



# Evaluation of Corporate Governance Practices in Emerging Markets

(A case study of Nigerian Banking Industry)

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## ABSTRACT

This study explores corporate governance practices within the context of the Nigerian banking industry using instances of corporate governance lapses that resulted in part to the Nigerian banking crises. We present multiple case analysis of publicly available documents and court papers (in the United Kingdom and Nigeria) to document instances of breach and areas of weakness in the existing Nigerian code of corporate governance. We supported these with data obtained from multiple sources (using semi-structured interviews, observation and further documentary analysis) to explain and yield insight to the motivation behind these corporate governance practices. The research's theoretical framework adopts theoretical triangulation and is designed to extend the present application of institutional theories and legitimacy theories to include roles of external and internal institutions, power blocks, and the role of legitimacy seeking acts in influencing corporate governance practices. From the case analysis, we suggest multiple actors and influences exist to shape the corporate governance practices within most commercial banks. These lapses make it possible for dominant actors within the organisation to exhibit symbolic compliance while taking advantage of these lapses to shareholders detriment.

## Keywords:

Corporate Governance, Financial crises, Corporate Governance practices, Institutional theories, Family business, Nigeria.



## 1. Introduction

As a fall out of the spate of corporate frauds in the last four decades, there has been a renewed focus on the role of corporate governance in corporations. This interest has been further influenced by the global financial crises which to date has been described as the worst in the history of mankind (Greenspan, 2006; Blanchard, 2009). Other similar factors such as privatisation, integration, globalisation of trade and Asian financial crises has sustained research interest in corporate governance (Betch *et al.*, 2002; Morck *et al.*, 2005; Christopher, 2010).

In furtherance of this interest, Claessans and Yurtoglu (2012), posit the financial crises highlights weaknesses of corporate governance systems across the world. Corporate governance issues as ineffective board over-sight, poor regulatory framework, supervision, excessive risk appetite of boards, executive management remuneration and problem of powerful directorship still exist in corporations in spite of several policy reforms and regulations aimed at curtailing them (Cadbury 1992, Higgs, Sarbanes-Oxley 2002 in the US , CBN and SEC codes in Nigeria).

While debate on corporate governance and its role in the global crises rages, an agreement exists in the literature around corporate governance and finance literature that the 2008-2010 global financial crises emerged primarily from subprime mortgage crises in the American banking industry (Cole and White, 2012; DeYoung and Torna, 2013; Ng and Roychowdhury, 2014) resulting in subsequent collapse of major banks like Freddie MAC and Freddie MAE, Lehman brothers and near collapse of the American economy. Given the interconnectedness of international financial system partly resulting from economic and political globalisation, the crises rapidly spread to other parts of the world with varied degree of impact (Soludo, 2009; Lang and Jagtiani, 2010). The negative impact has thus created a need to re-examine the role of corporate governance in banking industry. Given the financial crises indicate inherent weaknesses in the present model of corporate governance operated globally. These weaknesses may have contributed failed in addressing problems observed in running corporations and addressing governance issues in the banking industry and by extension other forms of corporations.

Although there is a significant body of literature on corporate governance (Laportal *et al.*; Shleifer and

Vishny, 1997; Solomon and Solomon, 2009; Monks and Tricker, 2012), these studies however focused mainly on western based models of corporate governance and with less attention on banking and specific requirements of the banking industry. The major studies of governance in banking are dominated by studies with American and European based data and less in the context of emerging markets (Spong and Sullivan, 2007).

According to Dallas (2011), less than 1% of research on corporate governance is related to emerging markets. A large portion of these studies adopt either a comparative study with western systems of governance or focus on board and firm performance with corporate governance (Ahunwa, 2001) there is thus a need to expand the frontier of corporate governance studies as well as examine the unique peculiarities that shape practice of corporate governance in emerging markets.

In the context of Nigeria, an emerging market economy, the issues of corporate governance re-emerged following from the banking crises of 1994, 2004 and 2008-2010 in addition to frauds in the manufacturing sector (Otusanya, 2010). Common issues of governance identified in the banking industry are fraudulent and self serving practices among board management, weak internal controls, ineffective board oversight, poor risk management, abuse of credit lending processes and rendition of false returns. Corporate governance lapses and insider trading are factors cited for the crises in Nigerian banking industry (Sanusi, 2008; CBN, 2009). As a consequence of these, five banks had to be bailed out to a tune of over ₦620 billion of public funds and four others declared to be in grave danger of liquidation.<sup>1</sup> Although various reforms and policy interventions have been made to improve the level of governance practises in the banking industry (examples are BOFIA, 1991; SEC, 2003 code of governance for Nigerian listed companies, CBN 2006 code of governance for banks). However, the extent to which these reforms have addressed governance issues in Nigeria (and by extension emerging markets) needs to be re-examined in light of apparent failure of corporate governance practices in curtailing previously identified governance lapses and the banking crises in Nigeria. This is necessary as the structure and causes of financial crises differs among countries largely because of the relative extent of dependence on the global economy.

To this end, the study is aimed at providing answers to the following research questions:

- 1) How has the code of corporate governance in Nigeria addressed problems of governance and accountability in Nigerian banks?
- 2) To what extent is the Nigerian corporate governance code effective in curbing problems of corporate governance in Nigerian banking sector?

The research questions of the study will be answered through the evaluation of existing corporate governance codes in the Nigerian banking industry and with reference to the existing governance practices of banks selected for the study.

### **1.1. Structure of the Paper**

The remainder of the study is structured as follows. Section two reviews the literature on corporate governance in the context of developed and emerging countries. This section examined factors that shaped the practices of corporate governance in emerging markets. An assessment of prior research on corporate governance issues and challenges were discussed in this section. Similarly, consideration was given to broad themes and trends that emerged in corporate governance research. It examined theories used to study corporate governance and the suitability in the context of emerging economies. An evaluation of theoretical perspectives adopted in previous studies was carried out and a critique of these theories in light of their suitability in emerging economies was determined. Section three built on the identified gaps in literature and developed a methodological approach that will be used to answer the research questions. Consideration was given to the available methodological frameworks available for social science research and a selection made based on justification of the selected method. Furthermore, the section made a case for the adoption of suitable theories for the study of corporate governance in the context of emerging economies. Section four considered the political, legal and social context of the Nigerian state and how these have influenced the practise of corporate governance in Nigeria. It will consider how the interplay of local factors has shaped the practise of corporate governance in Nigeria. Similarly, it will examine Roles of institutions, structures and systems in place for corporate governance regulation in Nigeria. It would highlight

how these have shaped the mechanisms for corporate governance regulation in Nigeria. The section concludes by highlighting provisions of existing codes and regulations on corporate governance in the Nigerian Banking Industry. Section five provides a case analysis of instances of corporate governance infractions in selected banks in Nigeria. The governance issues were analysed considering the provisions of the corporate governance codes. It analysed how these codes were breached and required amendments required to avoid repeat occurrence. Section six presents a summary and concludes the study by offering possible options based on evidence and theories evaluated, for the reform of the system of corporate governance in developing countries. It identified areas of limitation(s) and possible areas for future research.

## **2. Literature Review**

### **2.1. Introduction**

This section reviews existing body of literature on corporate governance by adopting both a global and local perspective with a deliberate focus on the banking industry. This is aimed at identifying the relevant theoretical frameworks to corporate governance, themes and trends which would shape the study. Similarly, the review seeks to identify gaps in existing literature and provide a means for formulating a methodological approach that will be suitable in answering the research question earlier advanced in section one. To this end the section is structured as follows 2.2 examines the multiplicity of definitions on corporate governance 2.3 considers the present state of debate on corporate governance with a focus on the Anglo Saxon vs. European models, concentrated ownership vs. Dispersed ownership 2.4 examines the development of corporate governance practices and attempts to trace the development of corporate governance practices and factors that explain the interest and growth in corporate governance research. 2.5 examines the study of corporate governance in emerging markets section 2.6 examines study of corporate governance in banking and attempts to understand the difference between corporate governance requirements of banks and other corporations. Section 2.7 provides a summary and conclusion to the section.

## 2.2. Concept of corporate governance

Corporate governance as a concept has no generally accepted definition. This is largely borne out of three factors; firstly it is an interdisciplinary concept with background in law, economics, management and finance. Secondly multi theoretical perspectives have been used to define the concept. Finally differences in country legal systems and level of investor protection account lack of consensus in defining corporate governance (Gnan and Montemerlo, 2002; La Portal *et al.*, 1999).

However, Zingales, (2008), defines corporate governance as a complex set of constraints that shape the ex post bargaining over the quasi rents generated by a firm. This definition assumes that the essence of corporate governance is to put in place a system that ensures management decisions are in line with company and shareholders objective.

Gourevitch & Shinn, (2005:3) on the other hand defines corporate governance with an emphasis on wider significance of issues of corporate governance. They posit that corporate governance is an “authority structure of the firm” which lies at the heart of important issues in the society...” They identified these issues as education welfare and social mobility. They argued that corporate governance authority structure determines who has claims on the cash flows, strategy and allocation of resources of the firm. They further argue that corporate governance decisions are outcomes of political decisions shaped by laws, rules, regulations and the degree of enforcement of these laws.

