THE UNIVERSITY OF HULL

Corporate governance deficits: The implications for Nigerian banking sector

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by

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Table of contents

Table of contents - - - - - - - - - - 2
Table of cases - - - - - - - - - - 6
Table of statutes/legislations - - - - - - - - - - 7
Table of codes/directives/principles - - - - - - - - 8
Table of abbreviations - - - - - - - - - - - 9
Lists/explanatory terms - - - - - - - - - - - 10
Acknowledgement - - - - - - - - - - - - 13
Declaration - - - - - - - - - - 14
Abstract - - - - - - - - - - - - - - 15
Chapter One - - - - - - - - - - 16
Introduction - - - - - - - - 16
1.1 Introduction - - - - - - - - - - - - 16
1.2 Justification for research - - - - - - - - - - 19
1.3 Research questions - - - - - - - - - 20
1.4 Research aims/objectives - - - - - - - - - - 21
1.5 Research methodology - - - - - - 22
1.6 Structure of research - - - - - - 23
1.7 Conclusion - - - - - - 31
Chapter Two - - - - - 32
Review of corporate governance framework in Nigerian banking - - 32
2.1 Introduction - - - - - - 32
2.2 Background to regulation of corporations in Nigeria - - 35
2.2.1 Governance features in Companies Act 1968 - - - 37
2.2.2 Governance features in CAMA 1990 - - - 38
2.3 Political and economic context - - - - - 40
2.3.1 Socio-cultural context of corporation in Nigeria - - 42
2.4 Ownership structures of corporations in Nigeria - - - - 43
2.4.1 Nigerian privatization program - - - - 47
2.5 Corporate governance environment in Nigeria - - 52
2.5.1 Lever Brothers Nigeria Plc - - - - - 58
2.5.2 Cadbury Nigeria Plc - - - - - 59
2.6 Company law and legal system in Nigeria - - - - 61
2.7 Banking sector - - - - 63
2.7.1 Bank versus firms - - - 67

2.7.2 History of banking in Nigeria - - - - - 73
2.7.3 Reforms in Nigerian banking sector - - 74
2.8 Banking regulation and regulatory institutions - - - 76
2.8.1 Corporate Affairs Commission (CAC) - - - 80
2.8.2 Securities and Exchange Commission (SEC) - - 81
2.8.3 Nigerian Stock Exchange (NSE) - - - - 82
2.8.4 Central Bank of Nigeria (CBN) - - - 82
2.9 Conclusion - - - 83
Chapter Three - - - - - - 87
Origin, meanings and theories of corporate governance 87
3.1 Introduction - - - - - - 87
3.2 Historical foundation of corporate governance - - 90
3.2.1 Defining corporate governance - - - - 96
3.2.2 Corporate failures - - - - 101
3.3 Doctrine of corporate personality - - 103
3.3.1 Division and exercise of powers of companies - - - 106
3.4 Corporate theories - - - 108
3.4.1 Assumptions of shareholder primacy - - 112
3.4.2 Agency relationship - - - - 120
3.4.3 Ownership implication of shareholding - - 125
3.5 Major criticisms of shareholding theory - - - 129
3.5.1 Certainty issue - - - 132
3.5.2 Short-termism - - - 137
3.5.3 Long-termism - - - 138
3.5.4 Ethics and Morality - - - - 140
3.6 Stakeholder theory - - - 142
3.6.1 Major criticisms of stakeholder theory - - 150
3.7 Implications for corporate governance theories in banks - - 156
3.8 Conclusion - - 166

Chapter Four - - - 172
Legal and regulatory regimes of Nigerian banking - 172
4.1 Introduction - - - 172
4.2 Companies and Allied Matters Act (CAMA) - - 173
4.3 Investment and Securities Act (ISA) - - - 174
4.4 Bank and Other Financial Institutions Act (BOFIA) - - 176
4.5 CBN Code of Corporate Governance in banks - - - 176
4.6 SEC Code of Corporate Governance in Nigeria - 177
4.6.1 Directors and board size - - - - 177
4.6.2 Board and CEO - - - - - - 179
4.6.3 Shareholders - - - - - - - 181
4.6.4 Audit committee - - - 182
4.7 Other challenges of corporate governance in banks in Nigeria - 183
4.7.1 Risk management - - - - - - - 185
4.7.2 Oceanic Bank (now Eco Bank Plc) - - - - - 187
4.7.3 Intercontinental Bank (now Access Bank Plc) - - - 188
4.8 Governance deficit in UK's banking - - - - - 190
4.8.1 RBS's failure - - - - - - - 192
4.8.2 RBS's lessons to banks in Nigeria - - - - - 195
4.9 Conclusion - - - - - - 198
Chapter Five - - - 202
Theories and strategies of regulation in banking sector - - 202
5.1 Introduction - - - 202
5.2 Aims of regulation in banks - - - 203
5.2.1 Understanding regulation - - 205
5.3 Theories of regulation - - 208
5.3.1 Public interest theories - - - 209
5.3.2 Interest group theories - - 212
5.4 Regulatory strategies in banking - 216
5.4.1 Paradoxes in regulatory governance - 217
5.4.2 Command and control (C&C) approach - 220
5.4.3 Self-regulation - - 222
5.4.4 Principles based regulation - - 227
5.4.5 Enrolment – gatekeeper and standard - - 231
5.4.6 Risk-based regulation - - - 235

5.5 Risk-based framework in Nigerian banking - - 240
5.6 Conclusion - - - 243
Chapter Six - - - 246
The future of Nigerian banking sector: Risk management and accountability - - - 246
6.1 Introduction - - - 246
6.2 Understanding risk - - - 250
6.2.1 Risk management in banking - - 252
6.2.2 A review of risk management practices - - 257
6.3 Suggested measures for good risk management - 269
6.4 Supervisory accountability in banking industry - - 274
6.4.1 Collaborative discharge of inter- agency responsibilities - 276
6.4.2 Several intra-agency responsibilities to prevent supervisory failures - 278
6.4.3 Culpability for governance and institutional failures - 282
6.4.4 Examination of policy justifications - - 284
6.5 Conclusion - - - 289
Chapter Seven - - - 294
Conclusion - - - 294
Major findings - contributions/recommendations (key arguments) - 294
Bibliography - - - 299

Table of cases

Access Bank Plc v Erastus Akingbola & Others [2012] EWHC 2148.

Advertising and Addressing Company Property Ltd (1975) 133 CLR 80.

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OECD Principles of Corporate Governance 2004

OECD Principles of Corporate Governance 2009

South Africa King Report on Corporate Governance 2009

UK Combined Code of Corporate Governance (Financial Reporting Council) 2012

Table of abbreviations

AC	-	Appeal Court
BBWA	-	British Bank of West Africa
BCBS	-	Basel Committee on Banking Supervision
BOFIA	-	Bank and Other Financial Institutions Act
CAC	-	Corporate Affairs Commission
CAMA	-	Companies and Allied Matters Act
CBN	-	Central Bank of Nigeria
C&C	-	Command and Control
CEO	-	Chief Executive Officer
CIBN	-	Chartered Institute of Banker of Nigeria
COSO	-	Committee of Sponsoring Organisation
ECB	-	European Central Bank
EFCC	-	Economic and Financial Crimes Commissions
ERM	-	Enterprise Risk Management
EU	-	European Union
FCA	-	Financial Conduct Authority
FSRCC	-	Financial Services Regulatory Co-ordinating Committees
GDP	-	Gross Domestic Product
HLR	-	Harvard Law Review
IFC	-	International Finance Corporation
ISA	-	Investment and Securities Act
LFN	-	Laws of Federation of Nigeria
LOLR	-	Lender of Last Resort
LSE	-	London Stock Exchange
NDIC	-	Nigerian Deposit Insurance Commission
NIPC	-	Nigerian Investment Promotion Commission
NSE	-	Nigerian Stock Exchange
NYSE	-	New York Stock Exchange
OECD	-	Organization of Economic Co-operation and Development
PBR	-	Principles Based Regulation
PRA	-	Prudential Regulation Authority
SCN	-	Supreme Court of Nigeria
SOEs	-	State Own Enterprises

Lists/explanatory terms

Bank - a bank is a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank links together customers that have capital deficits and customers with capital surpluses.

Bank deposit – this is money placed into a banking institution for safekeeping and these deposits are made to deposit accounts at a banking institution, such as savings accounts, checking accounts and money market accounts.

Bankruptcy - bankruptcy is a legal status of a person or other entity that cannot repay the debts it owes to creditors.

Corporation - a corporation is a separate legal entity that has been incorporated either directly through legislation or through a registration process established by law. It is used interchangeably with firm/organization in the thesis.

Creditor - a creditor is a person, bank, or other enterprise that has lent money or extended credit to another party.

Depositor – this is a person or company that places money in a bank account or building society for safekeeping or investment

Derivatives – a derivative is a contract between two or more parties and its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Derivatives are generally used as an instrument to hedge risk, but can also be used for speculative purposes.

Financial distress – this is a condition where a company cannot meet or has difficulty paying off its financial obligations to its creditors and depositors and the chance of financial distress increases when a firm has high fixed costs, illiquid assets, or revenues that are sensitive to economic downturns.

Financial regulation – this is a form of regulation or supervision, which subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the integrity of the financial system.

Financial risk – this is the possibility that investors will lose money when they invest in a company (bank) that has debt, if the company's cash flow proves inadequate to meet its financial obligations. When a company uses

debt financing, its creditors will be repaid before its shareholders if the company becomes insolvent.

Financial safety net – this is an action by the government or regulatory agencies to help companies and financial institutions with financial difficulties and these actions include capital guarantee, bail-out, deposit insurance and lender of last resort.

Governance - this means all processes of governing, whether undertaken by a government, market or network that seeks to define actions, grant power and verify performance.

Investor - an investor is a person who allocates capital with the expectation of a financial return and the types of investments include: equity, debt securities, real estate, currency, and commodity, derivatives such as put and call options.

Investment – this is an act of putting money into an asset with the expectation of capital appreciation, dividends, and/or interest earnings.

Liquidity – this is a company's ability to meet its short-term obligations and money, or cash is the most liquid asset, because it can be sold for goods and services instantly with no loss of value.

Macro-economics – macro-economics remains a field in economics that is focused on the movement and trends in the economy as a whole, while in micro-economics the focus is placed on factors that affect the decisions made by firms and individuals.

Management – This is the organization and co-ordination of the activities of a business in order to achieve defined objectives

Regulator – this is a person or body that supervises a particular industry or business activity.

Risk management: This is the management of risk as explained in chapter six in relation to the identification and assessment including mitigation of risks

Shareholder – this is a person, company or other institution that owns at least one share of a company's stock. Shareholders are part company's owners that have the potential to profit if the company does well, but that comes with the potential to lose if the company does poorly. A shareholder may also be referred to as a 'stockholder'.

Soft law - this refers to flexible and non-mandatory regulation.

