**CORPORATE GOVERNANCE AND PERFORMANCE OF BANKS IN NIGERIA**

**ABSTRACT**

An international wave of mergers and acquisitions has swept the banking industry as boundaries between financial sectors and products have blurred dramatically. There is therefore the need for countries to have sound resilient banking systems with good corporate governance, which will strengthen and upgrade the institution to survive in an increasingly open environment. In Nigeria, the Central Bank unveiled new banking guidelines designed to consolidate and restructure the industry through mergers and acquisition. This was to make Nigerian banks more competitive and be able to operate in the global market. Despite all its attempts, the Central Bank of Nigeria disclosed that after the consolidation in 2006, 741 cases of attempted fraud and forgery involving N5.4 billion were reported. In the light of the above, this research examined the relationships that exist between governance mechanisms and financial performance in the Nigerian consolidated banks. And also to find out if there is any significant relationship between the level of corporate governance disclosure index among Nigerian banks and their performance. The Pearson Correlation and the regression analysis were used to find out whether there is a relationship between the corporate governance variables and firm’s performance. In examining the level of corporate governance disclosures of the sampled banks, a disclosure index was developed guided by the CBN code of governance and also on the basis of the papers prepared by the UN secretariat for the nineteenth session of ISAR (International Standards of Accounting and Reporting). The study therefore observed that a negative but significant relationship exists between board size, board composition and the financial performance of these banks, while a positive and significant relationship was also noticed between directors’ equity interest, level of governance disclosure and performance. Furthermore, the t- test result indicated that while a significant difference was observed in the profitability of the healthy banks and the rescued banks, no difference was seen in the profitability of banks with foreign directors and that of banks without foreign directors. The study therefore concludes that there is no uniformity in the disclosure of corporate governance practices by the banks. Likewise, the banks do not disclose in general how their debts are performing, by providing a statement that expresses outstanding debts in terms of their ages and due dates. The study suggests that efforts to improve corporate governance should focus on the value of the stock ownership of board members. Also, steps should be taken for mandatory compliance with the code of corporate governance while an effective legal framework should be developed that specifies the rights and obligations of a bank, its directors, shareholders, specific disclosure requirements and provide for effective enforcement of the law.

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**CHAPTER ONE**

**INTRODUCTION**

###### **1.1 Background of the Study**

Globalization and technology have continuing speed which makes the financial arena to become more open to new products and services invented. However, financial regulators everywhere are scrambling to assess the changes and master the turbulence (Sandeep, Patel and Lilicare, 2002:9). An international wave of mergers and acquisitions has also swept the banking industry. In line with these changes, the fact remains unchanged that there is the need for countries to have sound resilient banking systems with good corporate governance. This will strengthen and upgrade the institution to survive in an increasingly open environment (Qi, Wu and Zhang, 2000; Köke and Renneboog, 2002 and Kashif, 2008).

Given the fury of activities that have affected the efforts of banks to comply with the various consolidation policies and the antecedents of some operators in the system, there are concerns on the need to strengthen corporate governance in banks. This will boost public confidence and ensure efficient and effective functioning of the banking system (Soludo, 2004a). According to Heidi and Marleen (2003:4), banking supervision cannot function well if sound corporate governance is not in place. Consequently, banking supervisors have strong interest in ensuring that there is effective corporate governance at every banking organization. As opined by Mayes, Halme and Aarno (2001), changes in bank ownership during the 1990s and early 2000s substantially altered governance of the world’s banking organization. These changes in the corporate governance of banks raised very important policy research questions. The fundamental question is how these changes affects bank performance. It is therefore necessary to point out that the concept of corporate governance of banks and very large firms have been a priority on the policy agenda in developed market economies for over a decade. Further to that, the concept is gradually warming itself as a priority in the African continent. Indeed, it is believed that the Asian crisis and the relative poor performance of the corporate sector in Africa have made the issue of corporate governance a catchphrase in the development debate (Berglof and Von -Thadden, 1999).

Several events are therefore responsible for the heightened interest in corporate governance especially in both developed and developing countries. The subject of corporate governance leapt to global business limelight from relative obscurity after a string of collapses of high profile companies. Enron, the Houston, Texas based energy giant and WorldCom the telecom behemoth, shocked the business world with both the scale and age of their unethical and illegal operations. These organizations seemed to indicate only the tip of a dangerous iceberg. While corporate practices in the US companies came under attack, it appeared that the problem was far more widespread. Large and trusted companies from Parmalat in Italy to the multinational newspaper group Hollinger Inc., Adephia Communications Company, Global Crossing Limited and Tyco International Limited, revealed significant and deep-rooted problems in their corporate governance. Even the prestigious New York Stock Exchange had to remove its director (Dick Grasso) amidst public outcry over excessive compensation (La Porta, Lopez and Shleifer 1999).

In developing economies, the banking sector among other sectors has also witnessed several cases of collapses, some of which include the Alpha Merchant Bank Ltd, Savannah Bank Plc, Societe Generale Bank Ltd (all in Nigeria), The Continental Bank of Kenya Ltd, Capital Finance Ltd, Consolidated Bank of Kenya Ltd and Trust Bank of Kenya among others (Akpan, 2007).

In Nigeria, the issue of corporate governance has been given the front burner status by all sectors of the economy. For instance, the Securities and Exchange Commission (SEC) set up the Peterside Committee on corporate governance in public companies. The Bankers’ Committee also set up a sub-committee on corporate governance for banks and other financial institutions in Nigeria. This is in recognition of the critical role of corporate governance in the success or failure of companies (Ogbechie, 2006:6). Corporate governance therefore refers to the processes and structures by which the business and affairs of institutions are directed and managed, in order to improve long term share holders’ value by enhancing corporate performance and accountability, while taking into account the interest of other stakeholders (Jenkinson and Mayer, 1992). Corporate governance is therefore, about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that will foster good corporate performance.

Jensen and Meckling (1976) acknowledged that the principal-agent theory which was also adopted in this study is generally considered as the starting point for any debate on the issue of corporate governance. A number of corporate governance mechanisms have been proposed to ameliorate the principal-agent problem between managers and their shareholders. These governance mechanisms as identified in agency theory include board size, board composition, CEO pay performance sensitivity, directors’ ownership and share holder right (Gomper, Ishii and Metrick, 2003). They further suggest that changing these governance mechanisms would cause managers to better align their interests with that of the shareholders thereby resulting in higher firm value.

Although corporate governance in developing economies has recently received a lot of attention in the literature (Lin (2000); Goswami (2001); Oman (2001); Malherbe and Segal (2001); Carter, Colin and Lorsch (2004); Staikouras, Maria-Eleni, Agoraki, Manthos and Panagiotis (2007); McConnell, Servaes and Lins (2008) and Bebchuk, Cohen and Ferrell (2009), yet corporate governance of banks in developing economies as it relates to their financial performance has almost been ignored by researchers (Caprio and Levine (2002); Ntim (2009). Even in developed economies, the corporate governance of banks and their financial performance has only been discussed recently in the literature (Macey and O’Hara, 2001).

The few studies on bank corporate governance narrowly focused on a single aspect of governance, such as the role of directors or that of stock holders, while omitting other factors and interactions that may be important within the governance framework. Feasible among these few studies is the one by Adams and Mehran (2002) for a sample of US companies, where they examined the effects of board size and composition on value. Another weakness is that such research is often limited to the largest, actively traded organizations- many of which show little variation in their ownership, management and board structure and also measure performance as market value.

In Nigeria, among the few empirically feasible studies on corporate governance are the studies by Sanda and Mukailu and Garba (2005) and Ogbechie (2006) that studied the corporate governance mechanisms and firms’ performance.In order to address these deficiencies, this study examined the role of corporate governance in the financial performance of Nigerian banks. Unlike other prior studies, this study is not restricted to the framework of the Organization for Economic Cooperation and Development principles, which is based primarily on shareholder sovereignty. It analysed the level of compliance of code of corporate governance in Nigerian banks with the Central Bank’s post consolidated code of corporate governance. Finally, while other studies on corporate governance neglected the operating performance variable as proxies for performance, this study employed the accounting operating performance variables to investigate the relationship if any, that exists between corporate governance and performance of banks in Nigeria.

**1.2 Statement of the Problem**

Banks and other financial intermediaries are at the heart of the world’s recent financial crisis. The deterioration of their asset portfolios, largely due to distorted credit management, was one of the main structural sources of the crisis (Fries, Neven and Seabright, 2002; Kashif, 2008 and Sanusi, 2010). To a large extent, this problem was the result of poor corporate governance in countries’ banking institutions and industrial groups. Schjoedt (2000) observed that this poor corporate governance, in turn, was very much attributable to the relationships among the government, banks and big businesses as well as the organizational structure of businesses.

In some countries (for example Iran and Kuwait), banks were part of larger family-controlled business groups and are abused as a tool of maximizing the family interests rather than the interests of all shareholders and other stakeholders. In other cases where private ownership concentration was not allowed, the banks were heavily interfered with and controlled by the government even without any ownership share (Williamson, 1970; Zahra, 1996 and Yeung, 2000). Understandably in either case, corporate governance was very poor. The symbiotic relationships between the government or political circle, banks and big businesses also contributed to the maintenance of lax prudential regulation, weak bankruptcy codes and poor corporate governance rules and regulations (Das and Ghosh, 2004; Bai, Liu, Lu, Song and Zhang, 2003).

In Nigeria, before the consolidation exercise, the banking industry had about 89 active players whose overall performance led to sagging of customers’ confidence. There was lingering distress in the industry, the supervisory structures were inadequate and there were cases of official recklessness amongst the managers and directors, while the industry was notorious for ethical abuses (Akpan, 2007). Poor corporate governance was identified as one of the major factors in virtually all known instances of bank distress in the country. Weak corporate governance was seen manifesting in form of weak internal control systems, excessive risk taking, override of internal control measures, absence of or non-adherence to limits of authority, disregard for cannons of prudent lending, absence of risk management processes, insider abuses and fraudulent practices remain a worrisome feature of the banking system (Soludo, 2004b). This view is supported by the Nigeria Security and Exchange Commission (SEC) survey in April 2004, which shows that corporate governance was at a rudimentary stage, as only about 40% of quoted companies including banks had recognised codes of corporate governance in place. This, as suggested by the study may hinder the public trust particularly in the Nigerian banks if proper measures are not put in place by regulatory bodies.

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

Despite all these measures, the problem of corporate governance still remains un-resolved among consolidated Nigerian banks, thereby increasing the level of fraud (Akpan, 2007) see Appendix 2. Akpan (2007) further disclosed that data from the National Deposit Insurance Commission report (2006) shows 741 cases of attempted fraud and forgery involving N5.4 billion. Soludo (2004b) also opined that a good corporate governance practice in the banking industry is imperative, if the industry is to effectively play a key role in the overall development of Nigeria.

The causes of the recent global financial crises have been traced to global imbalances in trade and financial sector as well as wealth and income inequalities (Goddard, 2008). More importantly, Caprio, Laeven & Levine (2008) opined that there should be a revision of bank supervision and corporate governance reforms to ensure that deliberate transparency reductions and risk mispricing are acted upon.

Furthermore, according to Sanusi (2010), the current banking crises in Nigeria, has been linked with governance malpractice within the consolidated banks which has therefore become a way of life in large parts of the sector. He further opined that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management.

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

The series of widely publicized cases of accounting improprieties recorded in the Nigerian banking industry in 2009 (for example, Oceanic Bank, Intercontinental Bank, Union Bank, Afri Bank, Fin Bank and Spring Bank) were related to the lack of vigilant oversight functions by the boards of directors, the board relinquishing control to corporate managers who pursue their own self-interests and the board being remiss in its accountability to stakeholders (Uadiale, 2010). Inan(2009) also confirmed that in some cases, these bank directors’ equity ownership is low in other to avoid signing blank share transfer forms to transfer share ownership to the bank for debts owed banks. He further opined that the relevance of non- executive directors may be watered down if they are bought over, since, in any case, they are been paid by the banks they are expected to oversee.

As a result, various corporate governance reforms have been specifically emphasized on appropriate changes to be made to the board of directors in terms of its composition, size and structure (Abidin, Kamal and Jusoff, 2009).

It is in the light of the above problems, that this research work studied the effects of corporate governance mechanisms on the financial performance of banks in Nigeria and also reviewed the annual reports of the listed banks in Nigeria to find out their level of compliance with the CBN (2006) post consolidation code of corporate governance. The study also finds out if there is any statistically significant difference between the profitability of the healthy and the rescued banks in Nigeria as listed by CBN in 2009. Finally, it went further to investigate if the banks with foreign directors perform better than those without foreign directors.

**1.3 Objectives of the Study**

Generally, this study seeks to explore the relationship between internal corporate governance structures and firm financial performance in the Nigerian banking industry. However, it is set to achieve the following specific objectives:

1) To examine the relationship between board size and financial performance of banks in Nigeria.

1. To appraise the effect of the proportion of non- executive directors on the financial performance of banks in Nigeria.
2. To investigate if there is any significant relationship between directors’ equity interest and the financial performance of banks in Nigeria.
3. To empirically determine if there is any significant relationship between the level of corporate governance disclosure and the financial performance of banks in Nigerian.
4. To investigate if there is any significant difference between the profitability of the healthy banks and the rescued banks in Nigeria.

**1.4 Research Questions**

This study addressed issues relating to the following pertinent questions emerging within the domain of study problems:

1) To what extent (if any) does board size affect and the financial performance of banks in Nigeria?

2) Is the relationship between the proportion of non-executive directors and the financial performance of listed banks in Nigeria statistically significant?

3) Is there a significant relationship between directors’ equity holdings and the financial performance of banks in Nigeria?

4) To what extent does the level of corporate governance disclosure affect the performance of banks in Nigeria?

5) To what extent (if any) does the profitability of the healthy banks differ from that of the rescued banks in Nigeria?

#### 1.5 Research Hypotheses

To proffer useful answers to the research questions and realize the study objectives, the following hypotheses stated in their null forms will be tested;

**Hypothesis 1:**

H0: There is no significant relationship between board size and financial

Performance of banks in Nigeria

**Hypothesis 2:**

H0: The relationship between the proportion of non-executive directors and the financial performance of Nigerian banks is statistically not significant

**Hypothesis 3:**

H0: There is no significant relationship between directors’ equity holding and the financial performance of banks in Nigeria

**Hypothesis 4:**

H0: There is no significant relationship between the governance disclosures of banks in Nigeria and their performance.

**Hypothesis 5:**

H0: There is no significant difference between the profitability of the healthy and the rescued banks in Nigeria.

**1.6 Significance of the Study**

This study is of immense value to bank regulators, investors, academics and other relevant stakeholders. By introducing a summary index that is better linked to firm performance than the widely used G-index, the study provides future researchers with an alternative summary measure. This study provides a picture of where banks stand in relation to the codes and principles on corporate governance introduced by the Central Bank of Nigeria. It further provides an insight into understanding the degree to which the banks that are reporting on their corporate governance have been compliant with different sections of the codes of best practice and where they are experiencing difficulties. Boards of directors will find the information of value in benchmarking the performance of their banks, against that of their peers. The result of this study will also serve as a data base for further researchers in this field of research.

**1.7 Scope and Limitation of Study**

Considering the year 2006 as the year of initiation of post consolidation governance codes for the Nigerian banking sector, this study investigates the relationship between corporate governance and performance of banks. The choice of this sector is based on the fact that the banking sector’s stability has a large positive externality and banks are the key institutions maintaining the payment system of an economy that is essential for the stability of the financial sector. Financial sector stability, in turn has a profound externality on the economy as a whole. To this end, the study basically covers the 21 listed banks out of the 24 universal banks, operating in Nigeria till date that met the N25 billion capitalization dead-line of 2005.The study covers these banks’ activities during the post consolidation period i.e. 2006-2008. The choice of this period allows for a significant lag period for banks to have reviewed and implemented the recommendations by the CBN post consolidation code. However it was not possible to obtain the annual reports of 2009/2010 since they are yet to be published by many of the banks as at the time of this research.

Furthermore, we focused only on banking industry because corporate governance problems and transparency issues are important in the banking sector due to the crucial role in providing loans to non-financial firms, in transmitting the effects of monetary policy and in providing stability to the economy as a whole. The study therefore covers four key governance variables which are board size, board composition, directors’ equity interest and governance disclosure level.

CHAPTER TWO

**LITERATURE REVIEW**

**2.1 Conceptual Framework**

**2.1.1 What is Corporate Governance?**

Corporate governance is a uniquely complex and multi-faceted subject. Devoid of a unified or systematic theory, its paradigm, diagnosis and solutions lie in multidisciplinary fields i.e. economics, accountancy, finance among others (Cadbury, 2002). As such it is essential that a comprehensive framework be codified in the accounting framework of any organization. In any organization, corporate governance is one of the key factors that determine the health of the system and its ability to survive economic shocks. The health of the organization depends on the underlying soundness of its individual components and the connections between them.

According to Morck, Shleifer and Vishny (1989), among the main factors that support the stability of any country’s financial system include: good corporate governance; effective marketing discipline; strong prudential regulation and supervision; accurate and reliable accounting financial reporting systems; a sound disclosure regimes and an appropriate savings deposit protection system.

Corporate governance has been looked at and defined variedly by different scholars and practitioners. However they all have pointed to the same end, hence giving more of a consensus in the definition. Coleman and Nicholas-Biekpe (2006) defined corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole. However, Mayer (1999**)** offers a definition with a wider outlook and contends that it means the sum of the processes, structures and information used for directing and overseeing the management of an organization. The Organization for Economic Corporation and Development (1999) has also defined corporate governance as a system on the basis of which companies are directed and managed. It is upon this system that specifications are given for the division of competencies and responsibilities between the parties included (board of directors, the supervisory board, the management and shareholders) and formulate rules and procedures for adopting decisions on corporate matters.

In another perspective, Arun and Turner (2002b) contend that there exists a narrow approach to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interests. However, Shleifer and Vishny (1997), Vives (2000) and Oman (2001) observed that there is a broader approach which views the subject as the methods by which suppliers of finance control managers in order to ensure that their capital cannot be expropriated and that they can earn a return on their investment. There is a consensus, however that the broader view of corporate governance should be adopted in the case of banking institutions because of the peculiar contractual form of banking which demands that corporate governance mechanisms for banks should encapsulate depositors as well as shareholders (Macey and O’Hara (2001). Arun and Turner (2002b) supported the consensus by arguing that the special nature of banking requires not only a broader view of corporate governance, but also government intervention in order to restrain the behaviour of bank management. They further argued that, the unique nature of the banking firm, whether in the developed or developing world, requires that a broad view of corporate governance, which encapsulates both shareholders and depositors, be adopted for banks. They posit that, in particular, the nature of the banking firm is such that regulation is necessary to protect depositors as well as the overall financial system.

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

##### 2.2 Historical Overview of Corporate Governance

The foundational argument of corporate governance, as seen by both academics as well as other independent researchers, can be traced back to the pioneering work of Berle and Means (1932). They observed that the modern corporations having acquired a very large size could create the possibility of separation of control over a firm from its direct ownership. Berle and Means’ observation of the departure of the owners from the actual control of the corporations led to a renewed emphasis on the behavioral dimension of the theory of the firm.

Governance is a word with a pedigree that dates back to Chaucer. In his days, it carries with it the connotation “wise and responsible”, which is appropriate. It means either the action or the method of governing and it is in the latter sense that it is used with reference to companies. Its Latin root, “gubernare’ means to steer and a quotation which is worth keeping in mind in this context is: ‘He that governs sits quietly at the stern and scarce is seen to stir’ (Cadbury, 1992:3). Though corporate governance is viewed as a recent issue but nothing is new about the concept because, it has been in existence as long as the corporation itself (Imam, 2006: 32).

Over centuries, corporate governance systems have evolved, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England. Similarly, much of the security laws in the United States were put in place following the stock market crash of 1929. There has been no shortage of other crises, such as the secondary banking crisis of the 1970s in the United Kingdom, the U.S. savings and loan debacle of the 1980s, East- Asian economic and financial crisis in the second half of 1990s (Flannery, 1996). In addition to these crises, the history of corporate governance has also been punctuated by a series of well-known company failures: the Maxwell Group raid on the pension fund of the Mirror Group of newspapers, the collapse of the Bank of Credit and Commerce International, Baring Bank and in recent times global corporations like Enron, WorldCom, Parmalat, Global Crossing and the international accountants, Andersen (La Porta, Lopez and Shleifer 1999). These were blamed on a lack of business ethics, shady accountancy practices and weak regulations. They were a wake-up call for developing countries on corporate governance. Most of these crisis or major corporate failure, which was a result of incompetence, fraud, and abuse, was met by new elements of an improved system of corporate governance (Iskander and Chamlou, 2000).

**2.3 Corporate Governance and Banks**

Corporate governance is a crucial issue for the management of banks, which can be viewed from two dimensions. One is the transparency in the corporate function, thus protecting the investors’ interest (reference to agency problem), while the other is concerned with having a sound risk management system in place (special reference to banks) (Jensen and Meckling, 1976).

The Basel Committee on Banking Supervision (1999) states that from a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management. This thus affect how banks:

1. set corporate objectives (including generating economic returns to owners);
2. run the day-to-day operations of the business;
3. consider the interest of recognized stakeholders;
4. align corporate activities and behaviours with the expectation that banks will operate in safe and sound manner, and in compliance with applicable laws and regulations; and protect the interests of depositors.

The Committee further enumerates basic components of good corporate governance to include:

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

On a theoretical perspective, corporate governance has been seen as an economic discipline, which examines how to achieve an increase in the effectiveness of certain corporations with the help of organizational arrangements, contracts, regulations and business legislation. It is not a disputed fact that banks are crucial element to any economy; this therefore demands that they have strong and good corporate governance if their positive effects were to be achieved (Basel Committee on Banking Supervision, 2003).

King and Levine (1993) and Levine (1997) emphasized the importance of corporate governance of banks in developing economies and observed that: first, banks have an overwhelmingly dominant position in the financial system of a developing economy and are extremely important engines of economic growth. Second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for majority of firms. Third, as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for the economy’s savings.

Banking supervision cannot function if there does not exist what Hettes (2002) calls “correct corporate governance” since experience emphasizes the need for an appropriate level of responsibility, control and balance of competences in each bank. Hettes explained further on this by observing that correct corporate governance simplifies the work of banking supervision and contributes towards corporation between the management of a bank and the banking supervision authority.