OECD (2004:12) defines a good system of corporate governance to include the needs of the society as a whole and not just profits regime. OECD (2004:12) argues “A good governance regime helps to assure that corporations use capital efficiently,....take into account the interest of a wide range of constituencies as well as the community in which they operate”. They further contend that boards should be accountable to the company and shareholders. This in turn helps to assure that corporations operate for the benefit of the society.

Given the above definitions, corporate governance may be perceived as the relationship between the corporation and stakeholders that determine and controls the strategic direction and performance of the corporation. In support of this, Cadbury,(1991) defines

corporate governance as the system by which corporations are directed and controlled.

The study of corporate governance in corporation specifies the distribution of rights and responsibilities among the diverse participants in an organisation (Yin ,2014). Thus, corporate governance requires a suitable framework to prevent agency problems between shareholders and managers.

Basel committee on banking supervision (2010:5) however adopts a banking view to the definition of corporate governance defining it as “the manner in which business and affairs of banks are governed by board of directors and senior management ...which affects how they set corporate objectives, operate the banks business on a daily basis , meet obligation of accountability to shareholders take into account the interest of other stakeholders”. It further contends that banks should “align activities and behaviour with expectation that banks will operate in a safe and sound manner, while complying with applicable laws and protect the interest of depositors”.

## 2.3. Corporate Governance Mechanisms

Corporate governance mechanisms are means by which shareholders can enforce their rights and ensure that their interests align with those of managers. Common among these mechanisms as identified by Solomon and Solomon (2002) are; Legal environment and law enforcement, Board of directors, executive compensation, large shareholdings’ market for corporate governance and corporate disclosure (Solomon *et al.*, 2002). Corporate governance mechanism refers to the means by which shareholders can hold managers to account. This is with a view to protecting their shareholdings and rights. Denis and McConnell, (2003) classified these mechanisms as Internal and External mechanisms of Corporate Governance. Luo, (2005) in analysing corporate governance in multinationals, however presents three main mechanisms of governance classified as; market based culture based and discipline based. For the purpose of understanding the mechanisms of corporate governance Dennis and McConnell, (2003) classification of corporate governance mechanisms will be adopted for the purpose of this study.

### **2.3.1. Board of Directors**

The main organ for control of governance in corporations are the board of directors which in the traditional Anglo-Saxon model is responsible for monitoring managers on behalf of shareholders, ensuring the protection of rights and make for shareholder profit maximisation. The board achieves this objective by a mixture of direct supervision and delegation of its role to subcommittees of the board. Two main types of board of directors are predominant in the literature of governance i.e. the single tier board as in UK, USA, Nigeria and the two-tier board as practised in continental Europe.

Significant research on the board structure of corporations has been carried out on the composition, skills and diversity of board membership, executive remuneration, however, a limitation of the board of directors as a mechanism of corporate governance is the inclusion of the same managers that it seeks to monitor and control on the board of directors. In other instances, the process of nominating directors of company has created an “old boys network” where directors pay are determined by other directors on whose board remuneration they serve (cross directorship).

Similarly, in emerging markets where external governance mechanisms are weaker, boards’ ability to effectively monitor managers on behalf of shareholders is a fundamental pillar for corporate governance. A limiting factor to this however is the concentration and family ownership (La Portal *et al.*, 1999; Dallas, 2011).

### **2.3.2. Ownership Structure**

Ownership structure represents another mechanism of control for corporation. The composition of equity holders and their size of holdings determine an important element of corporate governance as it helps align management objective with those of shareholders. However, the extent of manager ownership beyond that of aligning interest with shareholders can further serve as an incentive for managers to pursue their own objective contrary to that of the shareholders. However from a corporate governance research point the common issues that have been studied in the literature include the role of ownership structure in corporate governance, the relationship between ownership structure and board

performance (Shleifer & Vishny, 1999; La Portal *et al.*; Mitton 2002).

Although, corporate governance mechanisms are argued to be a suitable means of holding managers to account, previous research has criticised the extent to which these mechanisms are effective checks on accountability. They are argued as failing to account for the interplay of social and political considerations inherent in the process of formulating and implementing these codes both at national and organisational levels. Marnet (2007) argues that corporate governance models are incapable of addressing challenges of corporations as these models ignore social and political behaviours inherent in organisations. This argument is supported by the view that while corporate governance models may represent appropriate ideals, they fail to address the specific problems that faces organisations as evidenced in their inability to prevent the financial crises or the spate of frauds in the banks. Similarly, these mechanisms fail to consider local and specific country considerations in their formulation and design. The models assume in most cases the corporation is structured in line with the traditional American model i.e., a traditional system of dispersed ownership as opposed to the more prevalent system of concentrated or family ownership that is more prevalent around the globe. (La Portal *et al.*, 1999).

### **2.4. Corporate governance in emerging economies**

While corporate governance has been widely researched emphasis has naturally focused on the emerged markets of Europe America and Asia with less research from emerging markets of Latin America, Asia and Africa. To (Dallas, 2011) less than 1% of research on corporate governance are related to emerging markets with most of these studies adopting either a comparative study with western systems of governance or focus on board and firm performance with corporate governance. There is a need to expand the frontier of corporate governance studies as well as examine the unique peculiarities that shape practice of corporate governance in emerging markets.

The study of corporate governance in Nigeria has an emerging body of literature notable among which are Yahaya, 1998; Okike 2000, 2007; Yakassai, 2001; Adegbite and Nakajima, 2010; Adegbite and Amaeshi,

2010 Adebite, 2012. Among these studies common in terms of codes issued to date there are the SEC code of 2003, 2011; CBN mandatory code of 2006. (Opara, 2011; Angaye and Gwilliam, 2008). These studies adopt either a comparative study of governance or an exploratory study of corporate governance practice in the country.

Opara (2011) for instance examines barriers to issues and implications at a firm level of corporate governance practices in Nigeria by means of a mixture of qualitative and quantitative data. The study identified common barriers as the protection of minority shareholders, lack of commitment and responsibility of shareholders, regulatory framework and enforcement mechanisms concentration of ownership, transparency and disclosure. This view mirrors closely that of Oyejide and Sotibo, (2001). The study's population is however drawn from a mixed sample from Insurance, manufacturing and banking assuming that these separate industries have similar governance requirements. This does not make the findings applicable to the banking industry as the peculiar nature of banking was not considered by the study. Also the study fails to account for societal and political influences on the system of governance in Nigeria as the basis of the questionnaire and interview questions were based on the OECD corporate governance assessment framework without consideration for peculiar context of Nigeria. In terms of her governance need and how socio cultural factors influences governance mechanisms.

Adebite and Amaeshi(2010) examine the influences on corporate governance in sub Saharan Africa with a focus on actor and strategies influencing corporate governance practices. They argue that corporate governance practices in Nigeria (as most emerging countries) is subject to multiple influences of: rating agencies, international organisations whose influence determines the model of corporate governance to adopt by corporations in emerging markets. They argue using a mixed qualitative research method the predominant adoption of an Anglo-Saxon model is a subtle imposition foreign agencies without consideration for local factors.

The regulation of corporate governance in the context of emerging countries is discussed considering corruption and social economic problems of these countries. Mensah *et al.* (2003) posits that corporate governance and accountability are possible solutions to

the challenges of corporate corruption in emerging markets. This view however fails to recognise that corporate governance goes beyond the issues of protecting shareholders and regulation of corporation or minimisation of frauds in corporations. Wider issues such as satisfaction and participation of labour, customer satisfaction as this focus is rather ignored. Furthermore, it fails to give account of wider context of needs of other stakeholders as postulated by the stakeholder theory whose interest may be at variance of the shareholders. While the stakeholder theory postulates several parties to which a corporation owes obligations it however fails to provide a recognition criteria or which interest group is in cases of stakeholder conflicts.

Corporate governance in Nigeria is significantly influenced by corporate governance regulatory practices borrowed by from other jurisdictions notably the UK. Significantly, the SEC code is similar to the UK code of governance and the CBN code of 2006 while also bears close semblance in form to the US Sarbanes Oxley act as it provides detailed guidance in the requirements of the governance codes while also advocating the existence of principles (CBN, 2014; Adekoya, 2010; Adebite, 2011).

In terms of those prescribed to her by organisations such as the World Bank and the IMF. These in most cases are a by product of negotiations and bi lateral agreement aimed at providing Foreign Direct Investment (FDI) in the country. While the extent to which corporate governance adoption has resulted to FDI remains controversial, and is contested, Adebite, (2012), posits that these may have been a product of been over hyped and does not tackle the challenges of governance in the country.

## **2.5. Banks corporate governance**

While there has been a series of reforms in corporate governance practices in non financial sector these reforms may not be applicable to banks given their special nature and the risk they face and pose to the financial/economic system. Adams & Mehran (2003) suggested that corporate governance for banks differ from other industries as a result of the risk they pose to the economy which requires regulators (mainly central banks and Deposit Insurance) to put in place standards and rules to make management practices in banks more efficient.

