-5 [http://www.businessjouranlz.org/bmr.](http://www.businessjouranlz.org/bmr) Accessed on 15/3/2014

prescribes not less than 7 directors in the board of directors of insurance companies. On the issue of independent directors, the SEC Code, 2011 provides for at least one independent director who should be a non-executive director to be appointed on the board, while the CBN Code prescribes 2 independent non-executive directors. The PENCOM and NAICOM Codes do not have such provisions.

It is therefore, opined that a single Code of Corporate Governance that will apply to all sectors of the Nigerian economy will be better because it will carry all companies together at the same time instead of scattered and different Codes that will make other sectors to lag behind in regulation.

Many countries are presently adopting single Code of Corporate Governance. The United Kingdom that has a remarkable history of several committees reports that produced different Codes of Corporate Governance beginning with the Cadbury Code of 1992 (on financial reporting) to Greenbury Report 1995 (on directors remuneration) and Hampel Report, 1998 (on the role of the board of directors) adopted a harmonized single Code of Corporate Governance in 1998 known as the Combined Code.148 Since then it has maintained its single Code up till the current combined Code of 2008.149

The United States of America (USA) has passed its Code of Corporate Governance as a statute known as, the Sarbanes-Oxley Act, 2002 which applies generally to all U.S.A. Companies.150 In Japan it was its legislative assembly (the Diet) that passed its Commercial Code, thereby giving it a national identity and applicability. In Germany, the Code of Corporate Governance was first produced in 2002 by the German Corporate Governance Commission.151 As a government commission152 it produced a Code that was

148Coyle, B. *The ICSA Study Text in Corporate Governance*. Op. cit Pp. 262, 263, 267 and 269

149Ibid, 303

150Smerdon, R. *A Practical Guide to Corporate Governance*. Op. cit. p. 566

151Garret, A.D.

152Altman, K *Current Corporate Governance Trends in Germany.* The Harvard Law School Forum on Corporate Governance and Financial Regulation[.http://blogs.law.harvard.edu/corpgov](http://blogs.law.harvard.edu/corpgov) p. 2 of 2.Accessed on 31/8/2012.

nationalistic. It will be a step in a proper direction for Nigeria also to harmonize all the existing Codes on Corporate Governance into a single Code for effective and coordinated regulation and enforcement of corporate governance practices in Nigeria.

# CHAPTER THREE

# COMPOSITION OF BOARD OF DIRECTORS

# Introduction

The board of directors is the hallmark of corporate governance. The responsibility for ensuring compliance with or observance of the principles and provision of corporate code is primarily with the board of directors.1 The composition and structure of the board constitute an important corporate governance issue because the quality and effectiveness of the board depends largely on its configuration. Many Codes of corporate governance have specifically made provisions to guide the composition and structure of board of directors.2 The issues of board size, quality of individual directors, mix of executive and non-executive directors and independence are taken into consideration in constituting a board of directors so as to make an effective board. A consideration of these board dynamics is important to determine the effectiveness of board of directors in Nigeria.

# Structure of Company Board of Directors

The management of company‟s business as earlier stated is vested in the board of directors.3 The board is a group of persons who are duly appointed by the company to be collectively responsible for the management of the company. It therefore provides entrepreneurial leadership of the company and to be collectively responsible for its success. It is board leadership that generates the drive on which the growth of individual companies and of the economy as a whole depends. The growth or otherwise of an economy depends largely on the performance of corporate organizations within the business environment. The importance of the board cannot be overemphasized hence the

need for every company to be headed by an effective board that can purposefully take the

1 Section 1.3(b) SEC Code of Corporate Governance, 2011

2 Section 4-11. Ibid; Principles A.3, 4.1,B2.1, C3.1 The UK Combined Code of Corporate Governance, 2008; section 2.2, 2.3, 2.5, 2.7 King II Report on Corporate Governance, Code of Corporate Practices and conduct of South Africa

3 Section 63 (3) CAMA.Op.cit; Colley J.L.et al (2003) *Corporate Governance* (McGraw-Hill Companies Inc. New York) pp.14-15

company into the future. The success or failure of every company undoubtedly depends on the caliber of its board of directors. It is therefore imperative that the board should be properly configured in a manner that will make an effective board. In an ideal world, all boards of directors would comprise of diverse groups of experienced and talented individuals, all of whom would espouse and practice the characteristic and value of good commercial sense, courage, openness and integrity.

There are two types of board systems, that is the Unitary and Two-tier board systems. A unitary board is a type of board system where both the executive and non- executive members of the board consist of a single board of directors. All the members sit as one board and take collective decisions for the company.4 This is in contrast to the two-tier board system where the executive directors form the managerial board while the non-executive directors form the supervisory board. The two boards are separate and distinct and no one can be a member of both at the same time. The two-tier board system is practiced prominently in Germany5.

The board system that is practiced in Nigeria is the unitary type like in many major economies of the world where the board of directors is composed of a mix of both executive and non-executive directors6. Company statutes in almost all jurisdictions where unitary board is practiced have not actually made any distinction between executive and non-executive directors on the board despite the recognition of their different nomenclature and distinctive responsibilities in company management. For example, in Nigeria the duties of directors provided under sections 279 to 2827 apply to both executive and non-executive directors. Section 282(4) specifically makes it

4Section 43, SEC Code of Corporate Governance in Nigeria, op.cit.

5Foreword, German Corporate Governance Code (as amended May 26, 2010).deutsche.boerse.com. Accessed on 31/8/2012

6Section 43 SEC Code of Corporate Governance in Nigeria. Op.cit; Main Principle A.3 United Kingdom Combined Code, 2008; Section 2.2.1 South African King II Report Code of Corporate Practice and Conduct, 2002.

7Companies and Allied Matters Act, op.cit

abundantly clear that “the same standard of care in relation to directors‟ duties to the company shall be required for both executive and non-executive directors”. When a board takes decision they become collectively responsible for it. The board system that is practiced in Nigeria is the unitary board system,8 like the United Kingdom.9 The common features found in a unitary board are hereunder underscored.

# The Position Chairman

Every board of directors is mandated to appoint a chairman who would preside over both board and general meetings of the company. He is usually a non-executive director.10 The chairman occupies a very significant position of power and authority.11 The duties and power of the chairman are prescribed by the Companies and Allied Matters Act12 to include the duty to:

* + - 1. preserve order and powers to take such measures as are reasonably necessary to do so;
      2. see that proceedings are conducted in a regular manner;
      3. ensure that the true intention of the meeting is carried out by resolving any issue that arises before it;
      4. ensure that all questions that arise are promptly decided and
      5. act*bonafide* in the interest of the company.

The crux of the duties and powers of the chairman under CAMA is concerned essentially with conduct of meetings.

The position of chairman is further underscored by codes of corporate governance

beyond the scope of overseeing the conduct of meetings. The chairman is vested with wide range of powers and responsibilities that would enhance effective participation of all

8 Ibid

9 Report of Committee on the Financial Aspects of Corporate Governance (otherwise referred to as “The Cadbury Report”) Gee (a Division of Professional Publishing Ltd) London 1992, paragraph 4.1

10 Section 240 (1) (2) and 263 (4) CAMA op.cit

11 Section 5.1 (c) SEC Code of Corporate Governance in Nigeria, 2011

12 Section 240 (3) CAMA Op.cit

directors in carrying out their duties. These include the responsibility for leadership of the board, ensuring its effectiveness on all aspects of its role and setting agenda. He is also responsible for ensuring that the directors receive accurate, timely and clear information, effective communication with shareholders, facilitate the effective contribution of non- executive directors in particular; and ensuring constructive relations between executive and non-executive directors.13 The general trend of corporate governance round the world is that the chairman is not expected to be involved in the day-to-day running of the company.14 This is normal, because the chairman is usually a non- executive director. The fact that a non-executive director occupies the position of a chairman does not transmogrify him to executive position.

Given the importance and particular nature of the chairman‟s role he should not be a person of less caliber than the chief executive officer. He should equally demonstrate knowledge and experience in the company‟s business as well as industry, credibility and integrity, and should command the confidence and respect of the board. These qualities would enhance his leadership drive of the board. This is to avoid or limit the tendency of the chief executive officer controlling the chairman and therefore becoming a domineering power in the company. However, the code has failed to provide for a minimum standard of the quality of a person to be appointed as chairman. This gives room for any person to be appointed as chairman of the board in order to achieve some ulterior motives that may exist in the company.

# The Appointment of Chief Executive Officer/Managing Director.

13 Section 5.1 (d) SEC Code of Corporate Governance in Nigeria, 2011; Supporting Principle to the Main Principle A 2 of The United Kingdom Combined Code on Corporate Governance, 2008 (commonly referred to as the Combined Code, 2008)

14 Section 5.1 SEC Code of Corporate Governance in Nigeria, 2011; Paragraph 4.7 of the Cadbury Report.

The chief executive officer is another position that is very strong and influential on the board and of course the company. He provides leadership to the management team of the company15 which comprises of the executive directors and senior managers who are responsible for the day-to-day running of the company.16

The appointment of a chief executive officer is also backed up by statutory provision. Section 64 (b)17 provides that the board may “from time to time, appoint one or more of their body to the office of managing director and may delegate all or any of their powers to such managing director”. The term chief executive officer derives from the United States of America, but is now widely used in the United Kingdom and other countries including Nigeria where the term managing directors is also used.18

The chief executive officer is a person who is expected to be knowledgeable in relevant areas of the company‟s activities, demonstrate industry, credibility and integrity and have confidence of the board and management.19 The reason for this high expectation of the quality of the chief executive officer is of course due to the enormous functions and responsibilities vested on him. Section 5.2 (d)20 provides that:

“The functions and responsibilities of the CEO/MD should include the following:

1. day-to day running of the company;
2. guiding the development and growth of the company;
3. acting as the company‟s leading representative in its dealing with its stakeholders”

In view of the influential power and position of the chief executive officer, the new trend in almost every code of corporate governance is the clear division of

15 Section 5.2 (a) SEC Code of Corporate Governance in Nigeria Ibid

16 Section 5.1 (a) and 5.2 (d) (i) ibid

17 Companies and Allied Matters Act.Op.cit; see also section 263 (5) of the same CAMA, and section 5.2

(f) of the Code of Corporate Governance in Nigeria, 2011.

18 Coyle, B. (2009) *The ICSA Study Text in Corporate Governance*, 6thEdition (ICSA Information and Training Ltd London) p. 16; see also Section 5.2 (c) Code of Corporate Governance in Nigeria.

19 Section 5.2 (b) Code of Corporate Governance in Nigeria, 2011

20 Ibid

responsibilities between the chairman and the chief executive officer. That is to say the roles of the chairman and the chief executive officer should not be exercised by the same individual.21 The reason for such separation or division of responsibilities is to avoid over-concentration of powers in one individual so that one person does not have unfettered powers of decision, thereby robbing the board of the required checks and balances in the discharge of its duties. The wisdom in this strategy is to guide against the common saying that “absolute power corrupts absolutely”.

# The Mix of Executive and Non-Executive Directors.

In a country where unitary board of directors is practiced as is the case with Nigeria, there is a mix of both executive and non-executive directors on the board.22 Company statutes in almost all jurisdictions where unitary board is practiced have not actually made any distinction between executive and non-executive directors despite the recognition of their different nomenclature and distinctive responsibilities in company management. The duties of directors provided from sections 279 to 28223 apply to both executive and non-executive directors. In fact, section 282 (4) specifically makes it abundantly clear that “the same standard of care in relation to the directors duties to the company shall be required for both executive and non-executive directors.”

The fact that there is no clear distinction between an executive and non-executive director in company statute like the Nigerian Companies and Allied Matters Act does not mean that the two types of directors are not different especially taking into consideration their respective responsibilities in company management. In practice the executive directors are responsible for the day-to-day running of the company.24 They are

employees of the company and in most cases employed under terms of contract of

21 Section 5.1 (b), Ibid; A.2 Main Principle and A.2.1 Code Provision of the United Kingdom Combined Code, 2008; Section 2.3.1 (a) of the South African Code of Corporate Practices and Conduct, 2002

22 Section 4.3 Code of Corporate Governance in Nigeria, 2011; A.3 Main Principle, United Kingdom Combined Code, 2008; Section 2.2.1, South Africa Code of Corporate Practice and Conduct.

23 Company and Allied Matters Act, op.cit

24 Section 5.3 (b) Code of Corporate Governance in Nigeria op.cit

employment. They are employed based on the specific knowledge and experience they possess,25 as such they are referred to as technocrats in the corporate sense. Executive directors combine their role as directors with their position within the executive management of the company. That is to say, he is a director by virtue of his position in the company as an executive. Once he ceases to be in that position in the company, his directorship automatically abates.

On the other hand, non-executive directors do not engage in the day-to- day running of the company. They perform the functions of director only without executive responsibilities. Their duty is majorly to supervise the management team and scrutinize executive directors‟ activities and information to ensure proper running of the company.26 A modern non-executive director is expected to monitor the actions of the executives and of course, a company may reasonably at least look unto non-executive directors for independence of judgment and supervision of the executive management.27 The implication of the responsibility of non-executive directors is that they must play a proactive role in gathering and testing information supplied by management. Thus relying on information supplied by management would not appear to be enough discharge of responsibility.

The board of directors is expected to include a balance of executive and non- executive directors such that no individual or small group of individuals can dominate the board‟s decision taking.28 In order to achieve this principle, the supporting principle thereto states that “to ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and

25 Section 5.3 (a) Ibid

26 Section 5.4 (a) ibid

27 *Re Continental Assurance Company of London Plc*, (2001) B.P.I.R p.733; *AWA Ltd v. Daniels* (1995) 37

N.S.W.L.R p.438 and *Equitable Life Assurance Society v. Bowley and others* (2003) EWHC p.2263

28 A.3 Main Principle United Kingdom Combined Code, 2008

non-executive directors.”29 There is no similar provision to check dominance and overbearing on board decision making under the Nigerian code. However, section 4.430 provides that:

the members of the Board should be individuals with upright personal characteristics, relevant core competences and entrepreneurial spirit. They should have a record of tangible achievement and should be knowledgeable in Board matters. Members should possess a sense of accountability and integrity and be committed to the task of good corporate governance.

It may be argued that with the presence of the caliber of persons required to be on the board, no one or two individuals can claim monopoly of knowledge and experience to become a domineering force to control decision making. For all intent and purposes the Nigerian code of corporate governance requires a strong presence on the board of both executive and non-executive directors. This is arguably intended to curb the situation of an individual dominating the board‟s decision making by claiming superior knowledge and experience. A cohesive and effective board is created by a combination of a range of skills and attributes of skills acquired through a diversity of experiences and backgrounds. Identifying individuals of suitable quality and background is essential for a high performing board.

It is a common trend in corporate governance systems now that the board should consist of majority of non-executive directors.31 In some other prominent economies like the United Kingdom and South Africa for instance, majority of the non-executive directors are required to be independent (non-executive or outside) directors.

# The Concept of Independent Non-Executive Director

29 Supporting Principle, Ibid.

30 Code of Corporate Governance in Nigeria, 2011

31A.3.2 United Kingdom Combined Code op.cit; section 4.3 Code of Corporate Governance in Nigeria, 2011; Section 2.2 .1 (b) South African Code, op cit.

An independent director is one who is expected to be “free of any relationship with the company or its management that may impair, or appear to impair the director‟s ability to make independent judgments”32. In essence, he is “one who has no need or inclination to stay in the good graces of management, and who will be able to speak out, inside and outside the board room, in the face of management‟s misdeeds in order to protect the interest of shareholders.33 It has been acknowledged that the definition of independence in most corporate governance codes is exhaustive.34 For example, the criteria for determination of a director‟s independence are itemized under section 5.5(a)35. For a non-executive director to be independent he must be one who:

1. is not a substantial shareholder of the company, that is one whose shareholding, directly or indirectly, does not exceed 0.1% of the company‟s paid up capital;
2. is not a representative of a shareholder that has the ability to control or significantly influence management;
3. has not been employed by the company or the group of which it currently forms part, or has served in any executive capacity in the company or group for the preceding three financial years;
4. is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or group in an executive capacity;
5. is not a professional adviser to the company or the group, other than in a capacity of a director;
6. is not a significant supplier to or a customer of the company or group;
7. has no significant contractual relationship with the company or group and is free from any business or other relationship which could materially interfere

32Section 5.5(b), ibid. See also Definition of Independent Board of Directors. <http://www.ehow.com/>about p. 1 of 4. Accessed on 14/4/2013.

33Clarke, D.C. Three Concepts of the Independent Director.Op. cit. p. 13 of 40.

34Tricker, B. and Mallin, C. Corporate Governance: is Director‟s Independence Important? [http://corporategovernanceoup.boardpress.com.](http://corporategovernanceoup.boardpress.com/) Accessed on 14/4/2013 p. 3 of 4

35SEC Code of Corporate Governance in Nigeria

with his/her capacity to act in an independent manner; and

1. is not a partner or an executive of the company‟s statutory audit firm, internal audit firm, legal or other consulting firm that have a material association with the company and has not been a partner or an executive of any such firm for three financial years preceding his/her appointment.

The United Kingdom‟s Combined Code considers an independent non-executive director as one who is independent in character and judgment and that there are no relationships or circumstances which could affect, or appear to affect, the director‟s judgment.36 The criteria for determining a director‟s independence under the U.K. Combined Code are materially similar to those stated above under the Nigerian SEC Code. A director will not be considered independent if he:

1. has been an employee of the company or group within the last five years;
2. has or has had within the last three years a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
3. has received or receives additional remuneration from the company apart from a director‟s fee, participates in the company‟s share option or a performance-related pay scheme, or is a member of the company‟s pension scheme;
4. has close family ties with any of the company‟s adviser; directors or senior employees;
5. holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
6. represents a significant shareholder; or
7. has served on the board for more than nine years from the date of their first election.37

36 Section A. 3. 1 Code Provision, U.K. Combined Code, 2008

37 Ibid, See also Tricker, B. and Mallin, C. op. cit.

In the United States of America, the New York Stock Exchange (NYSE) states that “a director will qualify as “independent” only if… the director has no material relationship with the company (directly or as a partner, shareholder or officer of an organization that has a relationship with the company”)38. The National Association of Securities Dealers Automated Quotations (NASDAQ) Rules define an independent director to mean “a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.”39 The criteria for determining a director‟s independence are materially similar to those enumerated above under the Nigerian and UK requirements. Similar definitions and criteria for determining an independent director are provided in the codes of corporate governance of other countries like Mexico, Japan and South Africa.40

The above criteria for determination of an independent non-executive director as epitomized in the various codes and principles of corporate governance, show the existence of a common perspective on the meaning of independent director. For all intent and purposes, he is a person who does not hold any interest in the company in form of financial or business relationship with the company or its management.41 He is simply a director and paid for performing his duties especially in form of allowances for attending board and or committee meetings.

The concept of independent director is different from directors who are ordinarily referred to as non-executive directors, outside directors and disinterested directors. The non-executive directors are members of the board who do not hold managerial position in

38 Section 303 A.02 NYSE Manual.

39 Section 4200 (a) (15) NASD Rules

40 Corporate Governance Code for Mexico[.www.ecgi.org/codes/document/mexico-code-en.pdf. p.4](http://www.ecgi.org/codes/document/mexico-code-en.pdf.%20p.4) of 14. Accessed on 4/9/2012; Principle 4.2 Japan Revised Corporate Governance Principles, and section 2.4.3 (iii) South Africa King II Report Code of Corporate Practice and Conduct.

41 Signh, S. K. (2012) Corporate Governance and Independent Directors: An Analysis. Op. cit p. 6 of 12.

the company. The board of directors of companies in Nigeria and other countries like United States of America, United Kingdom and South Africa are required to comprise of a mix of executive and non-executive directors.42 Non-executive directors who are on the board do not satisfy the independent criteria. They are essentially appointed based on their major shareholding or business link with the company. It is the need to ensure independence of the board to check conflict of interest transactions that brought about independent non-executive directors who will not have vested interest in the company to promote to be included on the board.

The concept of outside director is similarly different from independent director. The outside director is one “who is not a company employee without regard to whether he meets a standard of independence.”43 Some Codes of corporate governancemake mention of outside directors. For example, in Japan an outside director is defined as “someone who is not and has never been a full-time director, executive, or employee of the company or its parent company, subsidiaries or affiliates (collectively, the company etc.)44 This definition does not exclude those who personally or through their employer do a large amount of business with the company, and thus does not match most definitions of independence.45 It means that they can be outside directors but not independent. It is against this notion that the same Codegoes further toprovide for independent director among the outside directors who should be completely independent from management and without interest in respect to the company.46 The idea of outside director for all intent and purposes is coterminous with the concept of non- executive directors. They are often used interchangeably.

Another term that is capable of misconception is the idea of “disinterested director” which is used mostly in state corporate statutes in the United State of America.

42 Section 4.3 SEC Code Of Corporate Governance in Nigeria, 2011; Section A. 3 Main Principle U.K. Combined Code on Corporate Governance, 2008; Section 2.2. South Africa King II Report on Corporate Governance, 2002

43 Clarke, D. C. (2007) Three Concepts of the Independent Director. Op. cit. p. 8 of 40.

44 Principle 4.1 Revised Corporate Governance Principles in Japan.

45 Clarke, D. D. Op. cit p. 9 of 40

46 Principle 4.2 Revised Corporate Governance Principles in Japan; Clarke, D. C. (2007) ibid. p. 9 of 40.

For example Delaware General Corporation Law does not provide for the institution of independent directors as such or define them. Instead, it focuses on conflict-of-interest transactions between a corporation and one of its directors or officers, or between a corporation and another entity in which one of its directors or officers has an interest.47

Where there is a transaction with the company and one or some directors have interest in the transaction, the other directors who do

not have interest in the transaction are referred to as disinterested directors. In such a situation, the interested directors are required to disclose their interest to the board and the disinterested directors would be the ones to consider the transaction whether or not to approve it. Where, the whole board has conflict of interest, the board would make disclosure to the shareholders to approve the transaction.48 The approach for disinterested directors is determined based on each transaction. A director may be disinterested in one transaction but may not be in another one. There are therefore no specific directors on the board that are said to be disinterested

or independent. The concept of disinterested directors is not synonymous with independent directors.

# The Role of Independent Non-Executive Director

Independent directors have long been viewed as a solution to many corporate governance problems49. They are considered as one of the most critical pillars of corporate governance50. It is widely accepted that the presence of independent directors in the boardroom improves the quality of corporate governance.51 Their role is to bring external and unbiased inputs which can bring a new and independent perspective, thereby giving a fillip to overall quality in governance52. On the other hand it has been argued that “the mere fact that boards have independent directors does not guarantee that the directors will function independently”53. Some studies were said to have revealed that “there is no solid evidence suggesting that independent directors improve corporate performance.”54

47 Clarke, D. C. ibid. p. 31 of 40.

48 Ibid Pp. 32 and 33 of 40. See also *Marciano v Nakash* (Del. 1987) 535 A. 2d 400, 405; *Code & Co. v.*

*Technicolor* (Del. 1993) 634 A. 2d 345, 366.

49 Clarke, D. C. Three Concepts of the Independent Director. Op. cit. p. 2 of 40.

50 Singh, S. K. Corporate Governance and Independent Directors; As Analysis, Op. cit. p. 6 of 12.

51 Ibid.

52 Ibid

53 Singh, S.K. Corporate Governance and Independent Directors: An Analysis. Op. cit. p. 7 of 12.

54 Clark, D. C. Three Concepts of the Independent Director. Op.cit. p. 4 of 40.

The Nigerian SEC Code of Corporate Governance has not specified any particular role to be performed by an independent non-executive director. However, as a non- executive director the responsibilities of non-executive directors generally apply to him. Under codes of corporate governance, non-executive directors are required to “bring independent judgement as well as necessary scrutiny to the proposals and actions of management and executive directors especially on issues of strategy, performance evaluation and key appointments”55. Even though they are required to exercise independent judgement in decision making, if a non-executive director is not independent he may not likely exercise independent judgement because of his vested interest. It is in view of the fact that non-executive directors could be non-independent that makes the need for the presence of independent non-executive directors in companies to bring their independence to bear on company decision making process.

The fact that directors have a legal duty to act in the best interest of the company56 is not a guarantee to give full assurance that potential conflicts will not impair objective board decision-making. A group of non-executive directors with no other connection with the company apart from being directors (regarded as independent) are better placed to bring dispassionate objectivity that directors with a closer relationship to the company cannot provide. Providing objective independent judgement is at the core of the board‟s oversight function. The independent non-executive directors provide an unbiased and uninfluenced judgement on issues presented before the board. Their role contributes significantly in fostering checks and balances in the affairs of the company. They help to diffuse the tendency of other directors who have interest in the company from fostering and projecting their personal interest above the interest of the company and other

55Section 5.4(a) SEC Code of Corporate Governance in Nigeria, 2011; Section 5(1) SEC/CAC Code of Best Practice on Corporate Governance in Nigeria, 2003

56Section 279 (3) (4) Companies and Allied Matters Act, Cap. C20 Laws of the Federation of Nigeria (LFN), 2004.

stakeholders. The absence of truly independent non-executive directors can affect the company‟s overall outcome. The directors would tend to do things that satisfy their personal interest.

In as much as the role of independent directors is very crucial to corporate governance, the problem is whether they are effective in discharging their roles. The question is whether the independent directors are duly qualified and willing to act as independent directors. Qualification here refers to knowledge, experience, insight and skill and industry expertise to enable them ask the right questions. Willingness portends

enough courage to voice genuine concerns and constructively challenge executive decisions.57The *onus*of acting independently actually rests with the individual. As a matter of fact the character of integrity plays a significant role in the way and manner an independent director would act. If a director is truly independent but lacks the ability

to challenge other directors, his independence would be of no effect.

In contrast to the postulation that independent non-executive directors on the board serve better to protect the interest of the company; it can be argued that since the independent director does not have a stake in the company which he stands to risk should the company fail, except his sitting allowances, he may not be quite vehement and selfless in pursuing the cause of the company. It is a good reason to say that those who have material interest in the company like major shareholders and those who have business and financial link with the company as directors would ordinarily do everything possible to ensure the success of the company in order to sustain their interests. However, it is the likelihood of promoting the personal interest to the detriment of the interest of other stakeholders that calls for the introduction of independent directors to check the tendencies of such conduct in the company.

The fall of Enron Corporation in the United States of America in 2002 was among other issues, linked to the lack of independence of its directors. From the outside

57 Singh, S. K. Corporate Governance and Independent Directors: An analysis. Op. cit. p. 8 of 12.

appearance it seemed Enron indeed had an independent board, as it had only one executive director. The rest were non-executive directors.58 However, it was discovered that majority of the directors had financial and business ties with Enron which seemed to have compromised their objectivity in their oversight of the company. It was argued that their relationships with Enron may have made it difficult for the board members to be objective or critical of Enron management. The non-executive directors did not question, but deferred to the company‟s management. They had been in the habit of bargaining over executive compensation and so did not have the moral audacity because they too were benefiting from business and financial ties with the company. This is likely the reason why it was discovered that Enron management received compensation beyond the norm.59 The board did not give enough consideration when making important decisions and they were too quick to approve proposals put forward by management.60 The Enron management and board members resorted to rewarding themselves and forgot about the interest of the company and shareholders. There was no independent voice on the board to challenge board decisions. The collapse is an indication that a company that does not have sufficient independent directors on the board is prone to suffer in the hands of directors who tend to protect their own interest against the interest of the company. The interest of the company and other stakeholders would obviously be jeopardized. The consequence would be the failure of the company.

The Nigerian SEC Code of Corporate Governance provides that “the board should comprise a mix of executive and non-executive directors… at least one of whom should be an independent director”61 The implication of the above provision is that in Nigeria, a company may have all directors on its board who are not independent except one.

58 Munzig, P.G. (2003) Enron and the Economics of Corporate Governance*.* Op. cit. p. 29.

59 Ibid. Pp. 6 and 30

60 Ibid. p. 7

61 Section 4.3 and 5.5. (c) SEC Code of Corporate Governance in Nigeria, op.cit

Directors, who are not independent of the management and the company, and who have personal or vested interest which they wish to protect, may do so to the detriment of the company and other stakeholders. The tendencies of non-independent directors who are in a majority on the board to resort to rewarding themselves exist potentially.

In a board where all the directors except one is independent who are poised to taking a particular decision, the single independent director cannot do anything to change the decision of the majority members. The Companies and Allied Matters Act provides that decisions of the board are taken by majority vote of the members. Section 263 (2)62 under proceedings of directors explicitly states that “any question arising at any meeting shall be decided by a majority of votes…” The single independent director invariably becomes an inconsequential voice in the decision-making of the board. In essence he is merely on the board to fulfill the requirement of the Code without actually achieving the objective of promoting good corporate governance on the company‟s board by way of entrenching objective decision making process.