Crespi, Cestona and Salas (2002)contend that corporate governance of banks refers to the various methods by which bank owners attempt to induce managers to implement value-maximizing policies. They observed that these methods may be external to the firm, as the market for corporate control or the level of competition in the product and labor markets and that there are also internal mechanisms such as a disciplinary intervention by shareholders (what they refer to as proxy fights) or intervention from the board of directors. Donald Brash the Governor of the Reserve Bank of New Zealand when addressing the conference for Commonwealth Central Banks on Corporate Governance for the Banking Sector in London, June 2001 observed that: improving corporate governance is an important way to promote financial stability. The effectiveness of a bank’s internal governance arrangements has a very substantial effect on the ability of a bank to identify, monitor and control its risks. Although banking crises are caused by many factors, some of which are beyond the control of bank management, almost every bank failure is at least partially the result of mis-management within the bank itself. And mis-management is ultimately a failure of internal governance. Although banking supervision and the regulation of banks’ risk positions can go some way towards countering the effects of poor governance, supervision by some external official agency is not a substitute for sound corporate governance practices. Ultimately, banking risks are most likely to be reduced to acceptable levels by fostering sound risk management practices within individual banks. An instilling sound corporate governance practice within banks is a crucial element of achieving this.

Carse, Deputy Chief Executive of the Hong Kong Monetary Authority, also observed in 2000 that:

Corporate governance is of course not just important for banks. It is something that needs to be addressed in relation to all companies’ … sound corporate governance is particularly important for banks. The rapid changes brought about by globalization, deregulation and technological advances are increasing the risks in banking systems. Moreover, unlike other companies, most of the funds used by banks to conduct their business belong to their creditors, in particular to their depositors. Linked to this is the fact that the failure of a bank affects not only its own stakeholders, but may have a systemic impact on the stability of other banks. All the more reason therefore is to try to ensure that banks are properly managed.

**2.4 Elements of Corporate Governance in Banks**

Different authors and management specialists have argued that corporate governance requires laid down procedures, processes, systems and codes of regulation and ethics that ensures its implementation in organization (Altunbas, Evans and Molyneux, 2001). Some suggestions that have been underscored in this respect include the need for banks to set strategies which have been commonly referred to as corporate strategies for their operations and establish accountability for executing these strategies. El-Kharouf (2000), while examining strategy, corporate governance and the future of the Arab banking industry, pointed out that corporate strategy is a deliberate search for a plan of action that will develop the corporate competitive advantage and compounds it.

In addition to this, the BCBS (1999) contends that transparency of information related to existing conditions, decisions and actions is integrally related to accountability in that it gives market participants sufficient information with which to judge the management of a bank. The Committee advanced further that various corporate governance structures exist in different countries hence, there is no universally correct answer to structural issues and that laws do not need to be consistent from one country to another. Sound governance therefore, can be practiced regardless of the form used by a banking organization. The Committee therefore suggests four important forms of oversight that should be included in the organizational structure of any bank in order to ensure the appropriate checks and balances. They include:

1. oversight by the board of directors or supervisory board;
2. oversight by individuals not involved in the day-to-day running of the various business areas;
3. direct line supervision of different business areas, and;
4. Independent risk management and audit functions.

In summary, they demonstrate the importance of key personnel being fit and proper for their jobs and the potentiality of government ownership of a bank to alter the strategies and objectives of the bank as well as the internal structure of governance hence, the general principles of sound corporate governance are also beneficial to government-owned banks. The concept of good governance in banking industry empirically implies total quality management, which includes six performance areas (Klapper and Love, 2002). These performance areas include capital adequacy, assets quality, management, earnings, liquidity, and sensitivity risk. Klapper and Love argued that the degree of adherence to these parameters determines the quality rating of an organization.

**2.4.1 Regulation and Supervision as Elements of Corporate Governance in Banks**

In most instances, it has been argued that given the special nature of banks and financial institutions, some forms of economic regulations are necessary. However, there is a notable shift from such regulations, which have always been offered by governments over time in different economies all over the world. As observed by Arun and Turner (2002e), over the last two decades, many governments around the world have moved away from using economic regulations towards using prudential regulation as part of their reform process in the financial sector. They noted that prudential regulation involves banks having to hold capital proportional to their risk-taking, early warning systems, bank resolution schemes and banks being examined on an on-site and off-site basis by banking supervisors. They asserted that the main objective of prudential regulation is to safeguard the stability of the financial system and to protect deposits.

However, Brown (2004) observed that the prudential reforms already implemented in developing countries have not been effective in preventing banking crises, and a question remains as to how prudential systems can be strengthened to make them more effective. Barth, Caprio and Levin (2001) argued that there have been gray areas in the ability of developing economies to strengthen their prudential supervision and questions have been raised on this issue for several reasons:

1. It is expected that banks in developing economies should have substantially higher capital requirements than banks in developed economies. However, many banks in developing economies find it very costly to raise even small amounts of capital due to the fear of fund mismanagement by shareholders.
2. There are not enough well trained supervisors in developing economies to examine banks.
3. Supervisory bodies in developing economies typically lack political independence, which may undermine their ability to coerce banks to comply with prudential requirements and impose suitable penalties.
4. prudential supervision completely relies on accurate and timely accounting

information. However, in many developing economies, accounting rules, if they exist at all, are flexible, and typically, there is a paucity of information disclosure requirements.

Barth et al. further argued that if a developing economy liberalizes without sufficiently strengthening it prudential supervisory system, bank managers would find it easier to expropriate depositors and deposit insurance providers. A prudential approach to regulation will typically result in banks in developing economies having to raise equity in order to comply with capital adequacy norms. They maintained the argument that prior to developing economies deregulating their banking systems, much attention will need to be paid to the speedy implementation of robust corporate governance mechanisms in order to protect shareholders.

In an earlier discourse, Arun and Turner (2002a) argued that in developing economies, the introduction of sound corporate governance principles into banking has been partially hampered by poor legal protection, weak information disclosure requirements and dominant owners. They observed further that in many developing countries, the private banking sector is not enthusiastic to introduce corporate governance principles due to the ownership control.

Besides control mechanisms in banks, supervision of banks is another concept that can have both positive and negative impact on the performance of banks. The Basel Committee on Banking Supervision (1999) upheld that banking supervision cannot function as well if sound corporate governance is not in place and, consequently, banking supervisors have strong interests in ensuring that there is effective corporate governance at every banking organization. They added that supervisory experience underscores the necessity having the appropriate levels of accountability and checks and balances within each bank and that, sound corporate governance makes the work of supervisors infinitely easier. Sound corporate governance therefore can contribute to collaborative working relationship between management and bank supervision.

It is clear that the development of corporate governance in banking requires that one understand how regulation affects the principal’s delegation of decision making authority and what effects this has on the behaviour of their delegated agents (Coleman and Nickolas-Biekpe, 2006). They further suggest that regulation has at least four effects on the principle regulation of decision-making:

* 1. the existence of regulation implies the existence of an external force, independent of the market, which affects both the owner and the manager.
  2. if the market, in which banking firms act is regulated, one can argue that the regulations aimed at the market implicitly create an external governance force on the firm.
  3. the existence of both the regulator and regulations implies that the market forces will discipline both managers and owners in a different way than that in unregulated firms.
  4. in order to prevent systemic risk, such as lender of last resort, the current banking regulation means that a second and external party is sharing the banks’ risk.

From the above, the external forces affecting corporate governance in banks include not only distinctive market forces but also regulation. The truth about bank regulation is that governance in banks must be concerned with not only the interests of owners and shareholders but with the public interest as well. Additionally, regulation and its agent (the regulator) have a different relationship to the firm than the market, bank management or bank owners.

However, as observed in the banking firm, there exists another interest; that of the regulator acting as an agent for the public interest. This interest exists outside of the organization and is not necessarily associated, in an immediate and direct way, to maximization of bank profits. The mere existence of this outside interest will have a profound effect on the construction of interests internal to the firm (Freixas and Rochet, 2003). Thus, because the public interest plays a crucial role in banking, pursuit of interests internal to the firm requires individual banks to attend to interests external to the firm. This implies a wider range of potential conflict of interests than is found in a non-bank corporation. In bank corporations, the agent respond not only to the owner’s interest, but also to the public interest expressed by regulation through administrative rules, codes, ordinances, and even financial prescriptions.

In summary, the theory of corporate governance in banking requires consideration of the following issues:

• Regulation as an external governance force separate and distinct from the market

• Regulation of the market itself as a distinct and separate dimension of decision

making within banks

• Regulation as constituting the presence of an additional interest external to and separate from the firm’s interest

• Regulation as constituting an external party that is in a risk sharing relationship with the individual bank firm.

Therefore, theories of corporate governance in banking, which ignores regulation and supervision, will misunderstand the agency problems specific to banks. This may lead to prescriptions that amplify rather than reduce risk. In Nigeria, the regulatory functions, which is directed at the objective of promoting and maintaining the monetary and price stability in the economy is controlled by the Central Bank of Nigeria while the supervisory bodies are Nigeria Deposit Insurance Corporation and the Central Bank of Nigeria (CBN, 2006) . In other words, if one accepts that regulation affects the banking sector in an important way, one must also accept the fact that this has important implications for the structure and dynamics of the principal agent relationship in banks.

**2.5 Corporate Governance Mechanisms**

One consequence of the separation of ownership from management is that the day to today decision-making power (that is, the power to make decision over the use of the capital supplied by the shareholders) rests with persons other than the shareholders themselves. The separation of ownership and control has given rise to an agency problem whereby there is the tendency for management to operate the firm in their own interests, rather than those of shareholders’ (Jensen and Meckling, 1976; Fama and Jensen, 1983). This creates opportunities for managers to build illegitimate empires and, in the extreme, outright expropriation. Various suggestions have been made in the literature as to how the problem can be reduced (Jensen and Meckling, 1976; Shleifer and Vishny, 1997 and Hermalin and Weisbach, 1998). Some of the mechanisms (based on Shleifer and Vishny, 1997), and their impediments to monitor and shape banks’ behaviour are discussed below:

**2.5.1 Shareholders**

Shareholders play a key role in the provision of corporate governance. Small or diffuse shareholders exert corporate governance by directly voting on critical issues, such as mergers, liquidation, and fundamental changes in business strategy and indirectly by electing the boards of directors to represent their interests and oversee the myriad of managerial decisions. Incentive contracts are a common mechanism for aligning the interests of managers with those of shareholders. The Board of directors may negotiate managerial compensation with a view to achieving particular results. Thus small shareholders may exert corporate governance directly through their voting rights and indirectly through the board of directors elected by them.

However, a variety of factors could prevent small shareholders from effectively exerting corporate control. There are large information asymmetries between managers and small shareholders as managers have enormous discretion over the flow of information. Also, small shareholders often lack the expertise to monitor managers accompanied by each investor’s small stake, which could induce a free-rider problem.

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

**2.5.2 Debt Holders**

Debt purchasers provide finance in return for a promised stream of payments and a variety of other covenants relating to corporate behaviour, such as the value and risk of corporate assets. If the corporation violates these covenants or default on the payments, debt holders typically could obtain the rights to repossess collateral, throw the corporation into bankruptcy proceedings, vote in the decision to reorganize, and remove managers.

However, there could be barriers to diffuse debt holders to effectively exert corporate governance as envisaged. Small debt holders may be unable to monitor complex organization and could face the free-rider incentives, as small equity holders. Also, the effective exertion of corporate control with diffuse debts depends largely on the efficiency of the legal and bankruptcy systems. Large debt holders, like large equity holders, could ameliorate some of the information and contract enforcement problems associated with diffuse debt. Due to their large investment, they are more likely to have the ability and the incentives to exert control over the firm by monitoring managers. Large creditors obtain various control rights in the case of default or violation of covenants. In terms of cash flow, they can renegotiate the terms of the loans, which may avoid inefficient bankruptcies. The effectiveness of large creditors however, relies importantly on effective and efficient legal and bankruptcy systems. If the legal system does not efficiently identify the violation of contracts and provide the means to bankrupt and reorganize firms, then creditors could lose a crucial mechanism for exerting corporate governance. Also, large creditors, like large shareholders, may attempt to shift the activities of the bank to reflect their own preferences. Large creditors for example, as noted by Myers (1997) may induce the company to forego good investments and take on too little risk because the creditor bears some of the cost but will not share the benefits.

According to Oman (2001), corporate governance mechanisms including accounting and auditing standards are designed to monitor managers and improve corporate transparency. Furthermore, a number of corporate governance mechanisms have been identified analytically and empirically.

Davis, Schoorman and Donaldson (1997, p.23) suggest that governance mechanisms “protect shareholders’ interest, minimise agency costs and ensure agent-principal interest alignment”. They further opined that agency theory assumptions are based on delegation and control, where controls “minimise the potential abuse of the delegation”. This control function is primarily exercised by the board of directors.

# However, in other to address the specific objectives of this research, this study will focus on the internal/ insider mechanisms of corporate governance as they relate to banking operations.

# 2.6 Linkage between Corporate Governance and Firm Performance

Better corporate governance is supposed to lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision-making. In expectation of such an improvement, the firm’s value may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty (Imam, 2006). Good governance means little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. As investors and lenders will be more willing to put their money in firms with good governance, they will face lower costs of capital, which is another source of better firm performance. Other stakeholders, including employees and suppliers, will also want to be associated with and enter into business relationships with such firms, as the relationships are likely to be more prosperous, fairer, and long lasting than those with firms with less effective governance.

Implications for the economy as a whole are also obvious. Economic growth will be more sustainable, because the economy is less vulnerable to a systemic risk. With better protection of investors at the firm level, the capital market will also be boosted and become more developed, which is essential for sustained economic growth. At the same time, good corporate governance is critical for building a just and corruption-free society. Poor corporate governance in big businesses is fertile soil for corruption and corruptive symbiosis between business and political circles. Less expropriation of minority shareholders and fewer corruptive links between big businesses and political power may result in a more favorable business environment for smaller enterprises and more equitable income distribution (Iskander and Chamlou, 2000).

According to a survey by McKinsey and Company (2002) cited in Adams and Mehran (2003), 78% of professional investors in Malaysia expressed that they were willing to pay a premium for a well-governed company. The average premium these investors were willing to pay generally ranged from 20% to 25%. Many scholars have attempted to investigate the relationship between good governance and firm performance in a more rigorous way.

**2.7 The Role of Internal Corporate Governance Mechanisms in Organizational Performance**

According to the Asian Development Bank (1997), Dallas (2004) and Nam and Nam (2004) cited in Kashif (2008), various instruments are used in financial markets to improve corporate governance and the value of a firm. Economic and financial theory suggests that the instruments mentioned below affect the value of a firm in developing and developed financial markets. These instruments and their role are as follows:

**2.7.1 Role of Auditor**

The role of auditor is important in implementing corporate governance principles and improving the value of a firm. The principles of corporate governance suggest that auditors should work independently and perform their duties with professional care. In case of any financial manipulation, the auditors are held accountable for their actions as the availability of transparent financial information reduces the information asymmetry and improves the value of a firm (Bhagat and Jefferis, 2002).

However, in developing markets auditors do not improve the value of a firm. They manipulate the financial reports of the firms and serve the interests of the majority shareholders further disadvantaging the minority shareholders. The weak corporate law and different accounting standards also deteriorate the performance of the auditors and create financial instability in the developing market.

**2.7.2 Role of Board of Directors’ Composition**

The board of directors can play an important role in improving corporate governance and the value of a firm (Hanrahan, Ramsay and Stapledon, 2001). The value of a firm is also improved when the board performs its fiduciary duties such as monitoring the activities of management and selecting the staff for a firm. The board can also appoint and monitor the performance of an independent auditor to improve the value of a firm. The board of directors can resolve internal conflicts and decrease the agency cost in a firm. The members of a board should also be accountable to the shareholders for their decisions as argued by Vance (1983), Anderson and Anthony (1986), Nikomborirak (2001) and Tomasic, Pentony and Bottomley (2003).

The board consists of two types of directors; outsider (independent) and insider directors. The majority of directors in a board should be independent to make rational decisions and create value for the shareholders. The role of independent directors is important to improve the value of a firm as they can monitor the firm and can force the managers to take unbiased decisions. The independent directors can also play a role of a referee and implement the principles of corporate governance that protect the rights of shareholders (Bhagat and Jefferis, 2002; Tomasic, Pentony and Bottomley, 2003).

Similarly, internal directors are also important in safeguarding the interests of shareholders. They provide the shareholders with important financial information, which will decrease the information asymmetry between managers and shareholders as argued by Bhagat and Black (1999) and Bhagat and Jefferis (2002). The board size should be chosen with the optimal combination of inside and outside directors for the value creation of the investors. The boards of directors in the developing market are unlikely to improve the value of a firm, as the weak judiciary and regulatory authority in this market enables the directors to be involved in biased decision-making that serves the interests of the majority shareholders and the politicians providing a disadvantage to the firm (Asian Development Bank, 1997).

**2.7.3 Role of Chief Executive Officer**

The Chief Executive Officer (CEO) of an organization can play an important role in creating the value for shareholders. The CEO can follow and incorporate governance provisions in a firm to improve its value (Brian, 1997; Defond and Hung, 2004). In addition, the shareholders invest heavily in the firms having higher corporate governance provisions as these firms create value for them (Morin and Jarrell, 2001).

The decisions of the board about hiring and firing a CEO and their proper remuneration have an important bearing on the value of a firm as argued by Holmstrom and Milgrom (1994). The board usually terminates the services of an underperforming CEO who fails to create value for shareholders. The turnover of CEO is negatively associated with firm performance especially in developed markets because the shareholders lost confidence in these firms and stop making more investments. It is the responsibility of the board to determine the salary of the CEO and give him proper remuneration for his efforts (Monks and Minow, 2001). The board can also align the interests of the CEO and the firm by linking the salary of a CEO with the performance of a firm. This action will motivate the CEO to perform well because his own financial interest is attached to the performance of the firm as suggested by Yermack (1996).

The tenure of a CEO is also an important determinant of the firm’s performance.

CEOs are hired on short-term contracts and are more concerned about the performance of the firm during their own tenure causing them to lay emphasis on short and medium-term goals. This tendency of the CEO limits the usefulness of stock price as a proxy for corporate performance (Bhagat and Jefferis, 2002). The management of a firm can overcome this problem by linking some incentives for the CEO with the long-term performance of the firm (Heinrich, 2002).

**2.7.4 The Role of Board Size**

Board size plays an important role in affecting the value of a firm. The role of a board of directors is to discipline the CEO and the management of a firm so that the value of a firm can be improved. A larger board has a range of expertise to make better decisions for a firm as the CEO cannot dominate a bigger board because the collective strength of its members is higher and can resist the irrational decisions of a CEO as suggested by Pfeffer (1972) and Zahra and Pearce (1989).

On the other hand, large boards affect the value of a firm in a negative fashion as there is an agency cost among the members of a bigger board. Similarly, small boards are more efficient in decision-making because there is less agency cost among the board members as highlighted by Yermack (1996).

**2.7.5 Role of CEO Duality**

Similar to the other corporate governance instruments, CEO duality plays an important role in affecting the value of a firm. A single person holding both the Chairman and CEO role improves the value of a firm as the agency cost between the two is eliminated (Alexander, Fennell and Halpern, 1993). On the negative side, CEO duality lead to worse performance as the board cannot remove an underperforming CEO and can create an agency cost if the CEO pursues his own interest at the cost of the shareholders (White and Ingrassia, 1992).

**2.7.6 Role of Managers**

Managers can play an important role in improving the value of a firm. They can reduce the agency cost in a firm by decreasing the information asymmetry, which results in improving the value of a firm (Monks and Minow, 2001). Managers in the developed market create agency cost by under and over investment of the free cash flow. Shareholders are disadvantaged in this case as they pay more residual, bonding and monitoring costs in these firms.

Managers in developing financial markets generally play a negative role in the value creation of investors. The rights of the minority shareholders are suppressed and the firms in these markets cannot produce real value for shareholders as actions of the managers mostly favour the majority shareholders. The management and the shareholders in a developing market do not use the tools of hostile takeover and incentives to control the actions of managers. In the case of a hostile takeover, the managers are forced to perform well to be able to hold their jobs. Similarly, appreciation and bonuses can motivate managers to produce value for shareholders (Bhagat and Jefferis, 2002).

The ownership of the management in a firm has an important bearing on its value (Morck, Shleifer and Vishny, 1988). Also, firms can improve their value in developing markets by streamlining the interests of managers with those of the shareholders. This results in the convergence of the goals of shareholders and managers ultimately improving the value of the shareholders as suggested by Mehran (1995).

**2.8 Regulatory Environment for Banks in Nigeria**

The special tasks of providing the general public with a payment system and funding their operations with deposits are the main reasons why banks are regulated, i.e. there is a need for a safety net to protect depositors from the risk of bank runs and failures (Freixas & Rochet, 2003). As mentioned earlier on, the subject of corporate governance and the more specific issue of board independence have suffered neglect both in the academia and public policy in Nigeria. Before the introduction of a code of corporate governance, there were three main legislations that influenced the operations of enterprises: The Companies and Allied Matters Act 1990 prescribes the duties and responsibilities of managers of all limited liability companies; the Investment and Securities Act (ISA) 1999 requires Securities and Exchange Commission to regulate and develop the capital market, maintain orderly conduct, transparency and sanity in the market in order to protect investors; the Banks and other Financial Institutions Act 1991 empowers the Central Bank of Nigeria to register and regulate Banks and other Financial Institutions.

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

Other provisions of the code related to strengthening board independence include the recommendation that non executive director (NED) should chair the audit committee, in addition to the requirement that a non executive director should have no business relationship with the firm. They also include a recommendation that provides that the non-executive directors should be in the majority, and that a non-executive director should chair the remuneration committee, the membership of which should comprise wholly or mainly of outside directors. However, it is observed that the code is silent about other equally important committees like the appointment committee which is for regulating board independence. Moreover the code lacks legal authority, as there is no enforcement mechanism and its observance is entirely voluntary (Nmehielle and Nwauche, 2004). Recognising the potential problem to effective governance that family affiliation of board members could cause, the committee recommended that in order for the board to be truly independent, (outside) directors should not be connected with the immediate family of the members of the management.