Solvency - this is the ability of a company to meet its long-term financial obligations but a company that is insolvent must enter bankruptcy; a company that lacks liquidity can also be forced to enter bankruptcy even if it is solvent.

Stakeholder – this is a person, group or organization that has legitimate interest or concern in an organization and these include shareholders, creditors, depositors, bondholders, employees and the rest.

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Finally, responsibility for any error, infelicity or inadequacies that may remain in this thesis is entirely mine.

Declaration

I hereby declare that this thesis is authored by me and that the work of this research has been done by me, and that no part or whole of the thesis has been previously and in anyway accepted for a higher degree at any University.

Kenneth I Ajibo

Abstract

In 2009, the Nigerian banking sector experienced an upheaval that was unparalleled in the nation's financial history as a result of poor corporate governance practices in the sector. These deficits in corporate governance culture included: poor management, fraud and insider abuse by management and board members, loan losses and poor risk management, inadequate supervision, regulatory and enforcement lapses and other crises of confidence among the corporate stakeholders. In light of the economic and social impact of governance failures in banks which has led to the poor investment environment, depletion of investors' funds and job losses, this research is particularly justifiable as it aims to consider measures that might rekindle confidence in Nigeria's banking sector. Furthermore, entrenching good corporate governance practices in Nigeria's banking sector will benefit economies of countries on the Continent and beyond where Nigerian banks maintain some banking activities. This thesis aims to critically examine corporate governance deficits and its implications for the future of Nigeria's banking sector. In essence, it aims to analyse the legal, regulatory and institutional frameworks that regulate the corporate governance culture in line with global best practices for operators and regulators of the Nigerian banking sector. Building upon relevant corporate and regulatory theories; and incorporating current realities as they relate to the regulation of companies, this thesis suggests a regulatory model which is based on risk management as an approach to managing risks in corporate governance and as part of the corporate governance resolution process. As a library-based research, this thesis is doctrinal and its methodology remains analytical and exploratory in approach.

Chapter One

Introduction

1.1 Introduction

This chapter is an overview of the corporate governance practices in the Nigerian banking industry and it aims to summarise the basic objectives, the research questions including what the thesis sets to achieve in the context. With respect to banking, the distress in the industry has become a global problem.[1] Given the recent international financial downturn, European and Asian crises, the distress phenomenon has enveloped the banking sector in many countries of the world.[2] The crisis has threatened to reduce what was once an enviable sector of the economy to rubble as shareholders and stakeholders are caught in the issues including poor corporate governance practices.[3] In many countries, the banking and financial sector is undergoing a difficult period now and it is too important to be neglected in view of its importance and contribution to the world economy.[4] In essence, banking has always been and will continue to be the pivot around which every economy in the world revolves. Globally, banks occupy a delicate position in the economic equation of any country and as a fulcrum of socio-economic development, it contributes significantly in attaining the macro-economic objectives and an economic transformation of a country.[5]

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[1] Malla Bahasa, 'Global Corporate Governance: Debate and Challenges' (2004) 4(2) Corporate Governance 5-17.
[2] ibid.
[3] ibid.
[4] Gerald Vinten, 'The Corporate Governance Lesson from Enron' (2002) 2(4) Corporate Governance 4-9.
[5] Wilson Inam, 'Regulatory and Institutional Challenges of Corporate Governance in Nigeria Post Banking Consolidation' (2006) 2 Nigerian Economic Summit Group Economic Indicators 22-29.

In 2009, the Nigerian banking sector experienced a turbulence that was unprecedented in the financial history given the poor corporate governance culture in the industry.[6] These deficits in corporate governance practices include: poor management, fraud and insider abuse by board members, poor risk management and loan losses, inadequate regulation, poor supervision and other problems bordering on failing system and crisis of confidence among corporate stakeholders.[7] Poor corporate governance practices contributed largely to the bank failures, which posed significant public costs and serious consequences including the risk of contagion and impacts on payment systems. In addition, poor governance led markets to lose confidence in the ability of banks to properly manage its assets and liabilities including deposits, which in turn triggered a bank run (systemic risks), liquidity crisis, unemployment and negative impact on the economy.[8] The implication for banks in Nigeria in particular is that none of the 20 recapitalised banks operating now is immune from failures if they continue to operate in what is arguably a poor corporate governance environment.[9]

The frequent failure of these corporations within and outside Nigeria has rekindled the interest to re-examine the objective of corporate directors. The conceptual argument regarding corporate governance system is traceable to the separation of ownership from control as postulated by Berle and Means.[10] Their main contention was that agency issues came as a result of the diffusion

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[6] Olusola Akinpelu, *Corporate Governance Framework in Nigeria: An International Review* (Bloomington, iUniverse Inc 2011) ch 1; Alhaji Yakasai, 'Corporate Governance in a Third World Country with Particular Reference to Nigeria' (2001) 9 (3) Corporate Governance 238-253.
[7] Obodo Chimere, 'Globalization and corporate governance challenges in Nigeria: A regulatory and perspective' (2014) 4(2) African Journal of Social Sciences.
[8] Kami Rwegasira, 'Corporate Governance in Emerging Capital Markets: Wither Africa?'(2000) 8(3) Empirical Research Based and Theory Building Papers 258-268.
[9] Fabian Ajogwu, *Corporate governance in Nigeria: law and practice* (Lagos, Centre for Commercial Law and Development 2007) 20-50.
[10] See Aldolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (New York: Macmillan 1932)

of share ownership leading to the inability of the owners to observe the agent properly so as to ensure adequate returns on their investments.[11] Given the above issue, a model for reducing the agency problems became necessary.[12] Shareholder theory and the stakeholder theory emerged regarding these governance conceptual issues.[13] From the shareholder conceptual analysis, it would appear that the sole objective of the corporation is to maximise the interest of the shareholder which means that governance mechanism must prioritise shareholder value.[14] On the other hand, the stakeholder theory argues that corporation exists to cater for larger interests of the affected constituencies including the shareholders, creditors, employees and the suppliers.[15] An examination of the conceptual arguments shows that appreciable differences are observable between viewpoints on corporate governance as practised in Anglo American jurisdictions in comparison with Continental European countries including the South Asian economies.[16]

[11] The problem arises where the two parties have different interests and asymmetric information (the agent having more information), such that the principal cannot directly ensure that the agent is always acting in its (the principal's) best interests, particularly when activities that are useful to the principal are costly to the agent, and where elements of what the agent does are costly for the principal to observe. See Michael Jensen & William Meckling, 'Theory of the Firm, Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3(4) Journal of Financial Economics 305-360; John Parkinson, Andrew Gamble and Gavin Kelly, *The Political Economy of the Company* (Oxford: Hart Publishing 2001).

[12] See Magdi Iskander & Naderh Chamlou, *Corporate Governance: A Framework for Implementation* (The World Bank Group 2000) 3, where it is contended that corporate governance became important given the need to balance divergent interests because the objectives of the owners of a company can differ from those of the managers of that company and it is important to align these interests for the effective functioning of the company.

[13] Tirole contended that a good governance structure is one that selects the most able managers and makes them responsible to investors and this should be the reason why recruiting managers who are most capable of pursuing the investor's objectives is to be given a priority. See Jean Tirole, 'Corporate Governance' (2001) 69(1) *Econometrica* 1-35

[14] ibid

[15] Edward Freeman, Andrew Wicks & Bidhan Parmar, 'Stakeholder Theory and "The Corporate Objective Revisited' (2004) 15(3) Organisation Science 364-369. There is also an emerging third way that has be termed 'enlightened shareholder theory' which is a kind of hybrid of shareholder theory and stakeholder theory that emphasises that directors should run the companies in the interests of shareholders in an enlightened and inclusive way for long term interest of corporation and stakeholders. See generally Andrew Keay, 'Section 172(1) of the Companies Act 2006: an interpretation and assessment' (2007) 28 Company Lawyer 106, 108; Demetra Arsalidou, 'Shareholder primacy in cl 173 of the Company Law Bill 2006' (2007) 28 Company Lawyer 67; Andrew Keay, 'Section 172(1) of the Companies Act 2006' (2007) 28 Company Lawyer 106, 109.

[16] This division has been loosely described further by a scholar as 'market oriented' systems and 'network oriented' systems of corporate governance. See generally Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford: Oxford University Press

Given that directors are mainly appointed by shareholders to run the affairs of the corporation and may be removed by them especially in Anglo-American jurisdictions including Nigeria, it can be argued that the objective of directors is to maximise shareholders' value.[17]

This research aims to critically examine the legal and regulatory framework as well as the institutional bodies that regulate corporate governance in Nigerian banking industry. The purpose is to determine the nature and causes of persistent bank failures so as to proffer practicable solutions in line with global best practices for operators and regulators within and outside Nigeria.

1.2 Justification for research

Good corporate governance practice is particularly important in Nigeria given that the country cannot afford to have an under-performing banking industry which is seen to be the heartbeat of the social economic development of the nation.[18] Banks have been the main sources of financing in the Nigerian financial market and bank loans are the predominant sources of debt financing of the economy.[19] Since the industry has undergone many recent changes as a result of consolidation to improve the liquidity level, the good governance of Nigerian banks is much more important now than ever before given its pivotal role in the nation's economy. In light of the economic and social

2006) 204. For full discussions on theoretical and conceptual issues on corporate governance see chapter three of this thesis.

[17] Agents at common law owed the principal duties such as to act in the best interest of the principal, to avoid conflict of interest and to apply care and skill. See generally UK Companies Act 2006, ss 171-177. See Art 4 of the Model Articles Regulations under UK Companies Act. For similar provisions under the Nigerian Company law, see CAMA 1990 ss 63 and 279. See Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' (2007) 29 Sydney Law Review 577.

[18] Sunday Kajola, 'Corporate governance and firm performance: The case of Nigerian listed firms' (2008) 14 European Journal of Economics, Finance and Administrative Sciences 17.

[19] Chibuike Uche, 'Banking regulation in an era of structural adjustment: The case of Nigeria' (2000b) 8(2) Journal of Financial Regulation and Compliance 157-59.

impact of governance failures in banks which has led to poor investment environment, depletion of investors' funds and job losses in the country this research is particularly justified now than ever before to protect the general public.[20] Moreover, without good corporate governance in the sector, the Nigerian economy would not only be affected but its ripple effect will affect the economies of other African countries and beyond where Nigerian banks maintain some banking activities.[21] There have been previous studies on corporate governance in Nigeria generally. Arguably, none of these studies has specifically examined the gaps and failures in the governance standard in the nation's banking industry.[22] The primary aim of this research is to fill these critical gaps in the corporate governance literature in the industry so as to improve the investment horizon in the sector in particular and the nation's economy generally.

1.3 Research questions

Thus, this thesis aims to provide practicable answers to the following research questions:

(1) Whether the existing corporate governance theories and its mechanisms are adequate in the Nigerian banking sector?