The only way an independent director can afford to sway board decision to do what he considers appropriate in the circumstance is to be courageous enough to threaten the board that he will publicize and report to regulatory authorities the wrong intended to be done by the board. The board for fear of the consequence of regulatory sanction and bad image to the public will change their decisions.

* + 1. **The Position of SEC Code of Corporate Governance on Independent Director** The SEC Code of Corporate Governance took positive steps to align with international best practices in the area of composition of the board of directors. Like codes of corporate governance in other countries especially OECD member countries like the UK, USA, and the SEC Code has provided that “the majority of Board members

62 Companies and Allied Matters Act, op. cit.

should be non-executive directors.”63 This provision is an improvement from the earlier Code of Best Practice on Corporate Governance64 which did not mandate that majority of board members should be non-executive directors. It simply required the board to comprise of a mix of executive and non-executive directors.

The SEC Code, however, deviated from the general trend of requiring majority or significant number of the non-executive directors that constitute the board to be independent directors. The SEC Code provides that at least one of the non-executive directors should be an independent director.65 The SEC Code having been produced far after the OECD Principles (2004) and other prominent codes in countries like the United Kingdom66 and United State of America,67 it is believed in this paper that SEC might have taken into consideration the peculiarity of the economic, social, legal and cultural circumstances68 of Nigeria in requiring at least one independent director on the board.

The position of the SEC Code for majority of non-executive directors with one independent director can provide effective decision making body where the non-executive directors bring their independent judgment and objectivity to bear on the scrutiny of proposals and actions of the management. In the case of *Bernard OJeifoLonge v. First Bank of Nigeria Plc*,69 the plaintiff was appointed the managing director/chief executive of the defendant on 24/02/2000. Before that date, the plaintiff had been the defendant‟s executive director. Following an improper grant of loan to a customer of the defendant, the plaintiff was on 22/04/2002 suspended by the defendant‟s board of directors, and on 13/06/2002 his appointment was terminated. Even though the crux of the plaintiff‟s case was the failure to serve him with notice of the meeting which his appointment was

63 Section 4.3 SEC Code of Corporate Governance in Nigeria, 2011

64 Which was produced jointly by the Securities and Exchange Commission and Corporate Affairs Commission in 2003.

65 Section 4.3 SEC Code of Corporate Governance. Op cit.

66 Combined Code, 2008

67 Sarbanes-Oxley Act, 2002

68 Preamble, “OECD Principles of Corporate Governance” OECD Publications Service, Paris-France, 2004

69 (2010) ALL FWLR (pt. 525), p. 258 at 279 paragraphs F-G.

terminated, the lesson to be learnt in the circumstance of the case is that the non-executive directors are capable of taking far reaching decisions that border on executive actions.

The role of non-executive directors in promoting corporate governance is indeed to “bring independent judgment and necessary scrutiny to the proposals and actions of management and executive directors especially on issues of strategy, performance evaluation and key appointments.70 The action taken by the non-executive directors in Longe‟s case above was necessary to check the impropriety of the action of the chief executive of the company. This is a situation where the non-executive directors were unbiased and therefore could exercise objective and independent judgment. In this circumstance, the provision of the SEC Code that majority of the board members should be non-executive directors with at least one independent director may provide objectivity in decision taking of the board.

The problem, however, is where the non-executive directors are not independent, that is, they have interest in the subject for which the board is to take decision. For instance, in Longe‟s case (supra), if the non-executive directors had interest or had compromised their independence in the transaction which brought the chief executive into scrutiny, they would not have been able to take the drastic actions they took to terminate his appointment. In a situation where all the non-executive directors are not independent except the minimum one that is mandatorily required by the SEC Code to be independent, he cannot defeat the decision of the rest of the directors. It is in this regard that the provision for at least one independent director at the board appears to be insufficient to deal with conflict of interest transactions because in most cases non-executive directors do not meet the independent criteria.

# Size and Balance of Board of Directors

70 Section 5.4(a) SEC Code of Corporate Governance. Op cit.

The issue of board balance and independence is also raised by various principles and codes of corporate governance. The OECD principles say “the board should be able to exercise objective independent judgment on corporate affairs”.71 More succinctly put, “the board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board‟s decision taking.”72 Similarly stated “the board should ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, *inter alia*, usually reflected by separating the roles of the chief executive officer and chairman, and by having a balance between executive and non-executive directors”.73 The South African Code also provides for “a balance of executive and non-executive directors, non- executive directors should comprise the majority, sufficient non-executive directors should be independent directors, a division of responsibilities between CEO and chairperson to ensure no one has unfettered power or authority”.74

The German Corporate Governance Code on its part stipulates that “to permit the Supervisory Board‟s independent advice and supervision of the Management Board, the Supervisory Board shall include what it considers an adequate number of independent members.”75 In Japan, it is recommended that “the board of directors should be comprised of outside directors (directors who are not also executives or employees)” and that “the majority of the board of directors should be comprised of outside directors”76 some of these outside directors are expected to be independent directors.77

71 Principle VI (E), OECD Principles. op cit

72 Principle A3 United Kingdom Combined Code of Corporate Governance. Op cit.

73 Principle 9, Principles for Corporate Governance in the Common Wealth Op cit.

74 Sections 2.2.1(a) (b)(c) and 2.3.1(a) and (b) South African Code of Corporate Practice and Conduct. Op. cit.

75 Section 5.4.2 German Corporate Governance Code

76Principle 3(2) and (3) Revised Corporate Governance Principles of Japan

77Principle 4(1) and (2) ibid

In Canada also the changes in corporate governance now require public companies to have a majority of independent directors and that possibly the board chairperson should be an independent director.78 Canadian public companies listed on the Toronto Stock Exchange must have a board of directors composed of at least three independent directors in order to satisfy corporate and securities laws requirements for an audit committee composed of at least three directors, all of whom are independent.79 Even countries like India with recent history of securities regulations under clause 49, a mandatory stipulation that independent non-executive members of the board of directors should comprise at least half of a board if the chairperson is an executive director, but where the chairperson is a non-executive director at least a third of the board should consist of non-executive directors.80

To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and non- executive directors. In defining independent members of the board; some national principles of corporate governance have specified quite detailed presumptions for non- independence which are frequently reflected in listing requirements. While establishing necessary conditions, such as “negative” criteria defining when an individual is not regarded as independent can usefully be complemented by “positive” examples of qualities that will increase the probability of effective independence. Independent board members can contribute significantly to the decision-making of the board. They can bring an objective view to the evaluation of the performance of the board and management. In addition they can play an important role in areas where the interests of management, the company and its shareholders may diverge.

78Binch, M. Corporate Governance in Canada. Op.cit. p. 2

79Ibid. p. 5

80 Chakrabarti, R; Megginson, W. L. and Yadar, P G (2007)Corporate Governance in India, *Journal of Applied Corporate Finance*. p.14

Genuinely independent directors are less likely to defer to the chief executive officer and more likely to bring broader and objective views to board deliberations. Independent directors could also be effective monitors of executive management. If a director is connected to management personally or in business, he or she can easily be influenced into rubber-stamping management decision.81

The size of board of directors is becoming an important factor of an affective board. The United Kingdom Combined Code specifically provides that “the board should not be as large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board‟s composition can be managed without undue disruption”.82 What amounts to sufficient size is not defined by the said code but it is meant to be determined by the complexities and requirement of the company‟s business. Just as a large board is bound to be counter-productive, a tiny board will equally be constrained and therefore become ineffective. There is therefore the need to determine what amounts to sufficient size that is neither too small nor large in practical terms.

The Companies and Allied Matters Act has left the determination of the number of directors to constitute a board to individual companies. Section 249(3)83 accordingly states that “the directors may increase the number of directors so long as it does not exceed the maximum allowed by the articles, but the general meeting shall have power to increase or reduce the number of directors generally”. However, the minimum number of directors to constitute a board has been stated to be two. Section 24684 categorically states that “every company registered on or after the commencement of this Act shall have at least two directors….” This provision says “every company‟ irrespective of whether the

81Holcomb, J. M. (2004) Corporate Governance: Sarbanes-Oxley Act, Related Legal Issues, and Global Comparisons.*Heinonline 32 Denver Journal of International Law and Policy*, p.180

82 Supporting Principles to Main Principles A.3, Combined Code, 2008

83 Companies Allied Matters Act, op.cit

84 ibid

company is private or public, small or big. It means that any company can lawfully operate with only two directors even though the number may be insufficient to carry on the business of the company. This may have the effect of jeopardizing the company‟s business and consequently investors‟ fund.

The critical issue with the statutory minimum threshold of two directors is whether a public company can effectively operate in view of the increasing requirements by statute and codes of corporate governance in conformity with international best practices. There are increasing recommendations for the establishment and composition of various board committees to enhance good corporate governance. For instance, in the United Kingdom its code requires that both the remuneration and audit committees have at least three independent non-executive directors respectively.85 The Nigerian code also directs the establishment of governance/remuneration committee which should be comprised solely of non-executive directors,86 however, without stating the minimum membership of the committee. As for the statutory audit committee, it is mandatory for every public company to establish it.87 The said audit committee “shall consist of an equal number of directors and representatives of the shareholders of the company (subject to a maximum number of six members)…88 In view of all the above obligations of the board, it is quite unrealistic to imagine that a public company or a big company can effectively be managed by a board of two members even though they may be within the ambit of the law. But the provision for minimum of two directors is a legal leeway which mischievous corporators can use to sit on and control other people money invested in the company without necessarily meeting up with investors‟ expectations.

85 B.2.1 and C.3.1 Combined Code op.cit

86 Section 11.1 SEC Code of Corporate Governance in Nigeria 2011

87 Section 359 (3) Companies and Allied Matters Act, op.cit

88 Section 359 (4) Ibid

The Nigerian SEC Code of Corporate Governance, however, provides for membership of the board not to be less than five.89 This code provision appears to contradict the statutory provision of the Companies and Allied Matters Act (CAMA), which stipulates the minimum number of two directors for every company. The CAMA is the principal law governing companies in Nigeria. However, Section 7 (2) of CAMA has recognized the powers, duties and jurisdiction of the Securities and Exchange Commission (SEC) under the Investments and Securities Act to do certain things that the general superiority of the CAMA in company matters would not be affected. In view of the above the SEC Code provision for minimum of 5 board members exceeding the minimum 2 members provided by the CAMA is not actually intended to create contradiction. It is for all intent and purpose to discourage companies from maintaining a tiny board of directors that would be constrained in exercising effective corporate governance at the level of board of directors.

Be that as it may, the current practice in the United Kingdom is that the average size of its listed companies is seven, comprising three executive directors and three non- executive directors and a chairman. But the average top 100 companies‟ board is generally bigger with an average of twelve members of whom six are non-executive directors, five are executive directors and one is chairman.90 Some commentators have suggested that ideal decision making body is between eight to ten members.91

Given the above analysis, it is opined here that a company with a board size beyond fifteen members is large by all standards. The reason simply is that despite the mega companies in the United Kingdom, their boards do not exceed twelve members but they are still operating effectively. As for the minimum number, it is suggested here that seven directors for public companies especially listed companies would be ideal. This

89 Section 4.2, SEC Code of Corporate Governance

90 Smerdon R .*A Practical Guide to Corporate Governance* op.cit p52

91 Ibid

will give room for the board to constitute the mandatory and necessary board committees that are required for the promotion of good corporate governance.

# Qualities for Appointment as Directors

The board of directors is a collection of individuals each with his or her views, interests and concerns. The character and integrity of individuals also differ. Some people have good moral integrity while others are given to inherent turpitude, corruption and dishonesty. It is not every person, though with high experience, skill and knowledge that is a proper candidate for appointment as a director. The caliber of persons to be appointed as a director of public companies should possess the character and qualities that are above board. They should also be suitable for the position of director on the board. These yardsticks would determine at least to some greater extent the right persons to constitute a responsible and competent board of directors. The factors that are necessary to be considered for appointment of a director which would constitute an apparent effective board of directors are hereunder discussed.

# Character Required of Directors

There is no gain saying that honesty and integrity are crucial characteristics expected of any person to be entrusted with leadership responsibilities and management of assets other than their personal assets. Of course, directors are appointed to lead and manage the assets of the company in which people have invested their resources. In practical terms, directors manage the funds invested by others in the company on their behalf. Therefore those to be appointed to the board of public companies should possess the qualities of honesty and integrity. They should be persons who will act in an ethical way in business and relationship with the company. Persons who are known to be dishonest and immoral or have such tendencies should not be permitted to become directors.

The requirement for personal integrity applies not only to individual directors, but also to the board of directors as a collective body. The decisions they make should take into account ethical issues and issues of good governance.92 It is against this backdrop that sections 257 (c) and 25493 disqualify and restrain fraudulent persons from being appointed as directors. Section 254 in particular provides that:

Where-

* + - 1. a person is convicted by a High Court of any offence in connection with the promotion, formation or management of a company; or
      2. in the course of winding up a company it appears that a person:-

1. has been guilty of any offence for which he is liable (whether he has been convicted or not) under section 506 of this Act; or
2. has otherwise been guilty, while an officer of the company, of any fraud in relation to the company or of any breach of his duty to the company,

the Court shall make an order that that person shall not be a director of or in any way, whether directly or indirectly, be concerned or take part in the management of a company for a specified period not exceeding 10 years.

The above provision offers the basis for creation of appropriate mechanism and process of selection and appointment of rightful directors. The emerging trend now is the constitution of a nomination committee who has the responsibility of searching for and selecting the right persons to be appointed as directors.94 The principle behind the creation of the nomination committee is to provide a formal, rigorous and transparent procedure for the appointment of new directors on the board. The essential factors to consider in trying to get the right candidates is to scrutinize the tract record of every nominated person for directorship. Records of him/her can be obtained from every place he/she had worked before to find out his personal integrity.

92 Coyle, B. op cit p.76

93 Companies and Allied Matters Act, op.cit

94 A.4.1 United Kingdom Combined Code, 2008

Unfortunately, in most cases this requirement of honesty and integrity is generally overlooked in practice. It is on record that weak corporate governance has been responsible for some recent corporate failures in Nigeria.95 Directors are usually responsible for corporate malfeasance. In the year 2009 the Central Bank of Nigeria sacked five chief executives of banks96 for unethical grant of loans that almost distressed the banks but for the timely intervention of the Central Bank. An example of corporate malpractice by directors was revealed in 2006 when SEC received the Annual Reports and Accounts through its Administrative Proceedings Committee (APC) hearing discovered that from 2002 to 2005 the directors of Cadbury Nigeria Plc “used stock buy banks, cost deferrals, trade loading and false suppliers stock certificates to manipulate its financial reports that were issued to the public and filed with the Commission.”97 An undisclosed offshore account was maintained and operated by the company from which… executive directors were paid offshore remunerations without the approval of the committee responsible for fixing remunerations of executive directors and not recorded in the company‟s financial report and account.”98 In addition, the APC findings revealed that the board of directors and the audit committee members in 2005 “authorized the issuance of a Rights Circular which contained untrue Statements”99 The SEC meted the company and its directors with various categories of punishments. The company was fined to pay money. Some directors were banned from holding directorship positions in public companies in Nigeria completely while others were banned for 3 years and one year respectively.

95 Introduction: Code of Corporate Governance in Nigeria, 2011, see also Bolo Edet, EFCC Arrest 3 Sacked Bank Chief. Daily Trust, Wednesday August 19,2009 Pp1 and 5

96 Habeeb, I and Nasiru L.A Troubled Banks: Dangote, Otedola among Debtors. Daily Trust. Ibid, Pp.1 and 5, the banks affected were Intercontinental Bank, Oceanic Bank, Union Bank, Fin Bank and AfriBank.

97 Oloyi, L. (2008). “SEC Sanctions Cadbury over Misstatements in Published Accounts,” *Journal of the Nigerian Securities and Exchange Commission*, Vol. 4.No. 2. p. 6

98 Ibid

99 Ibid

Another example which happened in the United Kingdom is exemplified by the case of Robert Maxwell. At one time, he owned Pergamon Press, which was the target of a failed takeover bid in 1969. Following this, the Department of Trade and Industry (DTI) carried out an investigation in Maxwell‟s businesses. The resulting report (1971) stated: “we regret having to conclude that, notwithstanding Maxwell‟s acknowledged abilities and energy, he is not in our opinion a person who can be relied on to exercise proper stewardship of a publicly quoted company.” Maxwell eventually revived his business career, buying the British Printing Corporation in 1980, and building up a publishing and media empire in the 1980s that eventually included Mirror Group Newspapers, US publisher Macmillan and the New York Daily News. Mirror Group Newspapers obtained a stock market listing, but other companies in the group remained privately owned. In spite of the 1971 DTI report, he received enthusiastic backing and funding from investment institutions and bankers. In November, 1991 Maxwell died in mysterious circumstances, drowning whilst cruising off the canary island. Investigations found that he had misappropriated about £900 million from the pension funds of his companies, using the funds to finance his corporate expansion and support his ailing private companies. The Maxwell companies were forced to file for bankruptcy protection in the United Kingdom and United States in 1992100. If the DTI report about Maxwell‟s credibility and integrity was considered, he wouldn‟t have been put in a position to manage other people money.

The above incident serves as an eye opener to prompt industry sector regulatory bodies to regularly conduct investigations into the activities of corporate organizations and their operators and publicize reports. Such reports would provide additional information for consideration on the fitness of a candidate for directorship. The cases of the aforementioned five chief executives of banks that were sacked by the Central Bank

100 Coyle, B. Op.cit p.76

of Nigeria and prosecuted by the Economic and Financial Crimes Commission for unethical business conduct provide a good ground to disqualify them from being directors thereafter.

The Securities and Exchange Commission in exercise of its regulatory powers punished the directors that were indicted by its Administrative Proceedings Committee in the Cadbury Nigeria Plc Corporate governance abuses afore said. The affected directors were banned or suspended from operating in the Nigerian capital market, being employed in the financial services sector and holding directorship positions in any public company in Nigeria for various periods of time respectively.101 The action taken by SEC against the Cadbury directors was commended by stakeholders in the capital market and it was said that the punishments would serve as a deterrent to directors of other quoted companies.102 It is opined in this work that if other regulatory bodies is the Nigerian Corporate environment emulate the SEC by taking drastic punitive measures against errant directors of public companies and their actions publicized, it can make company directors to be more cautious and careful in what they do. Many directors might not what their names published and associated with fraudulent activities. They may want to avoid what might be regarded as scandal. This will go a step further to reduce cases of corporate

malpractices.

# Suitability, Knowledge and Experience of Directors

Suitability of a person to be appointed on the board is determined by the role and capabilities required to be performed. That is to say, suitability depends on the individual‟s contribution to the decision making capability of the board. In this regard, it is expected that the board of directors should possess a breadth of experience, skills and

101 Oloyi, L. (2008) op. cit. p. 9.

102 “SEC‟s Action in the Eyes of Stakeholders as Reflected in Media” *Journal of the Nigerian Securities and Exchange Commission*, 2008. Op. cit. Pp. 11-14

knowledge.103 Where two persons possess similar skill and knowledge which would result to performing essentially the same thing as each could do, it would of course be unreasonable to appoint the two persons on the board. For example, a public company that carries out major contract work for the military might decide to appoint a retired senior military officer on the board, for his experience and knowledge on how the military works. It would be unreasonable to appoint two of such individuals on the board.

Taken as a body, the board should have an appropriate mix of skills and experience that would enhance its effective decision capability. It is the range of skills and attributes of skills acquired through a diversity of experience and backgrounds that combine to create a cohesive and effective board. Identifying individuals of suitable quality and background is essential for a high performing board. The Tyson report argued that:

diversity on the background, skills and experience of NEDs enhances board effectiveness by bringing a wider range of perspectives and knowledge to their honest use of company performance, a strategy at risk. Diversity can also send a positive and motivating signal to customers, shareholders and employees and can contribute to a better understanding by the company‟s leadership of the diverse constituencies that affect its success.104

In a similar vein, the Nigerian SEC Code of Corporate Governance recommends that the board should… be composed in such a way as to ensure diversity of experience…”105 Accordingly, individual executive directors also should be suitable to hold their position on the board of a public company. For example, it would be quite apt to expect the finance director to be a qualified accountant with a tract record in finance, accountancy or auditing work.

103 Coyle, B. Op.cit p.75

104 The UK Tyson Report on the Recruitment and Development of Non-Executive Directors, June 2003. See also Smerdon, R. *A practical Guide to Corporate Governance*, op.cit p.57

105 Section 4.1 Code of Corporate Governance in Nigeria, 2011

From the foregoing discussion, there is therefore no gainsaying that knowledge and experience is a very significant prerequisite for appointment of a person as a director, including non-executive directors. The aim is to improve the quality of their contribution to decision making by the board. Even though the importance of knowledge and experience has been underscored by the Nigerian SEC Code of Corporate Governance, it has failed to indicate the categories of persons who are considered to have the requisite knowledge and experience to qualify for appointment as a non-executive director.

There is however, a general consensus that the experience and qualities required of a non-executive director can be obtained from working in other industries or in other aspects of commercial and public life.106 Accordingly, the under mentioned individuals have been considered apposite for appointment as non-executive directors. They include individuals who:

1. “are executive directors in other public companies.
2. hold NED position and chairmanship position in other public companies.
3. have professional qualifications
4. have experience in government as politicians or former senior civil servants.”107

It is expected that non-executive directors of the above mentioned calibers would be able to bring judgment and experience to the deliberations of the board that the executive directors on their own would lack particularly in the area of strategy and business development. In view of this requirement a non-executive director must be one that possesses the expertise and knowledge to discharge his responsibilities. He must be well informed about the business, the environment in which it operates and the issues it faces. This also requires knowledge of the markets in which the company operates.108

106 Coyle, B. op.cit p.96

107 Ibid

108 Smerdon, R. Op.cit p.130

In addition to the background knowledge and experience of a person before his appointment as a director, many codes of corporate governance enjoin companies to ensure that newly appointed directors receive induction or formal orientation programme to familiarize them with the company and its business.109 In order to keep directors abreast with the ever dynamic business environment, they are mandated to continually develop and increase their knowledge and experience. Accordingly, section 18.2110 provides explicitly that:

It is mandatory for all directors to participate in periodic, relevant, professional continuing education programmes in order to update their knowledge and skills and keep them informed of new developments in the company‟s business and operating environment. The objective of the training is to assist the directors discharge fully and effectively their duties to the company.

In an attempt to achieve the objective of directors continuing education, there have been established in many countries including Nigeria, Institute of Directors to provide professional director training at different levels. The different cadres include membership, fellowship and chattered-ship of the institute. There are also business schools that offer courses on board development programmes.111 Apart from these professional courses, a director can increase his knowledge by furthering his academic qualification and acquiring additional certificate or degree that is relevant to enhance the performance of his responsibility as a director. Those qualifications are obtainable from academic institutions like universities and polytechnic that offer relevant courses.

The interesting thing about the continuing education is that it is made to be at the company‟s expenses.112 This is an incentive to facilitate and ensure that directors possess the necessary knowledge and experience that would make them perform their

109 Section 18.1 Code of Corporate Governance in Nigeria Op.cit. A.5.1 U.K Combined Code, 2008; 2.4.6 South Africa Code of Corporate Practice and Conduct, 2002.

110 Code of Corporate Governance in Nigeria, 2011

111 Smerdon, R. Op.cit p.65 such Institutes include: Institute of Chartered Secretaries and Administrators

112 Section 18.2 Code of Corporate Governance in Nigeria, op.cit

responsibilities effectively as directors. Given these provisions there is no reason why a non-executive director should be inept in the performance of his duties.

# Board Committees That Are Common In Many Countries

The Companies and Allied Matters Act has mandated the board of directors to create committees consisting of its members who will carry out specific functions of the board as may be delegated to them. Section 64113 provides thus: “---the board of directors may – (a) exercise their powers through committees consisting of such members of the body as they think fit.” Similarly, section 263 (5)114 says that “the directors may delegate any of their powers to… committees consisting of such members or member of their body as they think fit and… any committee so formed shall, in the exercise of the power so delegated, conform to any regulations that may be made by the directors”. The establishment of any committee of the board of directors depends on the needs and complexities of the company. There is no specific kind of committee recommended. However, section 359(3)115 requires, in case of public companies, the establishment of an audit committee. Thus the audit committee has been made to be a statutory mandatory committee of the board.

In the same vein, the Code of Corporate Governance in Nigeria states generally that “the board should determine the extent to which its duties and responsibilities should be undertaken through committees…“116 Section 9.2117 proceeds to recommend among other committees that the board may deem necessary in addition to the statutory audit committee to establish “a Governance/Remuneration committee and Risk management committee”. Another board committee that is gaining wide acceptability is the nomination committee. This committee becomes necessary due to much criticism which centers on

113 CAMA Cap.C20 LFN 2004

114 Ibid

115 Ibid

116 Section 9.1 Code of Corporate Governance in Nigeria 2011

the fact that most non-executive directors (NED) appointments come from a fairly small circle of successful businessmen, many of whom know each other instead of casting the net much wider and choosing individuals from more diverse backgrounds.118

It is therefore obvious that corporate governance recognizes the importance and necessity of three essential committees to be established by the board of directors. They are: the audit committee, remuneration committee, and nomination committee. These committees will be distinctly considered to see their significance to good corporate governance.

# The Mandatory Audit Committee

The establishment of audit committee and the appointment of external auditor is a common standard required by all codes of corporate governance.119Other countries like Germany, Canada and Japan have respectively provided in their codes and principles of corporate governance the establishment of audit committees.120The common trend across many countries now is to prescribe its composition of essentially independent non- executive directors. The essence is to provide for significant level of independence of the audit committee in the discharge of its functions. The audit committee is responsible for providing oversight of the internal audit activities and the relationship with the external auditor of the company. The board is to ensure and be satisfied that the scope of the audit is adequate. The internal audit is expected to comply with standard for professional practice of internal auditing.

Section 359(3)121 requires public companies in Nigeria to establish the audit committee. The composition of the audit committee in Nigeria is prescribed to consist of

118Coyle, B. (2009). *The ICSA Study Text in Corporate Governance.*6th Edition. ICSA Information & Training Ltd. p.83

119 Principle C.3 of the United Kingdom Combined Code; Principle V (C) and(D) OECD Principles, Principle 10 Commonwealth Principles, and Sections 4 and 6 South African Code.

120Section 5.3.2 German Corporate Governance Code. Op.cit; Binch, M. (2004) Corporate Governance in Canada; and Principles 6(1), 7(3) Japan Revised Corporate Governance Principles.

“an equal number of directors and representatives of the shareholders of the company (subject to a maximum number of six members).”122 The implication of this is that, the representatives of the shareholders of the company on the audit committee need not necessarily be directors. They can be ordinary shareholders. It becomes difficult in Nigeria to refer to the audit committee as a board committee. But in other countries especially in the United Kingdom, the audit committee is clearly a board committee123 consisting of independent non-executive directors of at least three members. In Nigeria, it may be difficult to have two or three directors on the audit committee that might be independent non-executive directors because, the SEC Code of Corporate Governance permits a company to have only one independent director on its board.124 In most cases, most of the non-executive directors in public companies are major shareholders of the company or do not meet the independent criteria in one way or the other.

It is observed from the statutory and code provisions that there is no specific requirement for the kind of directors that should be members of the audit committee. The CAMA simply states that “the audit committee…shall consist of an equal number of directors and representatives of the shareholders of the company (subject to a maximum of six members)…”125 The SEC Code of Corporate Governance on its part provides that “it is the responsibility of the Board to ensure that the committee is constituted in the manner stipulated and is able to discharge its statutory duties and responsibilities effectively”.126 The board membership of the audit committee is left entirely to the board of directors to determine which director is appointed into the committee. It means that the board can appoint an executive director or non-executive director who is not independent as a member of the audit committee. An executive director is part of the management of

122 Section 359 (4) CAMA, ibid

123 C.3.1 U.K. Combined Code, 2008

124 Section 5.5(c) SEC Code of Corporate Governance in Nigeria, 2011

125 Section 259 (4) Companies and Allied Matters Act. Op.cit.

the company whose activities and information are reviewed by the audit committee. If he is appointed as a member of the audit committee he is then made to participate in reviewing his actions. There exists the element of bias when the director is to discharge the functions of the audit committee. A non-executive director who is not independent of the management and the company would hardly challenge or probe into management action, or critically scrutinize transactions with the company in which he has interest directly or indirectly.

