



CORPORATE GOVERNANCE, RISK
MANAGEMENT AND CORPORATE
PERFORMANCE: AN INVESTIGATION OF
THE NIGERIAN BANKING SECTOR

BY

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ABSTRACT

This thesis presents empirical evidence regarding the relationship among corporate governance, risk management and performance for a panel of 20 Nigerian banks over the period of 2006 to 2009. The study is based on quantitative and qualitative data collected from annual reports, financial databases, questionnaire and semi-structured interview. Statistical analysis such as correlation analysis, one-sample t- test and dynamic panel data regression models using the Generalized Methods of Moment (GMM) technique are employed to analyze the data and to seek support for the hypotheses. Qualitative interview based techniques were also employed to explain the quantitative results. Nine hypotheses and ten sub hypotheses are formulated based on two theories namely, agency theory and resource dependence theory. While some of the results were in line with theoretical expectations, others were found not to support the hypotheses formulated. Contrary to expectations, the study reveals that proportion of non executive directors on the board and directors' ownership was negatively significant in explaining corporate performance of banks. In addition, the study finds that interest-rate risk was statistically insignificant in explaining the accounting performance of banks. Furthermore, the study reveals that three corporate governance variables representing board size, proportion of non executive directors on the board, and ownership concentration were not significant in explaining the impact of financial risk on these variables. The study also finds a positive relationship between government ownership and credit risk on one hand and negative association between government ownership and both interest rate risks and liquidity risks respectively, on the other. Hence the results for the relationship between government ownership and financial risks are inconclusive. Overall, the study revealed supervisory deficiencies on the enforcement of corporate governance and risk management of banks as banks have not yet fully complied with corporate governance codes and risk managements framework. The study also shows that the regulatory approach/tools to risk management practices of these banks have been fairly average, indicating that more still need to be done to enhance sound risk management practices in these banks. The results of the study have both theoretical as well as policy implications. In terms of theoretical implications, the two theories used in this study (i.e., agency theory and resource dependence theory) were each partially supported by findings of the study. Thus, this adds further to the fact that no single theory can explain the nexus of governance and performance. In terms of policy implications, the fact that some corporate governance and risk factors are unable to enhance banks performance, even after the enactment of mandatory codes of corporate governance specifically meant for the banking sector, pose some regulatory questioning. Hence, the need for regulatory agencies to be more proactive in enforcing the codes to achieve the desire goals for which the codes are enacted. As detailed in the study, this thesis contributes to theory and practices in terms of knowledge, policy and regulation.