[20] See Mmadu Akpofurere, 'Corporate Governance and Bank Sector Crisis in Nigeria: Rescue Intervention or a Macabre Dance with the Economy?' (2013) 3(1) African Journal of Law and Criminology 83-109; Ngozi Okoye, 'The Personality of Company Directors As A Behavioural Risk Contributor in the Corporate Governance Process: Regulatory Intervention As A Risk Management Mechanism' (PhD Thesis, University of Dundee 2012); Anne Knott & Hart Posen, 'Is Failure Good?' (2005) 26(7) Strategic Management Journal 617-641.

[21] Nat Ofo, 'Corporate Governance in Nigeria: Prospects and Problems' (2010) <http://ssrn.com/abstarct=1618600> accessed on 24 July 2014.

[22] See generally Olusola Akinpelu, *Corporate Governance Framework in Nigeria: An International Review* (Bloomington, iUniverse Inc 2011) ch 1; Ola Orojo, *Company Law and Practice in Nigeria* (3rd edn, Lagos: Mbeyi & Associates Nig Ltd 1992) Ch 2; Akintunde Emiola, *Corporation Law* (Nigeria: Ogbomoso, Emiola Publishers Ltd 2005); Olatunji Sofowora, *Modern Nigeria Company Law* (2nd edn, Lagos: Soft Associate 2002) pp.29 – 34.

(2) Whether the existing legal and regulatory frameworks, including the institutions in the Nigerian banking sector can adequately reform the corporate governance practices?

1.4 Research aims/objectives

This research aims:

(1) to determine whether existing corporate governance theories and its practices are adequate to protect the shareholders and other stakeholders in banks in Nigeria.

(2) to determine the extent corporate governance theories can be applied in the modern corporations especially in banks.

(3) to determine the impact of the regulatory framework given the potential risk in banking.

(4) to determine if the good governance and accountability in banks has a credible and positive impact on the economy in general and investment opportunities in particular.

(5) to determine how viable are the legal, regulatory and institutional frameworks in Nigerian banking sector.

(6) to determine the role regulation plays in reducing systemic risks so as to protect depositors and the public and thereby reduce corporate failures in the sector.

(7) to determine the limits of regulation in corporate governance of banks.

(8) to determine how effective is risk management framework as a regulatory mechanism in complementing corporate governance systems which is for the board and management.

1.5 Research methodology

This thesis employs the doctrinal research methodology in law and as library-based research, the techniques adopted remain descriptive, exploratory and analytical in approaches in order to give a balanced discussion in the context. Doctrinal research method has been used in order to critically review and analyse the major relationships between legal rules and principles including theoretical issues relating to corporate governance practices so as to determine the future implications for the Nigerian banking sector. While this approach might appear to be subjective because it is not based on primary research, however, the strength of doctrinal legal research lies in ability to validate the findings and conclusions through authoritative legal decisions and legislations including published journals and conferences. Similarly, in designing the appropriate methodology in this research, regard is had to corporate theories as they provide the basis for understanding how companies exist and function.

Also, regard must be had to regulatory theories as they provide the underlying foundation upon which regulatory interventions in banks rests. In that connection, chapter one of the thesis is descriptive as it only describes the aims of the research, the research questions and what the research sets out to investigate and achieve in the context, including the summary of all the chapters. An introductory description is given to provide a background to the problem which led to the research, the aims of the research and the justification for undertaking the research. The introductory chapter also contains a section which explains the research methodology adopted. Chapters two to chapter six are the core of the thesis which should be analytical and exploratory in approach as the chapters critically identify and

discuss the gaps in the corporate governance literature in line with the best practices. The last chapter (chapter seven) is the conclusion which provides the key contributions and further recommendations in the industry.

The research relies mainly on primary and secondary materials on the subject matter of the discourse and these include statutes, case laws, treaties, policy documents, books, journal articles and information on corporate governance both in local and foreign jurisdictions. Internet based academic databases such as Westlaw, Lexis Nexis, Social Science Research Network and Heinonline have also been used in the research. The websites, reports and publications of relevant institutions in the Nigerian banking sector and other foreign jurisdictions will also be utilized. This research aims to contribute to a roadmap for effective corporate governance regimes, particularly in the Nigerian banking industry in order to form a basis for further research.

1.6 Structure of research

Chapter one is an overview of the research that attempts to summarise the objectives of the thesis, the research question, the justifications for research and the summary of the chapters of the thesis. This research aims to critically examine the legal and regulatory framework including the institutional agencies that regulate corporate governance so as to determine the implication for Nigerian banking industry.

Chapter two of the thesis discusses the corporate governance framework in Nigeria in order to specifically identify the major corporate governance failures in the banking industry. The discussion offers a rich background

regarding the Nigeria's socio-political and cultural context which is relevant to the thesis. The major mechanisms for corporate governance in Nigeria consist of both legal and non-legal means – a combination of mandatory and voluntary mechanisms – for the protection of investors and other stakeholders' interests in companies.[23] This chapter points out that in formulating corporate governance principles and other regulatory strategies, countries must account for their specific circumstances. [24] These include relevant historical perspectives, corporate ownership structures and characteristics, cultural norms and values, socio-political and economic climates; and the ethical environment of business conduct.[25] Given that corporate governance practice is context specific, Nigeria must therefore re-position her regulatory systems to tackle the particular challenges she faces in the banking industry in Nigerian context. In this regard, it must be noted that corporate governance practices and regulations in developing countries will differ in ideology, necessity, concerns, complexity and robustness in specific areas than what is basically seen from the perspective of developed countries.

Chapter three reviews the relevant literature on the areas which form the foundational basis for the thesis, and from which the meanings, theoretical and conceptual arguments of corporate governance are drawn. It discusses the relevant literature on the areas of corporate theory, corporate governance, regulation, and corporate risk. The origin, existence and functionality of companies can be explained by corporate theories and an adequate

[23] Babatunde Adetunji and Olawoye Olaniran, 'The Effect of internal and external mechanism on governance and performance of corporate firms in Nigeria' (2009) 7(2) Journal of Corporate Ownership and Control 330-340.
[24] ibid.
[25] Mmadu Akpofurere, 'Corporate Governance and Bank Sector Crisis in Nigeria: Rescue Intervention or a Macabre Dance with the Economy?' (2013) 3 (1) African Journal of Law and Criminology 83-109.

understanding of the issues regarding the formation, management and operation of companies cannot be achieved without knowledge of relevant corporate theories.[26]

With respect to the conception of a firm, Coase's theory is one which is rooted in the notion that the different factors of production have property rights which they exercise contractually as constituents within the firm.[27] The firm is therefore set up to maximise the economic welfare of the constituents.[28] Alchian and Demsetz refined Coase's theory to the extent that they highlight the voluntariness of the contract between the constituents of the firm and suggest that the firm is actually a portal for team production.[29] Whereas Coase argued that the firm exists to achieve the allocation of resources by authority and direction, Alchian and Demsetz viewed the firm as a mechanism which originates and exists based on joint efforts.[30]

Like other contractarian theorists, Easterbrook and Fischel [31] model the firm not as an entity, but as an aggregate of various inputs acting together to produce goods and services. For instance, employees provide labour and creditors provide debt capital and shareholders initially provide equity capital and subsequently bear the risk of losses and monitor the performance of management.[32] Management monitors the performance of employees and co-

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[26] See Demetri Kantarelis, *Theories of the Firm* (2nd edn, Geneve: Inderscience 2007); Alice Belcher, 'The Boundaries of the Firm: the Theories of Coase, Knight and Weitzman' (1997) 17(1) Legal Studies 22-39.

[27] Ronald Coase, 'The Nature of the Firm' (1937) 16 (4) Economic 386-405; Ronald Coase, 'The Lighthouse in Economics' (1974) 17 (2) Journal of Law and Economics 357–37.

[28] Ronald Coase 'The Problem of Social Cost' (1960) 3(1) Journal of Law and Economics 1-44.

[29] Arman Alchian and Harold Demsetz, 'Production, Information Costs and Economic Organisation' (1972) 62 (5) American Economic Review 777-795.

[30] See Eirik Furobotn and Sevetor Pejovich, 'Property Rights and Economic Theory: A Survey of Recent Literature' (1972) 10(4) Journal of Economic Literature 1137-1162.

[31] Frank Easterbrook and Daniel Fischel, 'The Corporate Contract' (1989) 89 Columbia Law Review 1416, 1428.

[32] However, in banks, it can be argued that depositors might be more exposed to the risk of losses than either the creditors or shareholders given the recent global financial crisis. See generally James Crotty, 'Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture' (2009) 33 (4) Cambridge Journal of Economics 563-580; Stephanie Blackenberg and Jose Palma, 'Introduction: the global financial crisis' (2009) 33 (1) Cambridge Journal of Economics 531-538.

ordinates the activities of all the firm's inputs.[33] The firm is simply a legal fiction representing the complex set of contractual relationships between these inputs. In other words, the firm is not a thing, but rather a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm.[34] The nexus of contracts model has important implications for a range of corporate law topics, the most obvious of which is the debate over the proper role of mandatory legal rules.[35]

Regarding corporate governance theories, the shareholder model (which is based on doctrine of shareholder value and primacy) suggests that a firm must be run to primarily advance the interest of the shareholder.[36] Shareholder primacy that has been justified by nexus of contract theory (contractarian theory) contends that a company is a collection of complex private arrangements with each participant free to negotiate in their own best interests.[37] In contrast, stakeholder theorists reject the main proposition of the prevailing system in the shareholder model that corporation should be governed for the sole interest of the shareholders.[38] Rather, they argue for the following: (1) that stakeholders have a right to participate in corporate decisions that affect them,[39] (2) that managers have a fiduciary duty to serve

[33] Melvin Eisenberg, 'The Structure of Corporation Law' (1989) 89 Col. L. Rev 1461, 1486.
[34] Michael Jensen and William Meckling, 'Theory of the Firm, Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3(4) Journal of Financial Economics 305-360.
[35] Clark implicitly rejected the contractarian theory with respect to both the contractual nature of the firm and the role of corporate law. See Robert Clark, *Corporate Law* (Little, Brown 1986).
[36] Andrew Keay, 'Enlightened shareholder value' (2006) L.M.C.L.Q 335, 336.
[37] ibid.
[38] Thomas Donaldson and Lee Preston. 'The stakeholder theory of the corporation: Concepts, evidence, and implications' (1995) 20(1) Academy of management Review 65-91.
[39] Thomas Jones, 'Instrumental stakeholder theory: A synthesis of ethics and economics' (1995) 20(2) Academy of Management Review 404-437.

the interests of all stakeholders groups and (3) the objective of the firm ought to be the promotion of all interests and not those of shareholders alone.[40]

In the banking sector, the current corporate governance theories are relevant but deficient in explaining the complexity and heterogeneity of banking corporations.[41] Given that the banking corporation operates much more in regulated and administered markets as a result of potential systemic risks inherent in the industry, neither the shareholder model nor stakeholder theory recognised the centrality role of the regulation in the banking industry. Corporate theories are deficient given that they assume that banks strictly conform to the concept of corporate governance as observed in non-financial firms.