It is against the backdrop to ensure credible membership of the audit committee that in other countries the membership of the committee is required to be comprised of non-executive directors who are independent. In the United Kingdom, the code provision states emphatically that “the board should establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors”.127 The requirement of independent directors to constitute the audit committee is also stressed in the United States of America (USA). The USA Securities and Exchange Commission Rule 10 A.3 made pursuant to section 301 of the Sarbanes-Oxley Act require independent directors to be members of the audit committee.128 In South Africa, it is required that majority of the members of the audit committee are independent directors.129 In the text of the Code the words “independent directors” are made bold to lay emphasis. A similar requirement obtains in Japan that “the majority of audit committee members should be independent directors”.130 The provision is very particular about the audit committee and has separated its membership requirement from other committees like the nomination and compensation committees and provides that these other committees may compose of outside (non-executive) directors with one or more independent directors.131 In Canada all

127 Section C. 3.1 Code Provision, United Kingdom Combined Code on Corporate Governance, 2008.

128 Rule 10 A.3 (b) (1) (i) U.S.A. SEC Rules.

129 Section 6.3.1 King II Report on Corporate Governance. Op.cit.

130 Principle 6.3 Japan Revised Corporate Governance Principles, 2002

of the directors that compose of audit committees of public companies are required to be independent.132

The necessary intendment of requiring independent directors to constitute the membership of the audit committee is to provide for transparent financial dealings of the company. This was a lesson learnt from Enron collapse which revealed that the executives of the company encouraged or permitted misleading treatment of transactions in the company‟s accounts. The audit committee gave its approval to a seriously misleading set of accounts which made individuals to profit personally from transactions they made with the company that employed them.133 The neglect or failure of Enron audit committee to question those transactions left much to be desired. It has been contended that the “idea of questioning that which is approved by the supposed experts on the topic, of course, is a most delicate issue, and lies at the core of governance and oversight measures.”134

In Nigeria where the members of the audit committee are not required to be independent, it is natural to expect that most of the functions of the audit committee would be compromised to benefit vested interests especially those of the management and directors to the detriment of the company and shareholders. The fear that non- independent directors in the audit committee are likely to compromise their duty was epitomized in the case of Cadbury Nigeria Plc. The Nigerian SEC Administrative Proceedings Committee (APC) discovered that during the years 2002-2005, the company had engaged in financial malpractices through falsification of sales figures, over statement of profits/assets and false suppliers certificates to manipulate its financial records/reports135. The APC found out that the members of the company‟s audit

132 McDermott, R and Farrell, 5 (2004) *Corporate Governance in Canada.*Op.cit. , p.2

133 Coyle, B. (2009) *The ICSA Study Text in Corporate Governance*, op.cit. p. 74

134 Munzig, P.G (2003) *Enron and the Economics of Corporate Governance ,*op cit. p.39

committee failed or neglected, to keep under review, the effectiveness of the accounting, and internal control system and ensuring that appropriate investigations are carried out by internal auditors into some aspects of the company‟s activities which ought to be of interest or concern to the committee.136 It further discovered that the directors were indeed benefiting from an undocumented and undisclosed offshore account that was maintained and operated by the company.137 This is what happened in Enron also, while management and directors were generously benefiting from highly risky transaction which they entered into with the company shareholders were shouldering the costs associated with the highly structured and risky strategies Enron was employing. The public disclosure of the financial impact the said unethical transactions were having on the firm led to a sharp fall in its stock price and eventual collapse138.

Another corporate governance issue in relation to the composition of the audit committee is the qualification of its members. In Nigeria, the Code provides that “members of the committee should have basic financial literacy and should be able to read financial statements. At least one member should have knowledge of accounting or financial management.”139 Financial literacy and ability to read financial statements is the general degree of qualification required of every member of the audit committee. However, it is expected that one of the members should possess a higher degree of knowledge and therefore required to have “knowledge of accounting or financial management.” What amount to “financial literacy” and “knowledge of accounting or financial management” are not defined. There is no clear distinction from the two degrees of knowledge for the general members and the one specific member. This necessarily calls for analogy to be drawn from the United Kingdom clearer expressions.

136 Ibid. p. 7

137 Ibid. p. 6.

138 Ibid p.40

In the United Kingdom, its code has emphatically directed that “the board should certify itself that at least one member of the audit committee has recent and relevant financial experience.”140 What amounts to recent and relevant financial experience is however, not defined, but it is expressed from the Financial Reporting Council Guidance on audit committee that it must go beyond a basic familiarity with financial statements and perhaps past employment experience, or a qualification, in finance or accounting or related service that may include experience as a CEO, with financial reporting oversight responsibilities or finance director.141

The said Financial Reporting Council Guidance recommends that the person with recent and relevant financial experience should have a professional qualification from one of the professional accounting bodies.142 Audit committee members must have expertise that goes beyond mere familiarity with financial statements. They must be able to understand the rules and, more importantly, the principles that underpin preparation of financial statements. Members should have experience in areas pertinent to the business. A committee‟s effectiveness in performing its mission is certainly enhanced by and is often dependent upon the members‟ experience, knowledge and competence in business matters, financial reporting, and internal controls and auditing. The audit committee is expected to possess the required knowledge and experience in order to perform the important functions that promote good corporate governance. In Nigeria, knowledge of accounting or financial managements need not be recent or relevant. This gives room for incompetent persons to form the audit committee.

The functions of the audit committee are mainly statutory. The Code of Corporate Governance in Nigeria just like other countries provide for additional and more detail

140 C.3.1 U.K. Combined Code, 2008.

141 Smerdon, R. *A Practical Guide to Corporate Governance*. Op.cit. p. 292

142 Coyle, B. op. cit p. 168

responsibilities of the audit committee.143 Section 359 (6)144 stipulates the functions of the audit committee to:

1. ascertain whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices;
2. review the scope and planning of audit requirements;
3. review the findings on management matters in conjunction with the external auditor and departmental responses thereon;
4. keep under review the effectiveness of the company‟s system of accounting and internal control;
5. make recommendations to the Board in regard to the appointment, removal and remuneration of the external auditors of the company; and
6. authorize the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee.

These functions are to a greater extent similar to the role and responsibilities of the audit committee under the United Kingdom Combined Code. The functions of the audit committee are meant to enhance the role of the committee in ensuring transparency in the company‟s financial statements and reporting. That is why it is the duty of the audit committee to consider significant accounting policies used to prepare financial statements, any changes to them, and any significant estimates or judgments on which the statements have been based. The committee is also responsible to consider the clarity and completeness of the disclosures in the financial statements.145 The integrity of a company‟s financial statements and disclosure requirements are key corporate governance issues. The lack of such is the bane of the collapse of many companies including the mega collapse of the giant Energy Company, Enron in the United State of America. The lessons from the Enron collapse revealed that the executives encouraged or permitted misleading treatment of transactions in the company‟s accounts; the audit

143Section 30.4 (a)-(o) Code of Corporate Governance in Nigeria 2011; C.3.2 UK. Combined Code, 2008.

144 CAMA, Op cit

145Coyle, B. op. cit. p.169

committee gave its approval to a seriously misleading set of accounts, and that individuals profited personally from transactions they made with the company that employed them146. It can be seen that the importance of the audit committee cannot be overemphasized, hence the need for clear regulatory guidelines to be made on it like in the United Kingdom where in addition to the code provisions, the Smith Guidance was introduced and later updated as Financial Reporting Council Guidance on Audit

Committee.

The primary role of an audit committee is to oversee the potential conflicts of interest that can arise during the preparation, publication and audit of financial statements147. The audit committee is expected to monitor the financial integrity of the financial statements and any formal announcements relating to the company‟s financial performance.148 The responsibility of preparing financial statements and disclosures is actually that of the management. The role of the audit committee is to ensure that the external auditors are satisfied that appropriate accounting principles are followed and there is transparent financial disclosures. In addition, the audit committee plays an important role to monitor management of the principal risks that could impact the financial reporting process of the company, monitor the integrity of the system of internal controls regarding financial reporting and accounting compliance, and oversee the internal and external audit process.149

Where the audit committee compromises its role, the financial probity and reporting integrity of the company would not be guaranteed. In 2006 the SEC‟s Administrative proceedings Committee (APC) hearing discovered the connivance of some directors and management staff with members of the audit committee to perpetrate

146Ibid p. 74.

147 Smerdon, R. (2007) *A Practical Guide to Corporate Governance.*p.290.

148 Ibid. p 295

financial malpractices in Cadbury Nigeria Plc. As a result of their compromise, the “members of the audit committee of the company failed and or neglected to discharge their statutory responsibilities…. by failing or neglecting to examine the auditor‟s report and making proper recommendations thereon to the annual general meeting”150 It was discovered that they had “failed or neglected to review and make proper finding on management matters in conjunction with the external auditors and department responses thereon”151 The APC further found that “they failed or neglected, to keep under review the effectiveness of the company‟s accounting and internal control system and ensuring that appropriate investigations are carried out by the internal auditors into some aspects to the company‟s activities which ought to be of interest or concern to the committee.152

In order to improve the quality of the audit committee in Nigerian companies, there is need to improve the corporate governance requirements on composition of the audit committee especially in the areas of independence and knowledge of its members in accordance with international best practices as canvassed above.

# Remuneration Policy and Committee

The issue of remuneration of key executives and board remuneration is appearing on many codes of corporate governance. In an increasing number of countries it is regarded as good practice for boards to develop and disclose a remuneration policy statement covering board members and key executives. Such policy statements specify the relationship between remuneration and performance. The board should examine regularly the impact of the effectiveness of its directors – collectively and individually. The evaluation of the board should be based on objective and tangible criteria, including the performance of the corporation, accomplishment of long-term strategic objectives and

150 Oloyi, L. SEC Sanctions Cadbury over Misstatements in Published Accounts. Op. cit. p. 7.

151 Ibid.

the development of management. Against this backdrop several codes and principles have enunciated the following provisions.

“The board should fulfill certain key functions, including aligning key executives and board remuneration with the longer term interest of the company and its shareholders.”153 “Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors‟ remuneration should be structured so as to link rewards to corporate and individual performance”.154 To this end some codes recommend the appointment of remuneration committee.155

In Germany too, the remuneration of both the management and supervisory boards is determined based on a performance assessment in relation to the director‟s personal performance, the economic situation and performance of the enterprise.156 The German Code permits the supervisory board to refer factual issues such as compensation of the members of the management board to a committee.157 Japan on its part clearly recommends the establishment of among other committees, a compensation committee.158 The establishment of a remuneration committee is in the same vein obtainable in Canada. The Canadian Securities Administrators Rules provides for “establishing… remuneration committees composed entirely of independent directors”.159

Compensation committees were a response to the need for a check and independent voice on decision over executive compensation and they have become more

153 Principle VI(D)(4), OECD Principles, op cit

154 Principle B.1, United Kingdom Combined Code. op cit

155 Section 2.5.2 South African Code of Corporate Practices and Conduct. Op cit. see also Principle B.2.1 United Kingdom Combined Code. op cit

156Sections 4.2.2 and 5.4.6 German Code of Corporate Governance. Op.cit.

157Section 5.3.4. ibid.

158Principles 6(1) and 7(2) Revised Corporate Governance Principles of Japan.

159Binch, M (2004). Corporate Governance in Canada.

necessary with the increasing controversy over chief executive compensations.160 Survey and analysis over some years ago pointed to ever escalating rewards for executives that frequently out space the returns afforded to shareholding investors.161

Directors‟ remuneration refers to the reward directors receive as salaries, fees, allowances or other incentives which may include severance payments, share options, bonuses and pension schemes162. Directors‟ remuneration is their primary interest in the company which, they tend to protect. The interest of directors must of necessity be balanced against the interest of the company, shareholders and other stakeholders. However, it became apparent that directors were involved in determining their remuneration packages and therefore rewarded themselves with outlandish remuneration packages. This aroused public criticism especially in the United Kingdom and United States of America about director‟s huge pay, sarcastically referred to as „fat cat directors” who continue to receive generous pay even when the company performed badly.163

Even though, there is popular resentment of high remuneration for directors, corporate governance systems recommend that remuneration of directors should be sufficient to attract, motivate and retain skilled and qualified persons needed to run the company successfully164. However, the remuneration of directors particularly executive directors has to be determined by linking it to the company and individual performance165. This is to promote good corporate governance by providing a situation where a director earns more if the company does well, but less if it does badly. If a director successfully achieves predetermined levels of performance, he or she should be

160Holcomb, J. M. (2004). Corporate Governance: Sarbanes-Oxley Act, Related Legal Issues, and Global Comparisons. Op. cit p. 177

161Smerdon, R, (2007) *A Practical Guide to Corporate Governance*. Op.cit. p. 213

162 Ibid, p. 18

163Coyle, B. op.cit Pp. 19, 194 and 195

164 Section 14.4 SEC Code of Corporate Governance in Nigeria, 2011; B.1 Main Principle, U.K. Combined Code, 2008

165 Section 14.1 (c) SEC Code of Corporate Governance in Nigeria Ibid; B.1 Main Principle, U.K. Combined Code, Ibid

rewarded accordingly. The purpose of performance-related remuneration is to give a director an incentive to achieve performance targets. When directors are unsuccessful, they might be dismissed. It is against this backdrop that the remuneration of each executive director including the chief executive officer is determined and approved individually, taking into consideration direct relevance of skill and experience to the company at the time166.

A critical issue with the remuneration of directors is who should determine what the remuneration package should be. In Nigeria, Section 267 (1)167 provides that “the remuneration of the directors shall, from time to time, be determined by the company in general meeting…” However, the remuneration of the managing director is determined by the board of directors168. The provisions of the CAMA create a situation where the board of directors determines their remuneration packages, which in practice is not usually questioned by shareholders.

In Nigeria, where most of the directors are major shareholders or nominees of major shareholders, they are the same persons that constitute voting power in decision making at annual general meetings. When the board of directors determine the remuneration packages of directors and present the report to the general meeting, they would use their voting power to approve it. Even though the SEC Code of Corporate governance provides that the remuneration committee should be comprised solely of non- executive directors169, it has not required that they should be independent directors. It means that members of the remuneration committee could be directors who are connected with the company in such a way that would impair their independent judgment in determining fairly the remuneration packages which they too are going to benefit. It

166 Section 14.2 (c) SEC Code of Corporate Governance in Nigeria Ibid.

167 CAMA, op. cit

168Section 268 (1), Ibid

169 Section 11.1 SEC Code of Corporate Governance.

means that the objective of making shareholders to act as a check on directors‟ remuneration by considering it at the company‟s general meeting is defeated if the remuneration committee is not independent of the company, the directors would always succeed in determining their remuneration.

The Enron affair provides a practical example of the abuse of directors involving themselves in setting their own remunerations. A United States of America Senate sub- committee reporting in 2002, found that; “in one financial year, the company paid out cash bonuses of almost $750 million to senior executives when the reported total net income of the group was only $975 million. Executives were permitted to run off-balance sheet partnership with the company, which earned hundreds of millions of dollars at Enron‟s expense”170.

It is in view of the abuse of setting directors remuneration that codes of corporate governance in many jurisdictions recommend the establishment of remuneration committee171. The remuneration committee in the United Kingdom is composed of at least three, or in the case of smaller companies, two independent non-executive directors172 whereas, in Nigeria the remuneration committee is comprised of simply non- executive directors.173 Independent non-executive directors are more likely to take unbiased decisions. However, in Nigeria, where a company chooses to have the minimum one independent non-executive director at the board as permitted by the code,174 it will be impossible to constitute a remuneration committee with only one independent non- executive director. This difficulty will not arise in the U.K. South Africa or other

170Coyle, B. op. cit p.205

171 Section 11.1 SEC Code of Corporate Governance in Nigeria 2011; B.2.1 U.K. Combined Code, 2008 Coyle, B. op cit. p.205 2.7.5 (b) South African Code of Corporate Practice and Conduct

172 B.2.1 U.K. Combined Code

173 Section 11.1 SEC Code of Corporate Governance in Nigeria.

174 Section 5.5 (c) Ibid

jurisdictions that provide for majority or sufficient independent non-executive directors at the board.175

In general, remuneration committees have the responsibility of setting the remuneration of all executive directors176. While the compensation for non-executive directors is the responsibility of the board to determine and approved by shareholders in a general meeting.177 It has been noted that the remuneration of non-executive directors has not raised particular controversy over the years178. The levels of remuneration for non- executive directors are required to reflect the time commitment and responsibilities of the individuals. The functions of the remuneration committee are stated in more detail under section 11.2 of the SEC Code of Corporate Governance in Nigeria.

# The Nomination Committee

On the issue of board appointment various codes and principles of corporate governance respectively provide thus: The board should fulfill certain key functions, including “ensuring a formal and transparent board nomination and election process.”179 The main principle of the United Kingdom Combined Code states that “there should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.”180 The Commonwealth principles on its part provides that “the board should ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process”.181

175 A.3.2 UK Combined Code, 2008; 2.2.1 (c) South African Code of Corporate Practices and Conduct

176 Section 11.2 (e) and 14.3 SEC Code of Corporate Governance in Nigeria op. cit B.2.2 U.K. Combined Code, Ibid.

177 Section 14.6 SEC Code of Corporate Governance in Nigeria, Ibid. 178Smerdon, R. *A Practical Guide to Corporate Governance,* op. cit. p. 233. 179 Principle VI (D) (5) OECD Principles. Op cit.

180 Principle A4 United Kingdom Combined Code. Op cit

181 Principle 2, Principles for Corporate Governance in the Commonwealth. Op cit

The Canadian Corporate Governance also requires specifically the establishment of a nomination committee to be composed entirely of independent directors.182 The Japanese Corporate Governance similarly recommends clearly the establishment of a nomination committee amongst other committees.183 The German Corporate Governance Code specifically enjoins the supervisory board to form a nomination committee composed exclusively of shareholder representatives which propose suitable candidates to the supervisory board for recommendation to the general meeting.184

Shareholders have the jurisdiction and discretion to appoint or remove directors but this has to be done through a properly constituted meetings. It has been observed that shareholders have had limited powers in nominating directors due to management‟s control of the proxy machinery. Shareholders‟ ability to nominate directors and participate in board elections have been undermined by the huge financial barriers of financing a campaign for their own nominees.185 Directors could influence appointment of directors that will serve their interest. It was noted that “most significant, the very heart of corporate governance, the election of directors, is still a sham.”186It is in this regard that nomination committee became necessary and widely accepted as a response to the need to both diversify boards and to identify outside directors not beholden to chief executive officers.187 While actual procedure for nomination may differ among countries, the board or a nomination committee has a special responsibility to make sure that established procedures are transparent and respected.

The process of appointing company directors is an important exercise which determines the caliber of persons that provide leadership of the company. Both the board

182Binch, M. (2004) Corporate Governance in Canada, Op. cit p. 3 183Principle 6(1), Revised Corporate Governance Principles of Japan 184Section 5.3.3 German Corporate Governance Code. Op. cit.

185Holcomb, J. M. (2004) *Corporate Governance: Sarbanes-Oxley Act, Related Legal Issues, and Global Comparisons*. Op. cit p. 187

186Ibid.

187Sonnenfield, J. A., (2002).What Makes Great Boards Great. *Harvard Business Review.* p.106 and 113

and the shareholders in general meeting have vital roles to play in the appointment of directors. Sections248, 249 and 259 of the CAMA place the duty of appointing directors on the general meeting and the board of directors. The board of directors has power to appoint new directors to fill casual vacancy subject to approval by the general meeting188 while, the general meeting has power to elect or reject directors and appoint new ones. 189 The process of appointment requires the directors to recommend a person to be appointed or a notice of nomination by a member of the company.190

Company law has not provided for a process that would ensure the appointment of the right caliber of persons through a formal, rigorous and transparent procedure. The lacuna in the law has allowed a leeway in some cases where appointment of directors may not be made on merit and against objective criteria. Criticisms were expressed on the fact that most non-executive directors appointments come from a fairly small circle of successful businessmen, many of whom know each other.191

In order to forestall appointment of directors on the basis of sentiments and vested interests, the nomination committee has been recommended to be established by the board and given the responsibility to handle issues of appointment of directors. The UK Combined Code specifically recommends t he establishment of a nomination committee that should lead the process for board appointments and make recommendations to the board.192 The major responsibilities of the nomination committee include: identification of candidates to fill vacancies on the board, as and when they arise, and nominate them for approval by the board, and importantly before making an appointment, evaluate the balance of skills,

188 Section 249 CAMA op cit

189 Section 248 Ibid

190 Section 259 (3) and (4) Ibid

191 Coyle, B. op cit p. 83

192 Principle A. 4.1 UK Combined Code, 2008

knowledge and experience on the board, and on the basis of this evaluation, prepare a description of the role and capabilities required for the particular appointment. 193 The board is therefore responsible for ensuring a formal and transparent board nomination and election process. There should be no primordial interest of cronyism and tokenism involved in any appointment of a director. This is the only way the board would be composed of people of integrity who can bring a blend of knowledge, skills, objectivity, experience and commitment to the board.

As important as the nomination committee appears to be in the realm of corporate governance, the Nigerian SEC Code of Corporate Governance has not specifically recommended its creation by companies. The creation of the nomination committee is left to the discretion of the company. The committee falls under the category of “such other committees as the Board may deem appropriate depending on the size, needs or industry requirement of the company”. It is hereby contended that the factors of “size, needs or industry requirement” to determine whether or not to create a nomination committee do not apply to it. This is because every company irrespective of size is managed by a board of directors. Every company needs an effective board. A board can only be effective when it is constituted of the right caliber of directors. The nomination committee provides a mechanism for appointment of the right and suitable persons as directors. In addition, it is posited that there is no company‟s need or industry requirement” that would discourage a process of putting in place a mechanism that will enhance leadership quality of the board of directors. In fact, the first priority of every company should be to constitute a competent and effective board of directors. This is in essence the hallmark of the nomination committee. There is therefore the need for the code of corporate governance in Nigeria to specifically recommend for the establishment of nomination committee in

193 Principle A. 4.2 Ibid

the same manner it mentions Remuneration Committee and Risk Management Committee.194

# CHAPTER FOUR

# STATUTORY RESPONSIBILITIES OF DIRECTORS UNDER CORPORATE GOVERNANCE IN NIGERIA

# Introduction

The board of directors is the main stay of corporate governance because it plays key roles in the implementation of corporate governance standards or guidelines. The board has been vested with the primary responsibility for ensuring good corporate governance.1 Whether a company adheres to good corporate governance practices or not depends on the roles the board of directors plays.

The general idea about corporate governance is perceived on ethical factors such as openness, honesty and transparency, independence; accountability; responsibility; fairness; and reputation. All these factors are human related and individuals and/or bodies have the responsibility of adhering to them in order to promote good corporate governance. It is against this backdrop that it becomes imperative to consider the responsibilities of directors as key players in corporate governance system.

# Directors as Corporate Managers

The board of directors has managerial responsibilities both under the statute as well as the code of corporate governance. Section 63(3)2 specifically vests the responsibility of managing a company in the board of directors. Accordingly, the section provides that: “except as otherwise provided in the company's articles, the business of the company shall be managed by the board of directors who may exercise all such powers of the company as are not by this Act or the articles required to be exercised by the members in general meeting.”

1 Section 13 (b) Code of Corporate Governance in Nigeria, 2011.

The management of company is t he hall mark of corporate governance. The concept of corporate governance in its simple definition is the system by which companies are directed and controlled.3 Of course, the management of company involves directing and control of the company. Perhaps that may be the reason why those who have this responsibility are called "directors" or "board of directors". Several principles and codes of corporate governance recognize the significant responsibility of the board of directors in providing entrepreneurial leadership and effective direction of the corporation.4 The main decision-making powers belong to the board of directors however, the board delegates many of the operational decision-making r e s p o ns ib i l i t ie s t o e xe c u t i ve ma na g e me nt . D e le g a t io n o f bo a r d responsibilities is recognized by law. Sections 63 (1) and 64 5 permit the board of directors to appoint officers or agents, committees or managing director and to vest them with the powers of the board to act for the company. The delegation of the board's powers does not however warrant it to abdicate it s responsibilities. It should retain the most sig nificant decis io ns t o it se l f, and mo nit o r t he per fo r mance o f t he execut ive management. An aspect of corporate governance is therefore the nature of the decisions that the board reserves to itself and the way in which the board reaches its decision. The board needs to be able to reach decisions that are well considered and in the interest of the company. As to the nature of the decisions which should be reserved to the board and not to be taken by executive managers include, for example, decisions on major new investments or divestments and about large mergers and takeovers. The

reaso n being t hat, t hese aspects ar e t he st rategic o bject ives and guidance

3 Cadbury, A. Report of the Committee on the Financial Aspects of Corporate Governance, Gee (a division of Professional Publishing Ltd) London (1992) Para 2.5.

4 Principle A.1 The UK Combined Code on Corporate Governance; Principle VI, OECD Principles of Corporate Governance; Principle 1, Principles for Corporate Governance in the Common Wealth (CACG) Guidelines); and section 2, King, II Report South Code of Corporate Practices and Conduct.

of the company which affect the interest of all direct and remote stakeholders in the company. The way the bo ard reaches its decisionshould be democratic in nature based on sufficient t imely information in advance of board meetings, relating to all the matters the board will be discussing at the meeting. Similarly the decision making process must not give room for a single individual like the chief executive officer, the chairman or a few group of persons to dominate and usurp decision making powers.

In order for the board to exercise leadership, enterprise, integrity and judgment in directing the corporation in the best interest of the company, its actions must be based on the ethical conduct of openness, honesty and transparency; independence; accountability; responsibility; fairness; and reputation.6 These values are briefly underscored hereunder.

# The Requirement for Openness, Honesty and Transparency of Directors

The three components of openness, honesty and transparency are the prerequisites of a company board that upholds integrity and ethical behaviour in the course of performing its leadership duties to the company in relation to other stakeholders. By openness, it entails a willingness to provide material and timely information to shareholders and investors. Such information is necessary to enable them to know the position of the company so they can take investment decision on an informed basis. Openness does not however, mea n t hat t he co mpany s ho uld g ive awa y co mmer c ia l l y se ns it ive information.

On the other hand, honesty requires the financial statement of the company to represent the true and fair position of the company. A company's statement should be believable as the actual representation of facts and not manipulation of facts.

While transparency refers to the ease with which an outsider is able to make a meaningful analysis of a company and it s actions. 7 A transparent company is, one that investors understand. It is the duty of the board to ensure t hat investors have access to clear and factu al information. A distinction is also made between a transparent company that reaches its major decisions through a clear process and one that reaches its decisions "behind closed doors' and in "smoke-filled rooms”8

Companies that are operated devoid of business ethics and integrity pose serious economic loss to the investing public and other stakeholders. For example, in 2008, the Securities and Exchange Commission (SEC) investigated Afroil Plc and discovered that the company continued to sell its warehoused shares within a period it ceased to be a going concern. The company did not notify the Commission and the public of the fact that it was no longer a going concern.9The SEC noted that the actions of the management of Afroil Plc constituted acts of insider trading.10

Similarly, the Commission‟s investigation found that there were high volumes of transactions in the shares of Capital Oil Plc when it was not in active business. The Commission discovered that the Chairman of Capital Oil Plc also sold 8.25 million of his holding within the period of in operation. In view of the fact that the Chairman was an insider, he was quite in the picture of the company‟s situation and in fact knew that the prevailing share price was without rational basis and therefore unsustainable when he went ahead to sell his holdings.11 The Commission rightly considered the action of the chairman as an insider abuse, possibly taken to minimize his loss and maximize his gains

from the price surge, fully aware that the company was not in operation.

7 Coyle B. Ibid p. 27

8 Ibid.

9 Olaleye, O. (2008) SEC Suspends Afroil of Trading on Capital Oil Shares” *Journal of the Nigerian Securities and Exchange Commission, SEC NEWS* Vol. 4 No. 2. p. 10

10 Ibid.

The investing public who were not aware of the condition of the two companies mentioned above went ahead to buy their shares at unrealistic higher prices.

# Independence of Directors

An independent director is one who is free of any relationship with the company or its management that may impair, or appear to impair the director‟s ability to make independent judgments.12 Independence of directors is also meant to avoid domination of the board's decision-making process by a powerful chief execut ive, chair man or major shareho lder. T he requirement o f independence is particularly relevant to non-executive directors and company professional advisers. They are expected to act or express honest and/or professional opinion in the best interest of the company. Independence is apparently impaired by having some connection to the company or dependence on t he good- will o f t he company or it s management. For example, a non- executive director will not be independent, if he/she has recently been a senior executive of the company or if he/she represents a major shareholder. Independence can also be undermined by familiarity: if a non-executive director has known the company's management for a long time, personal friendships may have developed that blind him to management failings and shortcomings.13 Perhaps that might be the reason why the Companies and Allied Matters Act has provided for retirement of directors by annual rotation.14 A board that consists of more number of independent non-executive directors is likely to be more independent.

# The Need for Proper Accountability of Directors

12 Section 5.5 (a) and (b) SEC Code of Corporate Governance in Nigeria. Op.cit; 2.4.3 (iii) South African Code of Corporate Practice and Conduct. 2002; A. 3.1 The United Kingdom Combine Code of Corporate Governance, 2008 p.28

13 Coyle, B. op cit.

14Section 259 (1) and (2) Companies and Allied Matters Act. Op cit.