Two schools of thoughts have thus emerged regarding the regulation of banks these are the proponents for a government led regulation and those for a profession or market led regulation. Traditionally, the approach to corporate governance regulation for banks involves the government regulator relying on statutory authority and standards to promote the interest of shareholders and other stakeholders. The main mechanisms used for controlling banks are restriction on connected lending, restriction of holding, legal and prudential guidelines.

### **2.5.1. The special nature of banks**

Banks are considered special as they perform multiple functions in an economy. Traditionally banks perform the role of financial intermediation and play important roles in the development of economies. Levine (2004) argues that banks exert a “strong impact on economic development of countries”. These roles of strong impact is however not sufficient reasons to warrant a different set of corporate governance model or principle different from those that presently operate for other sectors and industries.

Caprio and Levine (2002) identify two attributes of banks that make them special and in need of greater governance as opposed to the governance of conventional corporation these are:

- a. Greater opaqueness than other corporations
- b. Greater regulation

Caprio and Levine (2004), argue that both factors account for the inability of conventional mechanisms applicable to public corporations to effectively function for banks. They contend that the greater opaqueness makes it difficult for equity owners to monitor banks

The roles of banks are of importance in any economy as they provide funds to deficit sectors of the economy, financial intermediation role, facilitate payment and exchange and are regarded as the engine room of growth of emerging countries. Banks assume this role in emerging countries which are characterised by weak and underdeveloped capital markets (Hawkins and Turner, 2000; Arun, 2003) hence the inability of the capital market to finance growth results in banks adopting these roles in emerging countries. The level of importance ascribed to banks is also evident in the extent of regulation imposed by regulatory bodies around the world.

Banks in addition to its traditional role of financial intermediation, banks also serves a social function which necessitates the required extent of regulation required in the banking industry. Soludo (2006) indicates that Nigerian banks account for over 90% of assets in the financial system and significant roles in financing economic development of Nigeria (Soludo, 2006).

## **2.6. Theoretical perspectives of corporate governance**

The literature of corporate governance has adopted diverse theories in the study of corporate governance. This is evident in the diverse theoretical frameworks that have been used to define and study of corporate governance. Most of these studies have been based on use of multiple disciplinary approaches to understand the concept of corporate governance. Notable among these are the agency theory in finance and economics, stakeholder theory from the social oriented theoretical school and legitimacy theory from the regulatory/institutional school. While these theories approach the subject from multiple and diverse perspectives, they analyse same problems and raise similar issues. Solomon (2007:8) puts it thus: “though there are marked differences they analyse same problem from different perspectives”.

Hence this section will examine common used theories in corporate governance and their relevance and appropriateness for understanding corporate governance practises in an emerging economy as Nigeria.

### **2.6.1. Agency theory**

The agency theory approach to corporate governance is based on the consequences of separating power between dispersed owners and the management of a corporation. Agency theory assumes that managers (agents) will not carry on business in interest of principals except corporate governance mechanisms are in place to reduce tendencies of managers acting in self interest of both parties. Hence there is a need to align managers’ interest with those of principal (Shareholder). This theory suggests that corporate governance as a means of ensuring minimisation of managers’ opportunistic behaviours by ensuring that board exists to monitor the activities of managers and align it with the interest of shareholders. (Jensen and

Meckling 1976; Fama and Jensen, 1983; Phan and Yoshikawa, 2000; Clarke, 2004). The agency theory is based on two fundamental assumptions: It assumes that managers are opportunistic and self-serving. To resolve this, there is thus a need for strong director monitoring through the board of directors to ensure an alignment of shareholders and managers interests. The second assumption of the agency theory is that it assumes agents control the information flow to principal thus allowing for opportunistic behaviours to the detriment of shareholders.

Although the agency theory is widely used in corporate governance research, it has been criticised for reducing the corporation to relationship between the manager (agent) and shareholder without consideration to other groups excluded by the agency contractual relationship. While it has been argued that agency theory has been helpful in the study of corporate board, executive remuneration, role and functions of board of directors, it also fails to account for sociological and psychological mechanisms inherent in the principal agent relationship (Carreaux, 2004).

### **2.6.2. Stakeholder theory**

The Stakeholder theory is an attempt to broaden the scope of accountability of corporations from the shareholder group to include considerations for other groups in the society beyond those defined by the agency theory. Emerson *et al.* (2011) affirms that stakeholder theory is an interdisciplinary theory widely used in the field of corporate social responsibility and business ethics. Although the theory was initially designed as a theory for use in management, it has been widely adopted in the field of corporate governance (Gibson, 2000; Wolfe and Putler, 2002; Friedman and Miles, 2006). By defining the firm as a network of interconnected relationships it emphasises the need for consideration and extension accountability to the interests of it diverse stakeholders, and seeks to explain internal behaviour as well as external relationships (Key, 1999)

SHT views the corporation as a set of relationships “explicit and implicit” across the environment (internal and external) of an organisation. This is achieved by focusing on other members of the society, as opposed to traditional focus on shareholders or owners of the corporation.

Freeman (1984), (as cited by Key 1989) defines stakeholders as ‘individuals or groups that may affect or is affected by the organisational objectives’. This definition creates an endless list of whom and what can be classified as a stakeholder and the extent of obligation owed to that group. This throws up a challenge of criteria to determine who qualifies as a stakeholder. Clarkson, (1995), provides a guideline in classifying stakeholders by highlighting three main factors determining stakeholder relationship. These are the organisation, other actors and nature of company-actor relationship. On the other hand, Lepineux, (2005), classifies stakeholders on the basis of shareholder, internal stakeholder and community. This helps clarify and possibly rank the extent of obligation owed to each group. This classification enable for understanding relationships in the banking industry. However, stakeholder theory fails to provide for political and social interactions that shape demand of groups of stakeholders. Neither does the theory account for the whole system within which organisation operate and how identified stakeholders are linked with the corporation other than they are affect and or affected by classification (Key, 1999).

Furthermore, Key, (1999), argues that the stakeholder theory lacks a theoretical basis for explaining firm behaviour, an essential requirement for understanding corporate governance practices in specific sector or country context. In the context of corporate governance for instance, stakeholder theory provided no explanation as to how socio-political and culture can shape the governance practise of a firm.

While there is a wide use of stakeholder theory in the literature of corporate governance it has been criticised both in the wider literature of management and corporate governance for failing to provide a prescription to determine the extent of accountability owned stakeholder groups. This is a result of its lack of definition of what constitute a stakeholder, and to whom a corporation is accountable other than the affect/affected by criteria. Similarly, in cases of stakeholder conflict it does not provide for what legitimate right is owed a group or which group is more important, extent of obligation owed or means of resolving conflict of interest between groups of stakeholders when interests are at cross purposes. Hence there is a need for the theory to provide an explanation for the linkages that exists between groups

of stakeholders and how the firm can resolve the conflict between these groups.

### **2.6.3. Legitimacy theory**

The legitimacy theory assumes that a social contract exists between an organisation and the society. Corporations attempt to gain legitimacy by taking actions that portray it as complying with societal norms and values. Legitimacy theory is widely used in corporate disclosure studies and environmental reporting (Deegan, 2002; O'donovan, 2002). However, few scholars have adopted it to explain corporate governance disclosure practices. In the field of corporate governance notable research using the legitimacy theory include (Aguilera and Curevo Cazzura, 2004; Qui and Luung, 2006; Zattoni and Cuomo, 2008).

Zattoni and Cuomo (2008:12) argue the adoption of CG codes is symbolic and intended to impress investors on one hand and deter regulators from formulating more stringent regulation for an industry. This position was further strengthened in Zattoni and Cuomo, (2010), where they identify two views that explain the introduction of corporate governance codes in countries i.e.

(1) That corporate governance codes are introduced to improve performance of corporations, and

(2) That the codes are adopted to legitimize listed companies and capital markets. Legitimacy according to Suchman, (1995:574) is 'a generalised perception or assumption that the actions of an entity are desirable proper or appropriate within some socially constructed system of norms values beliefs and definitions'. While these values and systems are subject to change, organisations will seek means of survival by reference to a third party (ies) regarded by the society as possessing legitimacy (Deegan and Bloomgust, 2006). Legitimacy is a social construct and what is considered legitimate varies between societies with varied measure of what is considered legitimate and social perception of corporate behaviour (Suchman, 1995).

In the context of corporate governance, the choice of what model, practise and mechanism a firm or country adopts is an attempt to gain legitimacy in the environment in which the company operates. Hence corporations are posited to only adopt those practices that foster and improve its societal legitimacy rather than efficiency, accountability or transparency. This to

Deegan and Uneram, (2011), is an attempt by an organisation to be perceived as operating within the 'norms and bounds of their respective societies'

The legitimacy theory is founded on the notion of a social contract containing implicit and explicit expectation of a society in the organisation Deegan and Unermam, (2011).

Legitimacy theory assumes that organisations are allowed to continue operations provided the company comply with the terms of the social contract. Where there is non-compliance, it is likely to result in difficulty in assessing resources required for continued survival.