Flowing from the above, chapter four reviews the legal and regulatory regimes in Nigerian banking. The chapter is important to the thesis given that it examines the contemporary legal and regulatory issues, problems and future of the banking industry. A common thread in corporate failures in Nigerian banking industry is the poor corporate governance culture such as poor and inexperienced management, insider abuses, bad loans and loan losses, corruption and fraud by management and board, and poor risk management. As an emerging market, it is noted that the institutions, structures and legal framework for corporate governance are still developing in the industry, however, these structures and frameworks remain inadequate with respect to

[40] Charles Hill and Thomas Jones, 'Stakeholder-agency theory' (1992) 29 (2) Journal of Management Studies131-154.
[41] For more see Lewis Spellman, *The depository firm and industry: Theory, history and regulation* (New York, Academic Press 1982) 9.

the global best practices.[42] Effective and efficient corporate governance in Nigeria cannot be realistic if the underlying legal, institutional and regulatory framework remains weak, inefficient and inadequate.[43] The responsibility of monitoring the compliance with corporate governance rules requires institutional dedication and human resources which is less than satisfactory in the industry.[44]

Thus, an effective legal, regulatory and institutional framework is of utmost importance to the success of the Nigerian banking sector which should be complemented by sound judicial systems which enforce property rights coupled with speedy resolution of commercial disputes in a fair manner. This has the potential to impact positively on corporate governance practice in order to boost the confidence of prospective investors and other stakeholders.[45] Moreover, a competent board must be encouraged by appointing persons with requisite knowledge and skills for the job and adequate and regular training should be made mandatory for directors and other officers of the company to make them more conversant and effective in their oversight functions in line with global best practices.[46] Furthermore, shareholder activism and participation must be encouraged as provided in CAMA.[47]

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[42] ibid.
[43] ibid.
[44] Boniface Ahuwan, 'Corporate governance in Nigeria' (2002) 37(3) Journal of Business Ethics 275.
[45] ibid.
[46] ibid.
[47] See Companies and Allied Matters Act, Cap C59, Laws of the Federation of Nigeria 1990. Hereinafter [CAMA 1990], ss 80, 219 (i) (a). See generally Olufemi Amao and Kenneth Amaeshi, 'Galvanising shareholder activism: A prerequisite for effective corporate governance and accountability in Nigeria' (2008) (82(1) Journal of Business Ethics 119-130; Emmanuel Adegbite, Kenneth Amaeshi, and Olufemi Amao. 'The politics of shareholder activism in Nigeria' (2012) 105(3) Journal of Business Ethics 389-402.

Leading on from this, chapter five examines how regulatory theory may complement and reform corporate governance theories and its structures in banking. Regulatory theories and its strategies are pivotal in the research given the deficits in corporate theories and the inherent systemic risk as well as social cost in event of bank collapse. Regulation is necessary in addressing one of the research questions because the application of its strategies and designs could reduce the systemic risk and other externalities inherent in the industry which does not occur in non-financial firms.[48] The banking industry is special in terms of regulation and unlike other non-financial firms, experience has shown that failure in the banking sector has external consequences beyond the shareholders.[49] Furthermore, this thesis stresses that the Nigerian banking industry needs a risk-based framework which is premised on risk management given that the industry has never had any model apart from relying on information from agency ratings as a regulatory strategy which has often failed to reduce the spate of bank failures.[50] A risk-based framework is not an entirely fool proof solution to all potential banking crises. However, risk management is necessary because it helps the board and manager to properly identify the risks and apply the best possible combination of regulatory strategies that have connections with sectorial risks. Similarly, regulators can apply the risk-based model in their oversight duties which can save costs from the limited resources in the sector.

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[48] ibid.

[49] ibid 13.

[50] This risk-based framework which is premised on risk management will involve assessing the safety and soundness of regulated financial institutions, providing feedback to the institutions, and using supervisory powers to intervene in a timely manner to achieve supervisory objectives. see CBN, *Supervisory Intervention Guidelines-General Supervisory Approach Part 1* (2011) <http://www.cenbank.org/.cbn%20supervisory%20intervention> accessed on 29th July 2014; see Babajide, Komolafe, 'Risk-Based Supervision: CBN to Conduct Pilot Examination of Banks' (2009) <http://www.vangaurdngr.com/2009/07/risk-based-supervision.pdf > accessed on 29th July 2014.

In consonance with the above, chapter six discusses risk management in Nigerian banking and it determines how an effective risk management approach and supervisory accountability might enhance the corporate governance structures in the industry. Risk management is essential to the thesis because the implication for practice suggests that it is an integral part of the decision-making process by the board of directors along with the management and has the potential to improve the governance of the banks and minimize the possibilities of banking failures. Risk management is still at the rudimentary stage in most banks in Nigeria and many banks do not have risk governance structure. Given that inappropriate and unethical practices (such as bad loans, loan losses and poor risk management) associated with the behaviour of the directors and management were highlighted as points of concern in the recent corporate governance failures, it is imperative that banks in Nigeria have risk-based framework as regulatory model regarding corporate governance issues.[51] This is apposite since behavioural risk issues of corporate officers contributed to corporate collapse.[52]

From the above perspectives, chapter seven is the concluding part of the research which highlights and emphasizes the major contributions and suggested recommendations.

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[51] ibid.

[52] Behavioural risk management, which extends to the broader field of risk management is the process of managing workplace risk factors pertinent to organizational behaviour including industrial and organizational psychology. In banking, behavioural risk management applies to risks connected with the workplace behaviour of employees and organizations (especially where managers exercise poor judgment in business decisions which result in bad loans and loan losses) that have a negative impact on the productivity of an organization. This should be distinguished from 'corporate fraud' where managers deliberately divert the corporate resources of the company for personal gains. See Hansen Susan, 'From 'common observation to behavioural risk management: workplace surveillance and employee assistance 1914-2003' (2004) 19 (2) Journal of International Sociology 151-171.

1.7 Conclusion

Chapter one has provided an overview and the objectives this thesis sets to achieve with respect to corporate governance practices in the Nigerian banking sector. Given that corporate governance is context specific, it is argued that corporate governance practices and regulations in developing countries will differ in ideology, necessity, concerns, complexity and robustness in the specific areas than what is basically seen from the perspective of developed countries. Furthermore, any theory of corporate governance in banking which ignores regulation will ultimately misunderstand the agency problem specific to banks. In other words, if one accepts that regulation affects the banking sector in an important way, one must also accept the fact that this has important implications for the principal/agent relationships in the banks.[53]

[53] ibid.

Chapter Two

Review of corporate governance framework in Nigerian banking sector

2.1 Introduction

The previous chapter summarised the major thrust of the thesis and the objectives it sets out to achieve in the context. Flowing from the above, this chapter aims to discuss the corporate governance framework in Nigeria in order to specifically identify the major gaps in the literature regarding banking industry. The discussion offers a rich background with respect to the country's socio-political and cultural context which is relevant in the thesis. The major mechanisms for corporate governance in Nigeria consist of both legal and non-legal means – a combination of mandatory and voluntary mechanisms – for the protection of investors and other stakeholders' interests in companies.[1]

The main corporate statute remains the Companies and Allied Matters Act (CAMA) which governs all companies registered in Nigeria.[2] In addition to the CAMA, there is a voluntary Code of Best Practice for Public Companies. This is designed to entrench good business practices and standard for boards and directors, CEOs, auditors (among others) of listed companies including

[1] The mandatory provisions include the Companies and Allied Matters Act 2004; Central Bank of Nigeria Act 2007; Bank and Other Financial Institutions Act (BOFIA) 2004; Investment and Securities Act (ISA) 2007, Securities and Exchange Commission Act (and its accompanying Rules and Regulation) 1979; Nigerian Deposit Insurance Corporation (NDIC) Act 2006. The institutional bodies in banking industry include - the Central Bank of Nigeria (CBN as the apex regulator), Securities and Exchange Commission (SEC), Corporate Affairs Commissions (CAC), Nigerian Deposit Insurance Commission (NDIC) and Nigerian Stock Exchange (NSE). These institutional bodies issue various Circulars and Guidelines as part of regulatory measures in the industry to enhance the governance standard. Similarly the voluntary Codes include – Code of Corporate Governance for Public Companies 2003; Code of Corporate Governance for Banks and Other Financial Institutions 2006; Code of Corporate Governance for Public Companies 2011 (SEC Code 2011). For more see Olusola Akinpelu, *Corporate Governance Framework in Nigeria: An International Review* (Bloomington, iUniverse Inc 2011) ch 4; Alhaji Yakasai, 'Corporate Governance in a Third World Country with Particular Reference to Nigeria' (2001) 9 Corporate Governance 238-253.

[2] See Companies and Allied Matters Act, Cap. C59, Laws of the Federation of Nigeria, 1990. Hereinafter [CAMA 1990].

banks.[3] Corporate governance in Nigeria is not just a matter for company law, but also for capital market law, such as securities regulation.[4] Control of the board of directors by the securities market with respect to disclosure is a major feature of capital market operations.[5] The overriding objective of the securities law is the protection of the general investing public given the potential ills and exploitations on unregulated stock market.[6] In the Nigerian banking sector, there are mandatory statutory provisions (apart from CAMA) and institutional bodies that promote good corporate governance practices.[7]

All the regulatory and institutional measures are in appreciation of the critical position corporate governance occupies in the sector and from the perspective of the banking industry, good corporate governance demands that banks will operate in a healthy manner with a high ethical standard.[8] It entails that the bank complies with applicable laws and regulations and will protect the interests of the shareholders and stakeholders.[9] However, few banks in Nigeria are noted for strict observance of corporate governance best practices

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[3] See SEC, 'Code of Corporate Governance for Public Companies' (2003) <http://www.sec.gov.ng> accessed 20th July 2014; Inam Wilson, 'Regulatory and Institutional Challenges of Corporate Governance in Nigerian Post Banking Consolidation' (2006) 12 (2) Nigerian Economic Summit Group, Economic Indicators 1-2.

[4] This is without prejudice to other sectors like insurance, manufacturing. It is mandatory for business carried out in these sectors to be incorporated under CAMA.

[5] See Investment and Securities Act 2007 [hereinafter ISA 2007].

[6] It is worthy to note that, until 1999, the provisions regulating the capital market, especially on the issue of securities were lumped together with provisions on corporate practices in a single statute which is the Companies and Allied Matters Act, (CAMA). However, with the promulgation of a separate statute titled the Investment and Securities Decree (now Act) 1999 (as amended in 2007, provisions on the capital market were separated from those on company practices. For more see ISA 2007 (n 5)

[7] The mandatory provisions include – the Companies and Allied Matters Act 2004; Central Bank of Nigeria Act 2007; Bank and Other Financial Institutions Act (BOFIA) 2004; Investment and Securities Act (ISA) 2007, Securities and Exchange Commission Act (and its accompanying Rules and Regulation) 1979; Nigerian Deposit Insurance Corporation (NDIC) Act 2006. The institutional bodies in banking industry include - the Central Bank of Nigeria (CBN as the apex regulator), Securities and Exchange Commission (SEC), Corporate Affairs Commissions (CAC), Nigerian Deposit Insurance Commission (NDIC) and Nigerian Stock Exchange (NSE). These institutional bodies issue various Circulars and Guidelines as part of regulatory measures in the industry to enhance the governance standard.