As mentioned above, by excluding certain vital means of strengthening board independence it would appear that Nigeria’s code of corporate governance does not take full account of such provisions in codes of corporate governance developed much earlier on in other countries such as the United Kingdom and USA. In the United States, the Sarbanes-Oxley Act 2002 has come into being, heralding the start of new far-reaching measures aimed at strengthening corporate governance and restoring investor confidence (Jensen and Fuller, 2002). Building on the progress made in the reports by Cadbury (1992); Greenbury (1995); and Hempel (1998), the United Kingdom in 2003 started to implement the New Combined Code, an outcome of the Company Law review and a report by the Higgs Committee. In both countries the new set of regulations have recognized the importance of non-executive directors and made special provisions aimed at promoting their independence and corporate governance.

**2.9 Corporate Governance and the Current Crisis in the Nigerian Banking Sector**

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

According to Sanusi (2010) it was well known in the industry that since consolidation, some banks were engaging in unethical and potentially fraudulent business practices and the scope and depth of these activities were documented in recent CBN examinations. Governance malpractice within the consolidated banks has therefore become a way of life in large parts of the sector, enriching a few at the expense of many depositors and investors. Sanusi further opined that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management. In addition, the audit process at all banks appeared not to have taken fully into account the rapid deterioration of the economy and hence of the need for aggressive provisioning against risk assets.

As banks grew in size and complexity, bank boards often did not fulfill their functions and were lulled into a sense of well-being by the apparent year-over year growth in assets and profits. In hindsight, boards and executive management in some major banks were not equipped to run their institutions. Some banks’ chairmen/CEOs were seen to often have an overbearing influence on the board, and some boards lacked independence; directors often failed to make meaningful contributions to safeguard the growth and development of the bank and had weak ethical standards; the board committees were also often ineffective or dormant. The Central Bank of Nigeria published details of the extent of insider abuse in several of the banks and it was revealed that CEOs set up Special Purpose Vehicles to lend money to themselves for stock price manipulation or the purchase of estates all over the world. For instance, one bank borrowed money and purchased private jets which the Apex bank later discovered were registered in the name of the CEO’s son. In another bank, the management set up 100 fake companies for the purpose of perpetrating fraud.

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

**2.10 The Current Global Financial Crisis**

Many seek the roots of the current financial crises in the rapid development of financial innovations and the increasing focus of banks on non-traditional commission and fee-based banking operations. There are however, substantial benefits from financial innovation development. Financial innovations have increased the efficiency of the financial system in that they have improved the ability to spread risk, reduced transaction costs and the level of asymmetric information (Merton, 1995).

Moreover, the liquidity created by financial innovations improves the ability of banks in providing resources to the real sector (Santomero & Trester, 1998). Hence, the main challenge with financial innovations may be the implementation of them rather than the actual products. More specifically, banks may have been unable to properly modify structures and incentive schemes designed for traditional banking operations to be appropriate as focus increasingly is on non-traditional banking operations where financial innovations have a significant role. In essence many banks have moved from an “originate and hold” business model to a “originate and distribute” business model.

In the latter business model, the bank does not hold the assets they originate, i.e. the loans, until maturity, but rather distribute them to investors through the issuance of structured finance products. This new business model increases bank risk. Santomero & Trester (1998) model the impact of the ease of selling bank assets to other investors and indeed find a positive connection between financial innovation market growth and bank risk. As loans are no longer held on the banks books, the incentives for screening and monitoring borrowers is reduced as banks are no longer residual claimants on the loans (Gorton and Rosen, 2009). Moreover, the quality of the process with selecting the assets to be bundled and resold deteriorates, hence increasing the risk of the portfolio (Ashcraft & Schuermann, 2008). Gorton and Rosen (2009) recognised that some risk was indeed born by the banks in their role as originators and underwriter; significant write-downs have been made by numerous banks. An improvement in the incentives and information flow between the participants in the “originate and distribute” model is called for in order to make the structured finance market efficient (Mercieca, Schaeck & Wolfe, 2008).

The incentive schemes, particularly the sub-prime mortgage loan officers, have also been named as a scapegoat. The roots in the excessive supply of sub-prime mortgage loans is, however, to be found in governmental decisions to provide every US citizen with the opportunity to own their own home. Volume based incentives schemes only added to the rapid growth in this market. By constructing sub-prime loans with very low fixed rate interest rates during the initial period of two or three years, unsophisticated customers were attracted through what is now called “predator lending” (Gorton & Rosen, 2009). The growth in the sub-prime loan market resulted in rapid increase in house prices, i.e. the product fed into one of the macroeconomic factors its value relied on (Lensink, Meesters, & Naaborg, 2008). This is, however, not the first time that extraordinary growth on the real estate market has ended in a market collapse.

The nexus of providers of off-balance sheet vehicles, derivatives, securitization and interbank market such as investment banks, hedge funds, mortgage originators, which is now commonly called the “shadow banking system”, is opaque. Information about the actual value of the claims along the chain from the underlying mortgages to the investor in a residential mortgage-backed security (RMBS), a collateralised debt obligation (CDO) or other instrument holding tranches of CDOs or a structured investment vehicles (SIV) have been lost due to challenges in understanding the core assets involved (Gorton & Rosen, 2009). The structure of the products has become increasingly layered and broader in the geographic span as banks has placed tranches of loans with foreign and non-bank companies. The opacity of financial innovations and, in particularly, the complex and layered process by which the cash flow rights and risks are channeled across the financial system make it next to impossible for an outsider to understand the full picture. To make evaluation even harder, there is no market for many of the products of the “shadow banking system”. Note that the increased inter-linkage of banks has broadened the concept of TBTF to banks which are too-net-worked-to-fail (Caprio, Laeven & Levine, 2008). As a result of opacity, investors handed over an increasing part of the due diligence to credit agencies and investment banks. The credit agencies are not objective in their assessment in that they are paid for their opinion by the arranger of the securitization deal rather than the investors (Ashcraft & Schuermann, 2008). As a result of the long period of market growth, participants were willing to invest in new and increasingly exotic instruments pushing providers to develop products and offer them to a broader range of investors (European Central Bank, 2008). Over-dimensioned commissions and fees as well as focus on short term profits rather than worrying about potential future losses, created incentives for rapid growth in this market (Caprio et al., 2008). Moreover, misconception in the differences in the ratings for structured products and corporations used in investment mandates enabled asset managers to seek out the greater spreads of the structured products. Eventually, the lack of information and increasing uncertainty about the credit worthiness of counterparties, created a situation were financial intermediaries refused to conduct business with each other, resulting in the interbank market meltdown (Gorton and Rosen, 2009).

Caprio et al (2008) argues that bank regulation, in particularly the explicit deposit insurance and the implicit TBTF government guarantee, has induced the current financial crisis, as insolvent banks remain active only as a result of governmental rescue. Moreover, the government guarantees increase the risk appetite of banks tremendously. The arguments presented by Goddard (2008) are along the same lines. Moreover, the current regulatory perspective of institutions rather than functions provokes market players to engage in “regulatory arbitrage”, i.e. to create synthetic products to replace the original product under regulation, hence make profits by circumventing regulation (Merton, 1995b). The increased use of off-balance sheet items after the implementation of Basel II is one example of regulatory arbitrage; as the weights for the capital requirements are defined along product or asset type categories, derivative instruments are used to move assets off-balance sheet (Caprio et al., 2008). Moreover, the increasing reliance on credit ratings in a regulatory setting has been strongly criticized (Caprio et al., 2008). Both Caprio et al. (2008) also points a finger at supervisors and argue that too little attention was given to new financial innovations in the US as they enabled US companies to compete more efficiently on the international market. IMF, among others, has a similar view as they see deficient regulation, especially of the “shadow banking system”, as the main cause for the current financial crisis. Finding the right balance of regulation and supervision, i.e. being able to distinguish between situations where regulation improve efficiency and situations where government intervention would be harmful, is challenging. But it is also important to recognise that there has always been and will always be imbalances between financial innovation development and regulation and that the regulated will always be able to move more often and more quickly than the regulator (Caprio et al., 2008).

Merton (1995b) promotes a functional perspective rather than the currently common institutional perspective on regulation, i.e. economically equivalent transactions would be treated similarly. While discussing the main reasons for the current financial crisis, IMF gives support to Merton’s arguments by stating that regulation should focus on activities rather than entities (Walker, 2009). More importantly, there should be a revision of bank supervision to ensure that deliberate transparency reductions and risk mispricing are acted upon (Caprio et al., 2008).

The causes to the financial crises have also been sought in global imbalances in trade and financial sector as well as wealth and income inequalities (Goddard, 2008). The global imbalances, i.e. the surplus of countries like China and the huge US deficit, is argued to be the blame for the financial crisis in that the excessive US consumption have been financed from abroad and that the increased demand for structured finance products reflects the channeling of funds across countries. To sum this very brief discussion on the potential reasons for the current financial crisis, it appears evident that a number of different factors have affected the development of a sub-prime crisis in the US to a fully fledged global financial crisis, having substantial impact on the real economy. Moreover, the causes and consequences are by no means independent. Hence, the answers have to be sought in the joint impact of increased reliance on non-traditional banking operations, deficiencies in incentive schemes and organisational structures, laxity in regulation and, in particularly, supervision as well as imbalances both in national and the world economy.

Finally according to Caprio et al. (2008), bank corporate governance plays a significant role in most of the above listed factors. He further noted that the reason for substantial measures taken to re-vitalise the banking sector across different countries can be sought in the central role of banks in the financial system.

**2.11 Prior Studies on Specific Corporate Governance Practices and Firms’ Performance**

The agency theory states that better corporate governance should lead to higher stock prices or better long-term performance, because when managers are better supervised, agency costs are decreased (Albanese, Dacin and Harris, 1997). However, as Gompers, Ishii, and Metrick (2003) suggest, the evidence of a positive association between corporate governance and firm performance may be traced to the agency explanation. In connection with the relationship between corporate governance and firm performance, the most studied governance practices include board composition, size and shareholder activities.

**2.12.1 Board Composition**

The composition of board members has been proposed to help reduce the agency problem (Weisbach, 1988). Empirical studies on the effect of board membership and structure on performance generally show results either mixed or opposite to what would be expected from the agency cost argument. While some studies find better performance for firms with boards of directors dominated by outsiders (Pfeffer and Salancik 1978; Ogus, 1994;1998; Pearce and Zahra 1992; Vafeas, 1999), others find no such relationship in terms of accounting profits or firm’s value (Weisbach, 1988; Daily and Dalton, 1992; Mehran 1995; Daily and Ellstrand, 1996; Rosenstein and Wyatt 1997; Klein 1998; Weir and Laing 2001 and Bhagat and Bolton 2005). Daily and Dalton (1992) provided analyses of 54 empirical studies of board composition and 31 empirical studies of board leadership structure and their relationships to firm financial performance. They find little evidence of a relationship between board composition or leadership and firm financial performance. This is also evident in the study by Hermalin and Weisbach (1999) and Bhagat and Black (2002).

As it is the case in many family-based Asian banks (Malaysian banks), boards dominated by insiders are not expected to play their role as effective monitors and supervisors of management. This is particularly when the board chairperson is also the firm’s CEO. In addition, outside directors provide firms with windows or links to the outside world, thereby helping to secure critical resources and expand networking (Daily and Ellstrand, 1996).

In the case of a sample of 228 small, private firms in Shanghai in the People’s Republic of China**,** Liang and Li (1999) cited in Sang-Woo and Lum (2004), reported that the presence of outside directors is positively associated with higher returns on investment, though they do not find such a relationship for board size or the separation of the positions of CEO and board chairperson. Furthermore, Bohren and Bernt (2003) showed that the amount of stock owned by individual outside directors is significantly correlated with various measures of firm performance as well as CEO turnovers in poorly performing companies.

Baysinger and Butler (1990) and Rosenstein and Wyatt (1997) showed that the market rewards firms for appointing outside directors. Brickley, Coles and Terry (1994) find a positive relationship between the proportion of outside directors and the stock market reaction to poison pill adoptions; and Anderson, Mansi and Reeb (2004) in their study showed that the cost of debt, as proxied by bond yield spreads, is inversely related to board independence.

However, Fosberg (1989) investigated the relationship between the proportion of outside directors and various performance measures and finds no relationship between the two variables. Hermalin and Weisbach (1999) also observed no association between the proportion of outside directors and Tobin’s Q; and Bhagat and Black (2002) find no linkage between the proportion of outside directors and Tobin’s Q, return on assets, asset turnover and stock returns.

Sanda, Mukaila and Garba (2005), used a pooled OLS regression analysis of quoted companies in Nigerian stock exchange firm to find no evidence to support the idea that boards with higher proportion of outside directors perform better than other firms. Attiya and Robina (2007) in Pakistan analysed the relationship between firm value (Tobin’s Q) and governance sub indices (board ownership and shareholdings). The result indicates that corporate governance does matter in Pakistan and that board composition has significant effects on firm performance.

Thus, the relationship between the proportions of outside directors, a proxy for board independence, and firm performance is mixed. Studies using financial statement data and Tobin’s Q find no link between board independence and firm performance, while those using stock returns data or bond yield data find a positive link.

**2.12.2 Board Size**

Unlike in board composition, a fairly clear negative relationship appears to exist between board size and firm performance (Yermack 1996). Eisenberg, Sundgren, and Wells (1998), documented a similar pattern for a sample of small and midsize Finnish firms. Their study also revealed that board size and firm value are negatively correlated.

Lipton and Lorsch (1992); Jensen (1993) in their studies also confirmed that; limiting board size is believed to improve firm performance because the benefits by larger boards of increased monitoring are outweighed by the poorer communication and decision-making of larger groups.

A large board is likely to be less effective in substantive discussion of major issues and to suffer from free-rider problems among directors in their supervision of management (Hermalin and Weisbach 2002). Mak and Li (2001) conducted an empirical analysis of firms listed on the Stock Exchange of Singapore. They stated that the sign and significance of the relationship between board size and performance, is sensitive to the estimation method. They concluded that the board characteristics are endogenous and failing to take endogeneity into account may yield a significant relationship with performance, which in reality does not exist.

Mak and Kusnadi (2002) also asserted an inverse relationship between board size and firm value. Their observation is based on a comparative study done on the firms listed on Singapore Stock Exchange (SGX) and Kuala Lumpur Stock Exchange (KLSE). Board effect was found in both countries. They further supported Healey (2003) that large groups are less effective than small groups in decision-making. Dwivedi and Jain (2002) conducted a study on 340 large, listed Indian firms for the period 1997- 2001. This study found a weak positive relation between board size and performance of the firm.

Beiner, Drobetz, Schmid and Zimmermann (2003) conducted a study over companies listed on the Swiss Stock Exchange (SWX). Study did not find a significant relationship between board size and firm valuation, as measured by Tobin’s Q. Authors suggested that Swiss firms, on average, choose their number of board members just optimally.

Mak and Yuanto (2003) echo the above findings in firms listed in Singapore and Malaysia when they found that firm valuation is highest when board has five directors. Bennedsen, Kongsted and Nielsen (2006) studied the relationship between board size and performance of 500 Danish firms. Their study also supported a negative relation between the two variables. Adams and Mehran (2002) accessed the relationship between banking firms’ performance (represented by Tobin’s Q) and board size and found a non-negative relationship between board size and Tobin’s Q. They further argued that M and A activity and features of the bank holding company organizational form might make a larger board more desirable for these firms. They further explained that the board size is significantly related to characteristics of the sample firms’ structures.

Harris and Raviv (2005) and Bennedsen et al (2006) quoted the study of Yermack (1996) as a first ever-empirical study conducted on board size effect. Yermack has conducted his study on 452 US firms between 1984 and 1991. He took Tobin’s Q as an approximation of market valuation. He documented an inverse association between board size and firm value. He further asserted that the fraction of lost value occurs more when size of firm is increasing from small to medium (for e.g. from 6-12) as compare to the firm whose board size is increasing from medium to big (i.e. 12-24).

In Manas and Saravanan (2006) it was concluded that the absence of a relationship between board size and corporate governance exists in Indian banks.In Ghana, it has been identified that small board sizes enhances the performance of MFIs (Kyereboah-Coleman and Nicholas-Biekpe, 2006). While in a study conducted in Nigeria, Sanda, Mukailu and Garba (2005) found that, firm performance is positively related with small size as opposed to large boards. In their study, Klein (1998), Booth and Deli (1999) and Anderson, Mansi, and Reeb (2004) tried to find out the relation between board size and ratio of debt to assets (book leverage). They presented a different result that firms with bigger boards have lower cost of debt. On contrary to the theory that larger boards are ineffective monitors, they stated that board plays an important advisory role that enables firms to gain access to low-cost debt. They observed that the board will be larger in firms with high leverage.

Klein (1998), Agrawal and Knoeber (2001), Adams and Ferreira (2003), and Adams and Mehran (2003) also tried to access the applicability of same board size for all classes of firms. Klein (1998) argued that the CEO’s need for advice will increase with the complexity of the organization. Coles, Daniel and Naveen (2004) examined the relationship between board size and performance across different type of US firms. They explored the question of applicability of ideal board size with each class of firms. It was observed that Tobin’s Q increases in board size for firms that have greater advising requirements. That is, Q is positively associated with board size in diversified firms, larger firms, and in firms with higher leverage. Moreover, when firm-specific knowledge of insiders is relatively important, measured by R and D intensity, Q is positively related to representation of insiders on the board. Haniffa and Hudaib (2006) also concluded in their study that larger board size has a greater range of expertise to monitor the actions of management effectively.

**2.12.3 Shareholder’s Activities**

Baysinger and Butler (1985) found little evidence that corporate governance resolutions initiated by shareholders lead to better firm performance. Smith and Watts (1992), reported a positive performance effects for the Shareholder’s activities of the California Public Employees' Retirement System. Huson, Malatesta and Parrino (2004) showed that financial institutions could be fairly effective in pushing target companies to take steps to comply with their corporate governance proposals. They also find that any short-term valuation effects resulting from activities are dependent on the specific type of governance issue targeted. Gillan (2006) find that shareholder proposals by individuals have small, positive announcement effects, while proposals by institutional investors have a small but significant negative effect on stock prices. Overall, the empirical literature on shareholder’s activities in the United States seems to indicate that it has a negligible impact on corporate performance (Black, Jang and Kim, 2003).

In other studies, Frankel, Johnson and Nelson (2002) showed a negative relationship between earnings and auditor’s independence, but Ashbaugh, Lafond and Mayhew (2003) and Larcker and Richardson (2004) dispute their evidence arguing that the study dwelt more on intrinsic factors. Agrawal and Chadha (2005) find no relation between either audit committee independence nor the extent auditors provide non-audit services with the probability a firm restates its earnings.

Furthermore, several studies have examined the separation of CEO and chairman, positing that agency problems are higher when the same person holds both positions. Using a sample of 452 firms in the annual Forbes magazine rankings of the 500 largest U.S. public firms between 1984 and 1991, Yermack (1996) shows that firms are more valuable when the CEO and board chair positions are separate. Core, Holthausen and Larcker (1999) also find out that CEO compensation is lower when the CEO and board chair positions are separate.

Gompers, Ishii and Metrick (2003) used Investor Responsibility Research Center data, and concluded that firms with fewer shareholder rights have lower firm valuations and lower stock returns. They classified 24 governance factors into five groups: tactics for delaying hostile takeover, voting rights, director protection, other takeover defenses, and state laws. Most of these factors are anti-takeover measures so this index is effectively an index of anti-takeover protection rather than a broad index of governance.

Mallin, (2002) in USA studied the possible link between the corporations’ financial performance and its commitment to ethics. The emphasis of the paper was on attempting to find a link between overall financial performance and an emphasis on ethics as an aspect of corporate governance. Mallin, found that 26.8% of the 500 largest US public corporations are committed to ethical behaviour towards stakeholders, or emphasize compliance with codes of conduct. The financial performance of these corporations ranked higher than that of those corporations, which did not behave in this way. The statistical significance of the difference was highly significant.

Spong and Sullivan (2007), in their study on corporate governance of banks outlined that the previous studies by Pfeffer and Salancik (1978); Ogus, (1994);Pearce and Zahra (1992); Vafeas, (1999); Weisbach (1991); Daily and Dalton, (1992); Mehran (1995); Daily and Ellstrand (1996); Rosenstein and Wyatt (1997); Klein (1998); Weir and Laing (2001); Bhagat and Bolton (2005), Bhagat and Black (2002) and Sanda, Mukaila and Garba (2005 ) all on board composition and performance, focused majorly on corporate governance of firms while non-looked at the effect of board composition on banks’ value. Furthermore, apart from the studies by Sanda et al and Attiya and Robina (2007) as reviewed in board composition studies, all the other studies listed above, focused on developed market.

Studies by Lipton and Lorsch (1992); Jensen (1993); (Hermalin and Weisbach 2002); Mak and Li (2001); Mak and Yuanto (2003); Klein (1998); Agrawal and Knoeber (2001); Adams and Ferreira (2003); Adams and Mehran (2003) and Coles, Daniel and Naveen (2004) among other studies on board size and performance have been criticized by Bolton (2006) to consider just a single measure of governance. Bolton further expressed that this studies are also restricted to the Organization for Economic Cooperation and Development (OECD) framework only.

As further observed, most prior studies on corporate governance and performance make use of the market based performance measure and not accounting performance measures. In order to cover the lapses in prior studies, this study will build on the studies by Brown and Caylor (2004); Sandal et al (2005); Coleman and Nicholas-Biekpe (2006) to analyze the relationship between corporate governance and financial performance of banks in Nigeria.

This study used the CBN code of best practice and also made use of the specific governance index as provided by the Institutional Shareholder Services and as adopted in Brown and Caylor (2004), to create a summary index of firm- specific governance i.e. “Gov- Score”. This will be an improvement over the index as used in Gomper, Ishii and Metrick (2003) (i.e. the GIM index), which focused only on anti- takeover measures.