خلاصة البحث

تقدم هذه الرسالة دليلاً تجريبياً فيما يخص العلاقة بين إدارة الشركات، وإدارة المخاطر، والأداء من هيئة مشكلة من ٢٠ مصرفاً نيجرية خلال الفترة الممتدة من عام ٢٠٠٦ إلى ٢٠٠٩. تعتمد الرسالة على البيانات الكمية والنوعية التي جمعت من التقارير السنوية، وأساس البيانات المالية، والاستبيانات، والمقابلات شبه المركبة. وقد استخدم التحليل الإحصائي مثل التحليل الارتباطي، واختبار t ، والنموذج التراجعي الديناميكي الخاصة ببيانات الهيئة لتحليل البيانات باستخدام طريقة عامة للمناهج اللحظية (GMM)، والتماس الدعم للفرضيات. ووظف أسلوب إجراء المقابلات النوعية لتعليل النتائج الكمية. صيغت 9 فرضيات و 10 فرضيات فرعية على أساس نظريتين وهما نظرية الوكالة نظرية تعبئة الموارد. بينما وافقت بعض النتائج مع التوقعات النظرية إلا أن النتائج الأخرى لم تدعم الفرضيات التي صيغت. على عكس التوقعات. اكتشفت الدراسة أن نسبة المدراء غير التنفيذيين وأسهم مدراء المصارف كان لها تأثير سلبي في تفسير أداء الشركات للمصارف. ووصلت الدراسة إلى أن مخاطر اسعار الفائدة أيضاً لم تكن متطابقة إحصائياً في تفسير أداء المحاسبة المصرفية. علاوة على ذلك اكتشفت الدراسة إلى أن ثلاثة متغيرات لإدارة الشركات المتمثلة في حجم المجلس، ونسبة المدراء غير التنفيذيين، و تركيز ملكية، لم تكن متطابقة في تفسير تأثير المخاطر المالية على هذه المتغيرات. وجدت الدراسة علاقة ايجابية بين ملكية الحكومة ومخاطر الائتمان في جانب وعلاقة سلبية بين ملكية الحكومة وكلا من مخاطر سعر الفائدة ومخاطر الاموال المتاحة في جانب اخر. لذا نتائج العلاقة بين ملكية الحكومة و المخاطر المالية كانت غير حاسمة. واكتشفت الدراسة عن أوجه قصور إشرافية في تطبيق إدارة الشركات بشكل عام، ونظام إدارة المخاطر. كما أن المصارف لم تتمثل إمتثالاً كاملاً لمبادئ إدارة الشركات، ونظام إدارة المخاطر. تظهر الدراسة إلى أن النهج التطبيقي وأدوات تطبيق إدارة المخاطر لهذه المصارف كانت متوسطة إلى حد ما، مما يشير إلى أن هذه المصارف في أمس الحاجة إلى القيام بمزيد من الممارسات السليمة لإدارة المخاطر لنتائج الدراسة تطبيقات نظرية وأثرية على حد سواء. من حيث الآثار النظرية، النظريتان اللتان استخدمتا في هذه الدراسة (نظرية الوكالة و نظرية تعبئة الموارد) كانتا مدعومتين جزئياً. لذا يضيف المزيد إلى الحقيقة أنه لا توجد نظرية واحدة يمكن أن تفسر الرابطة بين الإدارة والأداء. من حيث الآثار المترتبة على سياسة إدارة الشركات وعوامل المخاطر تشير إلى عدم تعزيز أداء المصارف حتى بعد سن القوانين الإلزامية لإدارة الشركات للقطاع المصرفي. فهنا يطرح سؤالاً إشرافياً. لذا فإن الحاجة إلى وكالات تنظيمية لتكون فعالة في تطبيق القوانين لإنجاز الأهداف المرجوة التي من أجلها سنة القوانين. فإنها كما تمت تفصيل في هذه الدراسة، تساهم في نظرية و ممارسات في مجال العلم والسياسة والإشراف.

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PERFORMANCE: AN INVESTIGATION OF THE NIGERIAN BANKING
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LIST OF ABBREVIATIONS

AMA	Advanced Measurement Approach
ADB	African Development Bank
AMSCO	African Management Services Company
AMCON	Assets Management Committee of Nigeria
BIS	Bank for International Settlement
BOFIA	Banks and Other Financial Institution Act 1991
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
CBN	Central bank of Nigeria
CCG	Code of Corporate Governance
COSO	Committee of Sponsoring Organizations of the Thread way Commission
CAMA	Companies and Allied Matters Act
DU	Discourse Unit
ERM	Enterprise Risk Management
EAD	Exposure at default
FDIC	Federal Deposit Insurance Corporation
FITC	Financial Institution Training Centre
FSS	Financial System Strategy 2020
GMM	Generalized Methods of Moment
ICAEW	Institute of Chartered Accountants of England and Wales
ICAN	Institute of Chartered Accountants of Nigeria
IOD	Institute of Directors
IFC	International Finance Corporation
IMF	International Monetary Fund
LGD	Loss given default
NASB	Nigeria Accounting Standards Board
N	Nigeria Currency
NDIC	Nigeria Deposit Insurance Corporation
NSEC	Nigeria Securities and Exchange Commission
OECD	Organization for Economic Co-operation and Development
PD	Probability of default
IRB	Rating based approach
SECA	Security and Exchange Commission Act
SCGN	Society for Corporate Governance Nigeria
SA	Standard Approach
SAS	Statement of Accounting Standards
UNDP	United Nations Development Programme
VAR	<i>Value-at-Risk</i>

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

Corporate governance and risk management practices are today significantly influencing public policy debates on corporate organizational performance. As a result, corporate governance and risk management framework have entered the scene of academics, regulatory and investor discussion in today's market economies. These trends are now spreading to the financial sector of the economy, considering the importance of this sector as an important "engine of economic growth" (Andres and Vallelado, 2008). This study aims to gain insight into corporate governance and risk management practices, and to assess their impacts on corporate performance of Nigerian banks.