[8] ibid.

[9] ibid; this is however, as it would soon appear only in form not in substance judging from level of mismanagement, fraud and insider-abuse discovered in the banks in 2009.

and high ethical standard which leads to massive collapse in the industry.[10] The major cause of the failure has been identified as mismanagement, fraud and insider-abuse, poor risk management, lapses in the regulatory and institutional bodies and poor enforcement mechanisms.[11] These notable weaknesses have some implications in the Nigerian economy given that it negatively affects the investment climate in the industry.[12] It is posited that there is need to have a sound resilient banking system with good corporate governance practices that could boost the investors' confidence and the public in the sector.

The chapter is divided into four Parts with Part I providing the background to the company law and ownership structures of corporations as well as the socio-political and cultural context of firms in Nigeria. Part II discusses the corporate governance challenges in the Nigerian context generally. Part III explores the historical background of banking in the country and recent reforms in the industry. Also, it will review specifically the recent corporate governance problems and challenges in the sector in order to identify the gaps in the literature which will form the major focus of this thesis. Part IV is the conclusion which provides the ways forward.

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[10] The Nigerian banking and financial system has three sectors. They are: banking, securities and insurance. These sectors are regulated on the basis of their functions. Thus, the CBN regulates banking; the SEC regulates dealings in securities; and the National Insurance Corporation of Nigeria (NAICOM) regulates insurance. For background on past financial crises in Nigeria and excellent source material see Tunde Ogowewo and Chibuike Uche, '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) 50 (2) Journal of African Law 161.

[11] Measured by the economic crisis, which followed the stock market crash of 2008 and the banking insolvencies announced by the CBN in 2009; the period, from March 2008 to August 2010 marks the critical phase of the crisis under review. From all indications however, the crisis has yet to abate. In addition to the ensuing economic crisis, issues such as creditor activism, claims of shareholders marginalisation, expropriation of share in the insolvent banks and the legality of CBN intervention in the banks are yet to be resolved. For more see Olumide Famuyiwa, 'The Nigerian Financial Crisis: A Reductionist Diagnosis' (2013) 2(1) Journal of Sustainable Development Law and Policy 36-64; Gabriel Onagoruwa, 'Early intervention regime under the bank resolution framework in Nigeria: Resolving the diverging interests' (2013) 1(1) Journal of Sustainable Development Law and Policy 113-141.

[12] ibid.

2.2 Background to regulation of corporations in Nigeria

The history of company law in Nigeria forms part of the country's heritage from the English legal system imposed since colonial days. Nigeria was a colony of Great Britain for almost a century from 1861 till 1960 when independence was attained. [13] Before the advent of the colonialism, trade had existed among the component ethnic tribes now making up the country but the contemporary conception of company law and practice was alien to the traditional Nigerian society. [14] There was no company statute within the constituents of what is today known as Nigeria but the situation changed when the principles of company law in force in England were imported wholesale in the country. [15] This was attained mainly through reception clauses enshrined in various Ordinances which extended the application of certain English statutes, principles of the common law and the doctrine of equity to Nigeria.[16]

The principles of English law were in the first instance made applicable to the territory of Lagos by virtue of the Supreme Court Ordinance of 1874. However, the provision applied subject to any existing or future Ordinance as far as local circumstances permitted.[17] It seemed an irony of history that, in spite of the effort made in 1863 to introduce the principle and practice of

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[13] For more details analysis on the evolution and trends in the development of company law in Nigeria, see generally Ola Orojo, *Company Law and Practice in Nigeria* (3rd edn, Lagos: Mbeyi & Associates Nig Ltd 1992) Ch 2; Akintunde Emiola, *Corporation Law* (Nigeria: Ogbomoso, Emiola Publishers Ltd 2005) p.11; Olatunji Sofowora, *Modern Nigeria Company Law* (2nd ed, Lagos: Soft Associate 2002) pp.29 – 34; Ignatius Ayua, *Nigeria Company Law* (United Kingdom, Graham Burn 1984) pp 10-12.

[14] ibid.

[15] ibid.

[16] This was attested to by the happenings immediately after the proclamation of the protectorates of Southern and Northern Nigeria in 1900 when the Supreme Court Proclamations respectively enjoined the enforcement of the common law, the doctrine of equity and statute of general application in force on the 1st day January, 1900 in England within the jurisdiction of the court. For more see the Supreme Court Proclamation of Southern Nigeria 1900, s.11 and the Supreme Court Proclamation of Northern Nigeria 1902, s.13.

[17] See Supreme Court Ordinance 1874, ss.14 and 17.

English law in Nigeria, there was actually no company law in the country until 1912.[18] Before 1876, the corporations operating in Nigeria had no local enactments governing their operations but these corporations which were in existence had status as foreign companies with rights and privileges which were available in Nigeria.[19]

This was the position until 1912 when the first statutory instrument on company law in Nigeria was introduced and the Ordinance which provided for the procedure for incorporation of companies by registration, derived its source from, and drew heavily on the English Companies (Consolidation) Act, 1908 which was the relevant English statute on company law in force in Britain at the time. It applied only to the colony of the Lagos until 1917 when it was amended and its territorial jurisdiction expanded to cover the rest of the country.[20] In 1922, another Company Ordinance that consolidated and re-enacted the Ordinance of 1912 and its amendment of 1917 was enacted. The 1922 Ordinance remained in force for 46 years with subsequent amendments in 1929, 1941 and 1954, most of which could not be described as significant or monumental.[21]

Owing to the rapid economic development in Nigeria with its attendant consequences, some of them which included the increase in the number of the incorporated companies and their activities, it became necessary to introduce

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[18] Ayua (n 13) 17.

[19] However, in 1876 with the enactment of the Supreme Court Ordinance of that year, the common law, the doctrine of equity and the statute of general application which were in force in England on the 24th day of July 1874 were received and made applicable in Nigeria. The implication of the foregoing is that the English common law, the doctrine of equity and statute of the general application relating to and touching on any aspect of the company law were received and made applicable in Nigeria and continued to form part of Nigerian company law.

[20] Ayua (n 13) 18.

[21] ibid.

a new and comprehensive company legislation to cure a number of inadequacies in the statute which had then become rather obsolete. Indeed, the Ordinance was a subject of severe criticisms in the National Development Plan of 1962-1968 given that it did not properly take into cognizance of the local circumstance.[22] Thus, the need for a new company legislation was positively recognised and committedly addressed in 1968 with the promulgation of the Companies Decree[23] by the then Nigerian Military Government which regulated the formation, incorporation, registration, management and winding up of companies. This Decree, which was redesignated during the civilian dispensation in 1980 as the Company Act, 1968,[24] was in operation for 22 years before it was repealed and replaced by the Companies and Allied Matters Decree, 1990.[25] As one might expect, while the 1968 Companies Act was largely drawn from the English Companies Act of 1948, the 1990 Act drew appreciable inspiration from the English Companies Act of 1985; and the English Companies (Amendment) Act 1987.[26]

2.2.1 Governance features in Companies Act 1968

The Companies Act of 1968 contained a number of provisions which was revolutionary in the history of the company law in Nigeria and reference was made here to Part X of the Company Act which required foreign companies

[22] Federation of Nigeria, *National Development Plan, 1962-1968* (Lagos 1962) p.18; Jacob Dada, *Principles of Nigerian Company Law* (2nd edn, Calabar: Wusen Press Ltd 2005) ch 2.
[23] No .51 of 1968.
[24] The Decree was redesignated by virtue of the Adaptation of Laws (Re-designation Virtues) Order. 1980.
[25] This later Decree has also been changed to the Companies and Allied Matters Acts (CAMA), 1990. Now cited as Companies and Allied Matters Act. Cap.C20, Laws of the Federation of Nigeria 2004. The repeal was by virtue of s.651 (1) of Companies and Allied Matters Act 1990.
[26] See See Dada (n 22); see Orojo (n 13).

intending to carry on business in Nigeria to be incorporated locally.[27] This was regarded as a fundamental provision and a major policy decision on the part of the Nigerian Government.[28] The reason was because this singular provision had a far reaching economic consequences given that foreign companies registered in Nigeria became more assessable to tax than if they had retained their identity as alien corporations.[29] Moreover, it gave the Government the right to regulate and supervise their activities, to ensure that they comply with its laws, rules and regulations.[30] With respect to corporate governance features, the 1968 Act contained mandatory provisions for accounts and encouraged greater accountability of directors and effective participation of shareholders in the affairs of the company.[31]

The accountability mechanism was further strengthened by other provisions designed to protect the interests of shareholders and the general public.[32] However, the 1968 Company Act was criticised because it was inadequate in dealing with rapid economic and commercial development of the country and this criticism became the major impetus for reform of company law leading to enactment of the CAMA 1990.

2.2.2 Governance features in CAMA 1990

The CAMA 1990 remains the principal statutory instrument on company law and practice in Nigeria and given the inadequacies of the Company Act 1968,

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[27] Ayua (n 13) 20.
[28] ibid.
[29] ibid.
[30] See Companies Act 1968, ss.117 – 150.
[31] ibid ss.172-195; the Act achieved this by ensuring that as much information as would be reasonably required were made available to the shareholders and the creditors including the general public.
[32] ibid s.201; In attaining this, the Companies Act 1968 specifically mandated corporate managers to supply specific details in the balance sheet as well as profit and loss account to improve the management of their companies.

further improvements were made in the CAMA with respect to governance features.[33] These improvements which are necessary for effective corporate governance framework include the provision of clear roles and responsibilities of the directors and management including the other officers of the companies.[34] A further improvement is remarkable in the Act owing to its recognition of the pre-eminence of the rights of shareholders and the provisions for mandatory disclosure and transparency of information as cardinal features of corporate governance practices.[35] By emphasising the equitable treatment of shareholders, CAMA has underscored the role of regulation in corporate governance landscape in the Nigerian context.[36] Similarly, CAMA has made substantial progress when compared with the previous Companies Acts in Nigeria, nevertheless, it has been criticised for being long-overdue for reforms to keep up with modern day commercial realities. [37]

On one hand, while CAMA was modelled after the UK Companies Acts, the UK government has made some appreciable efforts to improve her earlier Companies Acts to maintain the ever-increasing economic and commercial changes in this globalised world leading to the enactment of the Companies Act 2006.[38] On the other hand, the Nigerian government is still tied to her outdated CAMA which does not take into cognisance of the socio-cultural