Directors are vested with the responsibility of making decisions and taking actions on behalf of a company. They should be accountable for the decisions they make and the action they take. The board should be subject to assessment by the shareholders who should also have the opportunity to question them. If there is a mechanism that makes the board to have the sense of accountability, they will act more conscientiously. They will always have it in mind that at the end of a specified period of time they will be called up to render account of their stewardship. This will give opportunity to the shareholders to decide whether the board's performance is good or not. The requirement of accountability will make the board to be committed to the objectives of the company and returns to shareholders.

Sections 342 and 34515 have provided the statutory basis to entrench the aspect of accountability. Thus section 342 above requires the preparation of directors‟ report to contain a fair view of the development of the business and financial activities of the company. While section 345 places the duty on the directors to lay before the company in general meeting copies of the financial statements of the company. The copies of the financial statement are expected to be sent to the members of the company not less than 21 days before the date of the meeting at which they are to be laid or less than 21 days if all the members agree.16

It is worthy of note that the financial statement is not to be presented but merely laid in the general meeting. There is no obligation on the directors neither to present their report nor to present the financial statements. It is hereby opined that in view of the practical experience of late arrival of annual reports and accounts sent to shareholders, it is better to require the directors to present logically and precisely their reports and

15 Companies and Allied Matters Act. Op.cit

16 Section 344 (1) and (4) Ibid

financial statements during general meetings. This will give opportunity to shareholders to listen and raise some questions where necessary.

The issue of accountability is very important because it is the means by which the powers of the board of directors are checked. Due to the significance of accountability in corporate governance, Amupitan after considering several definitions of corporate governance, concluded that “what is glaring is that corporate governance is not just about how a company is governed or controlled but also how to make the controllers responsible to their companies and in some cases the shareholders”17 He contended that “a central issue arising there from is accountability. There must be some safeguards which will ensure that directors are accountable not only to the shareholders but also to creditors and other stakeholders”18.

A system of corporate governance that do not entrench a strong mechanism of accountability would give room for directors to conduct themselves irrationally in company affairs to the detriment of the company and its stakeholders. For example, it was reported that executive management and the board of directors of some banks19 were alleged to be reckless with investors funds, neglected due process and took biased decisions; conduct that negate the principles of corporate governance. In the case of Oceanic Bank, the former group managing director, Cecilia Ibru was alleged to have given out depositors funds worth over N150 billion as loans to friends and relatives without collateral; including her nanny who got N13 billion loan to cater for personal needs.20 The consequence of the improper acts of the directors of these banks was their eventual distress and failure.

17 Amupitan, J. O. (2008), Corporate Governance: Models and Principles. Hilltop Publishers, Ibadan & Abuja-Nigeria. p.6

18 Ibid. p. 7.

19 Intercontinental Banks, Oceanic Bank, Bank PHB, Afribank, Spring Bank, Societe Generale Bank Nigeria.

20 League of Defunct Companies. Why the Rising Business Failure in Nigeria? [www.myfinancialintelligence.com/banking-and-finance.](http://www.myfinancialintelligence.com/banking-and-finance) Accessed on 14/4/2013 at 6:10 pm p.2 of 5

# The Requirement of Fairness of Directors to other Stakeholders

The concept of fairness simply means equal t reatment of all shareholders. There should be equal treatment of minority and majority shareholders. For example, any material information should be given to all shareholders at the same time. Also, minority shareholders should be given opportunity to place items on the agenda of company meetings. To this end, shareholders should be given fair and equal opportunity to express their views at general meetings on the management of the company. Even though there are company law provisions for the protection of minority rights, 21 the directors need to be fair to all22 so that minority shareholders would not necessarily enforce their rights through court processes. Litigation in the court among company members will create internal mistrust and rancor which will not be in the interest of the company.

# General Duties of Directors

The managerial responsibility of directors imposes on them certain duties which they are obliged to observe. In the execution of their task certain standards are no doubt expected of directors to maintain. The responsibilities of directors have overtime developed into fiduciary duties which emanated from common law and principle of equity, as well as the general duties that have now been largely codified into company statutes of many countries including Nigeria.

# Fiduciary Duties of Directors

It is a recognized principle of law that the directors of a company owe certain fiduciary obligations to their company.23 The fiduciary duties of directors which stemmed

21 Section 311 CAMA. Op.cit

22 Oji E.A et al (2005) “Globalization and New Perspectives in Corporate Governance”, *In Globalization, National Development and the Law*. Edited by Goubadia, D.A and Azinge E, Nigerian Institute of Advance Legal Studies, Lagos, p. 162

23 Olawoyin, G.A. (1981) *Status and Duties of Company Directors.* University of Ife Press, Ile-Ife, p.33

from common law and principle of equity have now been statutorily recognized. Section 27924 states as follows:

* + - 1. A director of a company stands in a fiduciary relationship toward the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf.
      2. A director shall also owe fiduciary relationship with the company in the following circumstances.
         1. where a director is acting as agent of a particular shareholder;
         2. where even though he is not an agent of any shareholder, such a shareholder or other person is dealing with the company‟s securities.

The nature of the fiduciary duties of directors places them in certain legal positions that are akin to some special form of relationships that are not specifically entered into with the company. Section 283 (1)25 invokes the principle of trusteeship and considers directors as trustees of the company‟s money, properties and powers. While subsection (2) of the above section 283 inputs the relationship of agency by stating that a director may when acting within his authority and the powers of the company, be regarded as agents of the company.

These principles of trusteeship and agency were enunciated long time ago before their eventual statutory accolade. In the case of *Aberdeen Railway Co v Blaikie Brothers*26 it was clearly stated that: A corporate body can only act by agents, and it is of course, the duty of those agents so to act as best to promote the interest of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict, with the interests of those whom he is bound to protect.27

24 CAMA. Op.cit.

25 Ibid

26 (1854) 1 Macq 461

27 Ibid pp.471-472, per Lord Cranworth L.C

It is against the backdrop that directors are regarded as trustees and agents that impose on them certain standards of behavior which are akin to the fiduciary nature of trustees and agents. Most important of the duties are the twin duties of loyalty and good faith. The position of directors as trustees is underscored by their power and control they exercise over the company‟s moneys, properties which they are bound to account for consequently, they are obliged to exercise such powers honestly in the interest of the company and not in their own or sectional interests.28 The rule of trustee-like position of directors is based partly on the view of equity that a company is entitled to the protection of all its directors as trustees are in relation to a trust; hence in the consideration of matters relating to itself, the company should have the benefit of the unbiased and independent judgment of each director. Where a director is interested in a transaction with his company, it becomes difficult for him to exercise independent and unbiased judgment in the consideration of issues connected with the transaction.29 The loyalty of an interested director is, by the very nature of things is likely to be divided in the circumstance.

Similarly, as agents of the company, directors are required to observe the fundamental agents‟ duty to act in good faith30. The duty of good faith is considered in multiple dimensions. The first of it is that the agent must strive to avoid any situation in which his personal interest may come into conflict with that of his principal.31 The rule is strict and is justified on the basis that should an agent be faced with such a conflict in his dealings with or on behalf of his principal, he will naturally favour his own personal interest over that of his principal. The law therefore requires him not even to allow to be exposed to such temptation.32 It is against this background that section 280(1)33

28 Section 283(1), CAMA. Op.cit.

29*Parker v. McKenna* (1874), LR. 10 Ch. App 96. Per Lord Cairns L.C.

30 Igweike, K.I. (2011) *Nigerian Commercial Law Agency,* Malthouse Press Limited. p.97

31 Ibid

32 Ibid: See also *Berilly v. Craven* (1853) 18 Beav. 75;

categorically states that “the personal interest of a director shall not conflict with any of his duties as a director”. Consequently, a director shall act at all times in what he believes to be the best interests of the company as a whole.34

The easiest way to comply with this duty is not to engage in transactions that involve a conflict of interest. These types of transactions are often called in corporate parlance „self-dealing‟ transactions. The concept implies that the directors are dealing with themselves, and may not reach an agreement that is fair to the company. An alternative, that is accepted in most countries because a flat ban on self-dealing transactions can be impracticable, especially for smaller firms, is to have self-dealing transaction approved by a non-interested decision maker who has the right to reject the transaction altogether. The transaction is accepted unless a shareholder proves in court that the transaction is not entirely fair to the company. Public companies where the company has a majority of independent directors, almost always rely on non-interested directors to negotiate and approve a conflict-of-interest transaction.35

The second ambit of agents‟ duty of good faith is that the agent should not make any secret profit or other benefit from his position as agent.36 Against this backdrop, the Companies and Allied Matters Act provides that “a director shall be accountable to the company for any secret profit derived by him”37. The law takes a very serious view of secret profits because it can compel an agent to compromise his position. When the fact of secret profit or benefit is present an irrefutable presumption is created that the agent‟s conduct has been influenced by the secret profit which he has taken. It is not open to him to say in fact that he did not depart from his duties in spite of the money he had

33 CAMA. Op.cit

34 Section 279(3) Ibid.

35 Black, B.S. (2001) The Principal Fiduciary Duties of Board of Directors. Presentation at Third Asian Roundtable on Corporate Governance, Singapore, 4 April. Pp. 2-3.

36 Igweike, K.I. (2011) *Nigerian Commercial Law Agency* op. cit. p. 98

37 Section 280 (3) CAMA, op.cit.

received.38 A director can only escape liability where he discloses his interests before the transaction and before the secret profits were made, but he shall not escape liability if he discloses only after he has made the secret profits and in this case, he shall account for the profits.39

# Specific Duties of Directors

The general duties of directors are those that have now been introduced into statute law. The Nigerian Companies and Allied Matters Act was enacted in 1990 and contained certain specific duties of directors such as the duty to:

1. exercise power for right purpose40;
2. promote the success of the Company41;
3. exercise independent judgment42;
4. exercise reasonable care and skill43;
5. avoid conflict of interest;44 and
6. not to accept benefits from third parties.45

Similar provisions stated above are also contained in the United Kingdom Companies Act.46 These duties are owed to the company and not to individual shareholders or stakeholders.47 The consequences for breach of these duties are most

38 Igweike, K.I. op.cit. p.98

39 Section 280(6) CAMA, op.cit.

40 Section 279 (5) Ibid

41 Section 279 (3), Ibid

42 Section 279 (6), Ibid

43 Section 282, Ibid.

44 Section 280, Ibid

45 Section 287, Ibid

46 Sections 171-177 Companies Act, 2006

47 Section 279(3) CAMA Op.cit; See also Corporations Law Update: Recent Decisions about Directors‟ Duties and Liabilities, [http://www.stephens.com.au/view/22/47.](http://www.stephens.com.au/view/22/47) Accessed on 16/12/2011

likely to be legal action taken in the name of the company. Section 279(9)48 emphatically states that “any duty imposed on a director under this section shall be enforceable against the director by the company.” These duties of directors will now be discussed.

# Duty to Exercise Powers for Right Purpose.

Section 279(5)49 imposes the duty on the director to exercise his powers for the purpose for which it is specified. This duty means that directors must not exercise their powers for their own personal interests or the special interests of a third party, but must exercise them solely for the benefit and best interest of the company. It is therefore incumbent on the directors to acquaint themselves with the company‟s memorandum and articles of association to be able to know the extent of powers vested on them and comply to and ensure that the company complies with the obligations and limitations contained therein. The directors are expected to exercise such powers for a right purpose. This means that the exercise of such powers must not be for a collateral purpose. In the case of *Howard Smith Ltd v. Ampol Petroleum Ltd*50 the trial judge found that the primary purpose of an allotment of shares by the directors was to dilute and remove the blocking stake of two other shareholders who had refused to accept an offer to buy the share capital of the company, an offer which the minority shareholders and a majority of the directors wished to accept. The judge held that the directors had not exercised their powers for a “proper purpose” since the aim, on the basis of the evidence, was to remove the blocking stake and not to act in the best interest of the company.51

# Duty to Promote the Success of the Company

This duty is very central of all the general duties because the success of the company is the hall mark of corporate investment. Section 279(3)52 states that “a director

48 CAMA. Ibid.

49 Ibid.

50 (1974) A.C. 821

51 Smerdon, R. *A Practical Guide to Corporate Governance*. Op.cit p 103.

52 CAMA Op. cit.

shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed…” In fulfilling this duty the director‟s primary and overriding concern is the interests of the company‟s employees and its members. This is underpinned by subsection

1. of section 279 mentioned above that “the matters to which the director of a company is to have regard in the performance of his functions include the interests of the company‟s employees in general, as well as the interests of its members.” This same duty is also exemplified by the code of corporate governance to the effect that “it is the responsibility of the Board to oversee the effective performance of the management in order to protect and enhance shareholder value and to meet the company‟s obligations to its employees and other stakeholders.53

The CAMA does not create a duty to any stakeholders other than the company‟s employees and members, but the combined effect of the phrase “the interests of the company as a whole” and the code‟s mention of “other stakeholders” suggest the directors are required to give consideration to the interests of other stakeholders in reaching their decisions.

The CAMA has not provided the factors to be taken into consideration in fulfilling this duty, but the United Kingdom Companies Act54 provides under this duty about six factors a director must “have regard in fulfilling the duty of promoting the success of the company. These factors include:

* 1. the likely consequence of any decision in the long-term;
  2. the interests of the company‟s employees;
  3. The need to foster the company‟s business relationships with suppliers, customers and others;

53 Section 2.2 SEC Code of Corporate Governance in Nigeria, 2011

54 Section 172(1) Companies Act, 2006

* 1. The impact of the company‟s operations on the community and the environment:
  2. The desirability of the company maintaining a reputation for high standards of business conduct; and
  3. The need to act fairly as between members of the company.

The indices above recognize the fact that the interest of other stakeholders of the company is equally important. Apart from shareholders and employees other stakeholders such as suppliers, customers, the community and the environment have interest in the company that need to be addressed, and neglect of their interest can have a negative effect on the company. Their response to such neglect of their interests by way of judicial or extrajudicial means can obstruct the smooth activities of the company. For instance, if a company neglects its corporate social responsibility to its host community and its activities are causing environmental degradation, the community may decide to demonstrate against the company which may result to obstruction of its operation for a time where violent agitation is done; it may result to destruction of company assets and even loss of lives. These incidents are not in the interest of the company.

The directors therefore have a duty to take into consideration the interest of all stakeholders of the company so that no room is open for anything to hinder the success of the company. The above criteria from the United Kingdom Companies Act provide guiding principles in assessing the directors to promote the success of the company.

# Duty to Exercise independent Judgment.

This duty is aptly captured by section 279(6)55 thus: “a director shall not fetter his discretion to vote in a particular way.” This duty entails that a director should not agree to restrict his or her power to exercise an independent judgment. Thus a director may not

55 CAMA, Op. cit.

bind him or herself to vote on board resolutions (or to fulfill other functions as a director) in a particular way. He must consider all the circumstances at the time and decide on what is in the best interests of the company.56 Independent judgment either of a director or the board is a decision that is free from influence based on personal interest or that of connected persons. It means that there should not be direct or indirect interest that would create a bias in reaching a decision.

The limitation of this duty is that the Companies and Allied Matters Act (CAMA) does not prescribe the kind of directors to constitute the board. The board of directors consists of a mixture of executive and non-executive directors. The executive directors are employees of the company and form the management team. Their interest is to see that their salaries and remuneration packages are enhanced. They can do everything that would promote this personal interest. On the part of non-executive directors, most of them in practice have connection with the company either in business or financial link and therefore have vested interest to protect. These types of directors have personal interest to protect and therefore lack independence. It is when a non-executive director is independent from the company and its management that he may exercise independent and objective judgment. The CAMA has not provided for composition of directors in a way that would entrench independence in decision making process.

Another aspect is that where a board is controlled by an individual member or group of few members, for example, by an overbearing or domineering chief executive, the board would be unlikely to exercise independent judgment. The decisions of the board would in most cases be influenced by such a domineering director. Lack of independent Judgment is detrimental to corporate governance because board decisions are manipulated to benefit personal interests against the interest of the company as a whole.

56 Smerdon, R. Op. cit. p.92

However, this requirement of exercising independent judgment does not prevent a director from acting in a way authorized by the company‟s constitution (for example accepting resolutions passed by the shareholders in general meeting); or from acting in accordance with an agreement already entered into by the company that prevents the director from using discretion.57 Independent judgment does not require a director to be a dissident. He is expected to abide by the rules and regulations of the company and other lawful activities.

# Duty to Exercise Care, Skill and Diligence

The duty of care and skill of directors has been an age long duty that evolved from common law;58 however, it has now been introduced into company‟s statues.59 The CAMA states that “every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances.”60 The interpretation of the standard of skill and care expected of a director has been a subject of debate with different viewpoints.61 The perception of the duty of skill and care under the common law has been regarded as the traditional subjective standard while the statutory perception is considered as objective standard.62 In some jurisdictions particularly the United Kingdom, the manner in which the duty of skill and care is framed in its Companies Act, 2006; both the subjective and objective standards are jointly applied. It is therefore necessary to examine both the subjective standard and objective standard to find out which one is applicable to the interpretation of the Nigerian statutory position.

57 Coyle, B. *The ICSA Study Text in Corporate Governance,* Op. cit p. 56.

58 Coyle, B. Op cit p. 52; Olawoyin, G. A. Op. cit. p. 210

59 Section 280. CAMA op. cit; see also section 174 United Kingdom Companies Act, 2006

60 Section 280, CAMA Op. cit.

61 Olawoyin, G. A. Op. cit. Pp. 211-213.

62 Chambers, A. and Weight, C. *Corporate Governance Handbook*, 4th edition, Tottel Publishing (2008), P. 349.

# The Subjective Standard of Skill and Care.

The subjective standard of directors skill and care was informed on the basis that the company is free to choose anyone (subject to some disqualifications of minors, persons of unsound mind and fraudulent persons) however, ignorant of the business, to manage its affairs, and if the company suffers through such choice the court does not feel bound to come to its aid.63 As a result no business qualifications of any kind were needed to become a director of any company. Thus, a director was not bound to bring any special qualifications to his office. The law did not require a director to know anything about the business of his company; nor was he expected to be an expert in regard to the type of skill which could be employed to benefit such company. But where a director possessed some measure of competence, he must bring it to bear for the benefit of the company when he performed his functions. In *Re Brazilian Rubber Plantations & Estates Ltd,*64 it was held that a director of the rubber company who was acquainted with the rubber business was obliged to give the company the advantage of his knowledge when transacting the company‟s business65. The implication of this proposition was that the more skilled a director happened to be in his company‟s business, the greater was the likelihood of his incurring liability for his misdeeds in the management of such business. On the other hand, the more ignorant he is, the safer is his position from the point of view of liability for mismanagement66. It was based on this view point that the court held in *Re City Equitable Fire Insurance Company*67 that a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.68 That is to say that the care a director was expected to

63 Olawoyin, G.A. op.cit p. 215

64 (1911) 1 Ch. 425

65 Ibid at p.437 per Nerille J.

66 Olawoyin G.A. op.cit. p.216-217

67 (1925) Ch. 407

68 Ibid. p.428.

take was commensurate with the one an ordinary man of like intelligence would exert in similar circumstances on his behalf.

The above judicial view point made it difficult to hold directors liable for negligence even in circumstances that apparently appear negligent. In *Shonowo v Adebayo,*69 the supreme court refused to impose liability on directors who failed to study an auditor‟s Report (notwithstanding the fact that the auditor was commissioned to investigate the account of the bank by its managing director who was sacked by the Board before the submission of the Report) even though their failure resulted in the company losing large sums of money.70

Similarly, courts in the United Kingdom have been generally reluctant to condemn business decisions made by the board that appear, in hindsight, to show errors of judgment. It is believed that directors can exercise reasonable skill and care, but still make bad decisions. For legal action against a director to succeed a company would have to prove that serious negligence had occurred. It would not be enough to demonstrate that some loss could have been avoided if the director had been a bit more careful.

This approach of courts restraining themselves from second guessing the *bonafide* business judgment of directors developed into what is referred to as “business judgment rule”. The court could only interfere with decision of directors if the business view was so extreme that no reasonable director would hold it, either by taking into account factors that they should not have considered, or failed to take into account factors that they should have considered or if having considered all the right factors, they have come to a conclusion so unreasonable that no reasonable person could have come to it.71

69 (1969) 2 ALR Comm, 419 at 440

70 Olawoyin, G.A. op.cit. p.218

71*Associated Provincial Picture Houses Ltd v. Wednesbury Corporation* (1948) 1 KB.223; see also Smerdon, R. *APractical Guide to Corporate Governance*. Op.cit p.101

From the above analysis, it became settled that the standard of skill and care of a director was the level of knowledge and experience he possessed. This common law directors‟ duty of skill and care has now been incorporated into company statute, it is this statutory provision that seem to set a higher standard commonly known as the objective standard.

# The Objective Standard of Skill and Care.

The objective standard of skill and care is underscored by the provision of section 282(1).72 It states that “every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances.” This statutory test refers to what would be expected of a “reasonably prudent director.” There is a shift from the common law bench mark of a person with the same knowledge and experience of the director involved to the bench mark of the knowledge and experience of a prudent person if he were in the position of the director involved. The obvious question is who is a prudent director‟? The word „prudent‟ means to be cautious; sensible or managing carefully.73 The expression of prudence gives the impression of serious attention beyond the routine activity. It means therefore that for a director to discharge the duty of care and skill under the CAMA, he must have to exhibit the prudence which another director would show if he occupied the same position. The level of knowledge and experience of the director is immaterial. He is placed at the same level of expertise and experience of another experienced director if he were in the same position.

72 CAMA. Op.cit.

73 Geddes & Grosset (2005) *Webster’s Universal Dictionary & Thesaurus*, Scotland, U.K. P.440

The position of CAMA is similar to section 17474 which requires a director to exercise reasonable care, skill and diligence that would be exercised by a reasonably diligent person with: the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company. This is the basic benchmark of care, skill and diligence.

Against this background, there have been changes of judicial attitude by requiring a higher level of care beyond what was obtainable under the common law. The negligent conduct of a director which would have passed off under the common law is now held against him. In the case of *Re Continental Assurance Company of London Plc. (in liquidation) (No. 1*)75, a senior executive of a bank was appointed a non-executive director of the company and its subsidiary. The subsidiary made a loan to the holding company, when the subsidiary became insolvent, the director was disqualified, his ignorance about the purpose of the loan was held not to be a defence, but was evidence of his failure to exercise the appropriate degree of competence, especially in the light of his experience as a banker and his ability to understand the accounts of the holding company.76

Similarly, in the case of *Re Barings Plc. and Others (No.5)*77 the bank went into insolvency because of unauthorized securities trading of an individual employee. The executive chairman of the bank unsuccessfully defended himself that his expertise was in the corporate finance side of the business and that he had very little understanding of the activities in which the trader was involved, and that he relied on the internal audit and external auditors. Rejecting the defence, the court said that there is a continuing duty

74 United Kingdom Companies Act, 2006

75 (1997) 1 B.C.L.C. 48

76 Smerdon, R. op.cit p.94

77 (1999) 1 B.C.L.C. 433

incumbent upon the directors to acquire and maintain a sufficient knowledge and understanding of the company‟s business to enable them to discharge their duties.78

The implication of the current higher standard of care and skill expected of a company director is that any person, who accepts the position of a director, is placed at the same level of expertise and experience of another experienced and prudent director if he were in the same position. This is irrespective of the level of experience of the director in question.

The business judgment rule (the doctrine of non-interference with board decision by the court) is however, still relevant under the statutory dispensation of the duty of skill and care. Even though the standard required of directors to exercise skill and care is much higher under the statute than the common law position, it is a fact that directors are not infallible. They can make *bonafide* errors or the investment decision they make can be affected by other external factors to turn out adversely. Moreover, investment involves risk taking. Some risky decisions will work out wonderfully, while others will work out terribly. If the directors risk being found personally liable for bad outcomes, they will be reluctant to take risks, then there will be no better decisions on average, just more cautious decisions. On the basis of the business judgment rule, American courts simply do not hold directors liable for business decisions, made without conflict of interest, unless those decisions are completely irrational.79

It is therefore posited by this work that the standard of care and skill of directors under the Nigerian Companies and Allied Matters Act is the objective high standard that assessed a director based on the higher experience of another director, if he were in that position of the director in question. However, the business judgment rule is a welcome cautionary device to allow the court to assess the basis of directors‟ decision.

78 Smerdon, R. op.cit p.94

79 Black, B.S. The Principal Fiduciary Duties of Boards of Directors op.cit. p.6

This duty of care and skill as contained under the CAMA is very relevant to corporate governance because it raises the level of liability of directors for their negligent conduct in managing companies and to make them accountable for their decisions. This is intended to spur directors to be more careful, prudent and sensitive in the performance of their functions of managing a company.

# Requirement for Directors to Avoid Conflict of Interest

The duty to avoid conflict of interest by a director is provided under section 280(1)80 that “the personal interest of a director shall not conflict with any of his duties as a director under this Act”. Section 280(2)81 stipulates areas in which conflict of interest might arise. These are situations where a director makes personal use of opportunity, property and information belonging to the company or when a director enters into a contract with his company. Conflict of interest becomes an issue when a director makes a profit by taking advantage of his position without the knowledge and consent of his company. The duty to avoid conflict of interest covers all conflicts, direct and indirect between the interest of the director and that of the company. A director might have a direct or indirect interest in a contract (or proposed contract) where the company is planning to sign a business contract with another organization which the director or connected person is a member or owner of the company.

If a director has interest in a contract with a company but has failed to disclose it, and has made secret profit or derived unnecessary benefit under the contract, he shall be under obligation to turn over same to the company.82 However, section 280(6)83 provides a situation where a director can be relieved of liability under conflict of interests situations. A director may escape liability under the said section if he “discloses his

80 CAMA. Op.cit

81 Ibid

82 Section 280 (3). Ibid

83 Ibid

interests before the transaction and before secret profits were made before the general meeting, which may or may not authorize any resulting profit.” This provision has specifically mentioned the general meeting as the approving authority. Therefore, any other authority like the board of directors cannot validly approve conflict of interest transactions. The provision is neither made subject to any other provision of the Act nor the company‟s constitution. The requirement of authorization by the general meeting is applicable to both private and public companies since CAMA has not made any distinction.

On the other hand, the Nigerian Code of Corporate Governance provides that “directors should promptly disclose any real or potential conflict of interest that they may have regarding any matters that may come before the Board or its committees”.84 This appears to contradict the statutory provision of CAMA under section 280(6) which requires disclosure “before the general meeting, which may or may not authorize any resulting profits”. While the Act requires disclosure to be made before the general meeting, the code requires disclosure to be made to the board or its committee. There is apparent contradiction which must be resolved in favour of the CAMA so that the provision of the Act prevails over the code provision.

However, it is argued by this work that the apparent contradiction can be resolved by requiring initial disclosure to be made to the board, so that appropriate steps would be taken by the board as required by the code (that is disallowing the director from discussing or voting on the matter) in order to take independent decision on the matter. After the board‟s decision, if the interest of the director is approved by the board, then the director‟s interest should be disclosed to the general meeting to exercise its discretionary power to either authorize or refuse to authorize the resulting profits. A distinction has to be made between the transaction and the resulting profits. The directors have the

84 Section 16.1(a)(e) Code of Corporate Governance in Nigeria, 2011

responsibility to deliberate and take decision on whether the company should enter into any transaction, which if such decision is taken independently will be valid. The aspect that the directors do not have power is the approval of the benefit that a director would receive from the transaction. That lies within the power of the general meeting to either approve or not.

The statutory requirement for disclosure is different in the United Kingdom where authorization is given by directors who are genuinely independent in the sense that they have no direct or indirect interest in the transaction.85 The position in the United Kingdom might appear to be good because it is easier for board of directors to meet and take decisions than the general meeting. Most business transactions have time effects so that decisions in relation to them must be taken in that respect. This is however, subject to abuse in the sense that the members of the board of directors may tend to use the approving power to reward one another by approving transactions that involve a director with the expectation that when it comes to his turn, the director will support his/her interest. It is posited that the Nigerian position of requiring the approval of the general meeting of conflict of interest transactions provides a better transparent and independent decision on the transaction.

Whether the disclosure is to be made to the board of directors or the general meeting, the issue to be determined is whether the director has breached the duty to avoid conflict of interest. For example, in the case of *J.J. Harrison (Properties) Ltd v Harrison,*86 a director of a company acquired some land from the company at a price which reflected the fact that planning permission had been refused to develop the land. At the time of the acquisition, however, the director was aware that the prospect of planning permission being granted had improved. That awareness was not disclosed to the board at

85 Section 175(4) to (6) United Kingdom Companies Act, 2006; see also Smerdon, R. *A Practical Guide to Corporate Governance*. Op.cit p. 95.