**Table 2.1: Other prior studies on corporate governance are summarized below**

|  |  |  |  |
| --- | --- | --- | --- |
| **Author** | **Research objective** | **Methodology** | **Key findings** |
| Parker, Peters  and Turetsky  2002 | Investigated various corporate  governance attributes and  financial survival | 176 financially stressed firms  1988-1996  Regression analysis | Firms that replaced their CEO with an outside  director were more than twice as likely to experience  bankruptcy  Larger levels of insider ownership are positively  associated with the likelihood of firm survival |
| Kiel and  Nicholson  2003a | Examine the relationship  between board demographics  and performance | 348 public listed companies ASX  1996  SPSS analysis  Tobin’s Q | Positive relationship between the proportion of  inside directors and the market-based measure of  firm performance.  Board size is positively correlated with firm value |
| O’Sullivan and  Diacon  2003 | (1) Examined whether mutual  insurers employ stronger board  governance than their  proprietary counterparts.  (2) Examined the impact of  board composition on the  performance  of proprietary(stock) and mutual  companies | Data regression analysis  53 life insures operating in the  UK over the period 1984-1991 | Mutual insurers had greater non-executive  representation on their boards.  Lack of consistent evidence on non-executive  monitoring and impact on performance |
| Dulewicz and  Herbert  2004 | Investigated whether there is any relationship between board  composition and behaviour, and company performance | Data based on original study of  134 responses from a crosssection  of companies. Follow up  data based on 86 listed  companies (1997-2000)  SPSS analysis  CFROTA (cash flow return on  total assets) ratio used for  performance analysis | Board practices on identified tasks not clearly linked  to company performance  Limited support that companies with independent  boards are more successful than others |
| Uzun,  Szewcyz and  Varma  2004 | Examined the relationship  between fraud and board  composition, board size, board  chair, committee structure and  frequency of board meetings, | Constructed database for a  sample of 266 companies (133  that were accused of committing  fraud and 133 no-fraud) during  the period 1978-2001  Regression analysis | Board composition and structure of oversight  committees are significantly related to the incidence  of corporate fraud.  A higher proportion of independent directors  indicated a less likelihood of fraud. |
| Dalton, Daily,  Ellstrand and  Johnson  1998 | Reviewed research on the relationships between board composition, leadership structure  and financial performance | Meta-analysis of 54 empirical  studies of board composition, 31  empirical studies of board  leadership structure | No meaningful relationship between board  composition, leadership structure and financial  performance. |
| Millstein and  Macavoy  1998 | Directors and performance focus on board behavior | Empirical study of 154 firms  based on 1991-1995 data | Substantial and statistically significant correlations  between an active board and corporate performance |
| Muth and  Donaldson  1998 | Examined board independence  and performance based on  agency stewardship theory | 145 listed companies  1992-1994  Statistical analysis | Empirical results inconclusive that board  independence has a positive effect on performance |
| Lawrence and  Stapledon  1999 | Examined the relationship  between board composition and  corporate performance.  Examined whether independent  directors have a positive  influence on executive  remuneration | Empirical studies – data sample  selected from ASX listed  companies in 1995.  Regression analysis  700 directors sampled | No statistically significant relationship between the  proportion of NED’s and adjusted shareholder  returns  Little evidence that board size affects share price  performance  No evidence that the proportion of executive  directors influences CEO remuneration |
| Li and Ang  (2000) | Investigated the impact of the  number of directorships on  directors performance. | Empirical studies- sample  consisted of  121 listed firms and 1195  directors  1989-1993  Regression analysis | Negligible affect on the firm’s share value based on  number of directorships- considering just the number of appointments may not reflect how a director performs in corporate monitoring |
| Rhoades,  Rechner and  Sundaramurthy  (2000) | Examined the insider/outsider  ratio of boards and company  performance.  Examined the potential  moderating effects of different  operational definitions of  monitoring and performance | Meta-analysis of 37 studies  across 7644 organizations based  on initial search of 59 reports  with quantitative data on  monitoring and performance  1966-1994 | Overall conclusions are that there is a small positive  relationship between board composition and  financial performance.  Board and their director quality needs to be further  addressed in considering managerial implications of  board composition monitoring |
| Bhagat and  Black  (2002) | Examined whether there is any  relationship between board  composition, board size, board  independence and firm  performance | 934 firms using data form 1985-  1995  Regression analysis | Low-profitability firms increase the independence of  their boards.  Firms with more independent boards do not perform  better than other firms. |

Bhagat and Bolton (2005)

###### **2.13 The Perspective of Banking Sector Reforms in Nigeria**

The last two decades has witnessed several significant reforms and developments in the Nigerian financial services sector. As a result of the various financial sector reforms carried out since the late 1980s, the nation’s banking system has undergone remarkable changes in terms of the number of institutions, ownership structure, as well as depth and breadth of the market. The reforms had been influenced largely by challenges posed by deregulation, globalization, technological innovations and adoption of supervisory and prudential requirements that conform to international standards. In 2001 for example, the Universal Banking Scheme was introduced, following further liberalization of the nation’s financial sector. Its adoption was borne out of the need to create a more level-playing field for the financial sector operators than hitherto, encourage greater efficiency through economies of scale, and foster competition (Soludo, 2005). Soludo further asserts that as at the end of 2004, there were 89 universal banks operating in Nigeria, comprising institutions of various sizes and degrees of soundness. Structurally, the sector is highly concentrated, as the ten largest banks in the system account for about 50 per cent of the industry’s total assets/liabilities. Many of the banks in the system are small in size and unable to compete with the bigger ones. Some of the small banks, apart from being closely held, were plagued by high incidence of non-performing loans; capital deficiencies; weak management and poor corporate governance. Also, when compared with the banking sectors in emerging economies, the nation’s banking sector according to Soludo, was described as fragile, poorly developed and extremely small.

A critical look at the nation’s banking system no doubt, indicates that the sector faces enormous challenges that call for an urgent attention. That consideration informed the implementation of a banking sector reform currently being undertaken by the CBN. The reform policies basically, complement banking liberalization earlier-on undertaken in the system, and include a broad range of measures aimed at improving the regulatory and supervisory environment as well as restructuring and developing the banking sector entities. The reforms agenda according to Soludo (2004b):

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

Specifically, the objectives of the banking reform, which is part of the general agenda of the Government overall economic reform programme (National Economic Empowerment and Development Strategy (NEEDS), include:

* Creation of a sound banking system that depositors can trust;
  + Creation of banks that are investor-friendly and that can finance capital intensive projects;
* Enhancement of transparency, professionalism, good corporate governance and accountability.

The main thrust of the reform package, which was anchored on a thirteen-point agenda, was to consolidate and recapitalize banks by increasing their shareholder’s funds to a minimum of N25 billion (about US$190 million) which took effect from December 31st, 2005 (Alashi, 2005). Other highlights include: the adoption of risk-focused and ruled based regulatory framework; the adoption of zero tolerance in the regulatory framework, especially in the area of data/information reporting; enforcement of dormant laws, especially those relating to the vicarious liabilities of banks’ Board members in cases of bank failure; revision and updating of relevant laws, and drafting of new ones relating to the effective operations of the banking system etc. The reforms had in turn prompted a regulatory induced restructuring in the form of consolidation that would engender the alignment and realignment of banks and banking groups in determined moves, which translated into the merger of some banks and the acquisition of others (Craig, 2005). The emergence of mega banks no doubt, would expose banks to new challenges, which if not properly addressed could adversely affect the operations of the payment system and its credibility. Also, the nature of the business of banks, particularly its opacity could make the risk exposure of banks even more difficult to assess in a consolidated banking system. These developments make it compelling for operators to demonstrate far greater commitment to professionalism and good corporate governance practices in banking institutions. Essentially, the way banking institutions are governed under the new dispensation would have implications for the achievement of the overall objectives of the policy on consolidation.

###### **2.14 State of Corporate Governance in Nigerian Banks**

Owing to the unique nature of banking, there are adequate corporate governance laws and regulations in place to promote good corporate governance in Nigeria. Some of the most important ones include: the Nigeria Deposit Insurance Corporation (NDIC) Act of 1988, the Company and Allied Matters Act (CAMA) of 1990, the Prudential Guidelines, the Statement of Accounting Standards (SAS 10), the Banks and Other Financial Institutions (BOFI) Act of 1991, Central Bank of Nigeria (CBN) Act of 1991, CBN Circulars and Guidelines, among others (Adenikinju and Ayorinde, 2001). Also, there are some government agencies and non-governmental associations that are in the vanguard of promoting good corporate governance practices in the Nigerian banking sector. These organizations, apart from the CBN and NDIC, include the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE), Corporate Affairs Commission (CAC), Chartered Institute of Bankers of Nigeria (CIBN), Institute of Chartered Accountants of Nigeria (ICAN), Financial Institutions Training Centre (FITC) among others.

Basically, corporate governance in the nation’s banking system provides the structure and processes within which the business of bank is conducted with the ultimate objective of realizing long-term shareholders’ value while taking into account the interests of all other legitimate stakeholders. In meeting its overall commitment to all stakeholders, the various statutory and other regulations in the system impose the responsibilities with sanctions for breaches on bank directors to:

• Effectively supervise a bank’s affairs by exercising reasonable business judgment and competence;

• Critically examine the policies and objectives of a bank concerning investments, loan asset and liability management, etc.

• monitor bank’s observance of all applicable laws;

• avoid self-serving dealings and any other malpractices;

• ensure strict accountability (Umoh, 2002).

A critical review of the nations’ banking system over the years, have shown that one of the problems confronting the sector has been that of poor corporate governance. From the closing reports of banks liquidated between 1994 and 2002, there were evidences that clearly established that poor corporate governance led to their failures. As revealed in some closing reports, many owners and directors abused or misused their privileged positions or breached their fiduciary duties by engaging in self-serving activities. The abuses included granting of unsecured credit facilities to owners, directors and related companies which in some cases were in excess of their banks’ statutory lending limits in violation of the provisions of the law (Osota, 1999).

The various corporate misconducts in the affected banks caused pain and suffering to some stakeholders particularly, depositors and some shareholders for no fault of theirs. A review of on-site examination reports of some banks in operation in recent times, continued to reveal that some banks had continued to engage in unethical and unprofessional conducts such as:

* Non-implementation of Examiner’s recommendations as contained in successive examination reports;
* Continual and willful violation of banking laws, rules and regulations;
* Rendition of inaccurate returns and failure to disclose all transactions thereby preventing timely detection of emerging problems by the Regulatory Authorities (Oluyemi, 2006).

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

From the various reports reviewed, internal audit functions were, in some banks not given appropriate backing of the Board and Senior Management. As a result, there had been the prevalence of frauds and forgeries in some banks in the system. Lack of transparency in financial reporting had equally been noted in some banks’ examination reports. The Boards of some banks were also noted to be ineffective in their oversight functions as they readily ratified management actions even when such actions could be seen to violate the culture of good corporate governance. Many Board Committees were equally noted to have failed to hold regular meetings to perform their duties. From the forgoing, it is obvious that corporate governance in the system faces enormous challenges which if not addressed could have serious implications for the overall success of the bank consolidation exercise (Craig, 2005). If operators in the banking sector will keep to the rules, as specified by the regulatory agencies and in individual banks’ policies and transaction procedures all things being equal, financial sector stability could be guaranteed. However, when there is the possibility of flagrant abuse of the ethical and professional demands on operators as evidenced in some failed banks’ closing reports and on-site examination reports of some of the banks in operation, the prospect of restoring public confidence in the Nigerian banking system may be difficult to guarantee.

**2.15 The Imperatives of Good Corporate Governance in a Consolidated Nigeria Banking System**

The hallmark of banking is the observance of high degree of professionalism, transparency and accountability, which are essential for building strong public confidence. Due to the systemic distress witnessed in the nation’s banking system and its unpleasant consequences on all stakeholders as a result of inadequacies in corporate governance of banks in recent times, series of initiatives had been taken by the nation’s regulatory/supervisory authorities to encourage sound corporate governance in the system. Some of the initiatives included enhancing the legal framework; enhancing the surveillance activities of the financial system; strengthening the roles of internal and external auditors; developing of a code of best practices of corporate governance in the system; issuance of guidelines and circulars on matters such as pre-qualification for appointment to board and top management positions in banks, insider related credits, etc. While all the above-mentioned efforts are in the right direction, it is equally important to indicate some imperatives of good corporate governance for banks so as to ensure the safety and soundness of emerging bigger banks in the post-consolidation era with a view to enhancing public confidence in the nation’s banking system. Some of the imperatives as identified by Oluyemi (2006) include:

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

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

On the legislative side, the situation is promising as almost all the important laws for fostering good corporate governance practices in Nigeria are in place or being reviewed. A major breakthrough in these series of efforts has been the publication of a Code of Best Practices for Corporate Governance in Nigeria based on the work of the Atedo Peterside Committee.

Also, regulatory authorities’ roadmap for the development of the banking system firmly puts corporate governance at the forefront. That had over the years been demonstrated through regular issuance of guidelines/circulars on critical issues bordering on corporate governance in banks.

While refinements of existing laws and elimination of discrepancies with international best practices may certainly add further value, it is important that the discussion on awareness and commitment to corporate governance should not be limited to mere compliance with regulatory authorities’ rules, guidelines or circulars. To improve the quality of corporate governance in a consolidated Nigerian banking system, there is the need for strict adherence to internationally recognized corporate governance codes such as those of the Organisation for Economic Cooperation and Development (OECD) and the Basel Committee report on Banking Supervision. Apart from observing these universally acceptable standards, banks must develop their own codes, particularly with respect to corporate Directors and Board members. Efforts must also be made by bank management to draw up a binding code of ethical and professional practice for all members of staff.

The development and maintenance of a robust corporate governance framework in a consolidated banking system calls for the commitment of all stakeholders. Regulatory bodies, courts and professional bodies like the Chartered Institute of Bankers of Nigeria (CIBN), Institute of Chartered Accountants of Nigeria (ICAN), Nigeria Institute of Management (NIM), etc, must establish, monitor and enforce legal norms actively and strictly.

* **The Responsibilities of the Board**

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

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

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

Under the new dispensation, bank directors must commit adequate time to be informed participants in their banks affairs and must devote sufficient time and energy to their duties.

Board members have a responsibility to educate themselves about their bank’s operations and seek advice of external experts as and when appropriate. Even if board members are independent, they can be ineffective as directors if they lack expertise or knowledge relevant to banking and its business. Therefore, board members must also be willing to educate themselves about their bank and the risk it faces.

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

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

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

The need for banks to continue to recognize internal and external auditors as an important part of the corporate governance process cannot be overemphasized. Adequate internal control system will help to discipline banks in their daily business by ensuring compliance with internal and external regulations as well as help the board to effectively evaluate the bank’s risks and ultimately its future strategy. The Basel II Accord on Capital Adequacy reinforces the need for a strong and independent internal control system that provides the bank’s governing bodies with timely and accurate data to enable them performs their necessary oversight and control functions.

The accounting profession needs to rigorously work to rebuild its greatest assets i.e. public trust, in order to restore faith in the integrity and objectivity of the profession. The current control/audit system, which is administratively or functionally dependent on the CEO and not the board as noted in some banks’ examination reports, could limit their effectiveness. The professional development and growth in experience of internal auditors and internal control officers will be critical to the further development of the banking sector. There is need for the effective functioning of the board of directors’ audit committee. The job of the Audit Committee is critical because the directors cannot oversee the bank effectively without reliable audits. Under the new dispensation, the committee members should consist of independent directors who are adequately informed and knowledgeable about the activities of the bank.

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

* **Information Disclosure And Transparency**

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

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

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

## 2.16 Theoretical Framework for Corporate Governance

Sanda and Mikaila and Garba (2005) in their work titled corporate governance mechanisms and firm financial performance in Nigeria identified the agency theory, stakeholder theory and the stewardship theories as the three prominent theories of corporate governance which are discussed below:

**2.16.1 Stakeholder Theory**

One of the original advocates of stakeholder theory, Freeman (1984), identified the emergence of stakeholder groups as important elements to the organization requiring consideration. Freeman further suggests a re-engineering of theoretical perspectives that extends beyond the owner-manager-employee position and recognizes the numerous stakeholder groups.

**Definitions of Stakeholder Theory**

Freeman (1984:46) defines stakeholders as “any group or individual who can affect or is affected by the achievement of the organization’s objectives”. Freeman (1993) as cited in Freeman (1999: 234), suggests,

if organizations want to be effective, they will pay attention to all and only those relationships that can affect or be affected by the achievement of the organization’s purpose. That is, stakeholder management is fundamentally a pragmatic concept. Regardless of the content of the purpose of the firm, the effective firm will manage the relationships that are important.

Sundaram and Inkpen (2004a, p.352) also suggest that “stakeholder theory attempts to address the question of which groups of stakeholder deserve and require management’s attention” Donaldson and Preston (1995) provide a diagrammatical representation of the stakeholder model, which is reproduced in Figure 3. This diagram reflects the number of groups with interests in (or relationships with) the firm. They explained that under this model, all person or groups with legitimate interests participating in an enterprise do so to obtain benefits and that there is no prima facie priority of one set of interests and benefits over another. Stakeholder theory offers a framework for determining the structure and operation of the firm that is cognisant of the myriad participants who seek multiple and sometimes diverging goals (Donaldson and Preston 1995).

Nevertheless, Sundaram and Inkpen (2004a) posit that wide- ranging definitions of the stakeholder are problematic. In addition, the authors argue that empirical evidence supporting a link between stakeholder theory and firm performance is lacking. Finally, identifying a myriad of stakeholders and their core values is an unrealistic task for managers (Sundaram and Inkpen, 2004b).

**2.16.2 Stewardship Theory**

Whereas agency theorists view executives and directors as self-serving and opportunistic, stewardship theorists, reject agency assumptions, suggesting that directors frequently have interests that are consistent with those of shareholders. Donaldson and Davis (1991) suggest an alternative “model of man” where “organisational role-holders are conceived as being motivated by a need to achieve and gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses” (Donaldson and Davis, 1991, p.51). They observed that where managers have served a corporation for a number of years, there is a “merging of individual ego and the corporation” (Donaldson and Davis, 1991, p.51). Equally, managers may carry out their role from a sense of duty. Citing the work of Silverman (1970), Donaldson and Davis argued that personal perception motivates individual calculative action by managers, thus linking individual self-esteem with corporate prestige. Davis, Schoorman and Donaldson, (1997) argued that a psychological and situational review of the theory is required to fully understand the premise of stewardship theory. Stewardship theory holds that there is no inherent, general problem of executive motivation (Cullen, Kirwan and Brennan, 2006). This would suggest that extrinsic incentive contracts are less important where managers gain intrinsic satisfaction from performing their duties.

**Definitions of Stewardship Theory**

“A steward protects and maximises shareholders wealth through firm performance, because, by so doing, the steward’s utility functions are maximised” (Davis, Schoorman and Donaldson, 1997:25 cited in Cullen, Kirwan and Brennan, 2006:13). The stewardship perspective suggests that the attainment of organizational success also satisfies the personal needs of the steward. The steward identifies greater utility accruing from satisfying organizational goals than through self-serving behaviour. Stewardship theory recognises the importance of structures that empower the steward, offering maximum autonomy built upon trust. This minimizes the cost of mechanisms aimed at monitoring and controlling behaviours (Davis, Schoorman and Donaldson, 1997).

Daily et al. (2003) contend that in order to protect their reputations as expert decision makers, executives and directors are inclined to operate the firm in a manner that maximizes financial performance indicators, including shareholder returns, on the basis that the firm’s performance directly impacts perceptions of their individual performance. According to Fama (1980), in being effective stewards of their organization, executives and directors are also effectively managing their own careers. Similarly, managers return finance to investors to establish a good reputation, allowing them to re-enter the market for future finance (Shleifer and Vishny, 1997).

Muth and Donaldson (1998) described stewardship theory as an alternative to agency theory which offers opposing predictions about the structuring of effective boards. While most of the governance theories are economic and finance in nature, the stewardship theory is sociological and psychological in nature. The theory as identified by Sundara-Murthy and Lewis (2003) gives room for misappropriation of owners’ fund because of its board structure i.e. insiders and the chairman/CEO duality role.

**2.16.3 Agency Theory**

The agency theory has its roots in economic theory and it dominates the corporate governance literature. Daily, Dalton and Canella (2003), point to two factors that influence the prominence of agency theory. Firstly, the theory is a conceptually simple one that reduces the corporation to two participants, managers and shareholders. Secondly, the notion of human beings as self-interested is a generally accepted idea.

**Definitions of Agency Theory**

In its simplest form, agency theory explains the agency problems arising from the separation of ownership and control. It “provides a useful way of explaining relationships where the parties’ interests are at odds and can be brought more into alignment through proper monitoring and a well-planned compensation system” (Davis, Schoorman and Donaldson, 1997:24). In her assessment and review of agency theory, Eisenhardt (1989) outlines two streams of agency theory that have developed over time: Principal-agent and positivist.

* Principal-agent relationship: Principal-agent research is concerned with a

general theory of the principal-agent relationship, a theory that can be applied to any agency relationship e.g. employer employee or lawyer-client.

Eisenhardt describes such research as abstract and mathematical and therefore less accessible to organisational scholars. This stream has a greater

interest in general theoretical implications than the positivist stream.

* Agency theory and the firm: a positivist perspective: Positivist researchers

have tended to focus on identifying circumstances in which the principal and agent are likely to have conflicting goals and then describe the governance mechanisms that limit the agent’s self-serving behaviour (Eisenhardt, 1989). This stream has focused almost exclusively on the principal-agent relationship existing at the level of the firm between shareholders and managers. For example, Jensen and Meckling (1976), who fall under the positivist stream, propose agency theory to explain, inter alia, how a public corporation can exist given the assumption that managers are self-seeking individuals and a setting where those managers do not bear the full wealth effects of their actions and decisions.

**2.16.4 Agency Relationships in the Context of the Firm**

The agency relationship explains the association between providers of corporate finances and those entrusted to manage the affairs of the firm. Jensen and Meckling (1976, p.308) define the agency relationship in terms of “a contract under which one or more persons (the principal(s) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent”.

Agency theory supports the delegation and the concentration of control in the board of directors and use of compensation incentives. The board of directors monitor agents through communication and reporting, review and audit and the implementation of codes and policies.

**Agency Problem**:

Eisenhardt (1989 p.58) explains that the agency problem arises when “(a) the desires or goals of the principal and agent conflict and (b) it is difficult or expensive for the principal to verify what the agent is actually doing”. The problem is that the principal is unable to verify that the agent is behaving appropriately.