[33] This Act is now redesigned as Companies and Allied Matters Act Cap.C20, Laws of the Federation of Nigeria 2004 [CAMA 2004]. CAMA 1990 is divided into three material parts namely: Part A - Companies; Part B - Business Names and Part C – Incorporated Trustees. For more details on the recent changes in CAMA 1990, see the Council of Legal Education, *Principles and Practice of Company Law* (Nigerian Law School Synopsis 1999).
[34] See CAMA 1990, ss 244-400.
[35] ibid.
[36] ibid.
[37] Zakaree Saheed, 'Impact of globalisation on corporate governance in developing economies: A theoretical approach' (2013) 2(1) Journal of Business and Management 1-10.
[38] See the United Kingdom Companies Act (c 46) 2006.

and political context of the present Nigeria and it is out of touch with the current realities in corporate and commercial environment.[39]

2.3 Political and economic context

Post-colonial Nigeria, like many other developing countries, adopted an interventionist development strategy that involved the restrictions of the foreign ownership and an active role for the government in major economic sectors such as infrastructure, oil and gas and the banking.[40] This development strategy, operating in a context of weak market institutions and absence of robust political democracy, did not result in responsible and effective corporate governance framework.[41] It would be noted that several factors affected the direction of the Nigerian corporate governance environment and perhaps, the most important among these was the dominant ideological conviction of the post-colonial period which stressed economic self-dependence. In essence, economic self-dependence was primarily understood in the context of the indigenous ownership and control of the means of production which was operationalised in two areas.[42] First, the government imposed total control of the public utilities, infrastructure and social service provision by establishing state-owned corporations.[43]

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[39] Also, the penalty provisions provided by the CAMA1990 are too meagre and weak to deter non-compliance by the corporate offenders with respect to corporate governance framework and it is replete with errors and omissions. See Emiola (n 13) 25.
[40] AO Olukoshi, *Crisis and Adjustment in the Nigerian Economy* (JAD, Lagos 1991) 2.
[41] Godfrey Uzonwanne, 'The political economy of development in weak states: An institutional analysis of the Nigerian State' (2013) 40(1) International Journal of Social Economics 4-25; Joe Duke and Kechi Kankpang, 'Linking Corporate Governance with Organizational Performance: New Insights and Evidence from Nigeria' (2011) 11 Global Journal of Management and Business Research 1-13.
[42] Taiwo Abudullai, *Establishing Business in Nigeria (*4th edn, Lagos, Abudullai and Taiwo and Co 2000) pp 141-143; Ifeanyi Achebe, 'The Legal Problems of the Indigenization in Nigeria: A Lesson for the Developing Countries' (1989) 12 Hasting International & Comparative Law Review 637.
[43] Achebe ibid.

The implication of this was that while there was significant interest by foreign investors especially the British corporations, in these areas, the state prohibited foreign ownership.[44] In many of these areas, the state did not permit the participation of the private and domestic ownership.[45] Some of them included electricity generation and distribution, telecommunication and postal services. Second, the state encouraged indigenous ownership in other sectors by enacting some laws as a key strategy for this.[46] These Acts prohibited the creation or transfer of any security or interest in a security in favour of any person resident outside Nigeria except with permission of the Minister of Finance.[47]

For instance, the indigenisation decree restricted foreign ownership by creating three schedules of enterprises and the first schedule was: (i) the enterprises exclusively reserved for Nigeria; (ii) the enterprises where foreigners cannot hold more than 40% of the shares, and the enterprises where foreigners cannot hold more than 60% of the shares.[48] The second schedule was made up of manufacturing companies where foreign participation was expected to bring foreign capital as well as managerial expertise and the third schedule included capital-intensive enterprises. In other words, these

[44] ibid.
[45] Toyin Falola and Matthew Heaton, *The History of Nigeria*, (Cambridge: Cambridge University Press 2008).
[46] See Foreign Exchange Control Act 1962. However, this Act has been amended in 1995 to provide for the monitoring and supervision of the transactions conducted in the market and for matters connected therewith. See Foreign Exchange (Monitoring and Miscellaneous Provision) Act Chapter F34 Decree No.17 1995. Also see the Nigerian Enterprises Promotion Decree No.4 1972. Hereinafter [Indigenisation Decree]. In order to improve the investment climate the Indigenisation Decree was repealed and the Nigerian Investment Promotion Commission (NIPC) Decree No.17 1995 repealed both the Industrial Development Co-ordination Committee (IDCC) Decree No.36 1988 and the Nigerian Enterprises Promotion Decree (NEPD) of 1972 as amended in 1977 and 1989 which hitherto reserved for Nigerians the ownership of certain businesses.
[47] See Achebe (n 42) 639.
[48] ibid.

classifications of schedules of enterprises were based on the perceived financial and managerial need of the country at that time.[49]

2.3.1 Socio-cultural context of corporations in Nigeria

Given that there was a great deal of optimism after the independence in 1960 as a former British Colony about her development potential, nevertheless, more than 54 years after the colonialism, Nigeria is largely underdeveloped.[50] The country still lacks efficient infrastructure facilities such as good transportation systems, electricity and water and the unemployment figure is very high which outstrips the available social systems for the citizens.[51] Moreover, the country is rife with corruption in virtually all sectors of the economy and divided by tribal and ethnic tensions including the worsening security situation in the country.[52] These features of Nigeria's socio-cultural development have major repercussions and affect almost all businesses in the country both in private and public sectors including banking.[53] In commenting on further frustration felt by many Nigerians, the Central Bank of Nigerian Former Governor stated that:

> There appears to be a certain built-in stubbornness in the attitude of a typical Nigerian economic agent...it manifests itself in strong propensity to circumvent laid down rules of economic behaviour and to resist control and regulation...it tends to encourage softness and lukewarmness in application and implementation of legitimate rules of the economic conduct. Hence it provides a fertile ground for bribery, corruption, idleness and the contrivance of get-rich quick attitude which are antithetical to hard work and discipline.[54]

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[49] EI Kachikwe, *Nigerian Foreign Investment Law and Policy* (Lagos, Mikzik Publication Ltd 1988) 143-180.
[50] ibid.
[51] ibid; Richard Faletti, 'Investing in Nigeria: The Law, Good Intentions, Illusion and Substance' (1983) 5 Northwestern Journal of International Law 1-13.
[52] ibid; see Federal Office of Statistics: *Annual Abstract of Statistics* (Abuja, Nigeria 1997) p.74.
[53] Boniface Ahunwan, 'Corporate Governance in Nigeria' (2002) 37(3) Journal of Business Ethics 269-286.
[54] ibid 285; Gamaliel Onosode, *Three Decades of Development Crisis in Nigeria* (Lagos: Malthouse 1993) pp.226-243.

It is posited that Nigeria's problems are not only rooted in attitude of individual Nigerians alone, rather, it is connected to her larger political and socio-cultural structures which militate against the country generally and investors in the banking sector in particular. The next section examines the ownership structure of corporations regarding corporate governance in Nigeria.

2.4 Ownership structure of corporations in Nigeria

This section discusses the ownership structure with respect to corporate governance framework in Nigeria. In the past, foreigners were faced with the restriction of share ownership as defined by the Nigerian government in Indigenisation Decree and the major way in which the ownership structure was affected was through the provision which restricted 100% foreign ownership in a number of sectors.[55] Many foreign corporations had to divest their shareholding to meet this new regulatory requirement and it was the Nigerian government that ended up buying majority of the divested shares due to the inadequacy of the domestic investment funds available at the time.[56] This further entrenched state participation with foreign partners in industrial and commercial ventures, however, most of the divested shares that were not purchased by the government were bought by few wealthy Nigerians.[57]

Presently, the Nigerian Enterprises Promotion (Repeal) Act [58] has abolished any restriction as regards the limit of foreign shareholding in Nigeria's

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[55] Indigenisation Decree has been amended by the NIPC Act 1995 to permit the foreigners to own businesses in the country. See NIPC Act 1995, ss 5 and 17.

[56] ibid.

[57] See AA Akinsanya, 'State Strategies Towards Nigerian and Foreign Businesses' in a I.W.Zartman (ed),*The Political Economy of Nigeria* (New York: Preager 1983) p. 169.

[58] No. 7 1995.

registered or domiciled enterprises.[59] The principal law regulating foreign investment in Nigeria is the Nigerian Investment Promotion Commission (NIPC) Act.[60] Given the revocation of indigenisation policy, a foreigner can now fully own a business in Nigeria but with a caveat that if it is a company, it must be fully incorporated under the CAMA and be properly registered with the Nigerian Investment Promotion Commission (NIPC) before doing business in the country.[61] The only enterprises which are still exempted from free and unrestrained foreign participation are those involved in production of arms and ammunition and restriction is also placed on the enterprises dealing in the production of narcotic drug and psychotropic substances.[62]

The deregulation of equity structure and ownership has some notable implications, including that: (1) a non-Nigerian may invest and participate in operation of any business in Nigeria. (2) an enterprise in which foreign participation is permitted shall after its local incorporation or registration with Corporate Affairs Commission (CAC) separate from parent company, be registered again with NIPC and; (3) a foreign enterprise may buy the shares of any Nigerian enterprise in any convertible currency.[63]

A foreign investor in an approved enterprise is guaranteed unconditional transferability of funds through an authorised dealer in freely convertible currency of: (i) dividend or profits (net of taxes) attributable to the investment. (ii) payments in respect of loan servicing where a foreign loan has been obtained; and (iii) the remittance of proceeds (net of all taxes) and other

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[59] See NIPC Act 1995, s.17.
[60] ibid ss 20 -25; Also see the Foreign Exchange (Monitoring and Miscellaneous Provisions Act 1995 which repealed the Foreign Exchange Control Act 1962 to increase the foreign ownership of businesses in Nigeria.
[61] No. 16 1995.
[62] CAMA 1990, ss.54-59.
[63] ibid.

obligations in the event of sale or liquidation of the enterprise or any interest attributable to the investment.[64]

The combined effect of the government's economic and investment policy is not hard to imagine. In many cases, the government became proactively engaged in productive activities owning industrial, commercial and service provision corporations either solely or in joint ventures with foreign or local investors.[65] Foreign investors continued to operate as controlling (majority) partners with the government including local investors, but, in some cases, local investors operated as minority partners with foreign investors or through small family-owned corporations.[66] In essence, the ownership structure resulting from the government policy could be broadly divided into four categories and these are category A, B, C and D which will be discussed hereunder.