86 (2002) 1, B.C.L.C. 162

the meeting to approve the transaction. The court found that the director was in breach of his fiduciary duties to the company and held the property upon trust for the company. Accordingly, he was liable to account for the profits he made from the subsequent sale by him of the land.87

It is further contended that where the board or the general meeting is to take decision where a director has interest, the director in question or any other interested director should not participate in the meeting or vote to agree in the approval of the transaction.88 This is to allow independent judgment to be reached on the transaction. In *Erlanger v New Sombrero Phosphate Co.*89the Privy Council held that the board of directors to whom the disclosure is made for ratification should be independent, that is, the promoter (director) not having direct or indirect influence on their decision or he not being a member of it, nor taking part in the decision, and in the same way, the shareholders should be independent. The promoter (director) as shareholder nor those holding shares on his behalf or those holding shares of which he has beneficial interest do not vote in the resolution whether or not to ratify.

The duty to avoid conflict of interest of course is meant to promote good corporate governance. This is because where directors take decisions that are free from personal interest but for the interest of the whole company, it benefits all stakeholders in the company.

# Prevention of Directors from Accepting Benefits from Third Parties

The duty not to accept benefits from third parties is unambiguously provided by the CAMA that “a director shall not accept a bribe, a gift, or commission either in cash or kind from any person or a share in the profit of that person in respect of any transaction

87 Smerdon, R. op.cit. p.96

88 Section 16.1(b)(d) SEC Code of Corporate Governance in Nigeria, 2011

89 (1878) App. Cases. 1218

involving his company in order to introduce his company to deal with such a person”.90 This duty is strict and does not admit of any exception nor does it give room for ratification of the benefit by either the board or the shareholders in a general meeting. Subsection (4) of the said section 287 indeed states clearly that “in all cases concerning secrets benefits, the plea that the company benefited or that the gift was accepted in good faith shall not be a defence”. The only circumstance that attempts to relieve a director from liability for accepting a gift is where the gift was unsolicited and that it was made after the completion of the transaction. Even in this situation the director must have declared it to the board.91

The duty not to accept benefits from third parties is very relevant to corporate governance in the sense that it promotes the integrity and independence of directors in carrying out company business and decision making. This duty is to avoid possible conflict of interest between the interest of the company and that of the director. It is not expected that a director should be influenced by the personal gains he derives to determine his action or decision in any transaction between his company and another person. The duty further entrenched the common law principle of directors as fiduciaries to the company which prohibits them from deriving secret benefits by virtue of their office.

From the construction of section 287 (1) above quoted, the issue that calls for consideration is whether a benefit was received by a director to favour a person in a transaction with the company. It is assumed that the director when taking decision will tend to favour the person because of the benefits he had received and that would make him to compromise the interest of the company. The issue of conflict of interest sets in, which is prohibited.

90 Section 287 (1) CAMA. Op.cit.

91 Section 287 (3). Ibid

It is argued in other jurisdictions that where a benefit cannot be reasonably regarded as likely to give rise to a conflict of interest the duty not to accept benefits is not breached.92 It means that there will be no obligation to declare it to the board. The position of CAMA in Nigeria is stricter because under section 287(3)93 where an unsolicited gift is received after the transaction has been completed (which implies that there cannot be likelihood of conflict of interest), the director is still bound to declare the gift to the board. The board reserves the power to either approve or not approve the retention of the gift by the director.

# Consequence of a Breach of the General Duties

The breach of duty by a director calls to the question as to who is capable to enforce the breach. Generally, a director owes his duties to the company, so if a director breaches any of his duties, it is the company that can institute a legal action against the director94. The implication is that the board of directors might institute an action in the name of the company against the errant director. But if the directors appear not to be willing to proceed against a fellow director or previous board, individual members of the company can institute a derivative action against the director. A derivative action is brought in the name of the company so that if the action is successful, the company but not the individual shareholder takes the benefit. The procedures for instituting a derivative action are stated under sections 303-309.95 They include safeguards designed to prevent individual shareholders from instituting frivolous or unreasonable actions.96

The statutory provision for derivative action is very relevant to corporate

governance in the sense that it provides for a good check on the actions of directors and to make them responsible and accountable for their actions or inactions. Derivative action

92 Smerdon, R. Op.cit p.97.

93 CAMA. Op.cit

94 Sections 279 and 299, CAMA. Op.cit; see also *Foss v Harbottle* (1843) 2 Hare 461

95 CAMA. Ibid

96 Section 303(2) provides situations that must be established to the satisfaction of the court before an order for derivative action could be made.

has provided a good alternative to protect the interest of the company where fellow directors for their selfish interest, or an act of solidarity or any other reason are not willing to prosecute a fellow director. The whole essence of corporate governance is the protection of the interest of the company so that every stakeholder in the company would benefit equitably.

The remedies for breach of duty by directors have not been clearly set out by the Companies and Allied Matters Act. The same thing is noticed in the United Kingdom Companies Act. Under section 17897 the consequences are said to be the same as would apply if the “corresponding common law rule or equitable principles applied.”98 It means that the duties are enforceable in the same way “as any other fiduciary duty owed to a company by its directors.”99 The ultimate consequence is that the traditional remedies are still applicable. These include:

1. damages or compensation,
2. restoration of the company‟s property,
3. an account of profits made by the director who failed to disclose same,
4. rescission of a contract where the director failed to disclose interest, and
5. injunction.

Damages or compensation can be sought against a director where the effect of his breach of duty has made the company to suffer loss. Where a director fails to exercise the due care, skill and diligence expected of him or fail to exercise company powers for the right purpose and the company incurs loss in consequence thereof, it will be a proper case to hold the director responsible. Damages will be assessed in accordance with the normal rules applicable to negligence or breach of fiduciary duty. In the case of *Queens Moat*

97 United Kingdom Companies Act, 2006.

98 Smerdon, R. A Practical Guide to Corporate Governance. Op.cit p.99.

99 Ibid

*Houses v Bairstow and Others*100, dividends were unlawfully paid out of non-existent reserves. The directors were ordered to repay the unlawful dividends.101

Similarly, in the case of *Re-Engine Property Ltd and Another v Fergusson and Others,*102 Re-Engine property Ltd and its liquidators brought an action against the Fergussons and Della Court Property Ltd, a company in which the Fergussons were directors, alleging that the defendants were liable to account for funds advanced by ANZ Bank to Engine Property Ltd, which funds were subsequently misapplied. The claim was based on a breach of fiduciary and statutory duties by Mr. Fergusson, one of Re-Engine‟s directors. The Court found Mr. Fergusson, was in breach of his directors duties by causing Re-Engine to continue to apply for advances which were applied for purposes other than they were meant. The court ordered the money be recouped from Della Court Ltd who received it.

The remedies of restoration of the company‟s property and account of profits made by the director to the company have been statutorily mandated. Section 280(3)103 provides that “a director shall be accountable to the company for any secret profit made by him or any unnecessary benefit derived by him contrary to the provisions of subsection

(2) of this section”. The said subsection (2) prohibits a director from making any secret profit or achieving other unnecessary benefits in the utilization of the company‟s property. Section 287104 similarly states that where a director accept a bribe, a gift, or commission either in cash or kind from any person in breach of his duty, the company shall recover from the director the actual gift. These statutory provisions for recovery of secret profits are rather a reinforcement of the common law remedy for breach of

100 (2000) 1 BCLC. 549

101 Smerdon, R. op.cit. p.105

102 (2007) VSC 57

103 CAMA op.cit.

104 Ibid

fiduciary duties. In *Gluckstein v Barnes*105 A syndicate of four persons bought charges on a property at a discount and also bought the property at £140,000 afterwards. They formed a company to which they sold the property at £180,000 making a profit of

£40,000 and £20,000 on the charges when they were redeemed. The syndicate issued a prospectus disclosing only the £40,000 profit they made on the land but not the £20,000 on the charges on the land. It was held that the £20,000 amounted to secret profits made without full disclosure and therefore the syndicate was bound to return it to the company.

There is also the option for the company to rescind the contract a director enters into with the company without disclosure of the profit made. In *Erlanger v. New Sombrero Phosphate Co*,106 a company of which Erlanger was the head purchased an Island in the West Indies for £55,000 containing phosphates for mining. Erlanger formed a company to which this Island was sold at £110,000. The Privy Council held that since there was no disclosure of the amount of profit being made by the promoter, the company was entitled to rescind the contract and claim back its purchase price from Erlanger. The remedy of rescission does not apply where it is impossible to restore the parties to their *status quo* (their former position before the contract). For instance, in a contract like in the above case of *Erlanger v. New Sombrero Phosphate Co.* If the company had carried out mining activities on the island it will be difficult to restore the Island to Erlanger in its natural state as it was at the time of entering into the contract. In this circumstance, recovery of the profit or damages would be the appropriate remedies. In *Re-Leeds and Hanley Theatres of Varieties Ltd,*107 the court held that the quantum of damages shall be the amount of secret profits made by the promoter (or director).

With regard to injunction, it is meant to stop the director or board from carrying out or continuing with the breach. The CAMA has provided the basis on which a member

105 (1900) AC 240

106 Supra

107 (1902) 2 Ch. 809 (CA)

can apply to the court for an injunction. These include among other things where the company is taking any steps to enter into a transaction which is illegal or *ultra vires*, purporting to do by ordinary resolution any act which by its constitution or the Act requires to be done by special resolution; committing fraud on either the company or the minority shareholders where the directors fail to take appropriate action to redress the wrong done; and where the directors are likely to derive a profit or benefit from their negligence or from their breach of duty.108

All these remedies are available against the board or a director to ensure that directors in the company do not use their position to unduly derive unnecessary benefits or advantage to the detriment of other stakeholders in the company. This is the essence of good corporate governance in the sense that the goal of corporate governance (proper management of companies) is to balance the interests of the company‟s stakeholders. The remedies for breach of directors‟ duties are therefore meant to enforce the maintenance of equitable interest of all stakeholders.

108 Section 300 CAMA Op cit.

# CHAPTER FIVE

* 1. **DISCLOSURE REQUIREMENTS OF DIRECTORS UNDER CORPORATE GOVERNANCE IN NIGERIA**

# Introduction:

„Disclosure‟ which simply means making something known or revealing information is regarded as a very critical issue in the relationship between the company and its stakeholders, more importantly the shareholders and the general public. Both companies statutes and codes of corporate governance require companies to disclose information albeit material information about the company to the users of such information. Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of the information.1 Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management, and make informed decisions about the valuation, ownership and voting rights. The importance of disclosure is further underscored that it helps to improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environment and ethical standards, and companies‟ relationships with the communities in which they operate.2 Companies are required to engage in disclosures beyond the statutory requirements in the Companies and Allied Matters Act (CAMA).3

The responsibility of ensuring that the company fulfills the obligation of disclosure is vested in the board of directors. The Companies and Allied Matters Act4 specifically vests upon the directors the duty to prepare annual reports and accounts.5 The

1 Annotations to the OECD Principles of Corporate Governance, 2004 OECD Publications Service, France.

p. 50

2 Ibid. p. 49

3 Section 34.1 SEC Code of Corporate Governance in Nigeria, 2011

4 Cap. C20 LFN, 2004.

5 Sections 334(1) and 342 (1) Ibid.

code of corporate governance also vests the responsibility of preparing and ensuring the authenticity of annual reports in the board of directors.6 The annual report and accounts is the traditional channel of disseminating information about the company, however, in order to foster good corporate governance companies are expected to make timely disclosure of all material developments that arise between regular reports. Some of the key subjects of disclosure that require material information on them shall now be set and discussed.

# Information on Financial and Operating Results

The financial report is the most widely used source of information on companies.7 As noted earlier, the directors have the responsibility to prepare the company‟s financial statements and annual report.8 In a nutshell, a financial statement is required to show the financial performance and situation of the company. These include the balance sheet, the profit and loss account, the income and expenditure and notes on the accounts.9 The aims of financial statement are two-folds, that is, to enable appropriate monitoring to take place and to provide the basis to value securities. Investors are interested in information that may shed light on the future performance of the enterprise. This can only be possible and achievable if the financial statement discloses the true picture of the company‟s financial standing.

In an attempt to ensure the correctness of financial statements, the CAMA has provided that” the auditors of the company shall make a report to its members on the accounts examined by them, and on every balance sheet and profit and loss account, and on all group financial statements…”10 The annual audit of a company must be conducted

6 Section 34 SEC Code of Corporate Governance in Nigeria. Op. cit.

7 Annotations to the OECD Principles of Corporate Governance. Op. cit. p. 50.

8 Sections 334 (1) and 342(1) CAMA Op. cit.

9 Section 334(2) Ibid.

10 Section 359, Ibid.

by an independent, competent and qualified auditor.11 The audit provides external and objective assurance that the financial statements provide a fair and true representation of the financialposition and performance of the company. However, it has become a notorious fact that many of the corporate collapses have been linked to the compromises of external auditors. The case of Enron mega collapse in the United States of America in 2002 provides startling revelation that its external auditors compromised their independence and were caught up in the scandal.12

In order to further address the problem of manipulating financial statements, codes of corporate governance in some jurisdictions have provided additional requirement for authentication of financial statements. Section 34.213 provides that “the CEO and the Head of finance function of every public company should in a written statement to the Board, certify that the financial statements present a true and fair view of the affairs of the company”. In a similar vein, section 30214 requires certification of the annual report that “the annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made in the light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report.”

The essence of this certification requirement is to make the chief executive officer and chief finance officer who are primarily responsible for preparing financial statements to take responsibility so that they could be held liable for any malfeasance. With this understanding it is believed that they will be more careful in preparing financial statements. Trustworthy financial reporting and auditing is perhaps the most significant issue for corporate governance. Good corporate governance should ensure that financial

11 Section 358, Ibid.

12 Coyle, B. *The ICSA Study Text in Corporate Governance,* 6th Edition (Published by ICSA Information & Training Ltd. London) 2009.Pp. 12 and 171.

13 SEC Code of Corporate Governance in Nigeria. Op .cit.

reporting is reliable and honest, and that the opinion of the external auditors is objective and unbiased. If investors have doubts about the honesty or transparency of financial reporting, they will not be willing to invest thus resulting to decline of share value. Audited financial statements also have relevance to bond investors. When a company proposes to issue new bonds, rating agency caries out an investigation and then gives a rating to the bonds. The interest rate the company has to offer on the bonds will depend on the rating awarded. After the bonds have been issued, the rating agencies review the rating continually and adjust it if the financial condition of the company improves or worsens. The decision of investors whether or not to invest in bonds, and the rate of interest they require for doing so, depend on the judgment of the rating agencies. The rating agencies themselves rely on honest financial reporting from the companies they monitor. Full and fair financial disclosure helps the rating agencies to do their work. Where the financial report does not reflect the true position of the company it will cause rating agencies to make wrong judgments that will result to bond investors making wrong investment decisions with grave consequences.

# Disclosure of Company‟s Objectives

While companies ordinarily disclose their business or commercial objectives, they are expected to disclose polices relating to business ethics, the environment and other public policy commitments.15 Information on these matters can help investors and the concerned public to assess better the relationship of the company and the communities in which they operate and the steps that companies have taken to implement their objectives.

It is important that companies report on its social, ethical and environmental issues. The reasons are as follows: the company might have a genuine concern for social and environmental issues and consider that it is fulfilling its responsibilities to

stakeholders by reporting on them.16 This may show case the company‟s tract record of corporate social responsibility and therefore promote the company‟s relationship with the community which will make the company operate in a peaceful and friendly society. Another reason is that the company might recognize that its reputation with the public might be in jeopardy due to the nature of its business activities. Examples of such companies are mining, oil and gas exploitation companies. Having known that the public is aware of the effect of their activities on the natural resources and the environment, reporting on social and environmental issues allows the company to demonstrate that it appreciates the concerns of the society and explain how it is addressing them with its policies. It is also important to report on social, ethical and environmental issues because it is a way of trying to regain and build trust on the company where the company recognizes that the general public has lost trust in its ethics.

The company should be made to show that as it is carrying out its business activities, it is mindful of the damaging effect on the environment. The company‟s report should therefore consist of three aspects of performance, to wit, economic indicators, environmental indicators, and social indicators. The economic indicators are measures typically associated with financial reporting which has already been considered above. The social indicators might include measures relating to employment and employees, society and the community such as employee diversity, recordable injury rates, donations to communities and sponsorships.17 While the environmental indicators might include consumption of materials in products and services, reducing energy use, minimizing the release of toxic materials/pollutants, improving the recycling of materials, and maximizing the use of renewable resources.18

16 Coyle, B. *The ICSA Study Text in Corporate Governance*, Op.cit. p.184.

17 Cole,B. Ibid. p. 187; See also section 28 of SEC Code of Corporate Governance in Nigeria, Op. cit.

18 Coyle, B. Ibid. p.188

The Nigerian SEC Code of Corporate Governance has actually required a report on social and environmental issues. Section 34.4(k)19 states that the company‟s annual report should include the “company‟s sustainability policies and programmes covering issues such as corruption, community service, environmental protection, HIV/AIDS and matters of general corporate social responsibility.” Sustainability reporting also referred to as „triple bottom line‟ reporting is aimed at encouraging companies to recognize social and environmental issues in their business reporting system. This gives rise to the three Key indicators of economic, environmental and social aspects of performance as components of an annual report.

# Disclosure on Major Shareholding and Voting Rights

It is in the interest of good corporate governance to inform investors about the ownership structure of the enterprise and their rights vis-à-vis the rights of other shareholders. Such information should cover the structure of a group of companies and intra-group relations. The disclosures should make transparent the objectives, nature and structure of the group.20 Other countries require disclosure of ownership data once certain thresholds of ownership are exceeded. Such disclosure might include data on major shareholders and others that directly or indirectly, control or may control the company through special voting rights, shareholders agreements, the ownership of controlling or large blocks of shares and significant cross shareholding relationships.21 There are some cases where two companies might have cross-shareholdings so that each holds a block of shares in the other. When cross-shareholding exists, the companies might have some form of strategic alliance or mutual understanding. In other cases, one company might hold a block of shares in another, possibly potential base for launching a takeover bid in the

19 SEC Code of Corporate Governance in Nigeria, Op. cit.

20 Annotations to the OECD Principles of Corporate Governance Op. cit. p. 51

21 Ibid.

future. Some individuals own shares directly. In general, many shareholders hold only small number of shares. The votes of small shareholders are unlikely to affect the outcome of any shareholder vote at a general meeting of the company, where the block votes of institutional shareholders or large private shareholders carry much more weight.

In the United Kingdom company law requires shareholders to notify their company (public company) when their shareholding reaches 3 per cent of the issued share capital and then whenever their shareholding changes by 1 per cent or more (up or down). For institutions that manage share portfolios for other investors, the notification threshold is 10 per cent of the share capital.22 Quoted companies are in turn required to notify the stock market of these changes, so that the market as a whole could be kept aware of increases or reduction in large shareholdings.

The rationale for requiring major shareholdings to disclose their interest publicly has been stated in the United Kingdom thus:

a company, its members and the public at large should be entitled to be informed promptly of the acquisition of a significant holding in its voting shares… in order that existing members and those dealing with the company may protect their interests and that the conduct of the affairs of the company is not prejudiced by uncertainty over those who may be in a position to influence or control the company.23

The disclosure is not for the mere purpose of showing interest in the company‟s securities but it is aimed at revealing the actual or potential control of the company. The disclosure requirement is important because it serves as a prior warning to the company‟s management and to some extent its members by giving them notice of who is building up a stake in the company, which may be a potential takeover bid. On the part of the public it

22 Coyle, B. *The ICSA Study Text in Corporate Governance* Op. cit. p. 119

23 Department of Trade Disclosure of Interests in Shares (1980) p.2; See also Gower and Davies, (2008) *Principles of Modern Company Law.* 8th edition by Davies, P.L. Thomson Reuters (Legal) Limited-Sweet & Maxwell, London, p. 923.

may be said that disclosure promotes the conceptually separate goal of market transparency.24

It has been noted by this work that as important as disclosure of significant shareholding is to corporate governance, it is neither required by the Nigerian CAMA nor the general code of corporate governance. It is discovered however, that only the Code of Corporate Governance for Banks in Nigeria Post Consolidation25 that has made provision fordisclosure of significant equity holding. Section 5.1.326 requires that “an equity holding of above 10 per cent by any investor is subject to CBN‟s prior approval” This provision applies only to banking corporations because the code is a sectoral code enforceable only to the banking sub-sector. The requirement of the CBN‟s approval for equity holding of above 10 per cent by an investor is aimed at bringing such enormous investment in a bank to the close supervision and control of the regulatory body – the CBN. This will enable the CBN to monitor the corporate governance of the bank. The objective is to stem pressure and influence by major shareholders in the management of banks.

Given the importance of disclosure of significant shareholding in companies, it is canvassed here that such requirement be extended to all public companies. All companies in addition to their sectoral disclosure requirements make disclosure of any significant shareholding to the Corporate Affairs Commission (CAC) once the stated threshold is crossed. The CAC has functional interest in ensuring that all companies are properly managed.27 Every company irrespective of the nature of its business and in whatever sector is first and foremost registered by the CAC and therefore subject to the regulatory powers of the CAC.

24 Gower and Davies, Ibid

25 2006

26 Ibid

27 Section 7 Companies and Allied Matters Act, op.cit. This section states the functions of the CAC.

The disclosure of significant shareholding should not be limited to direct shareholding but to include indirect shareholding through nominee(s) and concert party. Shares held through a nominee are actually for the beneficial interest of the nominor. Where the sum total of the investor‟s direct shareholding and those through a nominee exceed the threshold, it should be subject to disclosure. Shares acquired through concert party or „acting in concert‟ occurs when such persons “who pursuant to an agreement or understanding (whether formal or informal) actively cooperate, through the acquisition by any of them of shares in a company to obtain or consolidate control of that company”28 Where the combined shareholding of the concert party exceed the threshold, they should disclose because their agreement is aimed at fostering a united front to have dominance and control of the company in order to chart their interest.

# Disclosure of Composition and Operation of the Board

Section 34.4(a) of the Nigerian SEC Code of Corporate Governance requires disclosure to include “composition of the Board of Directors.” The names of all the directors, their positions as well as their qualification/experience are relevant facts to know about a board.29 The OECD Principles of Corporate Governance further emphasize that information about individual members of the board in relation to their experience and qualifications, share ownership in the company and membership of other boards is very important30. Such disclosure shows the level of experience and the time commitment a board member has in the company. Directors experience, of course is acquired from among other means by participation in board membership of other companies. This may at the same time on the flip side of it be an indication that the member of the board may not have enough time for the company due to his several board memberships. But more

28 Gower and Davies, *Principles of Modern Company Law,* Op. cit. p. 599

29 Section 4, SEC Code of Corporate Governance in Nigeria, op cit

30 Annotations of the OECD Principles of Corporate Governance. Op.cit p. 51.

importantly, disclosure of directors‟ share ownership and membership of other boards will reveal potential conflicts of interest and make transparent the degree to which there are inter-locking boards.

Realizing the effect multiple directorship to some extent could have on a company‟s corporate governance, Section 6.131 enjoins companies to take into cognizance other commitments of a person nominated for appointment as director whether he/she can have time for the new appointment. The section states:

there should be no limit on the number of concurrent directorships a director of a company may hold. However, concurrent service on too many boards may interfere with an individual‟s ability to discharge his responsibilities. The Board and the shareholders should therefore give careful consideration to other obligations and commitments of nominees in assessing their suitability for appointment into the board.

In view of the above caution it is required of a prospective nominee to the board of a company as well as serving directors to notify the board of memberships/appointments on other boards.32 The disclosure is intended to provide the board with information that will form the basis to determine whether the prospective nominee can contribute effectively to the performance of the board and the discharge of its responsibilities.33 For avoidance of doubt, the code has clearly discouraged multiple directorships in the same industry. Section 6.1 (d)34 unequivocally provides that: “directors should not be members of Boards of companies in the same industry to avoid conflict of interest, breach of confidentiality and misappropriation of corporate opportunity.” This is intended to avoid a situation where a director is likely to use business information and knowledge acquired by virtue of being a director in one company for the benefit of another company. The reason is obvious because companies in

31 SEC Code of Corporate Governance in Nigeria, Op. cit.

32 Section 6.1 (a) and (c) Ibid.

33 Section 6.1 (b) Ibid.

34 Ibid.

the same industry are apparent potential competitors. To allow a person to hold multiple directorships in the same industry will not guarantee confidentiality of information acquired by the director who for some interest may divulge sensitive information to a competitor-company. Where information reveals that a prospective nominee is already a director in a company within the same industry, it will be a valid ground for disqualifying the individual from appointment.

On the issue of interlocking directorship, the code of corporate governance in the same vein provides that “to safeguard the objectivity and independence of the Board, cross memberships on the boards of two or more companies should be discouraged. However, where that will lead to a conflict of interest situation as in cross-memberships of boards of competing companies, then it must be disallowed”35 Interlocking directorship where it does not involve competing companies is more possible between parent and subsidiary companies or group of companies. It is more likely to see directors in each company being directors of the other company. This is a situation that can create an avenue to affect the decision making process of a particular company in the sense that in some cases decisions are taken by the board not in the overall interest of the company but the interest of the other company. This is of course contrary to established principles of company law that each company in a group of subsidiary companies has its independent corporate personality distinct from the parent or holding company.36 Accordingly, the decisions of a subsidiary company should not be taken at its expense to further the interest of another company.

There is no doubt that disclosure of board memberships will enable the public and corporate regulators to assess cross membership of the board and be in a position to determine whether in the circumstance the board is capable of being objective or

35 Section 7.2 Ibid.

36*Union Beverages Ltd v Pepsi Cola* (1994) 2 NACR, 59 at 68, C.

independent. When investors have this relevant information, they take considered investment decisions like either to invest, not invest or divest from the company. The regulators on their part take necessary steps to correct anomaly by enforcing the law.

Another vital aspect of disclosure of the composition of the board of directors is information on directors who are considered independent. In many countries, it is incumbent on the board to set out the reasons why a member of the board can be considered independent.37 The criteria for determining an independent director are set out under section 5.5(a) (i) – (viii).38 However, in a summary, an independent director is referred to as a non-executive director who is “free of any relationship with the company or its management that may impair, or appear to impair the director‟s ability to make independent judgments.”39 The relevance of independent non-executive directors is to provide objective decision making process for the board. It is in this regard that codes of corporate governance of other jurisdictions provide that majority of the members of the board should be independent non-executive directors.40 The contrary is the case with Nigeria which permits only one independent director on the board. Section 5.5(c)41 provides that “every public company should have a minimum of one independent director on its board.”

The disclosure of independent directors on the board becomes more necessary under the Nigerian situation because it will make the public to know the extent of the board‟s independence by the number of independent directors on it since no specific percentage is mandated. A board that consists of majority of non-independent directors is

37 Annotations to the OECD Principles of Corporate Governance Op. cit. P. 52

38 SEC Code of Corporate Governance in Nigeria, Op. cit. Similar provisions in other Jurisdictions are: Section 2.4.3 South African code of Corporate Practices and Conduct, 2002; Principle A. 3.1 The U.K. Combined Code on Corporate Governance, 2008

39 Section 5.5 (b) SCE Code of Corporate Governance in Nigeria op cit.

40 Principle A. 3.2 U.K Combined Code op.cit; Section 2.2.1 South African Code. Op.cit.

41 SEC Code of Governance in Nigeria. Op. cit. See also section 4.3 of the same Code.

bound to be bias and would take decisions that promote their interests above the interest of the company and other stakeholders. This is what corporate governance wants to avoid.