1.1 BACKGROUND OF THE STUDY

The last few decades have witnessed several economic downturns and a large number of corporate scandals across the world. Worldwide, there are notable cases of corporate upheaval include well-known companies like WorldCom Inc, Enron, and Adelphia (Mardjono, 2006; Quadri, 2010) and various financial crises across the world, including the Asian financial crisis of the late 1990s (Che Haat et al., 2008; 2009; Quadri, 2010) which have been mainly attributed to inefficient and poor governance practices (Goldin and Vogel, 2010). These corporate adversatives endangered and exposed misfortunes to millions of employees, customers, shareholders, vendors and other stakeholders (Boyd, 2003; Rezaee et al., 2003; Doost

and Fishman, 2004). The aftermaths of these crises are numerous governance initiatives proposed to improve corporate performance with significant emphasis placed on the role of corporate governance and risk management, as effective corporate governance and risk management practices helps organization achieve its corporate objectives (Nava et al., 2009).

This has been proven by various studies and pronouncements carry out by regulators, governments and independent institutions. In the United States for instance, the Sarbanes-Oxley Act 2002, came into force in order to strengthen corporate governance and to restore investors' confidence (Sanda, Mikailu, and Garba, 2008). Several international organizations and institutions such as Organization for Economic Co-operation and Development (OECD), the bank for International Settlement (BIS), the Institute of Chartered Accountants of England and Wales (ICAEW), the World Bank, International Monetary Fund (IMF), and different reports like Cadbury Report (1992), Greenbury Report (1995), OECD Principles of CG (1999) and Basel Committee on Banking Supervision (BCBS Hampel Report (1998), Combined Code, 1998), Turnbull (1999), Myners (2001), Higgs (2003), Smith (2003), and Combined Code (2003)) have also been developing policies to strengthen the management of the corporate world (Samantaray and Swagatika, 2008). These efforts are based on the belief that good corporate governance and sound risk management practices increase monitoring efficiency, rebuild competitiveness, restore confidence, and hence promote corporate performance of organizations.

Until recently, the subject of corporate governance had gained little attention in the developing world. However, the rising rate of globalization across the world coupled with the recent financial scandals in the West, are now driving the increasing attention in corporate governance practices in numerous developing countries such as

Ghana, Malaysia, UAE and Nigeria (Adelegan, 2001; Ahunwan, 2002; Reed, 2002; Gugler et al., 2003; Abdullah, 2004; Che Haat et al., 2008; Mohd Ghazali, 2010; Ayodele, 2011; Mohammed, 2012; Taktak and triki, 2012, Uwuigbe and Fakile, 2012).

In Nigeria specifically, as in most countries of the world, the observance of corporate governance principles has been secured through a combination of voluntary and mandatory mechanism. In 2003, the Atedo Peterside committee set up by the Securities and Exchange Commission (SEC), developed a corporate governance code for public companies in Nigeria. The code, even though voluntary, is designed to establish good business practices among listed companies, including banks. On the other hand, mandatory corporate governance provision relating to banks are contained in the Security and Exchange Commission Act (SECA) 1988, the prudential guidelines, the Nigeria Deposit Insurance Corporation (NDIC) act of 1988 the Companies and Allied Matters Act (CAMA) 1990, the banks and Other Financial Institution Act (BOFIA) 1991, the investment Act 1999, and the Code of Corporate governance for banks in Nigeria's post consolidation 2006. These principles cover such areas as the composition/tasks and roles of the board of directors, the duties, rights and privileges of shareholders, audit committees' disclosure requirement and risk management. However, various financial scandals in the Nigerian banking sector in recent times which resulted in a \$4 billion bailout of nine weakly capitalized banks and the dismissal of chief executives of five (5) top banks; with sixteen (16) senior bank officials (Sanusi, 2009). This occurrence doubted the usefulness of existing corporate governance practices in promoting sound accountability in the banking sector.

The concept of risk management, like corporate governance, has broadly influenced many aspects of corporate activities (Taylor-Gooby and Zinn, 2006), as there is a growing consciousness among organizations, particularly banks that sound risk management practices enhance corporate performance (Greuning and Bratanovic, 2003). Mashid and Naji (2003) asserted that the financial environment is associated with more risk than it was in the past, as financial markets have experienced increased growing uncertainties about inflation rates, exchange rates, interest rates and commodities prices. According to (Sanusi, 2009), risk now required increased attention and consideration due to the volatile nature of interest and exchange rate movements.