The category 'A' consists of the corporations wholly-owned by the government.[67] Both the federal government and state governments operate wholly-owned corporations, including four major oil refineries in the country (owned by the Federal Government), Petrochemical plants, insurance firms, banks, hotels and a range of other enterprises.[68]

The category 'B' comprises joint venture arrangements between the Nigerian Government and other multinational corporations (especially foreign firms)

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[64] NIPC Act 1995, ss.4 -24.
[65] See Ahunwan (n 53) 17.
[66] ibid.
[67] ibid.
[68] ibid.

in oil and gas sector and a joint venture (JV) is a business agreement in which the parties agree to develop, a new entity and new assets by contributing their equity (shares).[69] Given the enormous contribution of oil and gas in the Nigerian economy it makes appreciable sense that this industry is included as a separate category and the implication of this is that oil and gas (in category 'B') is the mainstay of Nigerian economy.[70]

Similarly, the group 'C' consists of the publicly listed corporations and in this category, foreign investors operate with local investors especially in industrial and commercial sectors. In other words, most foreign investors here are subsidiaries of multinational corporations and they hold controlling shareholding structure or interest in many of the enterprises.[71]

Group 'D' involves banks, insurance firms and other small companies that are privately owned by individuals and organizations, however, some of these enterprises are very large, with capital base comparable to some large companies. This is why most banks and insurance firms under this category have been re-registered from private to public companies and both foreign and local entrepreneurs operate in these areas.[72]

[69] A joint venture takes place when two parties come together to take on one project and in a joint venture, both parties are equally invested in the project in terms of money, time, and effort to build on the original concept. While joint ventures are generally small projects, major corporations also use this method in order to diversify. See generally Lawrence Atsegbua, 'Acquisition of Oil Rights under Contractual Joint Ventures in Nigeria' (1993) 37(1) Journal of African Law 10 – 29.
[70] ibid; For instance, a major determinant of the importance of this sector is the fact that the government of Nigeria derives roughly 90% of her total revenue from oil and gas sector. See the *Report of the Nigeria Federal Office of Statistic*, 1997.
[71] See Ahunwan (n 53) 20.
[72] ibid.

Flowing from the above, it is pertinent to point out that following the recent privatization and commercialization of public enterprises, as well as the wave of mergers and acquisitions that swept the banking industry, most of the banks in Nigeria are now public companies and regulated by listing rules of the Nigerian Stock Exchange.[73] The major implication of the above development is a change in the nature of shareholding given that a prominent feature of the equity structure is the majority and substantial minority ownership.[74]

2.4.1 Nigerian privatization programme

Despite the compelling evidence in developed countries and other emerging markets that privatization is a viable and capable of injecting dynamism into previously poor economies, only a few countries in sub-Saharan Africa have made notable and appreciable inroad in privatizing their state owned enterprises (SOEs).[75] While the timing, extent, technique and motivation for privatization have varied considerably across countries, there is a low level of success in the implementation of the privatization programmes in Africa.[76] The existing research is yet to provide a useful insight into the peculiar circumstances of the Africa including the manner in which they influence the outcome of the privatization effort and the case of Nigeria is even more puzzling given the high potential of successful privatization.[77]

[73] ibid.
[74] Elewechi Okike, 'Corporate Governance in Nigeria: the status quo' (2007) 15(2) International Review 173-93.
[75] See Dare Arowolo and Christopher Ologunowa, 'Privatisation in Nigeria: A critical analysis of the virtues and vices' (2012) 3 International Journal of Development and Sustainability 785-796.
[76] ibid.
[77] See Zakari Abdullahi, Hussainatu Abdullahi and Yelwa Mohammed, 'Privatization and Firm Performance: An Empirical Study of Selected Privatized Firms in Nigeria' (2012) 3 (11) Mediterranean Journal of Social Sciences; Kjetil Bjorvatn and Tina Sbreide, 'Corruption and Privatization' (2005) 21 European Journal of Political Economy 903–914; See Jean Laffont and Mathieu Meleua 'A positive theory of privatization for sub-Saharan Africa' (1999) 8 Journal of African Economics 30-67

In spite of the diminishing size and importance of SOEs as a result of privatization, Nigeria's public sector or government-owned corporation is one of the largest in the sub-Saharan Africa in terms of both scale and scope as reflected in a number of the enterprises and contributions to Gross Domestic Product (GDP).[78] Since the colonial period, the public enterprises have taken an increasingly diverse and strategic role in the Nigerian economy. This was particularly accentuated during the oil boom in Nigeria in 1970s and 1980s when successive military regimes, buoyed by economic nationalism and massive oil windfalls developed a large public sector encompassing a broad spectrum of economic activities.[79] These developmental strides in economy covered large basic industries such as manufacturing, services, agriculture, public utilities and infrastructure, telecommunication, banking, insurance, hotels and vehicle assembly amongst others.[80]

Prior to the privatization wave in Nigeria in 1988, there were about 600 public enterprises (PEs) at the federal level and about 900 smaller (PEs) in the various states and local governments in Nigeria.[81] It is estimated that the successive Nigerian governments invested about N800 billion (approximately USD $85 billion equivalent) in PEs sector over two decades which remain one of the largest in the horn of Africa.[82] However, the magnitude, scope and persistence of failures of the Nigerian Public enterprises generally have been

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[78] Nigeria's economy surpassed South Africa's as the largest on the continent after the West African nation overhauled her gross domestic product (GDP) data for the first time in two decades. On paper, the size of the economy expanded by more than three-quarters to an estimated 80 trillion naira ($488 billion) in 2013. While the revised figure makes Nigeria the 26th-biggest economy in the world and largest in Africa, the country lags in income per capita, ranking 121 with $2,688 for each citizen. For more see *Federal Office of Statistics Report* 2013 <http://www.nigerianstat.gov.ng > accessed on July 2014.
[79] See Arowolo and Ologunowa (n 75) 789.
[80] ibid.
[81] ibid.
[82] Ademola Ariyo and Afeikhena Jerome 'Privatization in Africa: An Appraisal' (1999) 27(1) World Development 201-213.

extraordinary.[83] These enterprises require continuous massive subsidies but deliver only intermittent and substandard services and industrial enterprises basically operated between 10-30% capacities.[84] The returns of these large investments have generally been poor, and in a number of cases negative with an especially low rate of return relative to the large amount of the resources invested in them.[85]

The reasons for poor performance are well documented and bear a uniform pattern globally and these include among others, the lack of residual claimant to profits, the presence of multiple and conflicting objectives determined by the politicians.[86] Also, the prevalence of incomplete contracts and the government subsidies that protect internal inefficiencies and perpetuate soft budget constraint including the scale of corruption and fraud in Nigeria's public enterprises which remain high.[87] For instance, employees of the Nigerian External Telecommunications (NET) set the company's 37-storey previous headquarters building ablaze rather than risk seizure of records revealing some fraud.[88] Furthermore, the political expediency rather than economic viability governed the key project parameters such as plant location, capacity planning, and implementation timeframe, employment product/service pricing and some of the large-scale projects especially in

[83] ibid.
[84] JJ Bala, 'The Impacts of privatization on the distributional equity' in V.V Ramanadhm (ed) *Privatization and Equity* (London and New York: Routledge 1994) pp.22-26.
[85] ibid.
[86] ibid.
[87] Mena Beck, Robert Cull, and Afeikhena Jerome, 'Bank Privatization and Efficiency in Nigeria: An Empirical Evidence' (2005) 29 (8-9) Journal of Banking and Finance 235-79.
[88] Afeikhena Jerome, 'Technical efficiency in some privatized enterprises in Nigeria' (2002) 11(1) African Journal of Economic Policy 17-34.

agriculture and industrial sectors have been on the drawing boards ranging from 10-35 years.[89]

A case in reality is the Ajaokuta Steel Plant which remains uncompleted some 30 years after commencement and the inefficiencies were also perpetrated due to misuse of monopoly powers, notably in infrastructure, resulting in unreliable delivery and availability of services. [90] Other contributions to this dismal picture have been excessive bureaucratic controls and governments interventions; inadequate policy and regulatory frameworks that impede competition, discourages private entry and private investment, weak capacity to implement reform; and gross mismanagement and nepotism.[91] These problems were compounded by a control and management structure that was complex, opaque and prone to political capture.[92]

The above scenario was the position of the public enterprises in Nigeria in the major establishments including banking and financial sectors where the Nigerian government had major equity holdings before the divestiture of shareholding from the government through privatization.[93] It is posited that the practical consequence of the above was that Nigeria under-achieved its growth potential as a result of huge public enterprise sector weighed down by inefficiencies, poor management and massive corruption.

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[89] ibid.
[90] ibid.
[91] Afeikhena Jerome, 'Public Enterprises Reform in Nigeria: Evidence from Telecommunication Industry' Nairobi, Kenya: African Economic Research Consortium, 2002 <http://www.aercfrica.org/documents/rp/129 accessed on 29/05/12 > accessed on July 2014.
[92] ibid.
[93] ibid.

From 1988 [94] when the privatization process began till now, a number of public enterprises have been privatized and they cover the following sectors: (a) manufacturing: cement, vehicle assembly, petrochemical and oil refineries; (b) Services: banking and financial institutions, hotels and oil services and (c) Infrastructure: telecommunication, power, ports, railways, airport amongst others.[95] A notable method used in the process was through a public offer of equity shares for sale and this was done through the Nigerian Stock Exchange for the enterprises that qualified for listing on the Exchanges.[96] However, the predominance of public offer in the privatization process was to ensure wider and diffused share ownership as well as the desire to extend the frontiers and the depth of the Nigerian capital markets which had almost collapsed. In all, more than 1.8 million shares were sold, resulting in the creation of more than 800 million additional new shareholders in Nigeria which is in the form of majority and strong minority shareholders generally and banking sector in particular. [97] The government relinquished more than 270 directorship positions in some of these privatized companies.[98]

However, the privatization process attracted a number of criticisms but the strongest opposition emanated from the labour unions particularly from the utility sectors and in part, the opposition was due to outmoded economic thinking.[99] The situation is further complicated by the deep-seated ethnic and

[94] See the Report of the Technical Committee on Privatization and Commercialization (TCPC) (1988) which was replaced by Decree No. 78, 1993 that established Bureau for Public Enterprises (BPE) as the implementing agency.
[95] Public Enterprises (Privatization and Commercialization) Decree No. 28, 1999.
[96] Other methods used during the privatization process include - private placement of equity share, sale of assets, management buy-outs and deferred public offer.
[97] Michael Ojo and Sussan Adeusi, 'Impact of capital market reforms on economic growth: The Nigerian experience' (2012) 2(2) Australian Journal of Business and Management Research 20-30
[98] See Chidozie Emenuga, 'Implementing privatization through stock markets: Lesson from Nigeria' (1997) Journal of Economics 29.
[99] ibid.

regional differences prevalent in the Nigerian society, which can complicate the sale of public enterprises generally and in particular the regions where the public enterprises are located unless it is fully supported by the local elite and local population.[100] Furthermore, the situation was heightened by the lack of credible privatization process; lack of proper and acceptable regulatory framework and total neglect of the issues relating to social safety nets among others.[101] The above analysis and discussion so far reflected the background to the ownership structure of corporations operating in Nigeria with respect to corporate governance framework. The analysis of privatization process is relevant in the thesis in order to demonstrate the decentralisation of equity holdings in corporations operating in Nigeria including the banking sector. Next, in the review, will be the Nigerian corporate governance environment and its inherent problems generally.