Shleifer and Vishny (1997) explain the agency problem in the context of an entrepreneur, or a manager, who raises funds from investors either to put them to productive use or to cash out his holdings in the firm. They explain that while the financiers need the manager’s specialized human capital to generate returns on their funds, the manager, since he does not have enough capital of his own to invest or to cash in his holdings, needs the financier’s funds. But how can financiers be sure that, once they sink their funds, they get anything back from the manager? Shleifer and Vishny further explained that the agency problem in this context refers to the difficulties financiers have in assuring that managers do not expropriate funds and/or waste them on unattractive projects.

Drawing on the work of Jensen and Meckling (1976), Fama and Jensen (1983) seek to explain the survival of organizations characterized by the separation of ownership and control and to identify the factors that facilitate this survival. Their paper is concerned with the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions.

The agency theory, posit that the control function of an organization is primarily exercised by the board of directors. With regard to the board as a governance mechanism, the issues that appear most prominent in the literature are board composition (in particular board size, inside versus outside directors and the separation of CEO and chair positions) and the role and responsibilities of the board (Biserka, 2007).

In relation to the research objectives, this study will adopt the agency theory because, it focuses on the board of directors as a mechanism which dominates the corporate governance literature. The theory, further explain the association between providers of corporate finances and those entrusted to manage the affairs of the firm.

**CHAPTER THREE**

###### **RESEARCH METHODOLOGY**

**3.0 Introduction**

This Chapter discusses the method and procedures employed in carrying out the research. It also discusses the research design, study population and the data gathering method. The methods employed for data analysis and measurement which include the content analysis technique, regression analysis and the t-test statistics were also discussed.

**3.1 Research Design**

Using the judgmental sampling technique, this study selected the 21 listed banks in the Nigerian stock exchange market from the 24 universal banks in Nigeria. In line with Maingot and Zeghal (2008), this study constructed a checklist for evaluating the content of corporate annual reports of the listed banks to determine the level of corporate governance disclosure of the sampled banks.

In a related study by Coleman and Nicholas-Biekpe (2006), where they carried out a study on corporate governance and bank performance in Ghana, secondary data based on the financial statements of all the 18 banks made up of listed banks from 1996 to 2000 was used. They employed the modified version of the econometric model of Miyajima, Omi and Saito (2003) in determining the relationship between bank performance and corporate governance in Ghana.

Rogers (2005) also conducted a cross sectional and correlation investigation on corporate governance and performance in Ugandan commercial banks. The target population included depositors in the banks. Other stakeholders considered include 16 officials in charge of financial institutions. In their sample, 4 commercial banks were selected based on their dealings with both retail and corporate customers. Rogers selected a sample size of 388 respondents using the stratified random sampling methods. The data were analyzed using Pearson’s correlation statistical technique to test and establish whether there exist a relationship between corporate governance variables and bank performance.

Another study was also conducted by the Egyptian Banking Institute, in 2007 in determining the extent of the Egyptian banks’ compliance with the applicable corporate governance best practices, using the OECD and the Basel Committee on Banking Supervision code of corporate governance to determine the compliance level of 25 Egyptian banks.

In line with these prior studies, this study therefore considering 2006 as the year of post-consolidation, made use of the corporate annual reports of the 21 listed banks in Nigeria to find out the relationship that exist between corporate governance variables and performance. We adopted the random effect model of the panel data regression analysis in analysing the impact of the corporate governance proxies on the performance of the listed banks.

However, the Pearson correlation was also used to measure the degree of association between variables under consideration and the t-test statistics was computed using the profitability of the healthy banks and the rescued banks to find out if there is any statistically significant difference between the profitability of the two groups. The t- test statistics was also used to find out if there is any significant difference in the performance of banks with foreign director(s) and those without foreign directors. The governance disclosure level is arrived at by using the content analysis method to compute the disclosure index for all the selected banks.

## 3.2 Study Population

The population for this study consists of all the 24 universal banks in Nigeria as at 2008. The time frame considered for this study is 2006 to 2008. This 3 year period, although shorter than most studies of this nature, allows for a significant lag period for banks to have reviewed and implemented the recommendations by the CBN post consolidation code. To therefore cover for the shortness in period, the data gathered covers all the listed banks in Nigeria.

**3.3 Sample Size**

The judgmental sampling technique was used in selecting the 21 listed banks out of the 24 banks that made the consolidation dead line of 2005. These banks were considered because they are listed in the Nigerian stock exchange market which therefore enabled us to have easy accessibility to their annual reports which is the major source of our secondary data.

**3.4 Data Gathering Method**

**3.4.1 Types and Sources of Data**

The data used for this study were secondary data derived from the audited financial statements of the banks listed in the Nigerian Stock Exchange (NSE) between the three years period of 2006 and 2008.This study also made use of books and other related materials especially the Central Bank of Nigeria bullions and the Nigerian Stock Exchange Fact Book (2008). Some of the annual reports that were not available in the NSE fact book were either collected from the corporate offices of concerned banks or downloaded from the banks’ corporate websites.

### 3.4.2 Research Instruments

In determining the level of corporate governance disclosure among the listed banks in Nigeria, the study used the content analysis technique as a means of eliciting data from the audited annual reports of the selected banks. This was done using the researcher’s checklist (see Appendix 4) constructed using the CBN post consolidated code and the OECD code of corporate governance. This is divided into 5 broad categories: Financial disclosures, non-financial disclosures, annual general meetings, timing and means of disclosure, and best practices for compliance with corporate disclosure. Under non-financial disclosures, different headings such as bank objectives, governance structure and policies, members of the board and key executives, material issues regarding employees, risk factors, and independence of auditors are used. Under all these broad subcategories, a total of 45 issues were considered.

**3.4.3 Method of Data Presentation**

Data gathered from the annual reports of the sampled banks are presented in tabular forms. Percentages were also used to present the level of compliance to corporate governance disclosure.

**3.5 Model Specification**

This study employed a modified version of the econometric model of Miyajima et al (2003) as adopted by Coleman and Nicholas- Biekpe (2006). The Econometric model of Miyajima et al (2003) is therefore seen below as;

Yit = βo + β1Git + β2SZEt + β3 BDTt + et

Where:

Yit represents firm performance variables which are: return on capital employed, earnings per share, return on assets and return on equity for banking firms at time t.

Git is a vector of corporate governance variables which include: Board Size (BDS), Board Composition (BDC) which is defined as the ratio of outside directors to total number of directors, a dummy variable (CEO) to capture if the board chairman is the same as the CEO or otherwise, CEO’s tenure of office (CET).

SZEt is the size of the firm

BDTt is the debt structure of the firm

et, the error term which account for other possible factors that could influence Yit that are not captured in the model

Based on the fact that we employed different governance and performance proxies, the above model is therefore modified to determine the relationship between bank performance and corporate governance of banks in Nigeria. In doing this we therefore developed two simple definitional models to guide our analyses. These models are as follows;

**Model 1**

ROEit = f(BOSt,BCOMPt,DEIt,CGDIt )……………………………….. (1)

ROEit = βo + β1BOSt + β2BCOMPt + β3DEIt + β4CGDIt +et ………………..(2)

**Model 2**

ROAit = f(BOSt,BCOMPt,DEIt,CGDIt )………………………………… (1)

ROAit = βo + β1BOSt + β2BCOMPt + β3DEIt + β4CGDIt +et…………….(2)

**Where:**

ROE and ROA represents firm performance variables which are: Return on assets and Return on equity for banking firms at time t.

BOS represents the Board Size; Board Composition is represented by BCOMP which is defined as the ratio of outside directors to total number of directors, while DEI and CGDI represents Directors’ Equity Interest and Corporate Governance Disclosure Index respectively.

et, the error term which account for other possible factors that could influence ROEit and ROAit that are not captured in the model.

The a priori is such that:

β1BOSt; β2BCOMPt; β3DEIt and β4CGDIt > 0. The implication of this is that a positive relationship is expected between explanatory variables (β1BOSt; β2BCOMPt; β3DEIt and β4CGDIt) and the dependent variable. The size of the coefficient of correlation will help us explain various levels of relationship between the explanatory variables.

**3.6 Data Analysis Method**

In analyzing the relationship between corporate governance and financial performance of listed banks in Nigeria, the panel data methodology was adopted. This is because the study combined time series and cross sectional data.

**Panel Data Regression Analysis:** this is a type of regression analysis that involves panel data analytical technique. Panel data are said to be repeated observations on the same cross section, typically of individual variables that are observed for several time periods (Pesaran, Shin and Smith, 2000; Wooldridge, 2003; Baum,2006 in Westham, 2009). Longitudinal data and repeated measures are other terminologies used for the kind of data mentioned above. Panel data analysis is an important method of longitudinal data analysis because it allows for a number of regression analyses in both spatial (units) and temporal (time) dimensions. It also provides a major means to longitudinally analyze the data especially when the data are from various sources and the time series are rather short for separate time series analysis. Even in a situation when the observations are long enough for separate analyses, panel data analysis gives a number of techniques that can help examine changes over time common to a particular type of cross-sectional unit.

In addition to the points mentioned earlier, there are some advantages of using panel data. Some of them are highlighted as follows:

i)It gives more informative data, more variability, less co-linearity among variables, more degrees of freedom, and more efficiency. This is because it combines time series of cross-section observations.

ii) It can detect and measure effects that simply cannot be observed when using only cross-section or time series data.

iii) It minimizes the bias that might result from aggregation of individual units into broad aggregates. This is due to the fact that data are made available for several units in a panel data setting.

iv) It helps to take care of heterogeneity in the estimation process because it allows for individual/specific variable assessment.

v) It helps in handling more complicated behavioural models such as technological change, which may not be easy with only cross-section or time series data.

vi)It is better suited when a study is dealing with the dynamics of change such as turnover because it involves the repeated cross section of observations.

**Pooled Regression (OLS) Model (PRM)**: is equally known as the constant coefficient model (CCM). It is the simplest among the three models in panel data analysis. However, it disregards the space and the time dimensions of the pooled data. In a situation where there is neither significant cross-section unit nor significant temporal effects, one could pool all of the data and run an ordinary least squares (OLS) regression model.

**Fixed Effects (FE) Model:** in the FE technique, the slope coefficients,  are constant but the intercept, varies across space i.e. the intercept in the regression model is allowed to vary across space (individuals). This is as a result of the fact that each cross-sectional unit may have some special characteristics. The FE technique is very suitable in cases where the individual specific intercept may be correlated with one or more regressors (independent variables). In order to take into cognizance the different intercepts, the mean differencing or dummy method is usually employed based on which is found more suitable. It is known as the least-squares dummy variable (LSDV) model in cases where dummy variables are used. This is another way of calculating the within estimator most especially when the number of observations (N) is not relatively large.

A major disadvantage of the LSDV model is that it significantly reduces the degrees of freedom when the number of cross-sectional units, N, is very large. In this case, N number of dummies is introduced, which will help to reduce the common intercept term

**Random Effect (RE) Model**: the RE technique which is equally known as the Error Components Model (ECM) is an alternative to FE technique. Basically; the RE estimator assumes that the intercept of an individual unit is a random component that is drawn from a larger population with a constant mean value. The individual intercept is then expressed as a deviation from this constant mean value. One major merit of the RE over the FE is that it is economical (parsimonious) in degrees of freedom. This is because one does not have to estimate N cross-sectional intercepts but just only the mean value of the intercept and its variance. The RE technique is suitable in cases where the (random) intercept of each cross-sectional unit is uncorrelated with the regresses.

Since there is no significant correlation between the unobserved units of observation, specific random effects and the regresses, the RE model may be more appropriate. However, based on variations in the capital base and the share capital of the banks under review, the intercept of each bank is said to be a random component. Therefore we adopted the random effect model of the panel data regression analysis in analysing the impact of the corporate governance proxies on the performance of the listed banks.

While, the Pearson correlation was also used to measures the degree of association between variables under consideration, t-test statistics was computed using the profitability of the healthy banks and the rescued banks to find out if there is a significant difference in the profitability of the two groups of banks. However, the proxies that were used for corporate governance are; board size, board composition, directors’ equity interest and corporate governance disclosure index. While proxies for the financial performance of the banks are the accounting measures of performance; return on equity (ROE) and return on asset (ROA) as identified by First Rand Banking Group (2006).

**3.6.1 Content Analysis**

Content analysis is used to assess the level of compliance with the Code on Corporate Governance in prior studies. Content analysis is a way of categorising various items of a document into a number of categories. It is an appropriate method to use where a large amount of qualitative data has to be analysed. The use of content analysis has been supported by a number of authors for similar type of research (Holsti, 1969; Boyatis, 1998; Weber, 1988; Krippendorff, 1980).

Krippendorff further identified the following forms of content analysis:

1. Number of sentences disclosed

2. Number of words

3. Pages or proportion of pages

4. Average number of lines

5. Yes or no approach (Presence or absence of social disclosures) - Mirfazli, (2008b) and Imam (2000).

This study therefore adopted the Yes and No approach, identified by various studies on corporate governance (Krippendorff, 1980; Weber, 1988; Imam, 2000 and Mirfazli, 2008b) as a more reliable method in analysing corporate annual reports for governance disclosure because it does not add the element of subjectivity. An essential issue in content analysis is reliability. Milne & Alder (1998) identified different types of reliability and this occurs in the process of coding. The main problem that arises in coding is when more than one coder is encoding the data. In other to take care of the reliability problem, the coding is done personally by the researcher.

The study therefore developed a disclosure index, using the CBN post consolidation code of best practices and guided by the OECD code and papers prepared by the UN secretariat for the nineteenth session of ISAR (International Standards of Accounting and Reporting) (2001), entitled “Transparency and disclosure requirements for corporate governance” and the twentieth session of ISAR (2002), entitled “Guidance on Good Practices in Corporate Governance Disclosure” for the banks under study. Using these governance disclosure codes of best practices, issues on corporate governance disclosure were classified into 5 broad categories: Financial disclosures, non-financial disclosures, annual general meetings, timing and means of disclosure, and best practices for compliance with corporate disclosure. Under non-financial disclosures, different headings such as bank objectives, governance structure and policies, members of the board and key executives, material issues regarding employees, risk factors, and independence of auditors are used. Under all these broad and subcategories, a total of 45 issues were considered (See Appendix 4).

With the help of the list of disclosure items, the corporate annual reports of the banks were examined and a dichotomous procedure was followed to score each of the disclosure issue. Each will be awarded a score of ‘1’ if it appears to have disclosed the concerned issue and ‘0’ otherwise. The score of each bank was totaled to find out the net score of the bank. A corporate governance disclosure index (CGDI) was then computed by using the following formula:

CGDI= Total Score of the Individual Company x 100

Maximum Possible Score Obtainable by Company

**CHAPTER FOUR**

**DATA PRESENTATION AND ANALYSIS**

**4.0 Introduction**

Considering the year 2006 as the year of initiation of post consolidation for the Nigerian banking industry, this chapter presents the analysis of the secondary data collected from the Nigerian Stock Exchange Fact Book and the companies’ annual report. The data from these sources are therefore presented in this chapter using tables and charts, depicting the frequency distributions for easy understanding. Data analysis as well as testing of the hypotheses formulated in chapter one are also covered.

In this chapter, we also provided two types of data analysis; namely descriptive analysis and inferential analysis. The descriptive analysis helps us to describe the relevant aspects of the phenomena under consideration and provide detailed information about each relevant variable. For the inferential analysis, we used the Pearson correlation, the panel data regression analysis and the t-test statistics. While the Pearson correlation measures the degree of association between variables under consideration, the regression estimates the impact of the corporate governance variables on profitability proxied by return on equity and return on asset. Furthermore, in examining if the profitability of the healthy banks is significantly different from that of the rescued banks, the t-test statistics was used.

**4.1 DATA PRESENTATION AND ANALYSIS**

In examining the level of corporate governance disclosures of the sampled banks, a disclosure index has been developed using the Central Bank of Nigeria post consolidated code of corporate governance, the OECD code and ISAR (2001; 2002).Issues on corporate governance disclosure are therefore classified into 5 broad categories; financial disclosures, non-financial disclosures, annual general meetings, timing and means of disclosure and best practices for compliance with corporate disclosure. Under non-financial disclosures, different headings such as company objectives, governance structure and policies, members of the board and key executives, material issues regarding employees, environmental and social stewardship, material foreseeable risk factors, and independence of auditors are used. Under all these broad and subcategories, a total of 45 issues have been considered (See Appendix 4). As earlier stated in chapter three, with the help of the list of disclosure items, the corporate annual reports of the banks were examined. A dichotomous procedure was followed to score each of the disclosure items. Each bank was awarded a score of ‘1’ if it appears to have disclosed the concerned issue and ‘0’otherwise.

**Table 4.0: Level of Corporate Governance Disclosure of Listed Banks in Nigeria**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Years** | **DBK1** | **DBK2** | **DBK3** | **DBK4** | **DBK5** | **DBK6** | **DBK7** | **DBK8** | **DBK9** | **DBK10** | **DBK11** | **DBK12** |
| **2006** | 28 | 27 | 32 | 27 | 36 | 31 | 29 | 28 | 24 | 26 | 26 | 26 |
| **2007** | 28 | 31 | 32 | 27 | 38 | 32 | 28 | 28 | 25 | 27 | 27 | 27 |
| **2008** | 29 | 35 | 32 | 27 | 41 | 32 | 30 | 28 | 25 | 27 | 28 | 27 |
| **Total** | 85 | 93 | 96 | 81 | 115 | 95 | 87 | 84 | 74 | 79 | 81 | 0.8 |
| **AVE** | 28.33 | 31 | 32 | 27 | 38.33 | 31.6 | 29 | 28 | 24.7 | 26.33 | 27 | 26.67 |
| **CGDI** | **0.63** | **0.69** | **0.71** | **0.6** | **0.85** | **0.7** | **0.64** | **0.62** | **0.55** | **0.59** | **0.6** | **0.59** |
|  | | | | | | | | | | | | |
| **Years** | DBK13 | DBK14 | DBK15 | DBK16 | DBK17 | DBK18 | DBK19 | DBK20 | DBK21 |
|  |  |  |  |  |  |  |  |  |  |
| **2006** | 29 | 25 | 24 | 27 | 28 | 39 | 29 | 31 | 34 |
| **2007** | 29 | 25 | 25 | 25 | 33 | 39 | 32 | 31 | 35 |
| **2008** | 30 | 26 | 26 | 29 | 34 | 40 | 31 | 31 | 35 |
| **Total** | 88 | 76 | 75 | 81 | 95 | 118 | 92 | 93 | 104 |
| **AVE** | 29.3 | 25.3 | 25 | 27 | 31.66 | 39.33 | 30.6 | 31 | 34.67 |
| CGDI | **0.65** | **0.56** | **0.56** | **0.6** | **0.7** | **0.87** | **0.68** | **0.69** | **0.77** |

Source: computed by researcher using data extracted from annual reports of banks (2009)

Note: for key to bank coding see appendix V

Table 4.0 presents a summary of the average corporate governance disclosure data by the 21 listed banks in Nigeria and also the disclosure index as at 2008. The table reveals that all the banks present a statement of their corporate governance practice. However, the extensiveness of the statement varies between banks. Based on the 45 governance indices used for assessment (see appendix 4), Wema bank and First bank plc emerged with the highest number of corporate governance disclosure with 39 and 38 disclosure items (i.e. 87% and 85% respectively) during the period under review. These two banks were followed by Afri Bank and ECO bank Plc with 77% and 71% respectively. On the other hand, Intercontinental bank, Union bank and United Bank for Africa, disclosed the least governance items. Intercontinental bank disclosed an average of 24.7 items (55%), Union bank and Stanbic Ibtc bank Plc both disclosed 25 and 25.3 items respectively and this is approximately 56% each.

**Table 4.1** **Percentage of Banks’ Compliance to Corporate Governance Disclosure Items**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| CGD ITEMS | CGD1 | CGD2 | CGD3 | CGD4 | CGD5 | CGD6 | CGD7 | CGD8 | CGD9 | CGD  10 | CGD  11 | CGD12 |
| Ave. no of compliant banks | **21** | **17** | **21** | **5** | **21** | **6** | **12** | **11** | **21** | **10** | **8** | **17** |
| % of compliant banks | **100%** | **80%** | **100%** | **23%** | **100%** | **28.5%** | **57%** | **52%** | **100%** | **47.6%** | **38%** | **81%** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| CGD ITEMS | **CGD**  **13** | **CGD**  **14** | **CGD**  **15** | **CGD16** | **CGD**  **17** | **CGD18** | **CGD19** | **CGD20** | **CGD21** | **CGD**  **22** | **CGD23** | **CGD24** |
| Ave. no of compliant banks | **21** | **21** | **21** | **21** | **21** | **20** | **5** | **11** | **20** | **21** | **4** | **17** |
| % of compliant banks | **100%** | **100%** | **100%** | **100%** | **100%** | **95%** | **23.8%** | **52%** | **95%** | **100%** | **19%** | **81%** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| CGD ITEMS | **CGD25** | **CGD26** | **CGD27** | **CGD28** | **CGD29** | **CGD30** | **CGD31** | **CGD32** | **CGD33** | **CGD34** | **CGD35** | **CGD36** |
| Ave. no of compliant banks | **21** | **21** | **2** | **6** | **2** | **14** | **14** | **21** | **21** | **20** | **9** | **20** |
| % of compliant banks | **100%** | **100%** | **9%** | **28.5%** | **9%** | **66.6%** | **66.6%** | **100%** | **100%** | **95%** | **42.3%** | **95%** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| CGD ITEMS | **CGD**  **37** | **CGD**  **38** | **CGD**  **39** | **CGD**  **40** | **CGD**  **41** | **CGD42** | **CGD**  **43** | **CGD**  **44** | **CGD**  **45** |  |  |  |
| Ave. no of compliant banks | **3** | **13** | **21** | **21** | **21** | **16** | **15** | **21** | **21** |  |  |  |
| % of compliant banks | **14%** | **61.2%** | **100%** | **100%** | **100%** | **76%** | **71%** | **100%** | **100%** |  |  |  |

Source: computed by researcher using data extracted from annual reports of banks (2009)

From tables 4.1, it was generally observed that all the banks (i.e. 100%) reported more on governance disclosure items 1, 13 to 17, 22, 32, 40, 41, 44 and 45. Disclosure items 4, 6, 19, 23, 27, 28, 29, and 37 were the least reported items with less that 30% of the banks disclosing them.