In banking this theory is of importance as it enables a trust and integrity building to take place between the bank and the society and enables a reassessment of compliance with the terms of the social contract. A bank may legitimise its actions by adopting a corporate governance mechanism which employs an independent director to its board. This may appeal as right to the society it does not assure that it will improve its accountability or management transparency.

Hence policy and systems disclosure will be based on efforts aimed at fostering legitimacy in the society. The expectation of an organisation is often shaped by the extent of societal expectation which is a product of societal knowledge culture and belief.

### **2.6.4. Institutional Theory**

Institutional theory assumes that organisations will adopt similar practices as those adopted by other organisations in an industry.

The foundation of the Institutional theory is based on the works of Di Maggio and Powell, (1983), who defined institutional theory as the forms organisations take and why organisations within a particular "organisational field" tend to adopt similar characteristics and forms ( Larrinaga and Gonzalez, 2007). They argue that organisations behaviour is driven by the institutional framework within which it operates. Thus, institutional theory assumes organisations seek to conform its behaviour and practices to similar organisations, industry regulation or mandates.

The theory presents three means by which an organisational behaviour achieves similarities (i.e. isomorphism) these are discussed below:

Coercive pressure i.e. coercive isomorphism which indicates a fear of a group(s) of stakeholders to which an organisation is dependent on for survival hence it assumes on the basis of a stakeholder theory that organisations will voluntarily adopt corporate governance mechanisms that addresses the concerns and fears of major stakeholder group(s).

Mimetic isomorphism refers to a desire by organisations to copy or improve upon institutional practices of other organizations regarded as models or benchmark to either gain competitive advantage or legitimacy (Deegan and Unerman, 2011).

The third category refers to normative isomorphism where group norms pressurise organisations to adopt certain institutional practices. It assumes normative theorists seek to professionalize the organization e.g. accountants and auditors.

The last concept in Institutional theory refers to decoupling which alternate form of isomorphism which assumes while there may be a need for organisations to adopt certain institutional practises; the actual implementation may differ from the formally sanctioned process and procedures. Deegan and Uneraman (2011) argue that an organisation can decouple actual practises from institutional practises hence organisation might adopt some process for publicity purposes rather than for improving accountability or transparency of the corporation.

## 2.7. Summary

This section has reviewed the literature on corporate governance drawing on previous research in advanced and emerging economies. The review has shown that over time the nature and form of organisation has evolved and has resulted in a demand for greater accountability by the state and a larger pool of stakeholders. While the traditional argument for governance was to resolve the agency problem the modern corporation has brought up more challenges than was previously known.

In the case of emerging countries, a desire to finance the huge costs of infrastructural development requires countries to seek an enabling environment that stimulates FDI to make such economies attractive destination for foreign investors. Hence countries like Nigeria through multinational agencies as IMF, OECD, IBRD are required to put in place relevant laws that replicate the regulatory environment in the parent countries.

Similarly, the review of the literature has highlighted that research into corporate governance has been focused in advanced and leading economies of the world with research in emerging countries far between. Similarly, most research on corporate governance are either country specific with a fewer number examining specific industries in the context of governance practices and the extent of their actual implementation in practice. The literature provides broad provisions on the mechanics for good corporate governance without specific study in the context of emerging markets on the requirements of governance mechanisms that address the peculiar needs of financial sector.

## 3. Methodology

### 3.1. Introduction

Research methodology is defined as the general approach that is taken to an enquiry as opposed to research methods which are the specific methods adopted in individual studies. (Saunders, 2009).

Remennyi et al., (2003) define methodology as the “overall approach to a problem which could put into practice in a research process from the theory underpinning the collection and analysis of data” Similarly Collins and Hasey,(2009) view methodology as “ the overall approach to the entire process of research study” there is a need to distinguish between research method which provides a guide to data source and analysis relevant to the research question while methodology refers to the philosophical perspective on which the research work is based.

This section will thus provide insight and justification for the research methodology and the research methods adopted to address the research question. The section is structured in line with Saunders *et al.*, (2009), research methodological approach. The followings form the sub-titles of discourse in this section methodology, approaches to research, philosophical approach, theoretical framework, research methods (data collection and analysis methods) and summary of the section.

### 3.2. Methodology and Philosophical approaches of research

This section will discuss the three main philosophical approaches to research as proposed by Hallenbone and Priest, (2007). The following section

discusses the three philosophical perspectives underpinning the social sciences research: interpretive, positivism and the critical theory, beginning with the interpretive approach.

### **3.2.1. Positivist approach**

Positivism as an approach to research has as its origin in the works of French philosopher Auguste Comte and it assumes that reality can be objectively determined and measured in a manner independent of the researcher. It is further argued that the predominant use of quantitative data by positivists follows the ontological belief that reality is external and can be objectively determined (Bryman, 2008). Generally, positivists adopt the use of quantitative data in carrying out research, it does not preclude the use of qualitative data for positivist research it is assumed that with positivist research, there is a possibility for the outcome of the research to be either generalized or replicated in other areas of research through the use of models or similar models (Myers, 2009).

Positivist approach believes that there is a fixed prior relationship within phenomena which is capable of reliable measurement. This belief follows the natural science that relies on the testing of hypotheses developed from pre-existing theory (ies). As such, Positivist research is thus a theory testing approach to research which usually follows the deductive method of reasoning (Saunders et al 2009). Positivists argue that testing theories facilitates an increased and predictive understanding of phenomena. (Myers, 2009).

A positivist researcher is argued to be “independent of the subject of the research” he neither affects nor is affected by the subject of the research (Remmery et al., 1998, p.3). A positivist research is believed to be fair, unbiased and less subjected to influence of the researcher of the subject of the research. Generally, positivists adopt the use of quantitative data in carrying out research; this does not however preclude the use of qualitative data for positivist research. It is assumed that with positivist research, there is a possibility for the outcome of research to be either generalized or replicated in other areas of research through the use of models or similar models.

The positivist approach is however declined in this study for its generalization of positive results in some instances as a general form of universal statements of

truth does not fit with the researcher view that truth is subject to the political and social context within which a phenomenon is studied.

### **3.2.2. Interpretive approach**

The interpretive approach is perceived differently by various scholars, which has contributed to the better understanding of it. Myers (2009) remarks that the essence of an interpretive research is to facilitate an in depth understanding of the context of a phenomenon as context. Similarly, Husserl (1965 cited in Kelhhar 2005) asserted that an interpretive approach is based on the belief that reality is a product of social construction and cannot be objectively determined and measured. This assertion is based on the philosophy that knowledge “.....is a product of social practices and institutions or of interactions and negotiations between relevant social groups” (Gasper, 1999, p.855). This approach of research is used to understand socially constructed realities Hallenbone and Priest (2009). In a similar vein, Blaikie, (1993), posits that an interpretive approach as that of an “anti-positivist that views the nature of reality has been socially constructed and subjective. Saunders et al. (2009) state that the essence of this approach is to seeks to understand the difference between individuals as social actors.

Also, interpretivists are known to perceive events in the light of experience and expectations thus the meaning attached to an event is a product of constant constructions and reconstructions developed by experience which brings about varied interpretations under which people act. However, the essence of an interpretive research is to facilitate an in depth understanding of the context of a phenomenon as context i.e. ‘what defines the situation and makes it what it is’ (Myers, 2009:39). Thus, Knowledge is a product of in depth study and understanding of the context of a phenomenon, but also involving the social actors and a deep understanding of his perspective.

An interpretive research is based on the belief that reality is a product of social construction and not objectively determined (Husserl, 1965 as cited by Kelhhar (2005). An interpretive approach allows a researcher to place actors in their social context which brings about an understanding of their activities (Hussey, 1997). To Neuman, (2011), Interpretivism tends to apply a transcendent perspective to research. Transcendent perspective entails going beyond

ordinary material experiences and perceptions. It entails going beyond the surface or observable to the inner and subjective level of human experience.

Although interpretive research is usually attached to researches of qualitative nature, Emksson and Kovalainen, (2008). Myers (2009) however argues that an interpretive philosophy does not necessarily imply a qualitative research as the basic philosophy will still be dependent on the underlining assumption of the researcher. He thus suggests that interpretive research can be either qualitative or quantitative.

### 3.2.3. Critical approach

Myers (2009) posits that in the field of management research, critical approach, though not as prominent as positivism and interpretivism, yet, has continued to gain increased prominence. Critical research is aimed at encouraging change in the society by challenging the status quo and exposing deep seated contradictions within the social system and thereby transforming these alienating and restrictive social conditions (Orlikowski and Baroudi, 1991). However, some of the prominent issues the critical research focuses on are; social injustice, environmental sustainability and open democracy and as argued by Myers, (2009). These factors form the “ethical basis” that motivates a critical research.

In a similar manner, Hallenbone and Priest, (2009) argue that critical research adopts a dialectical analysis that reveals the historical, ideological and contradictory nature of existing social practices. Hence, critical research is designed to examine a phenomenon and develop theories to address the problems observed in the society and proffer suitable solutions to these problems.