The considerable attention of risk management practices in the banking industry is not an exemption. Bank like other businesses is to maximize profit in order to add value to its equity by maximizing the risk- adjusted return to shareholders. However, what distinguishes a bank from other businesses is their exposure to a number of risks that are uncommon to other institutions (Williamson, 2008). Bessis (2002) quantifies banks as “risk machine” in the sense that “they take risks, transform them and embedded them in banking products and services.” These risks which include fundamental risks, interest-rate risk, market risk, credit risk, off balance sheet risk, technology risk and operational risk, foreign exchange risk, country or sovereign risk, liquidity risk and insolvency risk are in many ways interconnected, and an effective management of these risks is very important for the achievement of banks’ corporate goal (Sanusi, 2009). Admittedly, Mashid & Naji (2003) asserted that recent failures in the banking sector confirm the need for sound risk management practices in this sector.

Heightened regulatory interests in risk management practices of banks have prompted various international organizations to develop guiding principle and on risk management. The Basel Committee on Banking Supervision is best known for the promotion of international principles on bank supervision and foremost practices as it provides a standardized approach for dealing with risk management issues (Basel Committee on Banking Supervision, 2008). Similarly, The Committee of Sponsoring Organizations of the Thread way Commission (COSO) is also in the vanguard of providing a critical aspect of organizational governance and risk management framework. In Nigeria as in other countries of the world, the Central Bank of Nigeria as a supervisory regulative body issues guidelines and framework on risk management practices for banks, considering the uniqueness of this institution and the vital role, it plays in the financial sector. Also playing the regulatory role in the banking sector is the Nigerian Deposit Insurance Corporation (NDIC), which is charged with the role of providing financial guarantees to depositors in the event of the failure of member institutions and to administer the deposit insurance system in Nigeria.

It is an undeniable fact that the banking system plays an important role in the economic development of any nation. Nevertheless, banks' ability to bring about such economic growth and development depends on sound corporate practices of these banks. It would, however, be fitting to give some background on the Nigerian banking sector.

1.1.1 Evolution of the Nigerian Banking Sector

Nigeria had witnessed many series of structural transformations in various facets of the economy since its independence in 1960. In the early 60s, agriculture was the major sector of the economy accounting for about 70 per cent of Gross Domestic

Product (GDP) and about 90 per cent of foreign exchange earnings (Chinedu, et al., 2010). However, the dominance of earnings from the oil sector in recent times has accelerated the development of other sectors such as, information technology, service sectors and the financial sector among others (FSDH Securities Limited, 2011). Nigeria was also identified as the “World fourth fastest-growing economy in the last decade with an annual average GDP growth rate of 8.9%” (FSDH Securities Limited, 2011), and the 48th largest economy in the World in terms of GDP per capita (Chinedu et al., 2010). On the African continent, Nigeria apart from being the most populous country in Africa with a total population of about 150 million inhabitants also has the “second largest financial services sector in Africa after South Africa” in terms of bank total assets and market capitalization (Zhao and Murinde, 2009). Importantly, the banking sector has played a key role in these laudable achievements as the market capitalization of these banks stood at 41.8 percent, while their total assets stood at 35.43 per cent of the GDP in 2006 (Somoye, 2008). These notable contributions of this sector commensurate various transformations the sector underwent.

Reviews of the Nigerian banking sector since its commencement in 1892 have revealed various transformational developments in the sector. The first period of such transformation was the first consolidation exercise that took place between the periods of 1959 to 1969. The consolidation took place because most banks could not meet the liquidity requirements of their customers which were highly attributed to the fact that there were no well-organized banks. The consequential effects of these problems were series of banks' failure between the periods of 1953- 1959. In 1958, the federal government backed by the World Bank reports set up the Loynes Commission. The outcome from this commission led to the setting up of the Central Bank of Nigeria (CBN) in 1959.

The period from 1959 to 1969 was very remarkable as it heralded the establishment of formal money, capital markets, portfolio management and operation of the company act of 1968 in Nigeria (Somoye, 2008). In addition, the company acts of 1968 came into operation. This period could therefore be seen as the commencement of serious banking regulation in Nigeria. In the '90s, there was also another recapitalization exercise that saw bank's capital being raised to N500million (USD\$5.88) and subsequently, N2billion (US\$0.0166billion) on 4th 2004 (Somoye, 2008). The aftermath of this recapitalization was the policy of mandatory consolidation that was vigorously pursued to overcome these problems (Somoye, 2008).