While Union Bank provides only an outline stating its compliance with the code of corporate governance for banks, the number of board members, the separation of the offices of the chairman and managing director/chief executive, the committees of the board and such general principles employed to ensure good corporate governance, Intercontinental bank discloses a very brief statement which in broad sense, is an expression of an embrace for good corporate governance practices. For First Banks, Wema Bank and Eco-bank, the statements are more extensive, stating the board composition, board profile, board committees and their responsibilities.

Although most of the banks made disclosures on the performance of insider-related credit (CGD2), Zenith Bank and Intercontinental bank did not make clear statement on such disclosure. This disclosure will help to evaluate the objectivity in insider-related dealings and thus an evaluation of the riskiness of the banks.

Furthermore, the banks disclosed directors' remuneration by amount only, without an effort to disclose who receives what and for what purpose are such emoluments received. They only disclosed the gross amount paid to directors. This blurs the possibility of any meaningful analysis of the directors' remuneration. All the banks provided disclosures on compliance with banking regulations. This is also important as it shows how responsible the banks are.

Below is detailed information on how the banks responded to each of the governance items.

**CGD 1 (Financial and operating result)**: On the average of the three years considered, the mean of 1.0000 was recorded for this disclosure item. This implies that all the banks under review reported on CGD1.

**CGD 2 (Related party transaction)**: 0.80 was recorded as the average for CGD2 with 17 of the banks reporting on this item. Zenith bank, Intercontinental bank, Afri bank and Union bank did not disclose full information on this item but rather disclosed a very brief statement that they have related party transaction.

**CGD 3 (Critical accounting policies):** All the banks under consideration disclosed full information on this item. This represents a total of 100%.

**CGD 4 (Corporate reporting framework):** Only 23% of the banks were seen to have disclosed information on the company’s corporate framework. These banks that complied are; First bank, United Bank for Africa, Wema bank and Zenith Bank.

**CGD 5 (Statement of directors’ responsibilities towards preparation and presentation of financial statements):** All the banks under review reported on this particular governance item. This amounted to a percentage of 100%.

**CGD 6 (Risk and Estimates in preparing and presenting financial statements):** Diamond bank, Fidelity bank, First bank, FCMB and Intercontinental bank reported on this item of disclosure. While Access bank and Union bank made few comments on risk and estimates in preparing and presenting financial statements, other banks did not. The average compliant with this item of disclosure is 28.5%.

**CGD 7 (Segment reporting):** Onlyabout 12 of the banks amounting to 57% presented full details on segment report. Standard Chartered bank and First bank had the most comprehensive report on this item. Others with detailed information are ECO bank, Guaranty Trust bank, Platinum bank and Wema bank.

**CGD 8 (Information regarding future plan):** 52% of the banks presented information concerning future plan in their chairman’s statement while others like Afri bank, Fidelity bank, Fin bank, Guaranty Trust bank, Oceanic bank and bank PHB were silent about issues concerning their future plan.

**CGD 9 (Dividend):** Although all the banks reported on this item, Diamond bank, Sterling bank, Union bank, Wema bank and Unity bank did not make full report on this item in 2006.

**CGD 10 (Information about company objective):** Information on company’s objective was presented by only 10 of the banks. While banks like Oceanic bank, Spring bank, Stanbic IBTC, bank PHB, Unity bank, Afri bank and FIN bank made no disclosure, Fidelity bank, FCMB, SKYE bank, Sterling bank, United Bank for Africa made disclosure prominently in 2006 and 2008

**CGD 11 (Ownership Structure):** An average of 38% of the bank disclosed information on ownership structure. These banks include; United Bank for Africa, Afri bank, First bank, Wema bank and Fin bank. This item was also reported by Access bank for years 2006 and 2007 alongside with Fidelity bank and FCMB. Furthermore, Diamond bank and Zenith bank reported this item in only one of the years reviewed (2008).

**CGD 12 (Shareholders’ right):** A total of 81% of the banks i.e. about 17% of the listed banks reviewed, reported on shareholders’ right.

**CGD 13 (Size of board):** All the banks under review reported on the number of directors sitting on their board.

**CGD 14 (Composition of board):** This item was fully reported by all the banks under review. Most banks reported it under the governance heading, while some reported it under board of directors heading.

**CGD 15 (Division between Chairman and CEOs):** It was observed in all the banks that no chairman has the dual role of also being the CEO. The responsibilities of the head of the Board, that is the Chairman, is clearly separated from that of the head of Management, i.e. MD/CEO, such that no one individual/related party has unfettered powers of decision making by occupying the two positions at the same time.

**CGD16 (Chairman’s Statement):** The chairman’s statement was disclosed by all the 21 banks under review. The chairman’s statement covers issues like corporate social reporting, mission of the organization as required by the code of corporate governance.

**CCGD17 (Information about Independent directors):** This was also disclosed by all the banks, with first bank and standard chartered bank presenting full information relating to their non- executive and independent directors.

**CGD18 (Roles and Function of the Board):** All the banks under review disclosed the function and roles of the board with Afri bank not making full report for one of the years (2006) under review. In line with section 5.4.5 of the CBN code of best practices, all the banks had a review/appraisal covering all aspects of the Board’s responsibilities, processes and functions.

**CGD 19 (Organisational Hierarchy):** Only about 24% of the banks disclosed information concerning their organisational hierarchy. Banks like Diamond bank, First bank, Fidelity bank and Zenith bank made full disclosure on this item of disclosure.

**CGD 20 (Changes in Board Structure):** For the periods reviewed, less than 60% (52%) of the banks disclosed information on board structure which reflects clearly defined and acceptable lines of responsibility and hierarchy. This is in line with section 5.6.2 of the CBN governance code.

**CGD 21(Compliance with different legal rules):** All the banks disclosed this disclosure item with Diamond bank, Fidelity and Fin bank been silent in one or two of the years reviewed.

**CGD 22 (Audit Committee):** In line with section 8.1.0 – 8.1.5, all the banks reported on their audit committee, who according to the section are responsible for the review of the integrity of the bank’s financial reporting and oversee the independence and objectivity of the external auditors.

**CGD 23 (Remuneration Committee):** While the CBN code of post consolidation did not make provision for this disclosure item, about 19% of the banks still reported that they have remuneration committee. These banks include; Diamond bank, Eco bank and Fidelity bank.

**CGD 24 (Statement of Chief Executive Officer):** While all the banks included the statement of the head of board (chairman), only 81% presented a statement from the head of management. Oceanic bank, United bank for Africa, Afri bank, ECO bank and Fin bank are among the banks that did not present such information.

**CGD 25 (Composition of the Committees):** Composition of all the committees were well spelt out except for those committees that were not formed.

**CGD 26 (Functioning of the Committees):** The functions and the effectiveness of the committees were discussed by all the banks except or those committees that are yet to be formed.

**CGD 27 (Organisational code of ethics):** While majority of the banks were silent as to whether they have organisational code of ethics, only 9% ( First bank and FCMB) mentioned that they have organisational code.

**CGD 28 (Biography of board members):** 28.5% of the banks under review disclosed the biography of individual board member. These banks include; ECO bank, First bank, FIN bank and Wema bank. Meanwhile, Equitorial Trust bank, UBA and SKYE bank disclosed same only in 2008.

**CGD 29 (Number of directorship held by individual member):** About 10% of the banks disclosed the number of directorship held by individual board member. These include UBA (for 2008), First bank and FIN bank for the three years reviewed.

**CGD 30 (Number of board meetings):** In line with section 4.5 of the CBN code, that the Board should meet regularly at a minimum of four (4) regular meetings in a financial year,66.6% of the banks which include Access Bank, Diamond Bank, First Bank, Fin Bank, Intercontinental bank, United Bank for Africa e.t.c. disclosed the number of times the board meets. However, banks like Skye bank, Sterling bank, Union bank, Zenith Bank, Fidelity bank and FCMB did not disclose the number of times that the board members meet in every accounting year.

**CGD 31 (Attendance in Board Meetings):** The attendance of board members at board meetings was only disclosed by the same number of banks that disclosed the number of board meetings as in CGD 30 above.

**CGD 32 (Directors’ stock ownership):** All the banks under review disclosed the value of stock owned by their directors. This is also supported by section 5.1 of the CBN code.

**CGD 33 (Director’s remuneration):** All the banks disclosed directors' remuneration by amount only without an effort to disclose who receives what and for what purpose are such emoluments received. They only disclose the gross amount paid to directors. This blurs the possibility of any meaningful analysis of the directors' remuneration.

**CGD 34 (Employee relation/ Industrial relation):** Employee relation information was disclosed by 95% of the banks while on the average, United Bank for Africa and Spring bank did not make disclosure on this item. Although, the numbers of employees according to category are given but the corresponding costs are not similarly provided but are simply grossed.

**CGD 35 (Environmental and social responsibility):** Only about 42.3% of banks reported on their social responsibility as it relates to their environment. Banks that were environmentally friendly for the period under review were; Bank PHB, United bank for Africa, WEMA bank, ECO bank and First bank. While Intercontinental bank, Sterling bank and IBTC reported on environmental and social responsibility issues only once (2008).

**CGD 36 (Risk Assessment and Management):** Although all the banks mentioned something about risk management, but none of the banks discloses the risk profile of its credit performance.

**CGD 37 (Internal Control System):** While majority of the banks neglected the discussion on this disclosure item thereby expecting users to assume its existence within the banks, First bank and WEMA bank among few other, made available information on their internal control system.

**CGD 38 (Auditor’s Appointment and Rotation):** Over 60% of the banks disclosed direct information on the approval of the appointment of External Auditors by the CBN as stated in section 8.2.2. However, the tenure of the auditors was not disclosed by any of the banks as it relates to the recommended maximum period of ten years as in section 8.2.3.

**CGD 39 (Auditors fees):** This information was covered by all the banks with details in the note to financial statement.

**CGD 40 (Notice of the annual general meeting):** All the banks made available the notice of annual general meeting by the bank/ company secretary to the users.

**CGD 41 (Agenda of the annual general meeting):** The notice of meeting as reported in CGD40 included the agenda of the meeting.

**CGD 42 (Separate section for corporate governance):** Only 76% of the banks had separate section where they gave full and detailed disclosure on corporate governance. Some of these banks are; Oceanic bank, WEMA bank, Access bank, Diamond bank, ECO bank, First bank e.t.c.

**CGD 43 (Annual Report through Internet)**: 71% of the banks reviewed have their annual reports accessible in the banks’ website thereby making it possible for users to have easy information access. Banks like Access bank, Wema bank, Fidelity bank, Intercontinental bank, Oceanic bank, Bank PHB e.t.c. have their annual reports for the three years reviewed with five years financial summary online. However, spring bank, Diamond bank, Unity bank and Stanbic IBTC bank claimed to have their annual reports online but they cannot be accessed during the period of this study.

**CGD 44 (Compliance with CBN code): Although,** All the banks made report in terms of their compliance with the CBN code of best practice, however, majority were not detailed in the disclosure of the code requirement.

**CGD 45 (Compliance with SEC notification)**: All the banks claimed in their report to comply with SEC notifications.

For the directors’ equity interest in the listed banks for the 3 years considered, on the average, Wema Bank, ECO bank, Sterling bank and Unity Bank recorded the highest ratio of Directors’ Equity Interest (DEI). Meanwhile, Afri Bank and Union Bank recorded the lowest percentage of DEI. The result also indicates that on the average, Intercontinental Bank recorded the highest number of directors in 2008 followed by Bank PHB. For board composition which is the proportion of outside directors to the total directors on the board, Stanbic IBTC and FIN Bank recorded a high proportion of outside directors. Also, the lowest board composition was recorded by Unity bank which is more pronounced in 2006. Details of these analyses are presented below.

* 1. **DATA ANALYSIS (PRELIMINARY)**

**TABLE 4.2: Descriptive Statistics for model 1**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | N | Minimum | Maximum | Mean | Std. Deviation |
| ROE | 63 | .01 | .22 | .0494 | .04721 |
| BOS | 63 | 6.00 | 19.00 | 13.2381 | 2.48034 |
| NED | 63 | .45 | .83 | .6300 | .08968 |
| CGDI | 63 | .53 | .91 | .6606 | .09043 |
| DEI | 63 | .01 | .39 | .1114 | .08173 |
| Valid N (listwise) | 63 |  |  |  |  |

Source: computed by researcher using data extracted from annual reports of banks (2009)

**Table 4.3: Descriptive Statistics for model 2**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | N | Minimum | Maximum | Mean | Std. Deviation |
| ROA | 63 | .01 | .31 | .0721 | .06894 |
| BOS | 63 | 6.00 | 19.00 | 13.2381 | 2.48034 |
| NED | 63 | .45 | .83 | .6300 | .08968 |
| CGDI | 63 | .53 | .91 | .6606 | .09043 |
| DEI | 63 | .01 | .39 | .1114 | .08173 |
| Valid N (listwise) | 63 |  |  |  |  |

Source: computed by researcher using data extracted from annual reports of banks (2009)

Generally, from the 63 observations as seen in table 4.2, CGDI has a minimum figure of 53% recorded by Intercontinental bank. This implies that the bank with the least disclosure has a disclosure index of 53% while the maximum disclosure of 91% was disclosed by First bank in one of the three years reviewed. This further compliments the result of average disclosure for the 21 banks in table 4.0. The mean disclosure is about 66% with standard deviation of approximately 9%. This means that the disclosure can deviate from mean to both sides by 9%.

The table further revealed that on average, the banks included in our sample generates Return on Equity (ROE) of about 5% and a standard deviation of 4.7%. This means that the value of the ROE can deviate from mean to both sides by 4.7%. The maximum and minimum values of ROE are 1% and 22% respectively. However, a Return on Asset (ROA) of 7% was generated on the average, with a minimum and maximum percentage of 1% and 31% respectively.

For the two models, the average board size from the 63 observations is about 13 suggesting that banks in Nigeria have relatively moderate board sizes as suggested by Kyereboah-Coleman and Biekpe (2006) with a maximum board size of nineteen (19) and deviation of 2.48. The implication is clear that banks in Nigeria have relatively similar board sizes.

In addition, the average proportion of the outside directors sitting on the board is 63%. Also on average, about 11% of the directors are equity holders.

**4.3 Data Analysis- Advance (Inferential Analyses)**

Under the advance analysis, correlation analysis was first used to measure the degree of association between different variables under consideration. While the regression analysis was used to determine the impact of the corporate governance variables on profitability, the t- test statistics was used to ascertain whether there is a significant difference in the profitability of banks identified as healthy and those rescued. Finally, the t-test statistics was also used to find out if a significant difference occurred in the performance of banks with foreign directors and those without foreign directors.

**4.3.1 Pearson’s Correlation Coefficient Analysis**

In this section, we measured the degree of association between our governance variables and profitability variables i.e. if the governance proxies (board size, board composition, governance disclosure and directors’ equity interest) will increase profitability. From the a priori stated in the previous chapter, a positive relationship is expected between the measures of corporate governance and profitability variable (ROE and ROA). Table 4.4 and 4.5 presents the correlation coefficients for all the variables considered in this study.

**Table 4.4: Pearson’s Correlation Coefficients Matrix for Model 1**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **ROE** | **BOS** | **NED** | **CGDI** | **DEI** |
| ROE | Pearson Correlation | 1 | -.681(\*\*) | -.486(\*\*) | .539(\*\*) | .716(\*\*) |
|  | Sig. (2-tailed) |  | .000 | .000 | .000 | .000 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| BOS | Pearson Correlation | -.681(\*\*) | 1 | .409(\*\*) | -.496(\*\*) | -.657(\*\*) |
|  | Sig. (2-tailed) | .000 |  | .001 | .000 | .000 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| NED | Pearson Correlation | -.486(\*\*) | .409(\*\*) | 1 | -.225 | -.432(\*\*) |
|  | Sig. (2-tailed) | .000 | .001 |  | .076 | .000 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| CGDI | Pearson Correlation | .539(\*\*) | -.496(\*\*) | -.225 | 1 | .353(\*\*) |
|  | Sig. (2-tailed) | .000 | .000 | .076 |  | .005 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| DEI | Pearson Correlation | .716(\*\*) | -.657(\*\*) | -.432(\*\*) | .353(\*\*) | 1 |
|  | Sig. (2-tailed) | .000 | .000 | .000 | .005 |  |
|  | N | 63 | 63 | 63 | 63 | 63 |

\*\* Correlation is significant at the 0.01 level (2-tailed).

Source: computed by researcher using data extracted from annual reports of banks (2009)

**Table 4.5: Pearson’s Correlation Coefficients Matrix for Model 2**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | ROA | BOS | NED | CGDI | DEI |
| ROA | Pearson Correlation | 1 | -.624(\*\*) | -.447(\*\*) | .528(\*\*) | .669(\*\*) |
|  | Sig. (2-tailed) |  | .000 | .000 | .000 | .000 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| BOS | Pearson Correlation | -.624(\*\*) | 1 | .409(\*\*) | -.496(\*\*) | -.657(\*\*) |
|  | Sig. (2-tailed) | .000 |  | .001 | .000 | .000 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| NED | Pearson Correlation | -.447(\*\*) | .409(\*\*) | 1 | -.225 | -.432(\*\*) |
|  | Sig. (2-tailed) | .000 | .001 |  | .076 | .000 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| CGDI | Pearson Correlation | .528(\*\*) | -.496(\*\*) | -.225 | 1 | .353(\*\*) |
|  | Sig. (2-tailed) | .000 | .000 | .076 |  | .005 |
|  | N | 63 | 63 | 63 | 63 | 63 |
| DEI | Pearson Correlation | .669(\*\*) | -.657(\*\*) | -.432(\*\*) | .353(\*\*) | 1 |
|  | Sig. (2-tailed) | .000 | .000 | .000 | .005 |  |
|  | N | 63 | 63 | 63 | 63 | 63 |

\*\* Correlation is significant at the 0.01 level (2-tailed).

Source: computed by researcher using data extracted from annual reports of banks (2009)

From the correlation result for model 1 in table 4.4, board size has a strong negative correlation of -.681 with return on equity which is significant at 1% and 5%. This implies that how large the size of a board is does not have a positive effect on the level of profitability in Nigerian banks but however a negative effect. This also implies that an increase in the board size will lead to a decrease in profitability (ROE).

Similar trend was observed from the correlation result for model 2. From the correlation result, it was observed that board size also have a negative correlation of -.624 with return on asset (ROA). The outcome from the two models for BOS is consistent with earlier studies by Lipton and Lorsch (1992); Jensen (1993); Yermack (1996); Bennedsen et al (2006); Harris and Raviv (2005). They all argued that larger board is ineffective as compared to smaller boards.

The proportion of outside directors is another governance variable that recorded a negative correlation coefficient (r) of -.486 and -.447 for both models 1 and 2 respectively with a p-value of .000 which is significant at 1%, 5% and 10%. This invariably means that the more the number of outside directors who are sitting on a board, the lower the financial performance of the bank in terms of ROE and ROA. This is however consistent with Yermack (1996) and Bhagat and Black (1999) in their study, where they found a negative correlation between the proportion of outside directors and corporate performance. Furthermore, two other studies conducted in UK, Vegas and Theodorou (1998); Laing and Weir, (1999) did not find a correlation between the proportion of non-executive directors and corporate performance.

However, the corporate governance disclosure index is positively correlated at 0.539 and 0.528 for models 1 and 2 respectively. This is also seen to be significant at both 1% and 5%. This further indicate that banks that discloses more on corporate governance issues are likely to perform better than those that disclose less. This correlation result is consistent with Makhija & Patton (2000), O’Sullivan and Diacon (2003) and Cheng (2008) but however not consistent with Raffournier (1995) in Switzerland, and Depoers (2000) in France.

The result further showed that at 1% level of significance, directors’ equity interest has a positive correlation of 0.716 and 0.669 with return on equity and return on asset respectively. This indicates that individuals who form part of management of banks in which they also have equity ownership have a compelling business interest to run them well. This invariably is expected to improve the performance. This is also seen in Bhagat, Carey, and Elson (1999).

Among the governance variables, while BOS recorded a positive correlation with NED, BOS has a negative correlation with both CGDI and DEI. This is further explained to mean that bigger boards have more outside directors while bigger boards also disclose lesser governance information than smaller ones. Likewise, in smaller boards, the directors are more interested in the organisations’ equity.

More so, while NED recorded a weak negative correlation with CGDI, a negative relationship was also noticed with DEI. Finally, a positive correlation was observed between CGDI and DEI. This connotes that the more the equity owned by directors of the banks under review, the more they disclose on corporate governance issues and comply with the code of best practice

**4.3.2 Regression Analysis**

In this section, we used the panel data regression analysis to investigate the impact of corporate governance on banks’ financial performance proxied by return on equity and return on asset. In doing this, we used two simple definitional models as developed in our chapter three to guide our analyses.

**Table 4.6: Regression Result for Panel Data**

|  |  |  |
| --- | --- | --- |
| **Independent variables** | **ROE** | **ROA** |
| **BOS** | -0.004  [-1.977]\*  {0.053} | -0.027  [-1.606]  {0.113} |
| **BCOMP** | -0.084  [-1.871]\*  {0.066} | -0.458  [-1.304]  {0.197} |
| **CGDI** | 0.127  [2.795] \*\*\*  {0.007} | 0.869  [2.393] \*\*  {0.020} |
| **DEI** | 0.236  [3.957]  {0.000}\*\*\* | 1.382  [3.170]\*\*\*  {0.002} |
| **R Squared**  **Adjusted R Squared**  **F- Statistics**  **Number of Observations** | 0.659  0.635  28.009\*\*\*  63 | 0.580  0.551  37.217\*\*\*  63 |

Note: t-statistics are shown in the form [ ], while p- values are in the form { }.

\*Significant at 10% level

\*\*Significant at 5% level

\*\*\*Significant at 1% level

**Source**: Computed from Annual Reports of Banks (2009)

The result from the regression equation is shown in table 4.6. The equation employs return on equity and return on asset as its dependent variables while board size, proportion of non executive directors, directors’ equity interest and governance disclosure index are the independent variables. For the two models, the F-values which are significant at 1% level indicate that our models do not suffer from specification bias. However, from model 1, the coefficient of determination (R2) indicates that about 66% of change in return on equity is accounted for by the explanatory variables while the adjusted R-squared of 63.5% further justifies this effect. Also for the second model, 58% of change in ROA is accounted for by the independent variables.

The regression result for the two models further revealed that the relationship between the board size and the performance proxies are not in line with our stated expected result. The board composition also shows a contrary result with the priori (β1BOSt; β2NED < 0). This invariably means that the return on equity and return on asset goes down as board size increases. In addition, the return on equity and return on asset decreases when more outside directors are introduced to the board.