Similarly, Neuman, (2011) argues that the primary purpose of a research is not simply to study the social world; it is aimed at changing it by revealing sources of inequality and empowering people for change. This for the critical researcher implies reality is constructed of multiple layers of reality this is based on the adoption of critical realist ontology.

However, going from the above analysis and given the research questions put forward, both the positivist and interpretive theories will not be appropriate for the study as this study does not aim to detach itself from the phenomenon it tends to examine or being descriptive or represent the phenomena as it exists. But the researcher is assuming to be part of the

phenomenon being studied and attempts to advocate better means of regulating corporate governance in the Nigerian banking.

### 3.3. Methods

To answer the research question of the study a case study approach will be adopted. A case study approach method of research is more amenable for a descriptive or exploratory study and seeks to place emphasis on a full contextual analysis of fewer events or conditions and their interrelations for a single subject (Yin, 2014; Bryman & Bell, 2008).

Case study method of research is focused on exploring a single entity or phenomenon bounded by time and activity and collects data using a variety of data collection procedures over a period of time (Creswell, 1994; 12). According to Yin, (2014), case study is defined as an empirical inquiry that investigates a contemporary phenomenon within its real-life context, distinguishing between phenomenon and context are not clearly evident. Case study deals with technically distinctive situation, relies on multiple sources of evidence, and benefits from prior development of theoretical propositions to guide data collection and analysis. Yin (2014) identified case study as the preferred research strategy when phenomenon and context are not readily distinguishable. Although, case study research strategy is considered for use in single cases, Dul and Haks, (2008:4), consider case study as amenable for use in single cases or small number of cases. (I.e. multiple cases)

While case study research is more often associated with contemporary phenomenon (Saunders, 2009, Dul and Hak, 2008; and Yin, 2014). Eisenhardt and Graebner (2007) argue that case studies can also be historical in nature. The definition put forward by Collis and Hussey, (2009), identified some of the discernible characteristics of case study strategy. They defined case study as a method that is used to explore a single phenomenon in a natural setting using a variety of methods to obtain in-depth knowledge. Hence, where depth knowledge is required a case study is capable of utilising multiple research techniques to facilitate a study of phenomenon.

In spite of its highlighted advantages, the case study research is criticised for its lack of rigor, and difficulty to generalise beyond the case study in reference. Cooper and Schindler (2001:13), criticises

the case study method for using qualitative data which results in an unclear acceptance or rejection criteria. While these criticisms are valid, its ability to generate in depth knowledge on a phenomenon makes case study acceptable for the research. It similarly allows for the proposed use of multiple data sources as proposed by the research. The criticism of case study research will however be addressed by using documentary evidence to support evidences obtained from selected cases.

However, this study adopts case study approach to carry out the proposed case analysis. The choice of case study was selected as it allows the answers of the research question that focuses on the how and why of corporate governance practise in the context of Nigerian banking industry. It also allows for an independent study without manipulation of variables

The above discussions point out that case study strategy has been and can be used successfully use to conduct research on corporate governance. Hence it can be argued that case study strategy, where in-depth knowledge can be obtained, suits the study of corporate governance that has varied views and practises across countries, industries and firms; as noted in the previous section, corporate governance is a social political construct, which varies according to context hence conclusive generalisations are difficult to make.

A case study research strategy accommodates multiple data source data collection and analysis, these factors enables a researcher to satisfactorily answer the research questions using diverse range of data and analysis tools. (Yin, 2014) Secondary data /documentary review as data collection technique, with content analysis and quantitative analysis adopted for data analysis. (Matthews, 2005).

Alternate strategies like experiments defined by Bryman and Bell,(2003:39) as a research design that rules out alternative explanations to findings derived. This is done by having an experiment group and a control group from it were considered less suitable as the study has no control over the phenomenon been studied and does not aims at the manipulation of the dependent and independent variables. (Collis and Hussey, 2009; Easterby-Smith et al., 2012) the use of a control group is not possible in this study as the corporate code of governance been studied is made mandatory for the Nigerian banking industry hence a control group that is a commercial bank that does not

apply the principle of corporate governance is not available to the researcher.

Alternatively, the survey strategy commonly associated with the deductive approach (Saunders et al., 2009), and positivist philosophical positioning (Bryman and Bell 2008; Collis and Hussey, 2009). Would have been suitable but this research leans towards Interpretive and adopts a more inductive approach, thus, survey strategy was deemed inapplicable to this research.

Ethnography requires the researcher to be immersed in a setting, and become part of the group under study to understand the phenomenon being studied (Easterby-Smith et al., 2008). As the researcher was outside to the context in this research, banking, ethnography falls off as a strategy of research.

Grounded theory seeks to develop a well-integrated set of concepts that provide a thorough theoretical explanation of phenomena under study (Corbin and Strauss, 1990). In grounded theory, theory is derived from data, systematically gathered and analysed through the research process in an iterative process (Bryman, 2008).

Grounded theory perhaps can be identified as the next best alternative for this research, due to the nature of research questions being asked. However, this research seeks to explore corporate governance in a real-life context and examine how the issues of corporate governance have shaped the practice of governance in emerging markets, and apply existing theories as opposed to generating theories or theoretical models on corporate governance practices. Hence, grounded theory is deemed less suitable, when compared to the case study strategy. As noted in the review of the literature grounded theory method has been adopted by (Yahaya 2001; Goddard, 2004; Solomon and Solomon, 2006)

### **3.4. Methods of data collection**

In order to facilitate an understanding of corporate governance mechanism and practices in Nigerian banks, documentary evidence will be gathered from sources as newspapers, magazines, public records annual financial statements of selected banks (from 2006 to 2013) and regulatory reports within a similar time frame. To enable a qualitative analysis, archival data will be used to establish patterns and trends that have shaped practice and regulation of corporate

governance in Nigeria banking industry. This is with a view to identify key corporate governance lapses and how these lapses have been perpetuated.

However, the adopted data collection method i.e. archival and documentary records throw up a challenge of credibility of document sources. The limitation of this method notwithstanding, the study will make use of the method as it will provide evidence to support the arguments put for and provide evidence to answer the research question. To reduce this bias, an attempt will be made to analyse the issues and documents from a perspective of corporate governance to understand the specific issues of corporate governance that is at hand or what governance mechanism was absent or ineffective in preventing the corporate governance lapse

Alternative sources of data collection that could have been adopted for the research such as questionnaire survey are rejected as these will limit the depth of the study to only variables that can be measured and recorded in quantitative terms. Since, the purpose of the research is not to measure public perception or extent of awareness of corporate governance practices but to attain an in-depth understanding of corporate governance issues in the context of social, political culture of Nigeria.

Observation is similarly rejected as a method of observation give the subjectivity associated with its interpretation. As Anderson,(1983), argues reliance on observation as a means of study is error prone and will affect the outcome of research. This argument extends to the interpretation and analysis of data which cannot be totally detached from the subjectivity of the researcher or the environment as the choice of topic and method of research is a subjective choice.

### **3.5. Method of data analysis**

To facilitate an analysis of the research data a theme analysis method will be used to analyse and summarise the data collected from the financial statements, interviews and documented records. This classification will make for easy analysis of the gathered data. The data will thus be used to analyse two Nigerian Banks to highlight what factors resulted in the frauds that occurred and how this can be understood in the context of corporate governance and the issues in terms of regulatory weakness that accounted for the frauds in these banks

## **4. Country Context**

### **4.1. Background of Nigerian banking industry.**

Nigeria is the second largest economy on the African continent is regarded as the most populous black nation on earth with a population estimate of over 185 million people as at 2016(World bank, 2016). In terms of her economic index, Nigeria has a GDP of \$481.066bn as at December 2015(World Bank, 2016). Nigerian operates a mixed economic system that involves a dominant public sector and a less dominant government regulated private sector. (Ahunwa 2011, NPC 2011). While the country has embarked on a deliberate economic reform and deregulation and privatisation, the public sector still retains its dominance of Nigerian economy.

Nigerian economy is an export dependent economy with a large proportion of its export proceeds derived from oil and gas industry in spite of several attempts at diversifying the economy, oil retains a major role in the economy accounting for over 90% of all foreign exchange proceeds and over 80% of all budgetary revenues.(CIA fact book 2011; CBN,2011NBS 2010) Major trading partners of Nigeria include the USA which accounts for 28.9% India 12% and Brazil4.2% of all exports while China USA and Holland account for a largest position of imports to the country in the proportion 17.5%,9.1% and 4.9% respectively.

#### **4.1.1. Nigerian political system**

The Nigerian political system is a presidential system with a thirty six-state structure with an executive president and a bi-cameral legislature. The majority of socio economic polices are a creation of the military that has dominated governance in the country for a period of over three decades of it's 56 years existence as an independent nation. As noted by Otusanya, (2011), successive military incursion into the political and economic administration of the country has resulted in "de-emphasis on accountability" and institutions that fail to encourage democratic accountability. As a result, institutions as the judiciary, stock exchange and the central bank do not have in place adequate enforcement mechanisms capable of challenging the interest of its political class or military hierarchy. A comparative study of leading stock exchanges in Africa indicates that Nigeria is far

behind in terms of major market indices and does not compare with others notwithstanding a high concentration of industries and a higher national income. (Uche, 2007).