# Disclosure of Company‟s Governance Structure

In many countries now including Nigeria, there is a mandatory requirement that companies in their regular reporting should report on their corporate governance practices.42 The trend in several countries is that companies are directed to implement corporate governance principles set or endorsed by regulatory authorities. In Nigeria, the code requires “the board of a public company (to) ensure that the company‟s annual report includes a corporate governance report that conveys to stakeholders clear information on the strength of the company‟s governance structures, policies and practices.43 In countries like the United Kingdom, companies are required to disclose compliance with the code but where the company fails to comply with any aspect, there should be explanation for the non-compliance.44 This model is what is referred to as mandatory reporting on a “comply or explain” basis. However, other jurisdictions like the United States of America require mandatory compliance with its corporate governance provisions having been introduced by statutory enactment.45 Whereas, in Nigeria under the current regime of corporate governance, it cannot be categorically said that the method of reporting falls under the United Kingdom model or the United States of American model. From the beginning of the Nigerian Code, its perception has been captured in this respect that:

The code is not intended as a rigid set of rules. It is expected to be viewed and understood as a guide to facilitate sound corporate practices and behaviour. The code should be seen as a dynamic document defining minimum

42 Annotations to the OECD Principles of Corporate Governance. Op.cit. p. 53.

43 Section 34.4 SEC Code of Corporate Governance in Nigeria. Op.cit.

44 Preamble, The Combined Code on Corporate Governance, United Kingdom, 2008

45 Coyle, B. *The ICSA Text in Corporate Governance.* Op. cit p. 295

standards of corporate governance expected particularly of public companies with listed securities.46

Given the understanding that the code is not a rigid set of rules, it means that non- compliance with the code is not mandatory. The above quotation clearly states that the code should be viewed as a guide. Where there are areas of non-compliance, the company is only expected to report on the aspects it has complied. Section 34.1447 conveys this impression that “all public companies should state in their annual reports how they have applied this Code and the extent of their compliance.” This provision has not stated the obligation of the company in respect of those areas of non-compliance. Similarly, in section 1.3 (f)48 the Code provides that“in their Annual Report to the SEC, public companies shall indicate their level of compliance with this Code.” From the discussion above it can be seen that the model of reporting on a “comply or explain” is not categorically required under the Nigeria SEC Code. It also goes without contention that the mandatory and rigid application of the code as it is the case with the United State of America is not applicable to Nigeria. It means therefore that Nigerian companies are left to their discretion and to be driven by their desire to attract the benefits of compliance with the code to show that they are indeed applying good corporate governance.

The position of the Nigerian SEC Code for voluntary compliance with its requirements without any condition attached to non-compliance is arguably capable of weakening the application of the Code. The code of corporate governance is meant to check corporate fraud and other forms of malpractices by directors and managers in order to foster the interest of companies and diverse stakeholders.

From the information revealed in this study, it is clear that the Nigerian corporate environment is bedeviled with several cases of corporate abuses and lapses that resulted

46 Section 1.3(a) SEC Code of Corporate Governance in Nigeria Op.cit.

47 Ibid.

48 Ibid

to various degrees of company distresses. It has been shown in this research that corporate governance lapses were significantly responsible for the collapse of over 70 per cent of defunct companies in Nigeria over the last two decades.49The case of revocation of the licence of Peak Merchant bank was also on ground of corporate misbahaviour of the overbearing influence of the chairman, significant insider abuses and reckless granting of credits.50Another instance was the removal and replacement by the Central Bank of Nigeria of the chief executives of Oceanic bank, Intercontinental bank, Union bank, Afribank and Finbank due to deep rooted mismanagement and large cases of insider lending to directors and their relations, unsecured and bad debts. Other cases included the manipulation of financial reports and secret financial benefits to directors of Cadbury Nigeria Plc between 2002 and 2005 and, the illegal trading of shares of Afroil and Capital Oil Plc when the companies had ceased to in business as well as insider trading.51

In view of the already entrenched culture of corporate malpractices and disregard to laws, rules and regulations and, the loss of moral values and general corruption in Nigeria it will be difficult for corporate managers to voluntarily change to good standard of value system and observe best practices as required by the code of corporate governance. The Code can only make significant impact of transforming business practices in Nigeria in an atmosphere of some form of compulsion on the part of corporate managers to do the right thing. It means therefore that in Nigeria there should be some level of mandatory compliance with the code of corporate governance. Those issues that the SEC and other regulators consider as core to ensuring better management and survival of companies should be made mandatory while aspects of general principles

could be made voluntary.

49 Why the Rising Business Failure in Nigeria? [http://www.myfinancialintelligence.com](http://www.myfinancialintelligence.com/) p.2of5. Accessed on 14/4/2013

50 Osuagwu, G. O (2013) “Implication of Corporate Governance on Performance of Deposit Money Banks in Nigeria” Arabian Journal of Business and Management Review (Oman chapter) Vol.2 No2, p.107

51 Olaleye, O. (2008) “SEC Suspends Afroil of Trading on Capital Oil Shares” Journal of the Nigerian Securities and Exchange Commission, SEC News Vol.4 No 2 p.10

In order to ensure compliance of companies there is need to review the current position of the SEC Code of lack of sanctions for non-compliance to provision of sanctions. Unless sufficient sanctions are prescribed for non-compliance with the Code that can facilitate the observance of the Code for a better business environment in Nigeria. Prescribed sanctions give prior notice to law breakers of the consequence of their intended or committed acts. Deterrent sanctions can make some people to desist from doing wrong.

It is noted that in the corporate governance abuses by Cadbury Nigeria Plc, the SEC imposed different degrees of penalties against the company, directors and auditors, the penalties based on the discretion of SEC and not on the provision of the Code. This is not satisfactory situation where the determination penalty would depend on the discretion of SEC. This may not provide for a just and equitable assessment of penalties in all cases since there is no prescribed basis for determining penalties. There is therefore need for prescribed sanctions against specific non-compliance of with the provisions of the Code.

The situation in Nigeria is similar to that of the United State of America (USA) before the enactment of the Sarbanes-Oxley Act in 2002. Like Nigeria, the USA had robust accounting laws and rules which were being circumvented by corporate managers. It was during that time that Enron Corporation collapsed incredibly to dismay investors and government. The lessons of the Enron collapse compelled the USA Government to enact the Sarbanes-Oxley Act and made mandatory compliance by companies with its corporate governance provisions in order to entrench best practices. The level of corporate malpractices that had existed in USA prior to 2002 required the drastic and mandatory measures of the kind of Sarbanes-Oxley Act make considerable change of attitude in corporate management.

In view of the above submissions this study posits that the mandatory compliance with the SEC Code is a better measure than the voluntary approach. It is believed that the

mandatory approach with corresponding adequate sanctions for non-compliance will facilitate a faster observance of the Code by all companies to transform the corrupt business environment in Nigeria.

# Information on the Existence and Nature of a Risk Management System

Disclosure about the system for monitoring and managing risk is increasingly regarded as good practice.52 Users of financial information and market participants need information on reasonable foreseeable material risks of the enterprise. This will help investors to determine whether their investments or investing in the enterprise would be productive or adverse.

Risk refers to the possibility that something unexpected or not planned for will happen. In many cases, risk is seen as the possibility that something bad might happen.53 Businesses are exposed to the risk of losses through errors and omissions by its employees or by fraud and dishonesty. There is no doubt that every investment is risky. Thus every investment decision requires an evaluation of the risks as well as the potential returns. In as much as investor‟s desire high returns from their investments, they would be averse to taking excessive investment risks in order to achieve such returns. The board of directors has the responsibility to put internal control measures in place to check and prevent such risks as losses through error, omission, fraud and dishonesty. In the same vein, when directors take major investment decisions or decide on corporate strategy, they should properly assess the risks as well as expected returns.

The responsibility of directors in risk management is underscored by the Nigerian SEC Code of Corporate Governance that: “the Board is responsible for the process of risk management. It should accordingly form its opinion on the effectiveness of the process. Management is accountable to the Board for implementing and monitoring the

52 Annotations to the OECD Principles of Corporate Governance. Op.cit.

53 Coyle, B. *The ICSA Study Text in corporate Governance*. Op. cit. P. 220.

process of risk management and integrating it into the day-to-day activities of the company.”54 Risk management has been described as “the process by which executive management, under board supervision, identifies the risk arising from business … and establishes the priorities for control and particular objectives.55 Risk management is very important to a company because failure or neglect of it could result to financial and business collapse. For instance in the year 2008 a number of major banks suffered enormous losses, partly through their involvement in markets for collateralized debt obligations linked to high-risk mortgages. The problems began in the United States of America, but quickly spread to Europe and parts of Asia. For various reasons, many banks were faced with critical shortage of cash (liquidity) and capital (due to their huge losses). They had allowed their businesses to grow through high risk operations and had failed to provide for the possibility that events might eventually turn out unfavourably.56

Even though the overall responsibility for risk management is vested in the board of directors, there is usually a board committee that is delegated with detail and specific responsibility for managing risk. In Nigeria, the Code has particularly mandated the establishment of a risk management committee. Section 9.257 emphatically provides thus: “the Board may in addition to the Audit Committee required by the Companies and Allied Matters Act (CAMA) establish a Governance/Remuneration Committee and a Risk Management Committee…” In furtherance of the above provision, the Code states that “the Board may establish a Risk Management Committee to assist it in its oversight of the risk profile, risk management framework and the risk-reward strategy determined by the Board.58 The functions of the Committee are expected to cover issues that have been specified under section 10.2 of the code. The functions include the following:

54 Section 29.1 SEC Code of Corporate governance in Nigeria, 2011.

55 Coyle, B. op. cit. p. 221

56 Ibid

57 SEC Code of Corporate Governance in Nigeria. Op.cit.

58 Section 10.1.Ibid.

* + 1. Review and approval of the company‟s risk management policy including risk appetite and risk strategy;
    2. Review the adequacy and effectiveness of risk management and controls;
    3. Oversight of management‟s process for the identification of significant risks across the company and the adequacy of prevention, detection and reporting mechanisms;
    4. Review of the company‟s compliance level with applicable laws and regulatory requirements which may impact the company‟s risk profile.
    5. Periodic review of changes in the economic and business environment, including emerging trends and other factors relevant to the company‟s risk profile; and
    6. Review and recommend for approval of the Board risk management procedures and controls for new products and services.59

From the above functions, the objective is to establish a system that would address internal and external risks. Internal risks are addressed by establishing internal control mechanisms to prevent adverse events from happening or to detect failures in control when they occur. The internal control system should be sufficient and effective to minimize the risk of serious losses through error or fraud. On the other hand external risks arise due to unpredictable changes in the economic, business, political, technological and financial environment. It also includes regulatory and compliance risks. This refers to the risks the company would face for breaking the law or failure to comply with regulations. The business environment is now highly regulated, with laws or regulations affecting areas such as health and safety, environment, product safety, competition law, financial services regulations, bribery and corruption, taxation and company law in general. Breach of any can be punished with fine. In addition, a regulatory raid and the attendant publicity may adversely affect the reputation of the company to the advantage of its competitor.

Risk management policy of a company is important material information that is capable of affecting investor‟s decision concerning the company. Accordingly, codes of corporate governance of many countries including Nigeria require disclosure of risk

59 Section 10.2. Ibid

management policies. The Nigerian Code provides that “the board should ensure that the company‟s risk management policies and practices are disclosed in the annual report.”60 In the United Kingdom it similarly requires that “the board should at least annually, conduct a review of the effectiveness of the group‟s system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.”61 It can be seen that the United Kingdom Combined Code has identified the categories of internal control as “financial, operational and compliance controls” which the company should report on in addition to risk management systems. The Nigerian code provision on disclosure of risk management is rather general and leaves the company with the discretion of what risk policy to disclose. It is common with human nature that what is not specifically demanded to be done is in most cases not voluntarily done especially where it would be adverse to the interest of the person. It is hereby deemed necessary to briefly explain the three categories of internal control to identify their nature.

Financial controls are mechanism established to ensure that there are no errors in the preparation of accounting records and financial statements; no fraud is committed and detection of fraud when it occurs; assets of the company are not stolen, lost or needlessly damaged; or that the risks are reduced.62Operational controls are designed to prevent failures in operational procedures or to detect and correct operational failures if they do occur. Operational failures may be caused by machine breakdowns; human error; failure in the performance of systems; weakness in procedures; and poor management.63Compliance controls are meant to ensure that the company complies with laws, rules and regulations.64 Companies operate in different sectors of the economy and

60 Section 29.2 (e) Ibid

61 Section C. 2.1. Code Provision of the United Kingdom Combined Code, 2008.

62 Coyle, B. Op. cit. p.222.

63 Ibid. p.223.

64 Ibid

vary according to the nature of their businesses. Companies must comply with the general company law as well as specific sector regulatory rules and regulations.

It is opined in this work that in order to enhance a better understanding of what the companies are expected to report on and to provide a holistic content, the Nigerian Code should include among other things in its report requirement the above three types of internal controls.

# Statutory Disclosure Requirements to Enhance Corporate Governance

There are some transactions that involve the interest of the company and its directors, which the Companies and Allied Matters Act65 deems expedient to prohibit to some extent but where they exist they must be disclosed and necessary approval obtained before they are deemed valid. The class of transactions concerned are those that tend to promote the interest of directors in such a way that if they are not strongly regulated the interest of the company might be overreached. Some of the important transactions are considered here under.

# Loans to and other Arrangements Benefiting Directors

The Companies and Allied Matters Act in section 270(1) ordinarily prohibits companies from making loan to any person who is its director, or entering into any guarantee, or providing any security in connection with a loan made to a director. The above section mentions that a director in this respect includes a director of a holding company. This prohibition does not make any distinction between a private and public company. It means that both types of companies are covered by the prohibition.

65 Cap. C20 Laws of Federation of Nigeria, 2004

The prohibition of loans to directors has some elements of good corporate governance given the control directors exercise on the company‟s activities, they would like to explore such opportunities where they exist for their benefit against the interest of companies and their stakeholders. The directors would tend to approve loans for themselves that are not intended to be paid or at the expense of the company business. Apart from prohibition of making a direct loan by the company to its director, another transaction prohibited by the above section 270(1) is to enter into a guarantee or provide any security by the company for a loan made to its director by another person. In these instances, even though funds are not advanced to the director by the company, the ultimate effect is the same as loan because the company would be called upon to satisfy the loan where there is failure on the part of the director to make payment. It is the company‟s fund or property that would suffer in the circumstances. If a director claims to be credit worthy, he should be able to borrow money from other sources and provide good security and not necessarily affecting the company‟s fund.

There are however, instances where a company may be allowed to advance money to its director notwithstanding the prohibition under section 270(1). Paragraph (a) of the above subsection (1) permits the company to provide a director with fund to meet expenditure incurred or to be incurred by him for the purpose of the company or for the purpose of enabling him to properly perform his duties as an officer of the company.66 Where a company wants to utilize this proviso to make a loan, or enter into any guarantee, or provide any security, there must be disclosure of the purpose of the expenditure and the amount of the loan or the extent of the guarantee or the security for approval at the general meeting.67

66 Section 270(1) (a) Ibid

67 Section 270(2) (a) Ibid

From the above disclosure requirement it is the shareholders in a general meeting and not the board of directors that have the power to approve the transactions covered by section 270(1). The disclosure must be detail to provide the shareholders with sufficient information to take a candid decision. The items of disclosure mentioned by section 270(2) (a) are the purpose and amount of the loan. The disclosed purpose of the loan will enable the shareholders to know whether the fund is meant to enable the director to properly perform his duties as an officer of the company, or promote the interest of the company. The disclosure of the amount of the loan or expenditure would also provide the shareholders the yardstick to access the capability of the company to bear the risk without adversely affecting the company‟s income. This is one of the factors that led to the collapse of Enron company in the United States of America. In one financial year the company paid out cash bonuses of almost $750 million to senior executives when the reported total net income of the group was only $975 million.68 The company failed to take into account its financial strength in making the cash benefits to the directors.

The approval of such transactions must be given by the appropriate authority (that is, the company in a general meeting) and upon the conditions mentioned above (that is, for the purpose of the company or to enable the director to properly perform his duties). Where either of this is not observed, “the directors authorizing the making of the loan, or the entering into the guarantee, or the provision of the security, shall be jointly and severally liable to indemnity the company against any loss arising there from.”69 That is to say that the amount of the loan can be recovered from the director who took the loan and the directors who authorized the loan. Where the transaction incurs additional loss to the company, it will be incumbent on the company to claim damage against the affected director under the general common law principles.

# Information on Compensation to Retiring Directors and Loss of Office

The remuneration package of directors, especially executive directors comprises of both remuneration while in office and severance payments. It has already been pointed out in this work of the public outcry about the excessive remuneration packages of directors.70 The issue at this point is the payments made to retiring or removed directors. It has been observed that severance payments have been high for executives.71 The paradox is that in most cases such payments are made to executives who have failed having led their company to set backs in business strategy or even financial catastrophe.72 For instance, there was public anger over the pension perks of the former chairman of General Electric which included the use of the company‟s Boeing 737 and an apartment in central park, free wine, food, toiletries, flowers, limousine service, ticket to Wimbledon tennis and baseball game and country club membership, all in addition to his $9million a year pension.73 Even though he gave up most of his perks due to public outcry, it shows the outrageous retirement packages to directors which if not checked it will constitute a serious financial problem to companies. Where a director is removed from office for non- performance, such outlandish payment would mean rewarding failure.

Even though compensation for loss of office is permitted under section 262(6)74 it must however, be done in compliance with the said CAMA. For avoidance of doubt section 262 (6) provides thus:

nothing in this section shall be taken as depriving a person removed under it of compensation or damages payable to him in respect of the termination of his appointment as a director or of any appointment terminating with that as director, or as derogating from any power to remove a director which may exist apart from this section.

70 Coyle, B. *The ICSA Text in Corporate Governance.* Op cit. Pp. 19, 194 and 195

71 Ibid. p. 196

The payment of compensation for loss of office or in connection with retirement of a director can only be valid when the conditions mentioned in section 271 and 272(1)75 are complied with. The conditions are that the particulars with respect to the proposed payment and the amount have been disclosed to members of the company. The disclosure and approval of any severance payment to directors is made mandatory. The condition forms the basis for the legality of such payment. The section says, approval must be given by the company. In this regard company means the members in a general meeting, and not the board of directors. The inference is drawn from the fact that the disclosure is made to the members of the company and so should be the appropriate approving authority.

In furtherance of the above statutory provisions requiring disclosure and approval of director‟s severance payment by the members of the company, the Nigerian SEC Code of Corporate Governance enjoins companies to develop a comprehensive policy on remuneration for directors and senior management.76 The remuneration policy should define the criteria and mechanism for determining levels of remuneration.77 The Code could not provide the components of the criteria and mechanism which should form the basis of the determination. The details of the policy are left to the company. It is on the basis of the remuneration policy that a director‟s remuneration package is drawn. The package may include severance payments. It is at this juncture that shareholders‟ approval is needed. Once a remuneration package has been agreed between a company and a director, it becomes a binding and enforceable contract. In view of the above, members of the company must consider the issue of director‟s severance payment very critical and be willing to oppose where it is unreasonable. For instance, in 2005 shareholders of United Business Media voted against the company‟s remuneration report, in protest against a decision by the company to award an *exgratia* (bonus) payment of £250,000 to Lord

Hollick, the departing chief executive officer. Following the opposition, Lord Hollick agreed to waive the bonus.78

The fact that members of the company approve a remuneration policy does not obviate the requirements of approving a specific package which has been determined based on the policy. This was illustrated in the case of *Vodafone* and its chief executive officer (CEO) Sir Christopher Gent in 2002. The company consulted widely with institutional investors about a new remuneration package for the CEO, and obtained their approval for the principles of the package. However, when the company eventually applied the principles to devise a detailed package, many shareholders were dissatisfied.79 The problem appears not actually to be with the principles of the remuneration policy but in getting the detail of the package right. This makes it necessary for scrutiny of remuneration package by the members.

It is submitted that the drawing of severance package of a departing director either by retirement or termination should be done at the point of disengagement. This will enable the company to take into consideration important determining factors like the financial position of the company, the economic situation in the country at the time, and contribution of the director to the business and development of the company. If severance package is determined and agreed upon at the time of appointment of the director, it might not realistically reflect the above indices because they are bound to change especially the economic situation of the company and the country. For instance where a chief executive officer was appointed during a period of economic boom thus improving the company‟s stock prices, profit and financial strength but at the time of his retirement there was economic recession as witness in the year 2002 all over the world, the computation of the compensation package will not be same at the two periods. Another

limb of the argument is that where compensation package has been negotiated and agreed upon in the director‟s contract of service, as noted earlier it becomes a binding contract. This situation will make ambivalent directors not to render selfless service to the company because he believes that generous severance package awaits him even if he is removed.

# Disclosure of Directors‟ Shareholdings

The disclosure of director‟s shareholding under the Companies and Allied Matters Act is made by providing information of the director‟s interests in the company‟s shares in a register created by the company. Every company is required to keep a register showing each director the number, description and amount of any shares which are held by or in trust for him or of which he has any right to become the holder.80 Every company means both private and public companies alike. For the purpose of disclosure of directors‟ interest in shares of the company where he/she is a director, the definition of director incorporates a shadow director. A shadow director is any person on whose instructions and directions the directors are accustomed to act.81 The explicit provision of section 275

1. (a)82 states that “any person, in accordance with whose directions or instructions the directors of the company are accustomed to act, shall be deemed to be a director of the company”. Even though a shadow director is not a duly appointed director, once he is identified in relation to a company, his interest in the company‟s shares need to be disclosed by providing the information in a register provided by the company for that purpose. The inclusion of a shadow director under the disclosure of directors‟ interest in shares is the recognition of his/her indirect power to make managerial decisions affecting the future development and business prospects of the company. Such decision as may be

80 Section 275 (1) Companies and Allied Matters Act. Op.cit

81 Section 245 (1), Ibid

82 Ibid

taken upon his instructions would be for his interest, so where such decisions incur liability he should be accountable for them.

In some instances a director‟s interest in his/her company‟s shares may not be direct. The Companies and Allied Matters Act recognizes some situations where a director is deemed to have interest in shares of the company in which he/she is a director. Section 275 (11) (b) states that:

a director of a company shall be deemed to hold or to have interest or right over, any shares or debentures, if a permanent representative of the body corporate other than the company holds them or has that interest or right in or over them, and either-

* 1. that permanent representative is accustomed to act in accordance with his directions or instructions; or
  2. he is entitled to exercise or control the exercise of one third or more of the voting power at any general meeting of that body corporate.

The two situations above recognize the power of the director over the shares of his company that are held by another body corporate, if he can determine the way the shares are to be used, then he has interest in them.

The statutory requirement of disclosure of directors‟ interest in shares has failed to recognize some other relationships by which a director might naturally have interest in the shares held by another person. Such relationships include spouses, business associates and children. These relationships are referred to as “connected persons”. In the United Kingdom, the definition of connected persons brings in any relative of the person discharging managerial responsibilities who has shared the same household for at least twelve months. Many members of the director‟s family who are living with him are brought into the connected person‟s definition.83 The restriction of the definition of

„connected persons‟ to members of the directors family living with him has minimized the efficacy of the objectives of the provision, and cannot be effective to the Nigerian

83 Gower & Davies *Principles of Modern Company Law,*Op.cit. p.919

culture of extended family setting. The fact that a relative of a director is not living with him in the same household does not affect the relationship. The natural sentimental attachment of family relationship is capable of influencing the way in which shares held by family members are used for the interest of a family member director even though they might not be living in the same household.

It will be ideal for Nigerian corporate laws to recognize the natural interest a director is most likely to have in shares held by family relations in the company where he is a director. Family members as connected persons should not be restricted to nuclear family but applied to extended family in view of the Nigerian culture of extended family setting which still upholds strong bound of affection. This will provide a source to find out the basis and directions of company resolutions through shareholders voting where a director has interest.

# Disclosure of Material Transaction with Directors and Related Parties.

A company incorporated under the Companies and Allied Matters Act84 acquires a separate legal personality distinct from its members, and therefore has power to hold land and otherassets.85 The corporate personality of a company makes it to possess the powers of a natural person of full capacity in furtherance of its business or object.86 However, a company being an abstraction it cannot exercise its powers by itself except through the instrumentality of human agents. It has been held that “a limited liability company is a mere legal fiction that exists only in the eyes of the law. It has no eyes or brain of its own. It acts through biological persons of the likes of directors and shareholders whose actions are binding on it.87 Both the Companies and Allied Matters Act and the Nigerian SEC

84 CAMA, Op.cit

85 Section 37, ibid; *Habib (Nig) Bank Ltd v.Ochete* (2001) 3 NWLR (pt 699), *P. 117 R. 1*; *UBN Ltd v. Penny-Mart Ltd* (1992) 5 NWLR pt 240, *230 R. 1*

86 Section 38, CAMA. Ibid

87*Ladejobiv.Odutola Holdings Ltd* (2002) 3 NWLR (pt. 753), *129 R.1*; *Faith Enterprises Ltd v. Bash (Nig) Ltd* (2001) 8 NWLR pt 714, *244 R.4*

Code of Corporate Governance entrust directors with decision making powers of the company and to manage its affairs.88

Accordingly, when directors act properly within the scope of their powers their acts shall be treated as the acts of the company itself.89 Because of the special position of directors in the company they have the duty to act at all times in the best interest of the company as a whole so as to preserve its assets, further its business, and promote the purpose for which it was formed.90 To this end the personal interest of a director shall not conflict with any of his duties as a director.91 If directors are permitted to enter into transaction with the company on the company‟s assets, they would be the persons to take decision for the company concerning themselves and may likely favour themselves against the interest of the company which they stand to represent as directors.

In order to avoid such scenario of conflict of interest transactions, the Companies and Allied Matters Act prohibits material transaction on company‟s assets with its directors and persons connected with the directors.92 The inclusion of connected persons is to forestall the possibility of directors camouflaging by using other persons that are sentimentally attached to them to enter into the transaction to achieve the same personal interest of the director.

Section 28493 provides that

* + - 1. Subject to the exceptions provided by section 285 of this Act, a company shall not enter into an arrangement
         1. Where a director of a company or its holding company, or person connected with such a director, acquires or is to acquire one or more non-cash assets of the requisite value from the company; or
         2. Whereby the company acquires or is to acquire one or more non-cash assets of the requisite

88 Section 63 (3), CAMA Op. cit; Sections 2 and 3 SEC Code of Corporate Governance in Nigeria, 2011.

89 Section 65 CAMA, ibid.

90 Section 279, ibid

91 Section 280(1), ibid

92 Section 284, ibid

93 CAMA, op.cit

value from such a director or a person so connected…

What constitutes non-cash assets of the requisite value is stated under subsection (2) of the above section 284 thus: “for the purpose of subsection (1) of this section, a non-cash asset is of the requisite value if, at the time the arrangement in question is entered into, its value is not less than N 2, 000 but (subject to that) exceeds N100, 000 or twenty percent of the asset value…”

The primary target of the provisions above is to restrict directors from entering into conflict of interest transactions that is where a director who stands in fiduciary relationship with the company enters into transaction with the company. The legal position of directors to the company is apposite to that of trustees and agents of the company.94 It is generally believed that the said director would compromise his objectivity and promote his interest in the transaction against that of the company. These types of transaction are sometimes referred to as self-dealing transactions.

The restriction applies to directors qua directors. It means that all directors of any kind are affected by the restriction. Section 284(3)95 makes it clear that “for the purposes of this section…, a shadow director shall be treated as a director.” A shadow director is “any person on whose instructions and directions the directors are accustomed to act.”96 He does not form part of the board of directors of the company but for the fact that he wields power and control over the duly constituted board of directors he is deemed to be a director, since the essence of company directorship is mainly to direct and manage the affairs of the company.97 The fact that his instructions and directions are followed by the board in managing the affairs of the company, he stands in the position of the company director.

94 Section 285 ibid

95 Ibid CAMA

96 Section 245(1), ibid

97 Section 63(3), ibid

There is no contention as to who are the duly appointed directors because they constitute the company‟s board of directors with the responsibility to direct and manage the business of the company.98 They are identifiable because they are usually described by the company as directors.99 The problem that arises is how to identify a shadow director when a situation arises that would warrant the evocation of the restriction on material transaction between him and the company. If the directors choose not to disclose a shadow director, it will be difficult for mere shareholders to identify him. Such an undisclosed shadow director might enter into an arrangement with the company that would not have been allowed if he were known in that capacity. The only persons that are in a better position to disclose the existence of a shadow director are members of the board of directors, because they are the ones receiving and acting on instructions and directions from him. Despite the difficulty expressed above, the point that is being made is that once a person performs duties that are akin to those of directors even though he is not duly appointed as directors of the company he is deemed to be a director and therefore affected by the provision on prohibition of conflict of interest transactions.