Additionally, it was observed that the more equity the directors own in a bank the better their return on equity. Likewise, the more governance issues a bank discloses the higher the ROE and ROA. These last two results conform to the a priori result (β3DEIt and β4CGDIt > 0).

**Table 4.7: T-TEST: TWO-SAMPLE ASSUMING EQUAL VARIANCES**

|  |  |  |
| --- | --- | --- |
|  | **(Healthy Banks)** | **(Rescued Banks)** |
| **Mean** | 0.062177643 | 0.023739 |
| **Variance** | 0.00233563 | 1.38085E-05 |
| **Observations** | 14 | 7 |
| **Hypothesized Mean Difference** | 0 |  |
| **Df** | 13 |  |
| **t Stat** | 2.958540189 |  |
| **P(T<=t) one-tail** | 0.00554419 |  |
| **t Critical one-tail** | 1.770933383 |  |
| **P(T<=t) two-tail** | 0.01108838 |  |
| **t Critical two-tail** | 2.160368652 |  |
| **Mean** | 0.062177643 | 0.023739 |

**Source:** Computed by the researcher from annual reports of listed banks (2009)

From the t-test result, the healthy banks recorded a mean of 0.0621 while the rescued banks recorded a mean of 0.0237. However, the variance for the healthy banks and the rescued banks are 0.0023 and 1.3808 respectively.

Furthermore, at two- tailed, the t- calculated of 2.9585 is seen to be greater than the t-tabulated of 2.1603.

**Table 4.8: T-TEST: TWO-SAMPLE ASSUMING EQUAL VARIANCES**

|  |  |  |
| --- | --- | --- |
|  | **WITH FOREIGN DIRECTORS** | **WITHOUT FOREIGN DIRECTORS** |
| **Mean** | **0.046316333** | **0.051651083** |
| **Variance** | **0.00101648** | **0.002642089** |
| **Observations** | **9** | **12** |
| **Hypothesized Mean Difference** | **0** |  |
| **Df** | **18** |  |
| **t Stat** | **-0.292291459** |  |
| **P(T<=t) one-tail** | **0.386703063** |  |
| **t Critical one-tail** | **1.734063592** |  |
| **P(T<=t) two-tail** | **0.773406127** |  |
| **t Critical two-tail** | **2.100922037** |  |

The t-test result from table 4.8 shows that banks with foreign directors recorded a mean of 0.04631 while those without foreign directors recorded a mean of 0.05165. Furthermore, the variances of 0.0010 and 0.0026 were recorded for banks with foreign directors and those without foreign directors respectively. At two- tailed, the t- calculated of -0.2922 is seen to be less than the t-tabulated of 2.1009.

**4.4 Hypothesis Testing**

In chapter one, we formulated five principal testable hypotheses on the relationship between corporate governance and profitability, against which this study is anchored. In this section, we subject these propositions to empirical testing drawing from the results of our descriptive and inferential statistical analyses. Our decision rule is based on the significances of the t-statistics which are represented by the p- values flagged by the statistical packages used. This is based on the fact that the existence of a significant relationship can be inferred from a significant t-statistic (Agbonifoh & Yomere, 1999:267).

Based on the fact that more significant relationships are noticed between the governance variables and ROE than in ROA, this implies that ROE is a better performance proxy than ROA. This study therefore based its decisions on ROE. In addition, according to Westman (2009), in his doctorial thesis, he opined that ROE is a preferred measure of bank profitability to ROA because, ROA is a component of ROE (ROE= ROA X Gearing).

**Hypothesis 1:**

H0: There is no significant relationship between Board size and financial performance of banks in Nigeria

In our first hypothesis, we assumed that there is no significant relationship between board size and financial performance of banks in Nigeria. From the analysis, the correlation between board size and ROE has a coefficient (r) of -.681, indicating an inverse correlation between the two variables. Also, the regression coefficient of the model is negative (-1.977), with a p- value of .053 significant at only 10%. This indicates a significant negative effect of board size on the financial performance of the listed banks. On the premise of these results, since the negative effect is significant, we therefore reject the null hypothesis and accept the alternate hypothesis which states that there is a significant relationship between BOS and ROE. This invariably means that the board size must be considered while taking financial decisions. The result therefore supports the agency theory as the large board members being the agents, tend to look after their own interests.

The significant negative relationship found between bigger board size and ROE is consistent with the conclusion drawn by Yermack (1996), Eisenberg, Sundgren and Wells (1998), Conyon and Peck (1998) and Loderer and Peyer (2002). They have reported a significant negative relationship between board size and the performance of a firm. We therefore argue that a large board size leads to the free rider problem where most of the board members play a passive role in monitoring the firm.

Furthermore, the board members tend to become involved in dysfunctional conflicts where the board is not cohesive (board members are not working optimally to achieve a single goal) deteriorating the value of a firm. This view is also shared by Pathan, Skully and Wickramanayake (2007). The result however, differs from Kyereboah-Coleman and Biekpe (2005) who concluded with a positive relationship between a firms’ value and board size. The result of the hypothesis also differs from Zahra and Pearce (1989) who argued that a large board size brings more management skills and makes it difficult for the CEO to manipulate the board.

**Hypothesis 2:**

H0: The relationship between the proportion of non-executive directors and the financial performance of Nigerian banks is not significant

From the hypothesis above, we assume that there is no significant relationship between the proportion of outside directors sitting on a board and the financial performance of banks. The correlation result shows a negative correlation of -.503 which entails that the more the number of outside directors, the lower the financial performance of banks in Nigeria.

However, the regression result shows that the negative association observed between the variables is significant at only 10% with a p- value of 0.066. This also confirms that outside directors does have significant but negative impact upon bank performance as measured in terms of ROE. Based on the fact that the association is significant, we therefore accept our alternate hypothesis at the expense of the null hypothesis. The negative effect noticed is likely to be because non-executive directors are too busy with other commitments and are only involved with the company business on a part-time basis. It was also pointed out that an average director spends only twenty-two days per year on his duties, which is barely enough to perform the essential functions. Indeed it may be wondered whether the directors who put in less than average effort can be discharging their duties adequately. According to Carter and Lorsch, (2004: 45) since the average director spends a little time on the job, it is difficult to develop much more than a rudimentary understanding of their companies workings.

In addition, as discussed above, non-executive directors are likely not to have a hands-on approach or are not necessarily well versed in the business, hence do not necessarily make the best decisions. This is in tune with the study by Pi and Timme (1993); Bosch (1995); Belkhir (2006); Staikouras et al. (2007) and Adams and Mehran (2003 and 2008) who found a negative but significant relation between the tested variables. However, our findings disagree with Bebchuk, Cohen and Ferrell (2009)) and Pathan et al. (2007) who found a positive relationship between the variables.

**Hypothesis 3:**

H0: There is no significant relationship between Directors’ Equity Holding and

the financial performance of banks in Nigeria

The correlation result of the hypothesis above shows a strong significant positive correlation of .716 between the directors’ equity holding and the performance of listed banks in Nigeria. The regression result also shows that the positive correlation noticed between the studied variables is significant at 1%, 5% and 10% respectively. Based on this result, we therefore reject our null hypothesis and accept our alternate hypothesis. The result depicts that the more banks’ equity owned by the directors, the better the banks’ financial performance. This implies that individuals who form part of management of banks in which they also have equity ownership have a compelling business interest to run them well. Further explanation for this phenomenon is that the equity ownership creates better management monitoring on the part of the board and hence improved results.

It is therefore argued that one of the ways in which the board of directors could be motivated to take performance-improving measures and to protect the interests of the shareholders, is for the directors themselves to take part in the ownership of the firm. The argument is that this will enable them have more interest in the value of shares of the firm and that they will take measures to improve firm performance. Similar view is shared by McConnell, Servaes and Lins (2008); Loderer and Peyer, (2002) that within a certain range, a positive relation is predicted between director equity interest and firm performance. However, when they own a large proportion of shares of the firm, directors could pose other agency problems, especially those associated with conflicts between large and small shareholders. This findings is in line with Yu (2003) and also consistent with Saunders, Strock and Travlos (1990), Carey and Elson (1999) and Bolton (2006). However, Wei (2000) and Lin (2007) found that there was no significant positive relationship between the quantities of stock directors held and firm performance.

**Hypothesis 4:**

H0: There is no significant relationship between the governance disclosures of

banks in Nigeria and their performance

From this hypothesis, a positive correlation of .539 is observed between the level of governance items disclosed by the banks and ROE which is the proxy for performance. The regression result further reveals that a positive significant relationship with a p-value of 0.007 (significant at 1%) occurs between the dependent and the independent variables. However, based on these findings, we therefore reject our null hypothesis and accept our alternate hypothesis. This result implies that banks who disclose more on governance issues are more likely to do better than those that disclose less. Our result further revealed from the correlation result that banks with directors’ holdings will disclose more governance items. This result is consistent with Barth, Caprio Jr. and Nolle (2004), Brown and Caylor (2004) and Ogidefa (2008).

**Hypothesis 5**

H0: There is no significant difference between the profitability of the healthy and the rescued banks in Nigeria

The T- test result in table 4.7 shows a calculated t-statistic of 2.287 which is significant at 5% and 10% levels of significant with a P-value of 0.03. Additionally, since the calculated value of 2.9585 is greater than the critical or tabulated value of 2.1603**,** we therefore reject the null hypothesis that the profitability of the rescued banks is not statistically significantly different from the profitability of the healthy banks.

The result of hypothesis two is corroborated effectively with our disclosure result in table 4.0 which shows that majority of the healthy banks disclose more governance items and therefore perform better than the rescued banks. This result is in line with Rasid (2008) where he concluded in his study that firms without governance problems perform better than firms with specific governance problems.

**CHAPTER 5**

**SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

**5.0 Introduction**

The objective of this chapter is to discuss the findings, reach conclusion and make necessary recommendations from all the qualitative and quantitative analysis presented in chapter four.

The chapter is structured into five sections as follows: section 5.1 summarizes the research objectives and the analysis, section 5.2 presents the theoretical and empirical findings, section 5.3 covers the conclusion while section 5.4 and 5.5 covers the sections for recommendations and suggestions for further study.

**5.1 Summary of work done**

This study made use of secondary data in analyzing the relationship between corporate governance and financial performance of the 21 banks listed in the Nigerian Stock Exchange. The secondary data was obtained basically from published annual reports of the selected banks. Relevant data for the study were retrieved from the Nigerian Stock Exchange Fact Book for 2008 and corporate websites of the reviewed banks.

## The Pearson Correlation and regression analysis were used to find out whether there is a relationship between the variables to be measured (i.e. corporate governance and banks’ financial performance) and also to find out if the relationship is significant or not. However, the t-test statistics was used to establish if there is any significant difference between the profitability of healthy and rescued banks and also if a difference exist in the profit of banks with foreign directors and those without. The proxies that were used for corporate governance are; board size, proportion of non-executive directors on board and directors’ equity holdings. Accounting measure of performance (return on equity and return on asset) as identified by First Rand Banking Group (2006) were used as the dependent variable. Decisions were later taken based on return on equity.

However, in examining the level of corporate governance disclosures of the sampled banks, a disclosure index was developed using the CBN post consolidation code of best practices and guided by the papers prepared by the UN secretariat for the nineteenth session of ISAR (International Standards of Accounting and Reporting, 2001), entitled “Transparency and disclosure requirements for corporate governance” and the twentieth session of ISAR (2002), entitled “Guidance on Good Practices in Corporate Governance Disclosure”) for the banks under study. Using this post consolidation code of best practices, issues in corporate governance disclosure are classified into 5 broad categories: Financial disclosures, non-financial disclosures, annual general meetings, timing and means of disclosure, and best practices for compliance with corporate disclosure. Under all these broad and subcategories, a total of 45 issues were considered (See Appendix 4).

With the help of the list of disclosure issues, the annual reports of the banks were examined and a dichotomous procedure of content analysis was followed to score each of the disclosure issue. Each bank was awarded a score of ‘1’ if it appears to have disclosed the concerned issue and ‘0’ otherwise. The score of each bank was totaled to find out the net score of the bank. A corporate governance disclosure index (CGDI) was then computed. Furthermore, the t- test was used to establish if there is any significant difference in the profitability as recorded by the cleared banks as identified by CBN

**5.2 Summary of Findings**

The summary of findings is in two sections. The first section discusses the theoretical findings under prior related studies while the second section discusses the empirical findings from the study we carried out on the relationship that exists between corporate governance and the financial performance of banks in Nigeria.

**5.2.1** **Theoretical Findings**

This study reveals that both board size and the proportion of outside directors are significantly but negatively related to financial performance in banks. While the directors’ equity interest and the level of corporate governance items disclosed are significantly positive in relation with performance.

However, there is no doubt that several studies have been conducted so far and are still on –going on the examination of the relationship between firm performance and corporate governance. Our findings are therefore in line with the work of Staikouras et al. (2007) where they examined a sample of 58 out of the 100 largest, in terms of total assets, credit institutions operating in Europe for the period between 2002 and 2004. Their analysis inferred that bank profitability – measured in terms of ROE and Tobin’s Q is negatively and significantly related to the size of the Board of Directors. Pathan et al. (2007) using a dataset of the Thai commercial banks over the period 1999-2003, also obtained a negative relation between board size and ROE. This is also seen in Eisenberg, Sundgren, and Wells (1998), where a similar pattern for a sample of small and midsize Finnish firms. Their study also revealed that board size and firm value are negatively correlated. Finally, our findings also agrees with Zulkafli and Samad (2007) in their study in which they analyzed a sample of 107 listed banks in the nine countries of Asian emerging markets (Malaysia, Thailand, Philippines, Indonesia, Korea, Singapore, Hong Kong, Taiwan, India). They deduced that board size is not significantly correlated with performance measures, such as the Tobin’s Q and ROE. Our findings on board size, differs from Kyereboah-Coleman and Biekpe (2005) who conclude a positive relationship between a firms’ value and board size. The findings, also differs from Zahra and Pearce (1989) who argued that a large board size brings more management skills and makes it difficult for the CEO to manipulate the board. The result of Andres and Vallelado (2008) is also different from ours on board size and performance. After examining information on the characteristics of the boards of directors for 69 commercial banks operating in Canada, US, UK, Spain, France and Italy over the period 2000-2005, they found that the inclusion of more directors is positively associated with performance, which is measured by Tobin’s Q, ROA.

However, for the proportion of non executives, our findings is in line with Yermack (1996) who reported a significant negative correlation between proportion of independent directors and contemporaneous Tobin's q and ROE, but no significant correlation for several other performance variables (sales/assets; operating income/assets; operating income/sales); Agrawal and Knoeber (2001) report a negative correlation between proportion of outside directors and Tobin's q. Klein (1998) also reports a significant negative correlation between a measure of change in market value of equity and proportion of independent directors, but insignificant results for return on assets and raw stock market returns. Furthermore, Andres and Vallelado (2008) found an inverted U-shaped relation between the proportion of outsiders, defined as the number of non-executive directors, and bank performance, suggesting that an optimum combination of executive and non-executive directors would be more effective in securing value for banks than excessively independent boards.

Our findings on the proportion on non-executives, further disagree with the positive finding as noticed in Pathan et al. (2007) and Bebchuk, Cohen and Ferrell (2009). Our findings as it relate to directors’ equity holding is also in line with the findings of Saunders, Strock and Travlos (1990) and also Yu (2003). They found a significant positive relationship between the stock held by directors and the performance level of firms.

In other to find out how the level of corporate governance disclosure affects performance for US firms, a broad measure of corporate governance (Gov-Score) was prepared by Brown and Caylor (2004) with 31 factors, 8 sub categories for firms based on dataset of Institutional Shareholder Service (ISS). Their findings indicate that better governed firms are relatively more profitable, more valuable and pay more cash to their shareholders. Gompers, Ishii, and Metrick (2003) used Investor Responsibility Research Centre (IRRC) data, and concluded that firms with fewer shareholder rights have lower firm valuations and lower stock returns. Our study on governance disclosure (hypothesis 4) therefore took the same trend as in the prior studies discussed above.

Chibber and Majumdar, (1999) find out that the availability of foreign directors in a firm is positively associated with the degree of resource commitment to technology transfer. Djankov and Hoekman (2000) also find that firms with foreign directors to be associated with the provision of generic knowledge (management skills and quality systems) and specific knowledge.

**5.2.2 Empirical Findings**

From the descriptive analysis, it was revealed that on the average the board size of listed banks in Nigerian is 13. This result implies that on the average, a relatively moderate board size of 13 is noticed among the listed consolidated banks in Nigeria. This is in line with the suggestion of Kyereboah-Coleman and Biekpe (2006) that a board size of between 12 and 16 is appropriate. Also, board composition which is the proportion of outside directors in a board has a mean of 63%. This also reveals that on the average, about 63% of the board members are non-executive directors. This is in line with the section 4.10 of the CBN post consolidation code where it was stated that “the number of non-executive directors should exceed that of executive directors”. Although from the descriptive result, a minimum of 45% was notice in GTB in 2006. A critical review indicates that this was so because there was no immediate replacement of some directors who retired.

Although, the mean disclosure level of 66% indicates that all the banks present a statement of their corporate governance practices, however, the extensiveness of the statement varies between banks. Banks were noticed to disclose more on disclosure items1, 13-17, 22, 32, 40, 41, 44 and 45. Directors’ equity interest therefore recorded a mean of 11%. Furthermore, the findings revealed that on average, the banks included in our sample generate Return on Equity (ROE) of about 5% and a standard deviation of 4.7%. This means that the value of the ROE can deviate from mean to both sides by 4.7%.

From the regression result for the relationship between board size and performance, the coefficient of the model is found out to be negative (-1.977), with a p- value of .053 significant at only 10%. This result shows that board size and performance in terms of ROE move in opposite directions. The negative relationship is also seen to be considerably important to the performance of bank. This indicates a significant negative effect of board size on the financial performance of the listed banks.

The significant negative relationship found between a bigger board size and ROE is consistent with the findings of Yermack (1996), Eisenberg, Sundgren and Wells (1998), Conyon and Peck (1998) and Loderer and Peyer (2002). Our findings, therefore shows that a large board size can leads to the free rider problem where most of the board members play a passive role in monitoring the firm.

Furthermore, the board members will tend to be involved in dysfunctional conflicts where the board is not cohesive (board members are not working optimally to achieve a single goal) deteriorating the value of a firm.

Finally, the result implies that large boards in Nigerian banks are likely to be less effective and easier for a CEO to control. Also, when a board gets too big, it becomes difficult to co-ordinate and process. Whereas, smaller boards will tend to reduce the possibility of free riding by individual directors and increase their decision taking processes. The regression result also shows that a significant negative association exists between the proportion of outside directors and performance.

Our findings on the relationship between proportion of outside directors and financial performance indicates that significant negative relationship exist between the two variables. One of the reasons why increasing board independence apparently doesn't pay off in improved performance is that having a reasonable number of inside directors could add value. A support for our view is the suggestion by Baysinger and Butler (1985) that an optimal board contains a mix of inside, independent, and perhaps also affiliated directors, who bring different skills and knowledge to the board.

Executive directors may also be better at strategic planning decision. This view is also consistent with Klein's (1998) evidence that inside director representation on investment committees of the board correlates with improved firm performance.

The negative effect can also be because non-executive directors are likely to be too busy with other commitments and are only involved with the company business on a ‘part-time’ basis.

In addition, as mentioned earlier, non-executive directors are likely not to have a hands-on approach or are not necessarily well versed in the business, hence do not necessarily make the best decisions. Our findings are in tune with the study by Pi and Timme (1993); Belkhir (2006); Staikouras et al. (2007) and Adams and Mehran (2005 and 2008) who found a negative but significant relationship between the tested variables. However, our findings disagree with Bebchuk, Cohen and Ferrell (2009) and Pathan et al. (2007) who found a positive relationship between the variables.

Furthermore, our findings revealed that a strong positive relationship exist between the governance disclosure of banks and the performance of banks in Nigeria. This entails that banks that made more disclosures did better during the period under review. On the other hand, while most of the banks made disclosure on the performance of insider-related credit, Zenith Bank and Intercontinental bank do not make detailed disclosure. This disclosure will help to evaluate the objectivity in insider-related dealings and thus an evaluation of the riskiness of the banks. Also, all the banks disclosed directors' remuneration by amount only without an effort to disclose who receives what and for what purpose are such emoluments received. They only disclose the gross amount paid to directors. This blurs the possibility of any meaningful analysis of the directors' remuneration. These findings are therefore in line with Brown and Caylor (2004), Al-Amin, and Tareq (2006) and Ogidefa (2008).

Also, our study on directors’ equity interest reported a significant positive relationship between directors’ equity interest and performance. It was also noted that an average of 10% of the directors in the Nigerian banks holds equity in the banks. One explanation for this phenomenon is that the equity ownership creates better management monitoring on the part of the board and hence improved results. The study further revealed that in a bank where directors held stock, the ratio of directors’ stock holding is positively related to performance. This is seen to be in congruence with the findings in Bhagat, Carey and Elson (1999) and Yu (2003).

From our t- test results, it was revealed that the healthy banks differ significantly in terms of profit from the rescued. This also compliments the result as in Rashid (2008). Finally it was also observed that the profitability of banks with foreign directors do not differ from those without foreign directors.

**5.3 Conclusion**

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

Disclosures on directors' remuneration do not provide sufficient details that would enhance any meaningful analysis. This makes it difficult for anyone to judge the adequacy or otherwise of directors' remuneration. Similarly, disclosures about employees are scanty. They do not provide sufficient details that would enable anyone to do any meaningful analysis for the assessment of the adequacy or otherwise of their remuneration, vis-à-vis the number in each category of staff.

Despite the requirements of stock exchange and government regulators, certain bank managers still disclose selectively, especially when the monitoring and enforcement of disclosure requirements are not strict in Nigeria.

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

**5.4 Recommendations and Implication of Study**

Based on the findings of this research, we therefore present the following recommendations which will be useful to stakeholders.