#### **4.1.2. Legal system**

The Nigerian legal system is a product of its colonial history as her legal system closely mirrors that of the British system. The main code for company regulation on Nigeria is the Companies and allied Matters Act of 1990 (CAMA as amended to date) as well as the SEC codes for companies listed on her stock exchange. Thus, in theory the same rules are applicable to shareholders in terms of protection the extent to which this is implemented is different from what obtains in western countries. (Anganye and Gwilliam 2008).

#### **4.2. Pre-colonial and colonial history of banking in Nigeria**

The history of banking in Nigeria commenced in 1892 with the establishment of Nigeria's first bank, the African Banking Corporation. Prior to this time traditional means of banking existed which were the communal cooperative societies that entailed contribution to joint cooperative societies. (CBN 2014; Okezie et al, 2001). Formal legislation in banking commenced in 1952, with the banking ordinance of 1952 which brought about introduction of legislation requiring banks have among others, required reserves, and formal examination by the banking department of the federal ministry of finance. At this stage, Nigerian banking was dominated by three foreign banks namely (the Bank of British West Africa, Barclays Bank, and the British and French Bank) and two indigenous banks (the National Bank of Nigeria and the African Continental Bank) the ownership and structure of these banks were predominantly to facilitate colonial trade with little contribution for the development of the local and indigenous community or local involvement and or participation in the management of these banks. Uche and Ehikwe (2001) avers that British colonial officials established the West African Currency Board in 1912 to help finance the export trade of foreign firms in West Africa and to issue a West African currency convertible to British pounds sterling. These banks with the support of the

colonial administration failed to encourage failed to develop the existing indigenous financial institutions.

Flowing from the reluctance of foreign dominated banks to finance development of indigenous economy and financial system and a growing national consciousness culminated in the quest for the establishment of the Nigerian central bank on July 1 1959. As with the structure of governance and administration in Nigeria, the CBN roles and functions was modelled significantly after that of the Bank of England with functions including; establishing the Nigerian currency, controlling and regulating the banking system, serve as banker to other banks in Nigeria, and carry out the government's economic policy. During this era, bank ownership was dominated mainly by foreign owners as evident in the three main banks in operation at that time Barclays bank and British bank of West Africa. A significant attainment in this period was the establishment of the central Bank of Nigeria which had the mandate to regulate the practice of banking and grant licensing to banks operating in the country.

##### **4.2.1. Post-independence period**

By her independence from the British in 1960, Nigerian banking landscape had not changed much from what it was as the focus of the government was on economic stability as well as achieving political and Economic stability of the country. Within the first decade of her existence the ethnic and tribal polarisation of the county culminated in a thirty-month civil war. During this period, ownership and control of banking remained largely in the hand of foreigners who retained 100% stake in these banks with minimal government regulation beyond monetary policy and without an indigenous company law to regulate the operations of these banks (Uche,1988).

By the mid 1970's the oil boom era had commenced and along with this came a desire by the Nigerian government to regulate and control the banking system this was achieved by the nationalisation of three major foreign banks in operation in the country. At this time, the nationalised banks accounted for over 67% of total assets, 70% of total deposits and over 50% of branch offices, loans and advances in the banking system (CBN 2015, Nwankwo, 1980 as cited by Uche, 2001). The policy trust of the government was to ensure that the banks operated in the overall interest of the economy and the

benefit of Nigerians. The government take over however exposed several of these banks to the inefficiency and corruption that has characterised the Nigerian public sector. However, as a result of the oil glut and decline in the economic fortune of the country, corruption and greed of the political class the country embarked on a Structural Adjustment programme on the advice of the International monetary fund to curb the inefficiencies associated with the public sector and rationalize the role of the public sector (CBN, 1995)

The implication of the SAP was the need for government to divest its ownership of the nationalised banks and the as a result the government liberalised banking licensing process leading to a boom in the number of banks in the country from the period of 1985 for instance the number of banks in the country grew from 41 to 120. This highlights the influence of foreign practices on the Nigerian banking industry as the structure upon which the banking system is built is essentially a foreign shaped one.

The Nigerian banking industry is a relatively new one with the first bank African Continental Bank ACB established in 1892 .(Okezie et al.,2011,CBN 2000,2006) The main regulator of the Industry is the Central bank of Nigeria, other regulators are the Securities and Exchange Commission and Nigerian Stock Exchange for listed banks, the Nigerian Deposit insurance Corporation , Nigerian Financial Intelligence Unit and the Economic and Financial Crimes commission(EFCC), Corporate Affairs commission) and consists of Commercial banks , micro finance Banks , Bureau de change Discount houses and Mortgage Institutions. As of date there are twenty four commercial and merchant banks, five discount houses, six development institutions and thirty five primary mortgage finance institutions (CBN 2015,2014; ICR 2011;NDIC 2014) over the years the baking industry has however been plagued by series of crises that are as old as the industry itself. From the early failures and liquidation of virtually all indigenous banks to the near liquidation of 2009. Between 1947 and 1952, of the 25 indigenous banks in operation in the country 21 either liquidated or failed. Between 1991 and 1996, several of the banks that emerged as a result of the post liberalisation era were either liquidated or closed shop. During this era, it was adduced that problems of family ownership, regulatory gaps, insider abuses and skill gaps accounted for these failure (CBN 1998; Financial

Nigeria 2006 and NDIC 2008). While several of the factors have been regulated on by successive administration and prudential guidelines they remain dominant problems of the industry (Soludo, 2006; Sanusi, 2009; CBN 2011,2015).

#### **4.2.3. Post bank consolidation era.**

The Nigerian banking industry in terms of regulation the most regulated industry in Nigeria (ROSC, 2004; Okezie, 2009). Central bank of Nigeria regulates through policies and prudential guidelines issued on a regular basis. (NDIC 2011; CBN 2014). Similar regulations for the Nigerian banking industry are the NDIC, SEC NSE and EFCC and NFIU. The effectiveness of these regulations is however curtailed by other societal and institutional weakness that has prevented implementation and enforcement of the guidelines. The Nigerian legal process is very slow, which discourages regulators from taking any legal recourse in enforcing compliance with corporate governance provisions (ROSC, 2004). This is coupled with the political patronage and lack of independence of most regulatory agencies from government influence on its daily activity. Anganye and Gwilliam (2008), posits that there is a desire to adopt and implement regulatory framework as practised in western world economies, however the enforcement mechanisms of corporate governance in Nigeria are weak or non-existent.

In spite of these challenges however, the Banking industry has recorded growth in terms of aggregate market capitalisation for listed securities. The All Share Index dropped by 26.6% at the end of December 2014. As a result of the bearish conditions in the capital market, market capitalisation declined from NGN 13.23 trillion (USD 82.8 billion) at the end of December 2013 to NGN 11.5 trillion (USD 68.3 billion) at end December 2014. The decline in equities market performance was largely due to increased capital outflows, as some foreign investors sold off their assets amidst concerns over currency depreciation in the face of steady declines in external reserves and global oil prices and it represents the largest industry capitalisation on the Nigerian stock exchange accounting for 78% of the capitalisation on the stock exchange and been the main tool for economic development (Soludo, 2008; SEC, 2014).

Despite these achievements however, the problem of corporate governance and accountability has

remained a recurring problem for the industry as attempts at reform have not yielded the desired result thus requiring a need for examining the model the country has adopted to regulate corporate governance for possible areas of improvement and redesign.

## **5. Results**

### **5.1. Introduction**

This section examines the cases selected for examination in the Nigerian banking industry Intercontinental bank PLC and Oceanic Bank Plc. it will highlight corporate governance issues that contributed to the collapse of these banks. Implications of other issues considered in the literature review will be discussed. The first part gives a brief overview of the cases study Intercontinental Bank PLC and Oceanic Bank plc selected based on their size and amount of exposure to bad loans and the fact that they were previously family owned banks which enables a comparison to be drawn on the effectiveness of codes of governance introduced in 2006.

### **5.2. The Case of Intercontinental Bank PLC**

Intercontinental Bank PLC was established in February 1989 as part of the banking liberalisation policy of the post Structural Adjustment era. Initially, the bank was incorporated as Nigerian Intercontinental Merchant Bank Ltd. the bank was established with a capital of 12million as a private limited company it was listed on the stock exchange in January 2003. During the Nigerian banking consolidation exercise of 2006 Intercontinental bank integrated subsidiaries previously controlled as distinct entities Global Bank, Equity Bank and Gateway Bank. The bank indeed had a seamless integration and was awarded the CBN prize for successfully completing its integration in record time. The reason was that Intercontinental bank already held controlling interests in these and the managing director Erastus Akingbola was a director in each of these subsidiary banks.