98 Section 244(1) and 63(3), ibid

99 Section 244(2) ibid

# The Basis of Connected Persons Provisions

It is a recognized principle of company law that company directors owe certain fiduciary obligations to their company. Section 279100 expressly provides that “a director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf”. Good faith must not only be done but must manifestly be seen to be done, and the law will not allow a fiduciary to place him or herself in a position in which judgment is likely to be biased and then to escape liability by denying that in fact it was biased.101

The nature of the fiduciary duties of directors places them in certain legal positions that are akin to some special form of relationships that are not specifically entered into with the company. Section 283(1)102 invokes the principle of trusteeship and considers directors as trustees of the company‟s money, properties and powers while subsection (2) of the above section 283 inputs the relationship of agency by stating that “a director may when acting within his authority and the powers of the company, be regarded as agents of the company.” It has long been established that a corporate body can only act by agents, and it is of course, the duty of those agents so to act as best to promote the interest of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. It is a rule of universal application that no one having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict, with the interest of those whom he is bound to protect.103

The position of directors as trustees is underscored by their power and control they exercise over company‟s property which they are obliged to exercise such powers

100 CAMA, op.cit; Olawoyin, G.A. (1981) *Status and Duties of Company Directors*. University of Ife press, Ile-Ife p. 33

101 Davies, P.L. (2008) *Gower and Davies’ Principles of Modern Company Law, op.cit* p. 529

102 CAMA, op.cit

103 *Aberdeen Railway Co. v Blaikie Brothers* (1854) 1 Macq 461 at 471-472

honestly in the interest of the company and not in their own personal or sectional interest. The rule of trustee-like position of directors is based partly on the view of equity that a company is entitled to the protection of its directors as trustees are in relation to a trust, hence in the consideration of matters relating to it, the company should have the benefit of the unbiased and independent judgment of each director. Where a director is interested in a transaction with his company, it becomes difficult for him to exercise independent and unbiased judgment in the consideration of issues connected with the transaction.104

In a similar vein, as agents of the company, directors are required to observe the fundamental agents‟ duty to act in good faith.105 The duty of good faith among other things enjoins an agent to strive to avoid any situation in which his personal interest may come into conflict with that of his principal.106 The rule is strict and justified on the basis that should an agent be faced with such conflict in his dealings with or on behalf of his principal, he will naturally favour his own personal interest over that of his principal. The law therefore requires him not even to allow himself to be exposed to such temptation.107 It is against this backdrop that section 280(1)108 categorically states that “the personal interest of a director shall not conflict with any of his duties as a director.” A director shall therefore act at all times in what he believes to be the best interest of the company as a whole.109 The easiest way to comply with this duty is for a director not to engage in transactions that involve a conflict of interest in whatever guise.

It is against the background to avoid conflict of interest transactions involving directors that the issue of connected persons to directors came to fore. Where a director is prohibited from directly engaging in a particular transaction with the company he should

not indirectly enter into the transaction through his close associates such as family

104*Parker v.Mackenna* (1874), LR. 10 Ch. App. 96

105 Igweike, K.L. (2011) *Nigerian Commercial Law Agency*, op.cit. p. 97

106 Ibid

107*Berilly v. Craven* (1853) 18 Beav. 75

108 CAMA, op.cit

109 Section 279 ibid

relations. This natural presumption is that those who have family link with a director are likely to do things that would promote the interest of the director or put in another way, are likely to be easily used by the director for his personal interest. Bearing this in mind, the definition of persons connected to directors should encompass relations of the director who are most likely to be used by him to achieve his personal interest in a transaction.

The issue of conflict of interest transactions must be taken seriously by putting in place sufficient and necessary safety nets to curb its effect. It is in this regard that section 284(1)110 after prohibiting transactions between a company and its directors and persons connected with the directors, proceeded to provide conditions that must be fulfilled if such transaction must take place. The proviso to section 284 states that “unless the arrangement is first approved by a resolution of the company in general meeting”111 it means therefore, that the director has the duty to disclose his interest in the transaction to the general meeting before the transaction is entered into. The general meeting has authority to either approve or refuse to approve the transaction.112 This requirement provides for independent and objective review of the transaction to determine its effect on the company‟s interest.

# Definition of Persons Connected to Directors

The issue of the director affected under the substantial property transaction is reasonably clear because it is categorically prohibited except where the transaction is disclosed and approved by the general meeting. The only problem is the issue of “person connected” “connected person” with the director. The Companies and Allied Matters Act has defined a connected person under section 286(8)113 as:

* + - * 1. that director‟s spouse, child or step-child, including illegitimate child;

110 CAMA, ibid

111See also section 286(2) ibid

112Section 280(6) CAMA.

113 Ibid

* + - * 1. a body corporate with which the director is associated;
        2. a person acting in his capacity as trustee of any trust, the beneficiaries of which include.

The director, his spouse, any children or step-children; or

A body corporate with which he is associated or of a trust whose terms confer a power on the trustee that may be exercised for the benefit of the director, his spouse or any children or step-children of his or any such body corporate; or

* + - * 1. a person acting in his capacity as partner of that director…

The definition of connected person is quite expansive by trying to encompass both social and business associates of the director.

It can be seen that the Companies and Allied Matters Act decides to avoid using the phrase “family members” in relation to connected person, probably to avoid the problem of defining what constitute a family. The Act has rather chosen to mention the categories of biological persons related to the director as spouse, child and step-child. All other relatives such as father, mother, brothers and sisters are clearly left out. If the phrase family members is used these persons also might necessarily be included. The scope of the director‟s relatives as connected persons under the Companies and Allied Matters Act is undoubtedly too restrictive and will defeat the very essence of the provision on material property transaction. This is because the parental tie as well as that of brothers and sisters is not less significant to promote a director‟s interest in any arrangement or transaction with the company.

Where a person is a director in a company and his/her spouse and any children are prevented from entering into any transaction with the company because the director will benefit through them, the likelihood of the director benefiting in the same way exist if his father, brother or sister is permitted to enter into the transaction. The truth of the matter without being legalistic is that the father, mother, brothers or sisters because of the blood relationship would normally tend to do something that will promote the interest of their relative director.

The consequence of the provision of CAMA as to connected persons is that even though a director might be disallowed from entering into substantial transaction with the company but his father, mother, brother, or sister could be allowed to enter into the said transaction irrespective of the benefit the director is likely to benefit from the transaction. The exemption of these relations of the director from the prohibition of material transaction is capable of being abused by directors who might use such people to advance their interest against the company. For instance, a director of a public company can give money to his brother or sister to buy property from the company which can be used for the benefit of the director. This is contrary to good corporate governance in the sense that the overall objective of corporate governance is that the company is properly managed for the common benefit of all stakeholders. Where a person or group of persons gain more benefit from the company through improper means against the interest of other stakeholders is reminiscent of improper management of the company hence bad corporate governance.

Under section 23114 a director was defined to include “a wife, husband, father, mother, son, or daughter of a director.” The implication of this provision is that what a director is prohibited to do in relation to the company in which he/she is serving as a director, the above mentioned persons would also not be allowed to do in the company. This extended definition of director can only be used to regulate conflict of interest transactions involving these persons and the company where one of them is a substantive director. This paper contends that this provision cannot be used to impute liability whether criminal or civil to the mentioned relatives of a substantive director as a result of the performance of his/her duties and responsibilities in the management of the company. Those relatives can only become liable if it is proved that they have participated in the

114Failed Bank (Recovery of Debts) and Financial Malpractices in Banks Act. Cap. F2 Laws of the Federation of Nigeria, 2004

matter or transaction as a director if the circumstances show that he/she is a shadow director.

It will be wrong to hold any of these relatives of a director criminally liable for offences committed by a company directors of which they did not participate but simply because they are related to a director of the company. There is no vicarious liability under criminal justice system. It was held in *ACB v Okonkwo*115 that “it is a gross violation and most violent infraction of human rights which are fundamental for a person to be arrested and detained for the offence allegedly committed by another.” Under civil matters also, only a party to a contract can take the benefit or incur liability under the law.116 A person cannot be properly deemed to be liable for the actions of a relative director without establishing agency relationship between them. On the whole, this work is of the firm view that the definition of director stated above under the Failed Bank (Recovery of Debts) and Financial Malpractices in Banks Act is incongruous. These persons deemed as directors can be regulated under connected people‟s provisions in their dealings with a company where one of them is a director but not to deem them as directors except where there is evidence of shadow directorship.

On its part, the Nigerian SEC Code of Corporate Governance mentions “related party” which appears to be similar to connected person. Section 37117 defines “related party” to mean “entities, including shareholders that control the company or are under common control of a parent company or significant shareholders including family members and key management personnel”. This code definition of related party is not quite clear due to lack of prescribed criteria. The reference to “shareholders that control the company” is a very fluid statement as what amounts to shareholder control of

115(1997) NWLR pt. 480 p. 194

116*Niger Progress Ltd v. N.E.L Corporation* (1989) 1 CLRQ 1 at 3 para C, p.19 para C, p. 24 para D. and p. 25 para. D

117 SEC Code of Corporate Governance in Nigeria, 2011

company is not set on any threshold. In the United Kingdom, section 254118 defines the applicable connection as being “where the director and persons connected with him or her are interested in at least 20 percent of theequity shares of the company or control at least 20 percent of the voting power at a general meeting”.119 It can be seen here that the threshold of 20 percent interest in shareholding has been set.

Another unclear term in the code definition of related party is “family members”. This too, as noted earlier has neither been defined by the Companies and Allied Matters Act nor the code of corporate governance in Nigeria. The failure of the code to mention the persons who constitute a family for the purpose of related party transaction leaves the definition of family members to be subject of contention. What may be regarded as family member may differ from one society to another. The Code should have defined who family members are. In Nigeria, the existence of socio-cultural diversities poses serious challenges to define what family means. There are three major family set up in Nigeria with their respective perspectives of what family is. The Christian family setting because of the monogamous marriage would tend to regard family in its nuclear setup, that is, a group of people consisting of the immediate parents and the children. This does not however tend to disregard the fact that members of the extended family are still held with respect and given their due recognition. The natural bond of coming from the same lineage remains a strong force to be sentimentally attached to one another more than an outsider. In the ordinary course every one may be willing to do something that would promote the interest of the other in the family.

The traditional setting of family in most Nigerian cultures would mean more than the nuclear family. It is common to perceive family in the traditional way to comprise of the immediate family and extended family (consisting of siblings, and their children;

118Companies Act, 2006 of the United Kingdom.

119 Gower and Davies‟ *Principles of Modern Company Law.*Op.cit p.545

nephews, uncles, aunts and cousins). While in predominant Muslim areas their perspective of family may not even be definite. There are many definitions and descriptions of family.120 A definition might depend on the context in which family is to be used. In its simple definition, family is regarded under Islam as “a human social group whose members are bound together by the bond of blood ties and/or marital relationship”121 This definition takes into cognizance family relationships created through consanguinity and affinity. The idea here is certainly beyond what is commonly known as nuclear family. As family members, there are expectations, obligations and mutual commitments that are shared among them. “These pertain to identity and provision, inheritance and counsel, affection for the young and security for the aged. Maximization of efforts to ensure the family continuity in peace”122 These obligations and commitments extend beyond one‟s spouse, children and parents but include siblings, their children, grandparents and grandchildren. Thus where there is an opportunity to assist one another, there will be that willingness to so do than if it was someone outside the family.

Another trend in Nigeria is that the way men respect the people from where they marry their wives, not just the wife‟s immediate family members but the entire community creates a strong bond of affinity. This makes many people to pay special attention to their wife‟s community when they are in a position of authority.

Since the intention of the concept of connected persons is to prevent a director from using another person who is more likely to promote his interest to enter into transaction with the company where he is director, it is advisable to consider the socio- cultural setting in Nigeria to determine those who are likely and could be readily available to be used by a director.

120 Gurin, A.M. (2010)*An Introduction to Islamic Family Law*. Alrauf Press Limited, Zaria, p.10

121 Ibid, Pp. 8-9; Ati, H.A. (1980) *Islam in Focus*. ATP Indiana Pp. 16, 134

122 Gurin, A. M. Ibid p. 9

In view of the above it is canvassed herein that it is most likely for someone who wants to do something but if he cannot do it by himself, he can easily use not only members of his immediate family but extended family including spouses‟ relatives. If the desired intention of the provision on connected persons is to be achieved, the definition of connected persons should encompass immediate family members, and extended family members of both spouses.

As noted earlier, the definition of who is a family member is not quite easy. The word family itself is subject to multiple definitions thereby rendering the word family ambiguous. Black‟s Law Dictionary defines family as “a group of persons connected by blood, by affinity or by law, especially within two or three generations; A group consisting of parents and their children; a group of persons who live together and have a shared commitment to a domestic relationship”123 All these definitions have different scope. Where a reference is made to family or family member without qualification as it is done by the Nigerian SEC Code of Corporate Governance, it is bound to create confusion and difficulty in the application of the law. Apart from the problem of precise definition of family, there are two types of family setting, that is, the immediate (nuclear) family is defined as “a person‟s parents, spouse, children and siblings, as well as those of the person‟s spouse. Step children and adopted children are immediate family members.”124 While extended family is referred to as: “the immediate family together with the collateral relatives who make up a clan; the immediate family together with collateral relatives and close family friends.”125 Any law that makes reference to family must need to define the type of family that would satisfy the purpose of the requirement.

When the Code of Corporate Governance for Banks in Nigeria Post-Consolidation provided that “no two members of the same extended family should occupy the position

123 Garner, B. A.(2004) *Black’s Law Dictionary*, 8th edition Thomson West Publishing Co. USA, p. 637

124 Ibid, p. 639

of chairman and that of Chief Executive Officer or Executive Director of a bank at the same time”126, it is crystal clear about the kind of family intended. The Code proceeded to define the term „extended family‟ to “refer to the members of a nuclear family comprising the husband, wife and their siblings plus parents and brothers/sisters of both the husband and the wife.”127 The position of the banks Code is clearer and wider in scope in that it recognizes the sentimental attachment of parents and siblings of spouses as persons that would naturally be expected to do anything to promote the interest of any one of them who is in a position to gain advantage where the circumstance exists.

The problem with the banks Code is that it is a sectoral code and therefore applies only to banking corporations. But the SEC Code of Corporate Governance is meant to be of general application to all public quoted companies in Nigeria, including banks. Banks are in the first instance companies incorporated under the Companies and Allied Matters Act by the Corporate Affairs Commission before they obtain license to do banking business. They are therefore bound to observe and comply with the general code of corporate governance and at the same time observe the specific sectoral code applicable to them. However, as noted earlier, the provision of the Companies and Allied Matters Act and Code of Corporate Governance in Nigeria with regard to the definition and scope of connected person (related party) which applies to all companies in Nigeria is insufficient and would not achieve the desired intention of forestalling conflict of interest transactions involving directors.

On the issue of approval of the conflict of interest transaction, it must be given by a resolution of the company in general meeting. Section 284128 is very clear in stating as such. The problem still arising from this seemingly clear provision is a situation where

126 Section 5. 2. 3. Code of Corporate Governance for Banks in Nigeria Post-consolidation, 2006 (underline supplied)

127 Footnote 1 under section 5. 2. 3, ibid

128 Companies and Allied Matters Act. Op.cit.

the director is also a shareholder to approve a transaction he is interested in. The first issue is whether the director cum shareholder will be entitled to vote in his capacity as a shareholder. This work contends that the director‟s participation in voting on the resolution in respect of a transaction he/she has interest will cast aspersions on the independence of the general meeting especially where the director has controlling or substantial shareholding in the company. It is opined that such a director should abstain from participating in deciding on the resolution to either approve the transaction or not.

It must be pointed out clearly that a valid approval must precede the entering into the transaction. Section 284 (1)129 states without mincing words that “…a company shall not enter into any arrangement…unless the arrangement is first approved by a resolution of the company in general meeting…” The approval must be given before the director enters into the transaction. The tenets of the provision do not allow a situation where the director enters into conditional transaction pending approval to be given by the shareholders in general meeting. It is believed by this work that the prior approval is mandated to avoid preempting the shareholders resolution or merely being a rubber stamp authority. However, the company in a general meeting has the discretion to ratify such transaction entered without prior approval of the general meeting.130 The affirmation of the transaction is required to be made within a reasonable period after the transaction has been entered into.131 This exception has watered down the efficacy of objectivity in the consideration of the transaction before it is entered into, and therefore unnecessary.

129 Ibid

130 Section 286 (2) (c). Ibid

131 Ibid

# CHAPTER SIX

* 1. **APPLICATION OF SOME PRINCIPLES OF CORPORATE GOVERNANCE**

# Introduction

Principles of corporate governance are the key objects for the production of codes of corporate governance. Apart from the specific industry codes of corporate governance in Nigeria issued by regulatory bodies such as the Central Bank of Nigeria, the National Pension Commission and the National Insurance Commission which apply to companies in their respective sectors the Securities and Exchange Commission (SEC) Code of Corporate Governance in Nigeria applies to all public companies especially those quoted on the stock exchange irrespective of the sector in which such companies operate. In particular the SEC Code applies to all public companies seeking to raise funds from the capital market through issuance of securities or seeking listing by introduction.1 Due to the general application of the SEC Code it is made the focal reference for principles of corporate governance in this discussion.

The SEC Code 2011 is a product of a review of the 2013 Code of Corporate Governance for Public Companies in Nigeria.2 The fundamental principles of the code therefore stem from the 2003 Code. The application of principles of corporate governance in Nigeria had been an issue of concern since 2003 Code. It has been argued that despite the fact that there are adequate corporate governance rules and regulations in place to promote good corporate governance in Nigeria and the existence of regulatory bodies like the Securities and Exchange Commission and central Bank of Nigeria (in the case of banking industry,) Nigerian deposit money banks are yet to comply with corporate

1 Section 1.1. (a) and (b) SEC Code of Corporate Governance in Nigeria 2011

2 Introduction, Ibid

governance codes3. For a good and successful practice of corporate governance, its basic and commonly accepted principles must be adhered to. Codes are designed to achieve best practices of corporate governance standards. The SEC Code of corporate governance, 2011 apply to all public companies listed on the stock exchange in Nigeria. The provisions of the Code are considered as benchmarks for improving corporate governance generally.

# Application of Principles of SEC Code of Corporate Governance

The SEC Code of Corporate Governance in Nigeria has prescribed several principles to be observed by companies. The principles are contained under parts B.C.D.E and G of the SEC Code. They cover the aspects of the composition and structure of board of directors, relationship with shareholders and other stakeholders. The issues of disclosure of material information, risk management, accounting and reporting are also provided in the SEC Code. Information on these issues were gathered and assessed to show how companies in Nigeria have variously applied principles of corporate governance.

# Instrument for Data Collection and Sampling Techniques

The instrument used in gathering data for the determination of the level of application of the SEC Code of Corporate Governance was through collation of the Annual Report and Accounts of some companies that have been listed on the Nigerian Stock Exchange. The collation was done in such a way that it will reflect a diverse representation of the common industries in Nigeria to wit, the banking, insurance and manufacturing subsectors. The aim of this approach was to enable the researcher to get a general position of how corporate governance principles are been applied in Nigeria through the observance of the SEC Code of Corporate Governance.

3 Osuagwu, G.O. (2013). Implications of Corporate Governance on the Performance of Deposit Money Banks in Nigeria. Arabian Journal of Business and Management Review (Oman chapter) Vol. 2 No 10. . p.115

In an attempt to achieve the desire to obtain a general position of the level of application of principles of corporate governance in Nigeria, the researcher adopted a random sampling technique. This means that the companies whose annual report and accounts obtained were selected at random among companies in Nigeria.

A total number of 22 companies were selected from the banking, insurance and manufacturing industries in Nigeria. From each of the subsectors two categories of companies exist, that is the mega and minor companies or put differently, the old and new generation companies. In each of the subsectors the choice of the companies were made to reflect the two classes of companies. For example, in the banking industry, Union bank, First bank and Unity bank represent old generation banks while, Eco bank, Zenith bank and Diamond bank belong to the new generation banks. In the insurance industry, Industrial and General Insurance, Consolidated Hallmark Insurance, All CO Insurance America and Sovereign Trust Insurance belong to the mega group while Lead way Insurance Ltd, Crusader Life Insurance Ltd, fall under the minor group. From the manufacturing industry, Seven Up Bottling, Nigeria Bottling Co. Guiness Nigeria Plc and Unilever Nigeria Plc come under old generation companies while Dangote Sugar Refinery and Dangote Flour Mills fall under new general companies.

These companies represent what applies to other companies in Nigeria since all of them are quoted on the Nigerian Stock Exchange and make prescribed reports to the Securities and Exchange Commission which regulates the application of its Code of Corporate Governance as a general Code.

# Data Analysis

In analyzing the result of the data collected from the annual report and accounts of the companies selected, tables were used to present and interpret the date collated. Each table represented the position of the companies on the items of corporate governance on a

yearly basis from 2008 to 2012. From the analyses that were made, conclusions have been drawn representing the popular opinion upon which a position was taken.

# Composition and Structure of the Board

The provisions for the composition and structure of the board underscore the intention to constitute a board that should be effective and independent of management to enable it carry out its oversight function in an objective and effective manner. It is against the backdrop of establishing effective and independent board that the SEC Code of Corporate Governance has made recommendations of what an ideal board should be.

Under the SEC Code, 2011 the board is required to comprise a mix of executive and non-executive directors while majority of board members should be non-executive directors, at least one of whom should be an independent director.4 It further provides that the positions of the chairman of the board and chief executive officer be separated and held by different individuals.5Importantly also is the issue of creation of committees which the Code has left to the discretion of the company, however mandates the creation of Governance/Remuneration Committee and Risk Management Committee.6 From 2003 till now companies have been applying these requirements in various degrees of compliance. The tables below show compliance by companies in the aspect of board composition and structure. The companies are randomly selected from three sectors, these are, the banking, insurance and manufacturing industries.

4 Section 4.3 SEC Code of Corporate Governance

5 Section 5.1 (b). Ibid

6 Section 9.2.Ibid.

# Table 1: Board Composition and Structure, 2008

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Board Size** | **Chairman/ CEO Separation** | **Executive Directors** | **Non- Executive**  **Directors** | **Independent directors** | **Board committees** |
| 1 | Sterling Bankplc | 12 | Separated | 4 | 8 | Nil | 3+1 s |
| 2 | Eco bank Nigeria  plc | 11 | separated | 3 | 8 | Nil | 1+2 s |
| 3 | Law Union  &Rock Ins. Plc | 8 | Separated | 3 | 5 | Nil | 1+1 s |
| 4 | Industrial and Gen. Insurance  plc | 12 | Separated | 5 | 7 | Nil | 5+2s |
| 5 | Dangote sugar  Refinery plc | 9 | Separated | 3 | 6 | Nil | 2 |
| 6 | Seven-up  Bottling Company Plc | 10 | Separated | Not stated | Not stated | Nil | Nil |

Source: Compiled from 2008 Annual Report and Accounts of the named companies.

# Table2: Board Composition and Structure, 2009

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Board size** | **chairman/ CEO**  **separation** | **Executive directors** | **Non-**  **executive directors** | **Independent directors** | **Board committees** |
| 1 | Union Bank of  NigeriaPlc | 14 | separated | 5 | 9 | Nil | 3+1 s |
| 2 | First Bank of  Nigeria plc | 17 | separated | 8 | 9 | 1 | 6+2 s |
| 3 | AIICO  Insurance  American Internationalplc | 11 | separated | 4 | 7 | Nil | 4 |
| 4 | Sovereign Trust  Insuranceplc | 11 | Separated | 2 | 9 | Nil | 3 |
| 5 | Nigeria Bottling Company plc | 9 | Separated | No indication  except MD | No indication | Nil | 1 s |
| 6 | Dangote Sugar  Refinery plc | 9 | separated | 3 | 6 | Nil | 2 |

Source:Compiled from 2009 Annual Report and Accounts of the named companies.

# Table 3: Board Composition and Structure, 2010

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Board Size** | **chairman/ CEO**  **separation** | **Executive directors** | **Non-**  **executive directors** | **Independent directors** | **Board committees** |
| 1 | Zenith Bank Plc | 13 | separated | 6 | 7 | 2 | 2+1 s |
| 2 | Unity Bank plc | 15 | separated | 6 | 9 | Nil | 3+1si |
| 3 | Standard  Alliance Insurance Plc | 9 | separated | 2 | 7 | Nil | 2+1si |
| 4 | IGI Insurance plc | 8 | Separated | Not stated  except CEO | Not stated | Nil | 6 |
| 5 | Dangote Sugar Refinery plc | 9 | Separated | 2 | 7 | Nil | 2 |
| 6 | Dangote Flour  Mills Plc | 10 | separated | 2 | 8 | Nil | 1+1i |

Source: Compiled from 2010 Annual Report and Accounts of the named companies

# Table 4: Board Composition and Structure, 2011

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Board Size** | **chairman/ CEO**  **Separation** | **Executive Directors** | **Non- Executive**  **Directors** | **Independent Directors** | **Board Committees** |
| 1 | Diamond Bank plc | 19 | Separated | 6 | 13 | Nil | 1+2 s |
| 2 | Eco Bank plc | 16 | separated | 6 | 10 | 2 | 2+2 s |
| 3 | Leadway  Insurance Co. Ltd | 9 | separated | 3 | 6 | 2 | 1+1 s |
| 4 | Consolidated Hallmark  Insurance plc | 9 | Separated | 1 | 8 | Nil | Nil |
| 5 | Lafarge cement  WAPCO Nig. Plc | 13 | Separated | 2 | 11 | Nil | 2+1 s+1i |
| 6 | Dangote Flour  Mills Plc | 10 | separated | 2 | 8 | Nil | 1+1 si |

Source: Compiled from 2011 Annual Report and Accounts of the named companies.

# Table 5: Board Composition and Structure, 2012

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Board Size** | **Chairman/ CEO**  **Separation** | **Executive Directors** | **Non- Executive**  **Directors** | **Independent Directors** | **Board Committees** |
| 1 | EcobankTransnational  Incorporated | 18 | separated | 7 | 11 | Nil | 2 s |
| 2 | Zenith Bank Plc. | 14 | separated | 7 | 7 | 3 | 2+1 s |
| 3 | Crusader Life  Insurance Ltd | 7 | separated | 2 | 5 | Nil | 2+1 s |
| 4 | Leadway Assurance  Co. Ltd. | 8 | Separated | 3 | 5 | Nil | 1+1 s |
| 5 | Guinness Nig. Plc. | 12 | Separated | 2 | 10 | Nil | 1s+1i |
| 6 | Unilever Nig. Plc. | 7 | Separated | 5 | 2 | Nil | 1si |

Source: Compiled from 2012 Annual Report and Accounts of the named companies.

The above data and information contained in tables 1-5 are obtained from the Annual Reports and Accounts of twenty two different companies in Nigeria from 2008 to 2012. The tables show the composition and structure of company board of directors. The tables show how the companies have applied variously the requirements of corporate governance principles epitomized by the SEC Code of Corporate Governance since 2008 after the first SEC/CAC Code was issued in 2003.

The tables consist of 7 columns and 6 rolls. The 1st column contains the names of the companies that were studied. The 2nd column provides information on the size of each company‟s board of directors. It can be seen from the tables in column 2 that companies have different board sizes ranging from the minimum of 7 to as high as 19 memberships. The SEC/CAC Code of Best Practices on Corporate Governance stipulated that a board should not exceed 15 persons in total.7 Some companies however contravened this requirement. These are, First Bank of Nigeria Plchad 17 boards‟ members (in 2009); Diamond Bank had 19 board members (in 2011); Eco bank had 16 and 18 board members in 2011 and 2012 respectively. Majority of the companies have board membership above 10 persons. These are considered large boards in view of international best practices.

7 Section 1 (a) SEC/CAC Code of Best Practices on Corporate Governance in Nigeria, 2003.

Column 3 of the tables show full compliance with the Codes‟ provisions that require the separation of the position of Chairman of the board and chief executive officer to be held by different persons.8 Columns 4 and 5 show the number of executive and non- executive directors at the board of each company. The figures reveal more number of non-executive directors as required by section 4.3.9It is however, observed that the differences between the number of executive and non-executive directors are very little. This may not give the non-executive directors sufficient majority to entrench their power and effective oversight function on the executive management in decision taking of the collective board. The 6th column states whether the companies appointed independent director or directors as required by sections 4.3 and 5.5(c).10The table shows only five companies that appointed independent directors. These are, First Bank of Nigeria Plc. (1 independent director in 2009); Zenith Bank Plc (2 independent directors in 2010); EcobankPlc andLeadway Insurance Company Ltd (2 independent directors in 2011); and Zenith Bank Plc (3 independent directors in 2012). Majority of the companies did not appoint independent directors to their boards. This is an indication that all the directors of the companies that have not appointed independent directors are non-independent.

The last column on board committees shows the number of committees created by the board apart from the mandatory statutory audit committee. The two committees recommended by the SEC Code are, Governance/Remuneration Committee and Risk Management committee. They are represented on the tables by letter “s” (which means SEC Recommended Committees) the meaning is that any figure in column 7 that is attached to letter “s” shows the number of SEC recommended committees that are created by the board. On the other hand letter “i” in column 7 implies the international common board committees of Remuneration and Nomination committees. It means that any figure

8 Section (b) Ibid and Section 5.1 (b) SEC Code of Corporate Governance, 2011.

9 SEC Code, 2011, Ibid.

10 Ibid.

attached to letter “i” shows the number of these international board committees that are created by the board. Any other figure in column 7 that is not associated with either letters “s” or “i” indicate the number of other committees created by the board as it deem appropriate in view of the company needs or industry requirement. The data show that many companies have paid attention to the creation of at least one or both of the SEC recommended board committees. Some companies have also created either or both the remuneration and nomination committees. Examples are seen on table 3 of 2010 of companies like Unity Bank Plc, Standard Alliance Insurance Plc, Dangote Flour Mills Plc. Table 4 of 2011 also show Lafarge Cement WAPCO Nigeria Plc that created one of the international common board committee.