1. Efforts to improve corporate governance should focus on the value of the stock ownership of board members, since it is positively related to both future operating performance and to the probability of disciplinary management turnover in poorly performing banks.
2. Proponents of board independence should note with caution the negative relationship between board independence and future operating performance. Hence, if the purpose of board independence is to improve performance, then such efforts might be misguided. However, if the purpose of board independence is to discipline management of poorly performing firms or otherwise monitor, then board independence has merit. In other to have proper monitoring by independent directors, bank regulatory bodies should require additional disclosure of financial or personal ties between directors (or the organizations they work for) and the company or its CEO. By so doing, they will be more completely independent. Also, banks should be allowed to experiment with modest departures from the current norm of a “supermajority independent” board with only one or two inside directors.
3. Steps should also be taken for mandatory compliance with the code of corporate governance. Also, an effective legal framework should be developed that specifies the rights and obligations of a bank, its directors, shareholders, specific disclosure requirements and provide for effective enforcement of the law.
4. In this study, all the disclosure items were given same weight which helps to reduce subjectivity; however, authority may place higher emphasis on certain elements of governance. Some aspect of governance may be considered to be a basic component or prerequisite to implementing others and thus should be given more weight.
5. Finally, there is the need to set up a unified corporate body saddled with the responsibility of collecting and collating corporate governance related data and constructing the relevant indices to facilitate corporate governance research in Nigeria.

**5.5 Contribution to knowledge**

This study has however contributed the following to the study of corporate governance;

1. This study used the CBN code of best practice and some specific governance index as provided by the Institutional Shareholder Services (2001; 2002) to create a summary index of bank’s specific governance i.e. “Gov- Score”. This will be an improvement over the index as used in Gomper, Ishii and Metrick (2003) (i.e. the GIM index), which focused only on anti- takeover measures.
2. Instead of considering just a single measure of governance (as prior studies in the literature have done), this study considered four different governance measures. This will help researchers in this area of interest to draw inference.
3. Since to the best of the researcher’s knowledge, no study in Nigeria has extensively covered corporate governance of banks as it relates to performance, this study will serve as a data base for future research.

**5.6 Suggestions for further study**

The limitations of the study have prompted suggestions for further research as listed below;

1. This research has gone some way to exploring corporate governance and corporate performance of banks in a broader context. Further research could explore the relationship in more in specific categories for example, in not-for-profit organizations, in government organizations, and in family companies. Since this study focused on the Nigeria banking sector it would be beneficial to have a clearer understanding of corporate governance roles in other types of organizations. Such research could address the similarities and differences of the roles in different organizations and consider also the legal requirements for different organizations.
2. The period of study for this research is three years i.e. (2006-2008), which the post consolidation period. This limitation was imposed by the non availability of data pertaining to the reviewed banks. However, further research can consider more time frame based on the availability of the annual reports.
3. Further research is also required on the behavioral aspects of boards. Researchers in developed countries have recently started examining board processes by attending actual board meetings however this also needs to be expanded by researchers in developing economies. There is therefore the need to go beyond the quantitative research, which is yielding a mixture of results, to perhaps a more qualitative approach as to how boards work. Expanding this current research into a wider study of board dynamics and decision making would be a start in developing a better understanding of corporate governance.
4. The data used for the current study was derived from 24 banks and their return on equity. A larger data set comparing financial and non financial firms may result in a different model of the relationship between corporate governance and the value of a firm. The inclusion of new corporate governance instruments could also result in additional edge-worth combinations of the internal corporate governance mechanism while other performance measures can also be introduced.

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**APPENDICES**

**Appendix I: List of consolidated Banks in Nigeria and No of Branches**

**as at 2008**

|  |  |  |
| --- | --- | --- |
| **S/N** | **List of consolidated banks in Nig** | **No of branches** |
| 1 | [Access Bank Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Access%20Bank%20Nigeria%20Plc&institutetype=Universal%20Bank) | 120 |
| 2 | [Afribank Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Afribank%20Nigeria%20Plc&institutetype=Universal%20Bank) | 204 |
| 3 | |  | | --- | | [Citibank Nigeria Limited](http://www.cenbank.org/Supervision/fi.asp?name=Citibank%20Nigeria%20Limited&institutetype=Universal%20Bank) | | 13 |
| 4 | [Diamond Bank Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Diamond%20Bank%20Nigeria%20Plc&institutetype=Universal%20Bank) | 132 |
| 5 | [Ecobank Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Ecobank%20Nigeria%20Plc&institutetype=Universal%20Bank) | 191 |
| 6 | [Equitorial Trust Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Equitorial%20Trust%20Bank%20Plc&institutetype=Universal%20Bank) | 70 |
| 7 | [Fidelity Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Fidelity%20Bank%20Plc&institutetype=Universal%20Bank) | 85 |
| 8 | [First Bank of Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=First%20Bank%20of%20Nigeria%20Plc&institutetype=Universal%20Bank) | 410 |
| 9 | [First City Monument Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=First%20City%20Monument%20Bank%20Plc&institutetype=Universal%20Bank) | 150 |
| 10 | [First Inland Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=First%20Inland%20Bank%20Plc&institutetype=Universal%20Bank) | 146 |
| 11 | [Guaranty Trust Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Guaranty%20Trust%20Bank%20Plc&institutetype=Universal%20Bank) | 139 |
| 12 | |  | | --- | | [Intercontinental Bank plc](http://www.cenbank.org/Supervision/fi.asp?name=Intercontinental%20Bank%20plc&institutetype=Universal%20Bank) | | 207 |
| 13 | |  | | --- | | [Oceanic Bank International Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Oceanic%20Bank%20International%20Nigeria%20Plc&institutetype=Universal%20Bank) | | 207 |
| 14 | |  | | --- | | [Platinum Habib Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Platinum%20Habib%20Bank%20Plc&institutetype=Universal%20Bank) | | 250 |
| 15 | |  | | --- | | [Skye Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Skye%20Bank%20Plc&institutetype=Universal%20Bank) | | 160 |
| 16 | [Spring Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Spring%20Bank%20Plc%20&institutetype=Universal%20Bank) | 180 |
| 17 | [Stanbic - IBTC Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Stanbic%20-%20IBTC%20Bank%20Plc&institutetype=Universal%20Bank) | 56 |
| 18 | |  | | --- | | [Standard Chartered Bank Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Standard%20Chartered%20Bank%20Nigeria%20Plc&institutetype=Universal%20Bank) | | 18 |
| 19 | [Sterling Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Sterling%20Bank%20Plc&institutetype=Universal%20Bank) | 104 |
| 20 | |  | | --- | | [Union Bank of Nigeria Plc](http://www.cenbank.org/Supervision/fi.asp?name=Union%20Bank%20of%20Nigeria%20Plc&institutetype=Universal%20Bank) | | 379 |
| 21 | [United Bank For Africa Plc](http://www.cenbank.org/Supervision/fi.asp?name=United%20Bank%20For%20Africa%20Plc&institutetype=Universal%20Bank) | 600 |
| 22 | [Unity Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Unity%20%20Bank%20Plc&institutetype=Universal%20Bank) | 215 |
| 23 | [Wema Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Wema%20Bank%20Plc&institutetype=Universal%20Bank) | 110 |
| 24 | |  | | --- | | [Zenith Bank Plc](http://www.cenbank.org/Supervision/fi.asp?name=Zenith%20Bank%20Plc&institutetype=Universal%20Bank) | | 250 |

Source: www.cenbank.financialinstitution.com

**Appendix II: Total Fraud Cases, Amount Involved and total Expected Losses in Nigerian Banks**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Years | No of Fraud cases | Amount Involved  N’000,000 | Total Expected Losses | Proportion of Expected losses to Amt involved (%) |
| 2000 | 400 | 2844.2 | 1077.89 | 37.9 |
| 2001 | 943 | 11243.94 | 906.3 | 8.06 |
| 2002 | 796 | 12919.55 | 11299.69 | 10.1 |
| 2003 | 850 | 9383.67 | 857.46 | 9.13 |
| 2004 | 1133 | 8309.83 | 1804.45 | 21.71 |
| 2005 | 1229 | 10606.18 | 5602.05 | 39.17 |
| 2006 | 1193 | 4832.17 | 2768.67 | 57.29 |

Source: (Adapted from Akpan, 2007)

**Appendix III : List of failed banks which were closed, having had their licenses revoked by the Central Bank of Nigeria, between 1994 and 2006**.

|  |  |  |
| --- | --- | --- |
| **S/NO** | **BANKS IN LIQUIDATION** | **DATE OF CLOSURE** |
| 1 | Abacus Merchant Bank Ltd | Jan. 16, 1998 |
| 2 | ABC Merchant Bank Ltd | Jan. 16, 1998 |
| 3 | African Express Bank Ltd | Jan. 16, 2006 |
| 4 | Allied Bank of Nigeria Plc | Jan. 16, 1998 |
| 5 | All States Trust Bank Plc | Jan. 16, 1998 |
| 6 | Alpha Merchant Bank Plc | Sept. 08, 1994 |
| 7 | Amicable Bank of Nigeria Plc. | Jan. 16, 1998 |
| 8 | Assurance Bank of Nigeria Plc | Jan. 16, 2006 |
| 9 | Century Merchant Bank Ltd. | Jan. 16, 1998 |
| 10 | City Express Bank Plc | Jan. 16, 2006 |
| 11 | Commerce Bank Plc | Jan. 16, 1998 |
| 12 | Commercial Trust Bank Ltd | Jan. 16, 1998 |
| 13 | Continental Merchant Bank Plc | Jan. 16, 1998 |
| 14 | Coop. & Commerce Bank Plc | Jan. 16, 1998 |
| 15 | Credite Bank Nig. Ltd | Jan. 16, 1998 |
| 16 | Crown Merchant Bank Ltd. | Jan. 16, 1998 |
| 17 | Financial Merchant Bank Ltd. | Jan. 21, 1994 |
| 18 | Great Merchant Bank Ltd. | Jan. 16, 1998 |
| 19 | Group Merchant Bank Ltd. | Jan. 16, 1998 |
| 20 | Gulf Bank Ltd | Jan. 16, 2006 |
| 21 | Hallmark Bank Plc | Jan. 16, 2006 |
| 22 | Highland Bank of Nig Plc | Jan. 16, 1998 |
| 23 | ICON Ltd. (Merchant Bankers) | Jan. 16, 1998 |
| 24 | Ivory Merchant Bank Ltd. | Dec. 22, 2000 |
| 25 | Kapital Merchant Bank Ltd. | Jan. 21, 1994 |
| 26 | Lead Bank Plc | Jan. 16, 2006 |
| 27 | Lobi Bank of Nig. Ltd. | Jan. 16, 1998 |
| 28 | Mercantile Bank of Nig. Plc. | Jan. 16, 1998 |
| 29 | Merchant Bank of Africa Ltd. | Jan. 16, 1998 |
| 30 | Metropolitan Bank Ltd. | Jan. 16, 2006 |
| 31 | Nigeria Merchant Bank Ltd. | Jan. 16, 1998 |
| 32 | North-South Bank Nig. Plc. | Jan. 16, 1998 |
| 33 | Pan African Bank Ltd. | Jan. 16, 1998 |
| 34 | Pinacle Commercial Bank Ltd. | Jan. 16, 1998 |
| 35 | Premier Commercial Bank Ltd | Dec. 22, 2000 |
| 36 | Prime Merchant Bank Ltd. | Jan. 16, 1998 |
| 37 | Progress Bank Ltd. | Jan. 16, 1998 |
| 38 | Republic Bank Ltd | June 29, 1995 |
| 39 | Rims Merchant Bank Ltd. | Dec. 22, 2000 |
| 40 | Royal Merchant Bank Ltd. | Jan. 16, 1998 |
| 41 | Trade Bank Plc | Jan. 16, 2006 |
| 42 | United Commercial Bank Ltd. | Sept. 8, 1994 |
| 43 | Victory Merchant Bank Ltd. | Jan. 16, 1998 |

Source: www.cenbank.financialinstitution.com

**Appendix IV: Corporate Governance Disclosure Check List**

|  |  |
| --- | --- |
|  | **I. Financial Disclosures:** |
| 1 | Financial and Operating Results |
| 2 | Related Party Transaction |
| 3 | Critical Accounting Policies |
| 4 | Corporate reporting framework |
| 5 | Statement of Director’s responsibilities towards preparation and presentation of financial statements |
| 6 | Risk and estimates in preparing and presenting financial statements |
| 7 | Segment reporting |
| 8 | Information regarding future plan |
| 9 | Dividend |
|  | **II. Nonfinancial Disclosures:** |
|  | A). Company Objectives: |
| 10 | Information about company objectives |
|  | B). Ownership and Shareholders’  Rights: |
| 11 | Ownership Structure |
| 12 | Shareholder Rights |
|  | C). Governance Structure and Policies: |
| 13 | Size of board |
| 14 | Composition of board |
| 15 | Division between chairman and CEO |
| 16 | Chairman’s Statement |
| 17 | Information about Independent Director |
| 18 | Role and functions of the board |
| 19 | Organizational Hierarchy |
| 20 | Changes in Board Structure |
| 21 | Compliance with different legal rules |
| 22 | Audit committee |
| 23 | Remuneration committee |
| 24 | Any other committee |
| 25 | Composition of the committee |
| 26 | Functioning of the committee |
| 27 | Organizational code of ethics |
|  | D). Members of the Board and key executives: |
| 28 | Biography of the board members |
| 29 | No. of directorship held by individual members |
| 30 | No. of board meeting |
| 31 | Attendance in board meeting |
| 32 | Director stock ownership |
| 33 | Director remuneration |
|  | E). Material issues regarding employees, environmental and social stewardship: |
| 34 | Employee relation/Industrial relation |
| 35 | Environmental and social responsibility |
|  | F). Material foreseeable risk factors: |
| 36 | Risk assessment and management |
| 37 | Internal control system |
|  | G). Independence of Auditors: |
| 38 | Auditor appointment and rotation |
| 39 | Auditor fees |
|  | **III. Annual General Meeting:** |
| 40 | Notice of the AGM |
| 41 | Agenda of the AGM |
|  | **IV. Timing and means of disclosure:** |
| 42 | Separate Corporate Governance statement/ separate section for corporate governance |
| 43 | Annual report through internet |
| 44 | Any other event |
|  | **V. Best practices for compliance with corporate governance:** |
| 45 | Compliance with SEC notification |

Source: compiled by researcher using CBN Code of CG (2006)

**Appendix V: Banks and Average Measurement Variables**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **BANKS** | **Return on Equity** | **Return on Assets** | **Board Size** | **Board composition** | **CGDI** | **DEI** |
| DBK1 | ACCESS BANK | 0.03434 | .2404 | 13.00 | .69 | .63 | .14 |
| DBK 2 | DIAMOND BANK | 0.04486 | .3140 | 12.67 | .72 | .69 | .07 |
| DBK 3 | ECO BANK | 0.09774 | .5087 | 12.00 | .55 | .71 | .19 |
| DBK 4 | FIDELITY BANK | 0.03114 | .2180 | 13.33 | .58 | .60 | .06 |
| DBK 5 | FIRST BANK NIG PLC | 0.03976 | .2783 | 12.67 | .69 | .85 | .04 |
| DBK 6 | FIRST CITY MONUMENT BANK | 0.05848 | .4093 | 13.67 | .60 | .70 | .15 |
| DBK 7 | FIN BANK PLC | 0.02397 | .1793 | 15.00 | .74 | .64 | .05 |
| DBK 8 | GUARANTY TRUST BANK | 0.04182 | .2927 | 12.67 | .55 | .62 | .04 |
| DBK 9 | INTERCONTINENTAL BANK PLC | 0.01662 | .1163 | 17.00 | .67 | .55 | .03 |
| DBK 10 | OCEANIC BANK INTL PLC | 0.02378 | .1665 | 14.00 | .53 | .59 | .07 |
| DBK 11 | PLATINUM HABIB BANK PLC | 0.02448 | .1713 | 16.00 | .63 | .60 | .10 |
| DBK 12 | SKYE BANK PLC | 0.02772 | .1940 | 15.00 | .66 | .59 | .11 |
| DBK 13 | STERLING BANK PLC | 0.09952 | .6966 | 11.00 | .52 | .65 | .19 |
| DBK 14 | STANBIC IBTC BANK PLC | 0.03432 | .2402 | 13.33 | .78 | .56 | .14 |
| DBK 15 | UNION BANK PLC | 0.02224 | .1557 | 15.00 | .69 | .56 | .01 |
| DBK 16 | UNITED BANK FOR AFRICA PLC | 0.01646 | .1152 | 12.00 | .71 | .60 | .09 |
| DBK 17 | UNITY BANK | 0.152 | 1.064 | 9.67 | .51 | .70 | .25 |
| DBK 18 | WEMA BANK PLC | 0.16794 | 1.1756 | 6.67 | .54 | .87 | .28 |
| DBK 19 | ZENITH BANK PLC | 0.02438 | .4682 | 15.00 | .59 | .68 | .11 |
| DBK 20 | SPRING BANK PLC | 0.028 | .1364 | 12.33 | .53 | .69 | .17 |
| DBK 21 | AFRI BANK | 0.02708 | .2492 | 15.33 | .68 | .77 | .01 |

**Appendix VI: Descriptive Statistics on Disclosure of Governance Items**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **N** | **Minimum** | **Maximum** | **Mean** | **Std. Deviation** |
| **CGD 1** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 2** | **24** | **.0000** | **1.0000** | **.791667** | **.4148511** |
| **CGD 3** | **24** | **.0000** | **1.0000** | **.833333** | **.3806935** |
| **CGD 4** | **24** | **.0000** | **1.0000** | **.208333** | **.4148511** |
| **CGD 5** | **24** | **.0000** | **1.0000** | **.916667** | **.2823299** |
| **CGD 6** | **24** | **.0000** | **1.0000** | **.250000** | **.4423259** |
| **CGD 7** | **24** | **.0000** | **1.0000** | **.500000** | **.5107539** |
| **CGD 8** | **24** | **.0000** | **1.0000** | **.458333** | **.5089774** |
| **CGD 9** | **24** | **.0000** | **1.0000** | **.958333** | **.2041241** |
| **CGD10** | **24** | **.0000** | **1.0000** | **.416667** | **.5036102** |
| **CGD11** | **24** | **.0000** | **1.0000** | **.333333** | **.4815434** |
| **CGD 12** | **24** | **.0000** | **1.0000** | **.708333** | **.4643056** |
| **CGD 13** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 14** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 15** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 16** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 17** | **24** | **.0000** | **1.0000** | **.166667** | **.3806935** |
| **CGD 18** | **24** | **.0000** | **1.0000** | **.958333** | **.2041241** |
| **CGD 19** | **24** | **.0000** | **1.0000** | **.208333** | **.4148511** |
| **CGD 20** | **24** | **.0000** | **1.0000** | **.458333** | **.5089774** |
| **CGD 21** | **24** | **.0000** | **1.0000** | **.958333** | **.2041241** |
| **CGD 22** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 23** | **24** | **.0000** | **1.0000** | **.166667** | **.3806935** |
| **CGD 24** | **24** | **.0000** | **1.0000** | **.708333** | **.4643056** |
| **CGD 25** | **24** | **.0000** | **1.0000** | **.958333** | **.2041241** |
| **CGD 26** | **24** | **.0000** | **1.0000** | **.958333** | **.2041241** |
| **CGD 27** | **24** | **.0000** | **1.0000** | **.083333** | **.2823299** |
| **CGD 28** | **24** | **.0000** | **1.0000** | **.250000** | **.4423259** |
| **CGD 29** | **24** | **.0000** | **1.0000** | **.083333** | **.2823299** |
| **CGD 30** | **24** | **.0000** | **1.0000** | **.583333** | **.5036102** |
| **CGD 31** | **24** | **.0000** | **1.0000** | **.500000** | **.5107539** |
| **CGD 32** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 33** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 34** | **24** | **.0000** | **1.0000** | **.833333** | **.3806935** |
| **CGD 35** | **24** | **.0000** | **1.0000** | **.375000** | **.4945354** |
| **CGD 36** | **24** | **.0000** | **1.0000** | **.958333** | **.2041241** |
| **CGD 37** | **24** | **.0000** | **1.0000** | **.125000** | **.3378320** |
| **CGD 38** | **24** | **.0000** | **1.0000** | **.541667** | **.5089774** |
| **CGD 39** | **24** | **.0000** | **1.0000** | **.833333** | **.3806935** |
| **CGD 40** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 41** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |
| **CGD 42** | **24** | **.0000** | **1.0000** | **.666667** | **.4815434** |
| **CGD 43** | **24** | **.0000** | **1.0000** | **.625000** | **.4945354** |
| **CGD 44** | **24** | **.0000** | **.0000** | **.000000** | **.0000000** |
| **CGD 45** | **24** | **1.0000** | **1.0000** | **1.000000** | **.0000000** |

**Appendix VII: Comprehensive Result of Regression Analysis**

**Model Summary**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Model | R | R Square | Adjusted  R Square | Std. Error of the Estimate |
| 1 | .812 a | .659 | .635 | .02814 |

a Predictors: (Constant), DEI, CGDI, NED, BOS

**ANOVA** b

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Model |  | Sum of Squares | df | Mean Square | F | Sig. |
| 1 | Regression | .089 | 4 | .022 | 28.009 | .000 a |
| Residual | .046 | 58 | .001 |  |  |
| Total | .135 | 62 |  |  |  |

a Predictors: (Constant), DEI, CGDI, NED, BOS

b Dependent Variable: ROE

**Coefficients** a

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Model |  | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
| B | Std. Error | Beta | B | Std. Error |
| 1 | (Constant) | .047 | .056 |  | .825 | .413 |
| BOS | -.004 | .002 | -.220 | -1.977 | .053 |
| NED | -.084 | .045 | -.162 | -1.871 | .066 |
| CGDI | .127 | .046 | .247 | 2.795 | .007 |
| DEI | .236 | .060 | .415 | 3.957 | .000 |

a Dependent Variable: ROE

**(i) Determined by outsiders**

Institutional Shareholding

Outside Block

Holdings

Takeover

Activity

**(ii) Determined by Insiders**

Outside Markets

For managerial Talents

Debt

Financing

Board size

etc

Insider

Holdings

Audit

Committee

CEO Tenure

And horizon

Audit Quality

Non-executive Directors

Political Groups

Investors

Governments

Suppliers

Customers

**FIRMS**

Trade Associations

Communities

Employees

Principal

Agent

Agency relationship

Agent problem/ Conflict

Contract

Imperfect Contract

Perfect Contract

Agency Costs

Not Attainable in Practice

Residual Agency Costs

Bonding Costs

Governance Mechanisms