The bank, consequently, expanded rapidly between 2005 and 2008. For instance, from an asset base of about N200 billion, profit before tax of below N10billion, and deposit base of slightly over N100 billion, in 2005, Intercontinental Bank Plc's declared results for the 2006/07 financial year showed a profit

before tax of N21.5billion (the highest amount declared in the Nigerian banking industry, total assets of N663.5 billion and total deposits of N455.7billion, clearly placing it among the top five in the industry (Intercontinental bank Plc 2008). As of December 2008, the last financial report prior to the Central bank Intervention, the bank had a Profit before tax of 22.114billion and a 95% growth in profit. In fact, as at August 14 2009, the bank had customer deposits of N1.1trillion, the highest of the five banks affected by the CBN's action. It, also, had the highest total assets of N1.7trillion and with 354 branches-the second highest branch net work among the five institutions with foreign offices in the UK following its meeting the requirements for Financial Services Authority banking license for foreign bank subsidiary to operate in the United Kingdom.(Business Hallmark September 21,2009;Meristem Securities 2009, NSE fact Book 2008)

The Managing Director served as the president of Chartered Institute of Bankers Nigeria and was also Vice president of Nigerian Stock Exchange with a clear succession plan to emerge as the next president of the Nigerian Stock exchange (NSE annual report 2007). In recognition of the bank's growth, it was nominated in partnership with BNP Paribas to manage Nigeria's foreign reserves. Notable among investors in the bank was AIG global Emerging Markets Fund II (Sponsored by the AIG fund a subsidiary of the AIG insurance firm)

In spite of its rapid growth, there were significant doubts raised about the financial statements and its profits declared. In reviewing, Intercontinental Bank's target to be the "number one financial institution in Nigeria, among the top five in Africa and the top 500 in the world-measured in terms of total assets, ROE and/or profit before tax-within three years", JP Morgan states "... we view the three-year time frame as unrealistic and we are concerned that management may be drawn into focusing on balance sheet growth at the expense of profitability"

Several media awards noted Intercontinental Bank's record in corporate governance as one of the best in the industry although this view has been found to be doubtful with subsequent allegations of share manipulation, money laundering and financial statement frauds that was perpetuated during the period 2004 to 2009

Hallmark (September 2009:3) suggests that the MD of intercontinental bank had an overbearing influence on the board it notes from a bank analyst,

“Dr. Akingbola was probably the only bank Chief executive that was a member of his bank's audit committee”. His word was law and nobody dared question him; the bank probably had one of the highest staff turnover rates in the sector” Hallmark 2009. The audit committee and board was reflected in an inability for any form of internal audit report questioning the transfers or schemes of share buy back”

To achieve this, the bank engaged a network of related companies and subsidiaries with substantial holdings in the Akingbola family name. To Lord Justice Burton,

“.....the tropics payment claims relates to a total of =N=18,684,500.00 is paid in respect of moneys paid by the claimant(Intercontinental bank PLC) to or to the benefit of various companies in the tropics group of which the defendant (E.Akingbola)was a director; which he and or his wife or family directly or indirectly owed”

These payments while expressly prohibited by various sections of CAMA 1990. Section 160 provides

“a company may not purchase or otherwise acquire shares issued by it “

Section 159 similarly states that

“a company is prohibited from providing financial assistance to companies or individuals directly or indirectly for acquisition of company own shares”

However contrary to these provisions the bank granted loans to staff members and members of the public to acquire it share and deliberately used a share by back scheme to manipulate it share price over a period of four years from available records. Hence the mechanism of control designed to protect shareholders and guarantee independence of the auditors was high jacked by a dominant MD CEO. This is to prevent questioning of actions by the board on one hand and to prevent the functioning of internal control and audit mechanism aimed at protecting shareholders.

In summary the main issues from the case of intercontinental bank are the issues of non independence of directors cross directorship, money laundering, use of a network of related party company, non-disclosure of interests in related parties and use of professionals to divert depositors funds.

### 5.3. Oceanic bank PLC

Oceanic bank was incorporated in 1990 as a family owned bank with interests in the oil corporate banking and retail banking segments in the Nigeria. It commenced operations with an initial capital of 20million on April 10 1990 and was incorporated on the Nigerian stock exchange May 24, 2004(SEC 2008).

The CEO of Oceanic bank Plc Mrs Ibru started as a head of administration and rose through the ranks to become the MD/ CEO in 1997(Otusanya,2010). As at the time of its intervention, Mrs Ibru controlled over 35% of the bank through Special Purpose Vehicles(SPV)which were funded with customer deposits to acquire assets and also manipulate its shares Sanusi, (2009).

The main breach of corporate governance practise at Oceanic banks were cases of insider related loans and related party transactions in the acquisition of assets to shell companies and family members under Mrs Ibru extends beyond insider related loans and unauthorised credits. As MD, contrary to the code of Governance the MD CEO through directly or indirectly controlled subsidiaries awarded supply and procurement contracts at the bank to these connected firms at non arm length terms. She is alleged to owe the numerous companies that sold or rented real estate properties to the bank and provided manpower at above market rate while paying basic wage to clerks, cleaners and drivers.

In some of these instances, Mrs Ibru was said to have sold or leased property to the bank through her own firms or those in which she had substantial interests, at inflated rates. A particularly shocking accusation by enraged staffers claims that she paid herself agency commissions on Ibru family properties designated for her official use as MD CEO.(Economy, 2009) Since she was CEO and a member of the powerful family with a major shareholding, an ex-staff alludes “she exercised unrestrained approval rights with minimal delegation of function”. Among the charges to which Mrs Ibru pled guilty was the

allegation that her personal residence in Nigeria's commercial centre was leased to the bank for a cumulative term of eight and half years until 2017 at the sum of N225 million paid in full and she received agency commission for the transaction.

Unchallenged, the MD in abuse of the banks and CBN prudential guidance on credit facilities, repeatedly exceeded credit approval limits approving loans above her N1 billion statutory limit in breach of the Banks and Other Financial Institutions Act (BOFIA) cap B3, 2004 and section 422 of the Criminal Code Act, Cap C38, laws of the Federation. (The Economy September 2009) In most cases these loans were granted for her personal use through bogus companies, relatives, cronies and for investment in other companies. (The Economy, September 2009). As at the time of CBN intervention, the Bank had a non-performing loan portfolio of =N=620billion with majority being insider related to firms owned or controlled by the Ibru family. Sanusi (2009) states that over 75% of the non-performing loans in Oceanic are directly related to companies owned or controlled by the Ibru family.

#### **5.4. Issues of governance and evaluation of the weakness of the CBN 2006 code of governance**

##### **5.4.1. Ownership structure.**

The code of governance makes it mandatory that government ownership in banks shall not exceed 10% while that of individuals may exceed 5% subject to the approval of the CBN. This requirement though in place was abused by the use of shell companies and related parties to acquire dominant shareholdings in both banks. However, as with legal provisions the code falls short of what is defined as extended family. In the case of Oceanic bank two family members were on the board Mrs Ibru and Mr Oboden Ibru as a Non-executive member. There is a need to update the provisions of the code to provide for what is classified as family membership as opposed from the traditional father, Mother Children relationship definition of a family which has been used to breach this provision of the code. The code thus has made provisions for agency relationship problems associated with dispersed ownership without providing for concentrated owner manager problems that may arise

where ownership structure is dominated by few individuals.

##### **5.4.2. Remuneration**

As part of the regulations introduced to prevent excessive remuneration to members of the board, non-executive directors' remuneration is restricted to: sitting allowances, directors' fees, reimbursable travel expenses and hotel expenses as may be determined by the shareholders at annual general meetings. However as noted by Otusanya,(2011), the independent directors were paid \$10000.00 as holiday expenses in a country where the minimum wage is \$1350 per annum and majority of the population surviving on less than \$2.00 per day ( BBC 10.01.2012). Similarly, board members were similarly paid profit sharing bonus in clear disregard of the provisions of the code. These payments, contrary to the code of governance were not approved by shareholders and represent a means by which professional managers can influence and capture the non-executive directors. This results in a limit to their independence to serve as a check on managers' activities. This also indicates the role of cronyism in fixing remuneration as non-executive directors are responsible for fixing executive remuneration. As regard this feature there is no mechanism in place for monitoring or enforcing this provision. Banks are not required for instance to submit remuneration structure for approval neither is there a requirement to disclose details of allowances that are paid to directors during a financial year. A recent trend is to class some categories of senior managers as consultants whose remuneration and compensation is not required to be disclosed as employees on the financial statement thus restricting disclosures to directors fees.

##### **5.4.3. Non-disclosure of interest in related party transactions**

Tropics finance (a connected third party was used to acquire these shares) was owed by all respect by Mr Akinngbola and a director in charge of investments as a ED both at Intercontinental bank Plc and Tropics Finance Ltd. In spite of the fact that these transactions were in breach of the law the share buy back scheme was carried out without the process for approval of purchase of company own shares. The normal process requires prior approval of the board, Shareholders at

an AGM and regulatory approval from Securities and Exchange Commission. This was not done and this was not also flagged as a corporate governance and legal infraction by the audit process (internal or external).