The information derived from the tables above show that the level of compliance with corporate governance requirements is little, with neglect of critical issues of corporate governance like board size, executive and non-executive directors‟ mix, and appointment of independent directors.

# The Way Companies Apply Directors‟ Responsibilities.

The responsibility of company directors originates from the Companies and Allied Matters Act (CAMA)11.The directors have the responsibility of providing leadership and management of the company. They carry out this responsibility collectively as a board and through board committees to ensure effective performance of the board. The board and its committees hold meetings to discharge their responsibilities. Corporate governance is concern about the way a board takes its decisions. Meetings are the formal way of taking decision by the board and its committees12. The board has the responsibility to indicate that it and the committees have been holding meetings. The board is required

11 . CAMA, Cap. C20 Laws of the Federation of Nigeria,2004

12 .263(1) (7) Ibid; Section 12 SEC Code of Corporate Governance, 2011.

to meet at least 4 times a year to perform its oversight and monitor management‟s performance. Every director is required to attend at least two-thirds of all board meetings13. It is also expected of the board of directors to provide material information not only to the shareholders of the company but also to the investing public, on the position of the company. This is usually done through the issue of quarterly or annual reports and accounts of the company, where the directors‟ report and financial statement are made. Corporate governance requires that the financial statement should be made in simple and clear language to enable people understand. The technical nature of financial statement requires explanatory notes to be provided to give insight and basis of the results. Some of the aspects of directors‟ responsibilities are shown below and how companies apply them. The information have been obtained from the annual reports and accounted for 5 years from 2008-2012.

# Table 6: Application of Directors‟ Responsibilities, 2008

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ Report** | **Board meetings**  **yearly** | **Directors attendance**  **indication** | **Committee meetings** | **Financial statement/notes** |
| 1. | Sterling Bank  Plc | √ | 12 | √ | 2-9 | √ |
| 2 | Ecobank Nig.  Plc | √ | 4 | √ | 2-4 | √ |
| 3 | Law Union & Rock Insurance  Plc | √ | Not stated | Not stated | Not stated | √ |
| 4 | Industrial and  General Insurance Plc | √ | 8 | √ | Not stated | √ |
| 5 | Dangote Sugar  Refinery Plc | √ | 5 | √ | 2-4 | √ |
| 6 | Seven-up Bottling Co. Plc. | √ | Not stated | Not stated | Not stated | √ |

Sources: Compiled from 2008 Annual Report and Accounts of the named companies.

13 Section 12.1 and 12.2 SEC Code. Ibid.

# Table 7: Application of Directors‟ Responsibilities 2009

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ Report** | **Board meetings**  **yearly** | **Directors attendance**  **indication** | **Committee meetings** | **Financial statement/notes** |
| 1. | Union Bank of  Nig. Plc | √ | Note  stated | Not stated | Not stated | √ |
| 2 | First Bank of  Nig. Plc | √ | 7 | √ | 1-36 | √ |
| 3 | AIICO  Insurance Plc | √ | Not stated | Not stated | Not stated | √ |
| 4 | Sovereign  Trust Insurance Plc | √ | 4 | √ | 1-4 | √ |
| 5 | Nig. Bottling  Co. Plc | √ | 4 | Not stated | 3-4 | √ |
| 6 | Dangote Sugar  Refinery Plc | √ | 5 | √ | 1-3 | √ |

Sources: Compiled from 2009 Annual Report and Accounts of the named companies.

# Table 8: Application of Directors‟ Responsibilities, 2010

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ Report** | **Board**  **meetings yearly** | **Directors**  **attendance indication** | **Committee meetings** | **Financial statement/notes** |
| 1. | Unity Bank  Plc | √ | Note  stated | Not stated | Not stated | √ |
| 2 | Zenith Bank  Plc | √ | 8 | √ | 4-5 | √ |
| 3 | Standard Alliance  Insurance Plc | √ | Not stated | Not stated | Not stated | √ |
| 4 | IGI Insurance  Plc | √ | Not stated | √ | Not stated | √ |
| 5 | Dangote Flour  Mills Plc | √ | 5 | √ | 1-3 | √ |
| 6 | Dangote Sugar  Refinery Plc | √ | 2 | √ | 0-2 | √ |

Sources: Compiled from 2010 Annual Report and Accounts of the named companies.

# Table 9: Application of Directors‟ Responsibilities 2011

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ Report** | **Board**  **meetings yearly** | **Directors**  **attendance indication** | **Committee meetings** | **Financial statement/notes** |
| 1. | Diamond Bank  Plc | √ | 10 | √ | 4-9 | √ |
| 2 | Ecobank Nig.  Plc | √ | 5 | √ | 4-5 | √ |
| 3 | Leadway  Assurance Co. Ltd | √ | 4 | √ | Not stated | √ |
| 4 | Consolidated  Hallmark Insurance Plc | √ | 5 | √ | 1-4 | √ |
| 5 | Lafarge  Cement WAPCO Nig. | √ | 6 | √ | 1-5 | √ |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Plc |  |  |  |  |  |
| 6 | Dangote Flour  Mills Plc | √ | 5 | √ | 1-3 | √ |

Sources: Compiled from 2011 Annual Report and Accounts of the named companies.

# Table 10: Application of Directors‟ Responsibilities 2012

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ Report** | **Board**  **meetings yearly** | **Directors**  **attendance indication** | **Committee meetings** | **Financial statement/notes** |
| 1. | Ecobank Transnational  Incorporated | √ | 5 | Not stated | 4 | √ |
| 2 | Zenith Bank Plc | √ | 5 | √ | 5 | √ |
| 3 | Leadway Assurance Co.  Ltd | √ | Not stated | Not stated | 4 | √ |
| 4 | Crusader Life  Insurance Ltd | √ | Not stated | Not stated | Not stated | √ |
| 5 | Guinness Nig.  Plc. | √ | 4 | √ | 2-5 | √ |
| 6 | Unilever Nig.  Plc. | √ | 4 | √ | Not stated | √ |

Sources: Compiled from 2012 Annual Report and Accounts of the named companies.

Table 6-10 provide information about directors‟ responsibilities from 2008-2012. The tables contain 6 columns that provide information on the various subjects of responsibilities of directors. Column 1 contains the names of companies that were studied. Column 2 is in respect of „directors‟ report‟. The tick under the column in respect of each company indicates that the companies have made directors‟ report in their annual report and accounts. It can be seen from the able that in all the companies, the directors made report to the shareholders. The director‟s report is a resume of the principal activities and business review of the company, its operating results, disclosure of director‟s interest in shares and contracts, shareholding analysis, corporate social responsibility, board structure and so forth. The report is meant to give a general picture of the company and its prospect. Column 3 shows the number of times the companies‟ board of directors held meetings each year. For example in 2008 the board of Sterling Bank Plc held meeting 12 times, while Eco banks board held meeting 4 times. It is noted

from the tables that some companies‟ boards fail to state that they held board meeting. This is reflected on the tables as „not stated‟.

Column 4 contains an indication of directors‟ attendance to board meetings. The tick under the column shows that the companies have provided data on the number of times each director attended board meetings that were held in the year. It is observed here also that some companies did not provide this information. The absence of such information is marked on the table as „not stated.‟ The information contained in column 5 is in respect of the number of times the various board committees held meetings in the year. The numbers stated under column 5 shows the number of times within the stated range the committees held meetings. For example, in 2008 the board committees of sterling bank plc held meetings between 2-9 times. It means that some committees held meetings 2 times while others held 9 times and some held meetings for a number of times from 2-9. This information also is not provided by some companies as indicated in the tables as „not stated‟.

Information on board and committees meetings is very relevant to corporate governance because it provides a basis of assessment of each director‟s commitment to his/her responsibilities to the company. If a director appears to be consistently absent form board or committee meetings, the shareholders can exercise their statutory power to remove the director or may refuse to re-elect him/her when he/she retires and offers his/her self for re-election.

Column 6 of the tables shows whether the financial statements of the companies are accompanied with notes. The notes on financial statements provide the bases and variables upon which the financials were computed. This is meant to facilitate understanding of the financial statement which is usually reflected in figures. It is the duty and responsibility of directors to prepare and ensure the authenticity of their companies‟ financial statement. The tick under column 6 indicates that the financial

statement contained notes. It means that from all the tables, all the companies‟ board of directors discharged this responsibility.

The general observation from tables 6 to 10 is that the number of companies that adhered to directors‟ responsibilities are more than the companies that are non-observant. Most of the companies that are not applying this principle of corporate governance especially in the aspects of record of board and committee meetings, and attendance are in the insurance industry. This is indicated by table 6, 7, 8, and 10 above. These are general principles of corporate governance that all companies need to apply to promote good corporate governance. The prospect is that since majority of companies are applying these principles and with a stepping up regulatory and enforcement measures there will be major compliance by companies.

# Application of Disclosure Requirements

The application of disclosure requirements by companies in Nigeria is done through the annual reports and accounts. There are key issues of company affairs that are important to stakeholders to know so they can determine the position of the company. These issues include related party transaction or directors‟ interest in contract, directors‟ interest in shares, directors‟ profile, chief executive officer and chief finance officer‟s certification of the financial statement, corporate social responsibility and risk management system. The disclosure of information on these key items apparently shows that the company upholds the ethical values of openness, honesty and transparency. The tables below show how companies in Nigeria apply the corporate governance disclosure requirements. As noted earlier, these companies have been selected randomly. The information contained in the tables are obtained from annual reports and accounts of the companies from 2008 to 2012 which constitute duration of 5 years.

# Table 11: Application of Disclosure Requirements, 2008

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ profile** | **Risk Management**  **System** | **Directors‟ Interest in**  **Shares** | **Directors‟ interest in**  **contracts** | **Corporate Social**  **Responsibility** | **CEO/CFO**  **Certification** |
| 1 | Sterling  Bank Plc | Not stated | √ | √ | √ | √ | Chairman/CEO |
| 2 | Eco bank  Nig. Plc | √ | √ | √ | Not  Stated | √ | Chairman/CEO |
| 3 | Law Union & Rock Insurance  Plc | Not stated | √ | √ | √ | √ | Chairman/ Director |
| 4 | Industrial and General  Insurance Plc | Not stated | √ | √ | √ | √ | Chairman/CEO |
| 5 | Dangote Sugar Refinery  Plc | Not stated | Not stated | √ | √ | √ | 2 Directors |
| 6 | Seven-up  Bottling Co. Plc. | Not stated | Not stated | √ | √ | √ | Chairman/CEO |

Source: Compiled from 2008 Annual Report and Accounts of the named companies.

# Table 12: Application of Disclosure Requirements, 2009.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Directors‟ profile** | **Risk Managemen t System** | **Directors‟ Interest in Shares** | **Directors‟ interest in contracts** | **Corporate Social Responsibility** | **CEO/CFO**  **Certification** |
| 1 | Union Bank  of Nig. Plc. | Not stated | √ | √ | √ | √ | Chairman/CEO |
| 2 | First Bank  of Nig. Plc. | √ | √ | √ | √ | √ | Chairman/CEO  /Director |
| 3 | AIICO  Insurance Plc. | Not stated | Not stated | √ | √ | √ | 2 Directors |
| 4 | Sovereign Trust  Insurance Plc | Not stated | Not stated | √ | √ | √ | Chairman/CEO |
| 5 | Nig. Bottling  Company Plc. | Not stated | √ | √ | √ | √ | Chairman/CEO |
| 6 | Dangote Sugar  Refinery plc. | Not Stated | Not Stated | √ | √ | √ | 2 Directors |

Source: Compiled from 2009 Annual Report and Accounts of the named companies.

# Table 13: Application of Disclosure Requirements, 2010

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Directors‟ profile** | **Risk Management**  **System** | **Directors‟ Interest**  **in Shares** | **Directors‟ interest in**  **contracts** | **Corporate Social**  **Responsibility** | **CEO/CFO**  **Certification** |
| 1 | Unity  Bank Plc. | √ | √ | √ | √ | √ | Chairman/2  Group Ex. Dir. |
| 2 | Zenith  Bank Plc. | Not  stated | √ | √ | √ | √ | Chairman/CEO |
| 3 | Standard Alliance Insurance  Plc. | Not stated | √ | √ | √ | Not stated | Chairman/CEO |
| 4 | IGI  Insurance Plc. | Not stated | Not stated | √ | √ | Not stated | CEO/CFO |
| 5 | Dangote Sugar Refinery  Plc. | Not stated | Not stated | √ | √ | √ | Chairman/FD |
| 6 | Dangote  Flour Mills Plc. | Not Stated | Not Stated | √ | √ | √ | Chairman/ Director |

Source: Compiled from 2010 Annual Report and Accounts of the named companies.

# Table 14: Application of Disclosure Requirements, 2011

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/No** | **Company** | **Directors‟ profile** | **Risk Manageme**  **nt System** | **Directors‟ Interest in**  **Shares** | **Directors‟ interest in**  **contracts** | **Corporate Social**  **Responsibility** | **CEO/CFO**  **Certification** |
| 1 | Diamond  Bank Plc. | √ | √ | √ | √ | √ | Chairman/CEO |
| 2 | Ecobank Nig.  Plc. | √ | √ | √ | Not stated | √ | Chairman/CEO/Di  rector |
| 3 | Lead way Assurance  Company Ltd | √ | √ | √ | Not stated | √ | CEO/Director |
| 4 | Consolidated Hallmark  Insurance Plc. | √ | Not stated | √ | Not Stated | √ | Chairman/CEO |
| 5 | Lafarge  Cement WAPCO Nig.  Plc. | Not stated | √ | √ | √ | √ | Chairman/CEO |
| 6 | Dangote Flour Mills  Plc. | Not Stated | Not Stated | √ | √ | √ | Chairman/CEO |

Source: Compiled from 2011 Annual Report and Accounts of the named companies.

# Table 15: Application of Disclosure Requirements, 2012

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **S/NO** | **Company** | **Directors**  **‟ profile** | **Risk Management**  **System** | **Directors‟ Interest in**  **Shares** | **Directors‟ interest in**  **contracts** | **Corporate Social**  **Responsibility** | **CEO/CFO**  **Certification** |
| 1 | Ecobank  Transna- tional Inc. | Not stated | √ | Not stated | Not stated | Not stated | Chairman/CEO |
| 2 | Zenith  Bank Plc. | Not  stated | √ | √ | √ | √ | Chairman/CEO/C  FO |
| 3 | Leadway Assuranc e  Company Ltd | √ | √ | √ | √ | √ | Chairman/CEO & CFO |
| 4 | Crusader Life  Insurance Ltd. | Not stated | √ | √ | Not stated | √ | CEO/CFO/  Director |
| 5 | Guinness  Nig. Plc. | √ | √ | √ | √ | √ | 2 Directors |
| 6 | Unilever Nig. Plc. | √ | Not stated | √ | Not stated | √ | CEO/FD |

Source: Compiled from 2012 Annual Report and Accounts of the named companies.

Tables 11-15 above cover a period of 5 years from 2008 to 2012. The tables provide information on whether companies in Nigeria apply corporate governance requirements of disclosure of material information about it that will make investing public to make informed judgement on a company. The tables are made up of 7 columns that contain key items that are necessary to be disclosed in the annual reports of companies.

Column 1 contains the names of companies that were studied from 2008 to 2012. The companies were randomly selected form banking, insurance and manufacturing sectors. This is meant to provide a general coverage of how companies in Nigeria apply corporate governance principles.

Column 2 on the tables is in relation to disclosure of directors‟ profile. The profiles of directors supply information on each director‟s qualification, knowledge and worth of experience. It also provides information on directors‟ multiple directorship. A disclosure of directors‟ profile is very important because it will enable shareholders and

other stakeholders to the company to assess the directors‟ qualification, knowledge and experience whether they could perform the company‟s business. The disclosure of directors‟ multiple directorship similarly provides shareholders the basis to determine when a director becomes too busy to give full attention to the business of the company. As important as disclosure of directors‟ profile is, it is revealed from the tables that majority of the companies did not state their directors‟ profile in their annual reports. This is indicated in column 2 of the tables as “not stated”. The tick in the column indicates the companies that disclosed their directors‟ profile, for example Ecobank (in 2008), First Bank of Nigeria (in 2009) and Unity Bank (in 2010). In view of the trend of non- disclosure of directors‟ profiles by majority of the companies it can be said that there is minimal application of this aspect of corporate governance by companies in Nigeria.

In column 3, the item of disclosure that was considered is risk management system.‟ For the purpose of good corporate governance, companies are expected to establish a risk management committee to assist it in its oversight of risk profile and risk management framework. A company that does not address its risk profile becomes dangerous to invest in and because investors are risk averse they would like to know the risk management mechanism a company has put in place. The study of the companies in tables 11-15 shows the companies that have established risk management committee and those that have not shown in their annual report that they have established it. The companies that have established risk management committee are shown by a tick while those that have not shown that they have established are marked „not stated‟. It can be seen that there are many companies that have established risk management committee but there are still many companies that have not established it. What that implies is that the degree of application of this disclosure requirement is on the average.

Columns 4 and 5 in the tables show the disclosure of directors‟ interest in shares of their companies and any interest in contract with the company or related party

transaction. Directors‟ interest in shares reveals the amount of shares the company‟s directors hold directly and indirectly in the company. A disclosure of this information shows whether the directors have major or controlling shares in the company. It provides a yardstick to determine that a director is non-independent. On the other hand a disclosure of directors‟ interest in contract or related party is evidence that the company is transparent and that such transactions are done with honesty. The companies that have disclosed their directors interest in shares and have stated whether there were conflict of interest transactions or related party transactions are indicated by a tick while those who did not are indicated as „not stated‟. From the indications on tables 11-15, it is clear that all the companies have made disclosure of directors‟ interest in shares except Eco bank Transnational Plc in 2012. Greater number of companies also disclosed whether or not directors‟ had interest in contracts with the company. A few numbers of companies, however, did not disclose whether directors had interest in contract or not. The degree of compliance with these items of disclosure is high. This may be a reflection of what is obtainable generally of companies in Nigeria.

Column 6 in the tables provides information on the disclosure of corporate social responsibility. Corporate social responsibility reflects companies‟ activities and projects that are directed at improving the social welfare of the community and/or the public. This is to show that the company recognizes the interests of other stakeholders to the company. Companies undertake corporate social responsibility to show that they are responsible corporate citizens. May companies that were studied provide detail information of the corporate social responsibility projects and activities they have done in a year. Almost all the companies studied except a very few have made disclosure of corporate social responsibility. Those that have made the disclosure are marked by a tick while the few that did not disclosure are indicated as „not stated.‟ There is high degree of application of this item of disclosure.

The final column (7) is in respect of certification of financial statement by the chief executive officer (CEO) and chief financial officer (CFO) that it presents a true and fair view of the affairs of the company. The intention of this requirement is to make them responsible for the correctness of the financial statement. It has been observed from the tables that the common trend of certification is made by the chairman of the board and the chief executive officer. It is only in few cases that the chief finance officer counter signed the financial statement. From the companies studied the first companies finance officers that signed the financial statement was IGI Insurance Plc and Dangote Sugar Refinery plc in 2010. In 2011, only Diamond Bank‟s financial statement was counter signed by the chief finance officer. In 2012, Zenith Bank and Leadway Assurance Company and Crusader Life Insurance Ltd complied. It is clear from the information in column 7 of the tables that many companies are not applying strictly the corporate governance requirement. The positive aspect of it is that there is disclosure of those who certify the financial statements as those who take responsibility on behalf of the board of directors.

On a general note, having regard to the degree of compliance by the companies on the items of disclosure, it can be said that companies in Nigeria have started applying corporate governance principles and the rate of compliance is increasing in some areas while other areas experience poor compliance.

# CHAPTER SEVEN

**7.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS 7 . 1 Summary**

This research considered corporate governance with particular attention on the board of directors. In doing so, the study examined the global picture of corporate governance in order to situateNigeria‟s practice on the subject. The Securities and Exchange Commission (SEC) Code of Corporate Governance in Nigeria has made significant effort to introduce corporate best practices in the aspect of the board of directors that are common with other countries of the world. For example, like codes of many other countries, the SEC Code requires that the majority of the members of the board of directors should be non-executive directors, as well as the separation of the positions of the chief executive officer and chairman of the board with distinctive functions respectively.

There are however other important standards of best practices in relation to board of directors that are not contained in the SEC Code which are commonly regarded as best practices. The issues identified as findings hereunder jointly and severally show that there are important standard of best practices that need to be addressed by the SEC Code of Corporate Governance. These would provide for an effective board of directors. They also form the basis for recommendations for improvement. The salient findings are stated as follows:

# Qualification of the Board Chairman

Section 5.2(b) of the SEC Code of Corporate Governance in Nigeria has recommended that the CEO/MD should be knowledgeable in relevant areas of the company's activities and that he should demonstrate industry, credibility and integrity. But the Code has failed to recommend for the caliber of person the board chairman should be as it is done in the case of the CEO/MD. This omission raises concern about the ability of the

chairman to effectively perform his enormous responsibilities and in particular be able to match the chief executive officer who is usually a technocrat where the chairman does not have appreciable credentials. It is opined that such omission gives room for appointment of incompetent chairman there by providing opportunity for the CEO and his management team to manipulate the company. Once the CEO is able to overwhelm the chairman of the board he will be able to have his way in the decision making process of the company. This can affect the quality of the board and its decision making process.

# Lack of Mandatory Compliance and Sanctions for Non-compliance

It has been observed that theNigerian SEC Code of Corporate Governance has failed to provide sanctions for failure to comply with its Code. Compliance with the Code has been made voluntary without any condition required for non-compliance. This is contrary to international corporate best practices established on two models of, mandatory compliance with attendant sanctions for non-compliance and, the comply or explain approach with satisfactory reasons for non-compliance.

# The Issue of 'Connected Person' or 'Related Party'

Both the Companies and Allied Matters Act (CAMA) and the SEC Code of Corporate Governance in Nigeria restrict some transactions between the company and its directors or persons connected with a director of the company. This is meant to prevent a director from taking advantage of a transaction entered into with a person connected with the director for his personal benefits. The CAMA mentions persons connected with a director as that director's spouse, child or step-child including illegitimate child. On its part the code refers to related party to include family members. The problem with the code is that it has failed to define what constitute 'family members'. Whether it is nuclear or extended family is what cannot be determined under the Code. The problem of CAMA‟s definition on the other hand is that the persons mentioned as connected persons is too restrictive and has left out other

significant relatives like father, mother, brothers and sisters, father and mother in- laws. These relatives are likely to protect and promote the interest of their relative director in a company where circumstances exist.

# Restraint of Fraudulent Persons from Appointment as Directors

The provision on restraint of fraudulent persons from being directors under the Nigerian Companies and Allied Matters Act has been observed by this research to be too restricted to prevent or minimize fraudulent persons from appointment as directors. As noted in the research, the persons regarded as fraudulent for this purpose are those who had been fraudulent in relation to companies‟ affairs only. It means that those who had been fraudulent in other aspects like civil or public service would not be prevented from appointment as directors. This is ridiculous and would not ensure the constitution of boards of directors with persons of integrity and ethical values.

# Application of Disclosure Requirements

This research found that the items that many companies have significantly complied with the SEC Code of Corporate Governance are disclosure of directors‟ interest in shares of their companies, directors‟ interest in contracts and related party transactions, and corporate social responsibility. There are few companies that disclose their directors‟ profile that could show the qualification and experience of directors as well as their responsibilities in other companies in form of multiple directorships. It is also noticed that the common practice in almost all the companies is that the chairman and the chief executive officer certify the annual financial statement. However, few companies have started implementing the requirement that both the chief executive officer and chief finance officer should certify the company‟s financial statement.

# Conclusion

From the findings stated above it is observed that since the SEC Code of corporate governance has not prescribed the caliber of person to be appointed as chairman of the

board of directors, any member of the board could be appointed as chairman even if he does not have the requisite knowledge and experience to be able to contend with the experience and knowledge of the chief executive officer (CEO). Where the chairman is inexperienced it becomes easier for the CEO to control the chairman and indeed the board. This will make the CEO to become a dominant force at the board to influence decision taking of the board in the direction he wants. This situation can lead to promotion of personal interest of the CEO against the company.

The fact that the Securities and Exchange Commission Code of Corporate Governance has made voluntary compliance with its code without any condition attached to non-compliance gives companies unfettered discretion to decide the aspects of the Code requirements to observe and those not to observe. The implication is that those code requirements that complying with them would check the hitherto improper behaviours of the directors and executive managers may not be observed. This will make the application of the Code slow in Nigeria. More so the lack of prescribed deterrent sanctions for non- compliance with the Code makes it weak in enforcement. The cumulative effect of these is that the Code will not be effective in entrenching corporate best practices enshrined therein as intended to transform the business environment in Nigeria.

Another significant effect that has been noticed from the findings is in relation to the ambiguous and restrictive definition of “connected persons” to directors. There are other close relatives of directors that are not mentioned as connected persons. Such persons due to their affinity and consanguinity with a director can enter into transaction with the company in which the directors can derive personal benefits to the detriment of the interest of the company.

This study reveals that the categories of persons prohibited from being company directors on the basis of past fraudulent conduct is narrow. This can make persons who have past record of fraudulent conduct in civil and public service to be appointed

company directors since their fraudulent conduct was not in company affairs. This situation can make board of directors to be constituted of persons who do not have sound moral values and honesty. The effect of such persons at the board is that they may not act always in the best interest of the company but manifest fraudulent conduct for their personal interest. Fraudulent conduct should be elastic enough to cover other areas in order to significantly restrict all kinds of fraudulent persons from becoming company directors.

Finally, the non-disclosure by many companies in Nigeria of their directors‟ profile has a negative effect in the sense that it deprives the investors to know the caliber of persons that are managing their investments in the company. The knowledge about directors of a company contributes in taking investment decision either to invest, continue to invest or divest from the company. It becomes difficult to take an informed investment decision when such information is not available. Investors therefore take decisions that are ineffective.

# Recommendations

* + 1. **Prescription of Board Chairman‟s Qualification**

The board chairman occupies a very powerful leadership position in the company with enormous responsibilities. He provides a good check on the chief executive officer and his management team. He must therefore be a person that is likewise knowledgeable in relevant areas of the company's business activities and capable of demonstrating industry, credibility and integrity. It is desirable that similar qualities expected of the chief executive be applied to the chairman as well. The Nigerian SEC Code should make explicit provision on the caliber of persons to be appointed as chairman of the board.

# Provision for Mandatory Compliance and Sanctions

The study revealed that the Securities and Exchange Commission Code of Corporate Governance permits voluntary compliance with its requirements hence there is no sanctions prescribed for non-compliance. This position has been argued in this study to be ineffective in achieving corporate governance objective of entrenching corporate best practices in Nigeria. Consequently, this study recommends that in order to achieve significant transformation of corporate best practices in the Nigerian business environment, there should be statutory or code provision for mandatory compliance with corporate governance requirements and that adequate sanctions be prescribed for non- compliance. This will compel and facilitate observance of corporate best practices in order to experience a better and sanitized business environment faster in Nigeria.

# Definition of “Connected Person” or „Related Party‟

The main aim of preventing material transaction between the company and the directors or persons connected (related) to the director is to avoid conflict of interest where, the director is likely to take advantage of the transaction for his benefit. In view of the strong family ties that exist in the Nigerian culture which admits of the extended family system, it is postulated here that the definition of connected persons or related party be extended to cover both nuclear and extended families. These category of persons should be specifically mentioned as connected persons to a director: father, mother, brother, sister, father in-law, mother in-law, bother in-law and sister in-law

# Extension of Scope of „Fraudulent Persons‟

The issue of fraud is a matter of character irrespective of where a person has been conducting himself fraudulently. If a person has a record of fraudulent activities, whether in company‟s affairs or outside company‟s affairs, he is likely to conduct himself in the same way wherever he is. This research therefore recommends that in determination of a fraudulent person for the purpose of deciding whether or not to appoint a person as a

director, the record of his activities should not be limited to previous dealings with companies but be extended to other works of life such as civil and public service. It means that there is need to amend and expand the scope of the provision of the Companies and Allied Matters Act on restraint of fraudulent persons as directors to cover all areas of fraud committed by persons. This step will provide for appointment of directors who appear to be persons of integrity and ethical values that will promote an effective board of directors.

# Disclosure of Directors‟ profile

Directors‟ profile provides information about all the directors‟ academic qualification, knowledge and work experience. The disclosure of directors‟ profile helps to know whether the directors are knowledgeable and experienced in the business of the company, and to know whether a director is suitable on the board or not. Given the importance of this disclosure, it is recommended that all companies should be compelled to disclose directors‟ profile in their annual reports.

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