Table 1.1
Evolution of the Nigerian banking Sector (1952-2006)

Years	Minimum Capital Requirements	Minimum Capital (US\$)	Cumulative No of Banks
1952-1978	£200,000-Foreign £25,000-Nigerian £400,000-Foreign £25,000-Nigerian N 1,500,000-Foreign N 600,000-Nigerian	235,295 29,412 470,588 29,412 1,764706 705882	45
1979-1987	N 1,500,000-Foreign N 600,000-Nigerian commercial banks N2,000,000-other Banks	1,500,00 600,000 2000,000	54
1988-Feb.	N5Million-Nigeria Commercial Bank N 3Million-other Banks	250,000 150,00	66
1988-Oct.	N 10million- Nigerian Comm. Bank N 6million-Other Banks	500,000 300,000	66
1989-1990	N 20million- Nigerian Comm. Bank N 12million-Other Nigerian Banks	235,294 141,176	107
1991-1996	N 50million-Nigerain Comm. Bank N 40million-other Nigerian Bank	586,235 470,588	112
1997-2002	N 500million-Nigerian Comm. Bank N 500million-Other Nigerian Bank	5.88million 5.88million	110
2003-2004	N 2billion-Commercial Banking	0.0166billion	89
2004 July	N 25billion- Comm. Bank	0.2billion	25

Source: Somoye, 2008

A high point of the restructuring exercise in the banking sector is the introduction of a mandatory code on corporate governance for the banks. The introduction of the governance code came into the picture in the wake of grossly undercapitalized banks, and also several other weaknesses, including inadequate corporate governance practices, “poor asset quality, inaccurate reporting and non-compliance with regulatory requirements” (Sanusi, 2010). Hence, since the concept of corporate governance is usually expressed in the form of prescribed codes of conduct

and to guide the administration of corporate entities, the introduction of the mandatory code is expected to enhance best practices in the form of self-regulation, transparency and accountability in the banking sector (Achua, 2008).

However, recent poor performance in this sector has worked to the detriment of shareholders and created a class of stakeholders who have lost interest in the system (Quadri, 2010; Ayodele, 2011; Ogbulu and Emeri, 2012)). Those unacceptable and precarious developments in the Nigerian banking market require critical assessment in order to restructure and return the banks to the path of profitability and financial soundness.

1.2 STATEMENT OF THE PROBLEM

Weak corporate governance, poor risk management practices and inefficient nature of Nigerian banks got much attention in the public discourse in recent times (Quadri, 2010). This is surprising despite various guidelines and pronouncement issued to enhance sound governance in the system. This is particularly worrisome given the importance of the banking sector to the economic development of any nation. Regrettably, the sustainability of a sound financial system has remained largely unattained in Nigeria as a result of various deficiencies in the system (Sanusi, 2010). For instance, a special audit jointly conducted by the Central bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation (NDIC) in the mid of 2009 revealed a large amount of lapses in the system. Specifically, part of the report show various abuses in the culture of corporate governance and risk management practices, particularly as it relates to ineffective oversight of board and senior management roles, corporate abuses in granting of loans and advances among others (Nigerian Deposit Insurance Corporation, 2009).

In order to forestall any banking crises, the CBN urgently injected the sum \$4.1 billion of capital into the system, in addition to the dismissal of various banks' chief executive/senior officers (Sanusi, 2010). Against this backdrop and the clear absence of robust corporate governance and risk management policies in these banks, it was hardly surprising that investors retreated from the sector, particularly when the performances of these banks fall below their expectation (Sanusi, 2010).

From the forgoing, it is obvious that corporate governance and risk management practices in this sector need to be addressed to avoid having serious implications on the consolidation exercise (Nigerian Deposit Insurance Corporation, 2009). The question is 'are the activities of these banks in conformity with the established corporate governance and risk management standards and guidelines?' However, the empirical evidence of these problems seems to be missing so far. Hence the need for this study emerged from lack of studies addressing these problems in the Nigeria banking sector.

1.3 MOTIVATION OF THE STUDY

Despite the importance of corporate governance and risk management practices on organization performance, the development of these concepts in Africa and in the banking sector is still in its infancy as many studies have confirmed the paucity of literature and very limited rigorous research in this area (Okeahalam and Akinboade, 2003; Inyang, 2009; Quadri, 2010). In Nigeria, specifically scientific research on the subject matter is scanty (Okpalaobieri, 2009; Quadri, 2010; Awotundun te al. 2011 Mohammed, 2012; Uwuigbe and Fakile, 2012). This is despite various cases of financial scandals involving the falsification of the companies (Iyang. 2009), the collapse of the banking sector, such as the twenty six banks liquidated in 1997