#### **5.4.4. Fraudulent Financial reporting and False rendition of regulatory returns**

The growth of the bank can be traced to series of fraudulent financial reporting that took place from its listing in 2003 till the CBN intervention of 2009. As testified by the former director there existed a black box to which losses incurred from the deliberate prop up of the shares of the bank was warehoused by the bank. A mail from the banks Securities dealing services department (SDS) to the Group executive dated May 15, 2004 alludes to this by recommending

“before we resume direct intervention ... we need to manage our tradable volumes in the market better, as this is another area through which the price of our Bank remains depressed. This can be achieved through moral suasion and also discrete buy-back/buy-out agreements with such volume holders especially those in-House<sup>2</sup>”

by stating “before we resume” the correspondence pre-supposes the manipulation existed prior to the e-mail date (May 15, 2004.) The fraud spanned over a period of five years, unreported or detected by auditors, finance analysts and regulators. It is difficult to assume that such fraud or schemes can be concealed without the connivance of auditors or at best negligence on the part of auditors and regulators. It is worthy of note that two different set of professional audit firms examined the bank’s books on three occasions of public share offering (between 2005 and 2010) as reporting auditors and accountants. This raises the question of the effectiveness of audit models and reliability of auditors’ opinion for reaching investment decisions or as a tool of assessing management’s extent of compliance to the code of governance. These manipulations (or governance lapses) were not totally concealed as JP Morgan raised reservations in a review of Intercontinental banks financial statement where a 75% increase in share price was recorded. It expressed “Intercontinental’s rapid pace of growth has run ahead of its risk and

credit capability....” the same reservation was not noticed by auditors and regulators in their annual audits, thus raising questions on the extent of quality in discharging their oversight roles. Also, the roles of professional as accountants and lawyers in designing a complex wave of transactions calls to doubt their independence in discharging their roles in within these banks.

Similarly, the cases presented highlight selective valuation of loan portfolio by banks. These valuations were done without recourse to either the Nigerian accounting standards or CBN prudential guidelines which requires varying provisions required for various levels of bank credit. By classifying bad and or non-performing loans as if they were performing, banks were able to declare ‘super profits’ used to portray growth while further expropriating other share holders. As such super profits formed the basis on which dividends and performance bonuses are paid directors directly benefit from such wrong loan classifications. In most cases, these “paper profits” were converted to share loans without consent of shareholder. Where consent was obtained a review of shareholding rights indicate the existence of significant control by a group (proxies or cronies) of the shareholders. Hence these banks were able to circumvent governance provisions on disclosure of related party and making false renditions on financial statement positions. This calls as a whole to question the efficiency and technical competence of the board and audit committee as it indicates they were subject to manipulation and intimidation by dominant managers or group of shareholders. Although the code of governance has detailed responsibilities and functions of board members and organisational structures, in practise there is a failure to comply with them. This indicates the establishment of the governance structure is not aimed at fostering accountability but to legitimise the banks for continued existence.

#### **5.4.5. Regulatory failure**

These cases indicate a trend of reactive regulation as opposed to a proactive risk based assessment of banks. To regulate a banking industry requires constant changes and prudential guidelines as economic and social indices change or infractions become known. From the initial inception of the mandatory code of governance for Nigerian banks in 2006 to September 2009 the CBN has issued no

update(s) to the code or circular to update same. Sanusi (2009:9) asserts “of the 313 circulars issued by the CBN from January 2008 none addressed issues of corporate governance”. This indicates a regulatory body that ignored the tendency for regulatory arbitrage and malpractices prevalent in the banking industry. During the period 2006-2009 there were significant changes that called for a proactive re-assessment of prevailing corporate framework for banks. These changes included the global financial crises and its effect of loss of FDI in the country, the growth of institutional investors as a result of the 2004 Nigerian pension reforms act that licensed pension fund administrators to invest in the Nigerian capital market. However, the regulatory bodies<sup>3</sup> were in most cases working at cross purposes without joint examinations allowing for regulatory arbitrage. Sanusi (2009:10) suggests that lack of proper regulatory structure defining roles and accountability of functions made for poor and ineffective supervision and enforcement of sanctions. The approach to governance regulation indicates a market based approach as opposed to a regulatory led approach thus allowing for corporate governance failures.

CAC for instance in addition to its role of registering companies is expected to serve as a repository for corporate information and records of all incorporated companies in Nigeria. Peel (2006:34) however notes “at CAC it is difficult if not impossible to obtain information on numbers of directorship an individual holds and with which company(ies)” this was exploited in both cases as related party transactions were concealed using multiple names or combination of names without detection by regulatory bodies, auditors or shareholders.

## **6. Discussion and Conclusions**

### **6.1. Summary**

The recent global financial crises and Nigerian banking crises has shown that corporate governance of financial institutions requires more research both in emerging and developed countries. The role of the financial crises has been identified as a major cause of these crises as evidenced in liquidation and losses suffered as a result of bank liquidation or government bailout of banks. The emerging body of literature in Nigeria is yet to focus significant attention on corporate governance banks. Studies of this nature are

required to address the specific peculiarities of opaqueness and regulatory supervision identified in the literature as distinguishing banks from other forms of businesses.

This paper has reviewed the practice of corporate governance in emerging markets using Nigerian banking industry as a case study. A review of the literature indicates that while there is a large body of literature on corporate governance practices in western and emerged market economies less literature is available in emerging markets. A study of this nature in a context of other emerging countries may enable comparism across emerging markets. Future studies may consider adopting a different method of data collection such as more interviews and use of observation to understand the operation of some of the noted mechanisms in practise. Similarly, it will yield additional insight if studies are carried out over a longer time frame through the use of longitudinal studies and or archival studies to explore how these practices evolve over time.

### **6.2. Contribution of the study**

Clarke (2005) suggests the pattern of economic crises indicates that there is a cyclical trend in financial crises and regulation. As the global economy recovers from the 2007 to 2010 crises this study has highlighted the need for improved governance and regulatory monitoring of banks in emerging markets. Banks play a cardinal role in emerging markets hence there is a need for a separate model of governance to apply as opposed to that of conventional public corporation.

Similarly, this study has also contributed to the increasing body of literature in corporate governance with a focus on bank corporate governance practises and bank failure

### **6.3. Limitations of the study**

The study was limited to the mandatory code of corporate governance for Nigerian banks issued in 2006. There is a need to examine other codes of corporate governance enacted by regulators in Nigerian banking industry these include SEC code of 2003 (as amended in 2011) to assess the extent of compliance with these codes. This study has adopted a documentary analysis and use of secondary data to reach its conclusions. An empirical study to better

understand multiple perspectives to the study of governance and its influences on governance process may have yield more evidence and opinion upon which conclusions are drawn.

#### 6.4. Suggestions for further studies

This study has adopted a case study analysis with a documentary form of data another study might aim to carry out research using a structured interview to enable data from wider and multiple sources to aid the analysis. This study has reviewed practice of corporate governance in emerging markets using Nigerian banking industry as a case study. A review of the literature indicates there is a large body of literature on corporate governance practices in western and emerged market economies and less literature is available in emerging markets. A study of this nature in a context of other emerging countries may enable future researcher to compare the trend across emerging markets. Future studies may consider adopting varied methods of data collections as interview and use of observation to understand the operation of some of the noted mechanisms in the banking industry. This is however not expected to be generalisable as the influences will differ based on diverse country and institutional influences.

#### 6.5. Final remarks

This study has used a case study and documentary analysis to examine corporate governance practises in the context of emerging countries. It has used the corporate governance practices adopted in the Nigerian banking industry for the purposes of the study. The literature review indicates an emerging body of literature in the broad area of corporate governance in developing economies especially those in Asia and Africa. Focus of this study tends to be mainly at the country level or a comparative study of western models mechanisms of corporate governance.

Similarly, the Nigerian banking is faced by multiple issues of governance ranging from non-disclosure of information and The analysis indicates that corporate governance models used in developed countries though touted as by multinational agencies as World bank and IMF may not be suitable in addressing the country specific governance needs, and serves as a limitation on comparative studies of

corporate governance (Mensah 2002; Adegbite 2010; Armstrong and Guay,2016).

For successful corporate governance systems to be built there is a need to consider the political, economic, technological and cultural differences (Rabelo & Vasconcelos, 2002). Where the existing model is unable to address the peculiar problems in a sector, consideration s models of corporate governance that consider the conditions in each

Developing country and that are not directly borrowed from developed countries.

The issues identified in this paper can form a research topic for future researchers on corporate governance in countries to include other specific industries as insurance, oil and gas as opposed to a general study at the country level.

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## Notes

<sup>1</sup> As a result of the Special CBN NDIC examination of 2009 nine banks were declared to be in grave situation. Of these, there was a need to inject over 620 billion to five of these banks. The four others were given a time frame of 6 months to improve financial positions in light of several underperforming loan portfolio totalling 4.02 trillion( £16billion(approximate at an exchange rate of £1:=N=250.00) as atDecember2011) AMCON (2011).

<sup>2</sup> It is worthy to note that through a network of associated share brokers funds (in the form of margin finance loan" was made available to drive up the share prices on the Nigerian stock exchange. Reference to "in house" indicates the Stockbroking arm of the Bank"