2.5 Corporate governance environment in Nigeria

This section reviews the governance environment with respect to corporations in Nigeria generally. The recent global crisis which has so far been described as 'global meltdown' has necessitated the re-invention or re-configuration of the capitalist system.[102] Whether it is described as a stimulus, bail-out or recovery package, the truth of the matter is that throwing money at the current crisis without interrogating and identifying its causes can only guarantee a

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[100] ibid.

[101] Michael Obadan, *Privatization of the Public Enterprises in Nigeria: Issues and condition for success in the Second Republic* (Ibadan, Nigeria: National Centre for Economic Management and Administration 2002) pp. 3-12; GA Akamikor, 'A Survey of Privatization in Africa' (1995) 6 Journal of Nigerian Security Markets 7.

[102] Emmanuel Adegbite, 'Corporate governance regulation in Nigeria' (2012) 12 (2) Corporate Governance 257 – 276.

temporary relief.[103] It appears that the key to understanding the nature of the crisis lies in good corporate governance which warrants a thorough grasp of the ground rules of the activities of the corporate bodies and the application of the same.[104] The law, being a subject of human action to the governance of the rules is the condition *sine qua non* for the optimal performance of the corporate entities in the modern world.[105] While the law might not be a panacea, it is hardly in dispute that without acknowledging the centrality of the law in the scheme of things, it is highly unlikely that society will go far enough in the achievement of the set objectives and guaranteeing the well-being of the people.[106]

The fact has to be admitted that the limited liability of the companies established by the private persons hiding behind the corporate veil helped to advance the cause and fortunes of the investors for as long as the company established did not contravene their charters or act in any way considered inimical to the interest of the state or public good.[107] In other words, company charters did not envisage unlimited or unrestricted power to make money and if and whenever the companies acted contrary to the public interest or for instance, traded with the enemy in times of war, the granting authority could

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[103] ibid.

[104] See Mary Sullivan, 'Corporate Governance and Globalization' (2000) 570 American Academy of Political Science 153-154.

[105] See Oladayo Ayorinde, Amuda Toyin and Arulogun Leye, 'Evaluating the Effects of Corporate Governance on the Performance of Nigerian Banking Sector' (2012 1(1) Review of Contemporary Business Research 1-13.

[106] See Robert Shiller, *The Subprime Solution: How Today's Global Financial Crisis Happened and What to Do about it* (Princeton, NJ, Princeton University Press 2008) pp 20-29, John Taylor, *Getting Off Track: How Government Action and Interventions Caused, Prolonged and, Worsened the Financial Crisis* (Stanford, CD: Hoover Institution Press 2009) pp 89-100.

[107] See Peter Mair, 'The Revolutionary Origin of Corporations' (1993) 50(1) Williams and Mary Quarterly 51-82.

always pierce the corporate veil or revoke the licence thereby put to an end to its corporate activities.[108]

In modern times, companies have become subject of the innumerable regulations pertaining to matters such as structure, composition of boards, the duty of full disclosure of the accounts, payments of the taxes, prohibitions of monopolies, unwholesome business practices, compliance with employment laws and the rest.[109] Corporations are now generally required to comply with the tenets of the corporate governance as well as being good corporate citizenship by way of corporate social responsibility, non-payment of bribes for contracts and sensitivity to the need and interest of the communities in areas of their operations.[110] Accordingly, corporate governance entails that companies adhere to their memoranda and articles of the associations and other web of legislations, rules and regulations that order their operations.[111] Thus, companies do not have untrammelled powers to act or function in their quest for profit but may also pay particular attention to the matters such as fair labour practices, environmental pollution, global warming and sustainable development.[112]

In the Nigerian context, the corporate governance practices remain unsatisfactory and the recent collapse of the capital markets and uncovering

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[108] See Fox Eells, *The meaning of modern business: An introduction to the philosophy of large corporate enterprise* (New Yo rk 1960) 22; Amar Bhid*e, The Origin and the Evolution of New Businesses* (Oxford: Oxford University Press 1999) 100-120.
[109] Chris Ogbechie, 'Corporate Governance: A Challenge for Nigerian Banks' (2011) <http://www.businessdayonline.com > accessed on 10th July 2014.
[110] Ugo Pagano, 'Public Markets, Private Ordering and Corporate Governance' (2000) 20(4) Journal of Law and Economics 453-477.
[111] See Akinpelu (n 1) ch 5.
[112] Kenneth Amaeshi**,** Bongo Adi, Chris Ogbechie and Olufemi Amao, 'Corporate social responsibility in Nigeria: Western mimicry or indigenous influences?'(2006) 24 Journal of Corporate Citizenship, 83-99; see Nada Kakabadse, Cécile Rozuel and Linda Davies, 'Corporate social responsibility and stakeholder approach: a conceptual review' (2005) 1(4) Int. J. Business Governance and Ethics 277

of the flagrant abuse of loans including other perquisites in the banking sector as well as the high incidence of corruption in the Nigerian economy generally are enough reasons to pose a question indeed of not corporate governance but of its absence in the country.[113] The massive fraud and false accounting in the companies, a notable example of which is Cadbury Nigeria Plc,[114] and other insider dealing as well as compromised boards in many companies, the misinformation to shareholders including audit committees and rubber stamp Annual General Meetings suggest the collapse of the corporate governance culture in Nigeria.[115]

On paper, it should be pointed out that the CAMA envisages good corporate governance practices by specifying the structure of the companies, the powers and the role of the boards of directors, management, shareholders and auditors.[116] Nevertheless, it would be foolhardy to suggest that it is the same in application. In practice, the enforcement mechanisms of the major regulatory and institutional bodies are too weak to properly monitor these arguably key players in corporate governance framework.[117] The reality on the ground in Nigeria is that a number of provisions in CAMA have become merely academic as a result of the less than satisfactory nature regarding internal monitoring systems and the regulatory agencies.[118]

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[113] See Ivor Ogidefa, 'Nigerian Banks Disclosures and Governance' (2008) <http://www.bizcovering.com> accessed on 10th July 2014.

[114] As a conglomerate, its parent company is based in the UK. Cadbury Nigeria Plc is a subsidiary of Kraft Foods Inc - the second largest food business in the world is listed on the Nigerian Stock Exchange. For detail analysis on Cadbury Plc see subsection 2.5.2 of this chapter.

[115] See Olugoke Oladipupo and Famous Izedomi, 'Global Demand for Timely Financial Reporting: How Prepared are Nigerian Companies?' (2013) 4(8) Research Journal of Finance and Accounting 1-14.

[116] Fabian Ajogwu, *Corporate Governance in Nigeria: Law and Practice* (Lagos: Centre for Commercial Law Development 2007) 11.

[117] See Akinpelu (n 1) 337.

[118] These agencies are Corporate Affairs Commission (CAC), Securities and Exchange Commission (SEC), Central Bank of Nigeria (CBN) and Nigerian Stock Exchange (NSE).

Moreover, more often than not, the non-executive directors are hardly up to the task they are supposed to perform as the sentinels of the corporate governance practices having been largely nominated by the managing directors themselves.[119] Even the chairmen are usually drafted onto board from the ranks of retired civil servants, senior military officers or traditional rulers who though might have high public profiles, but lack the requisite skills and competence needed for the supervision and control of the companies.[120] Also, individuals who might be unable to correctly read and interpret the statement of accounts and are, *ipso facto* incapable of censuring the erring chief executive or in fact firing him are often appointed to the boards of many companies and banks in Nigeria.[121] While the performance of the dual roles of the chairman of the board and chief executive officer by one man appears to have been separated in most modern corporations, it does not seem to be the case in corporate governance practices in Nigeria.[122]

Furthermore, there is little compliance with the mandatory dispatch of the notices of meetings to the shareholders while the venue of the important meetings are deliberately fixed in distant locations in a bid to discourage the attendance by the shareholders.[123] It is relevant to stress the corruption that

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[119] See Babalola Adeyemi, 'Corporate governance in banks: The Nigerian experience' (2010) 7(4) Corporate, Ownership and Control International Journal, Ukraine, Special Conference Issue 34-41.
[120] ibid.
[121] See Adelaga Adekoye 'Corporate Governance Reforms in Nigeria: Challenges and Suggested Solutions' (2011) 6(1) Journal of Business Systems, Governance and Ethics 1-13.
[122] However, unlike in UK and Nigeria, the North American (US) CEOs strongly prefer the dual mandate of being Board Chairman and CEO given that it puts them squarely in charge and avoids the likelihood of conflicts or power struggles within the boardroom. However, it can be argued that the downside of this model is that in the past it often encouraged complacency by boards and discouraged them from getting deeply involved in issues until it was too late. For further arguments see generally John Morrison, 'Legislating for good corporate governance' (2004) 15 Journal of Corporate Citizenship 121-33; Leora, Klapper and Inessa Love, 'Corporate governance, investor protection and performance in emerging markets', (2002) 10 Journal of Corporate Finance 203-10.
[123] In making provisions for company meetings, CAMA makes it mandatory for companies in Nigeria to substantially comply with provisions on certain requirements for conduct of such meetings, the most important of which is notice of meeting. The essence of notice of meeting is to adequately advise the

goes on in pre-AGM forums in order to compromise shareholders or the deliberate recognition of the 'bribed' shareholders at meetings to chorus or celebrate the success of the board when the annual reports are being discussed in the AGM.[124] More importantly, a few members of the audit committees possess the requisite skills and competence to carry out their statutory functions. In essence, the critical roles of the audit committees and the shareholders which ought to act as the watchdog to the management have been whittled down by the overbearing influence and domineering attitude of the boards.[125]

From the conceptual perspectives, the empirical literature suggests that the predominant problem in most developing countries is only a conflict between a majority and minority shareholders, however, this does not mean that the classical agency problem does not arise.[126] In the Nigerian context, the problem arises and it is further worsened by the context of the political culture

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members on the kind of meeting they are called to attend, the venue, the business or items to be discussed at the meeting. However, practice does not appear to be the case as most corporations including banks do not abide by these provisions. See CAMA 1990, ss 211, 217. See Ademola Oyejide and Adedoyin Soyibo 'Corporate governance in Nigeria' Paper presented at the Conference on Corporate Governance Accra, Ghana (2011) <http://www.nigerianlawguru.com/articles/company%20lawCorporategovernance.pdf> accessed on 10th July 2014.

[124] ibid; see Nat Ofo, 'Code of Corporate Governance for Banks in Nigeria Post-Consolidation 2006: Revision Required' (2011) <http://www.ssrn.com/abstract=1751460> accessed on 12th July 2014.

[125] See Ola Orojo, 'An Overview of Companies and Allied Matters Decree' in E.O Akanki (ed) *Essays in Company Law* (Lagos: University of Lagos Press 1992) pp. 1-13; Marcel Okeke, 'Curious auditing regulations in Nigeria: a case study of cultural/political influences on auditing practices' (2004) 17 International Journal of Accounting 78-91; ROSC, *Report on the Observance of Standard Codes in Nigeria* < http://www.worldbank.org/ifa/rosc_aa.html > accessed on 5th July 2014.

[126] The principal-agent problem occurs when one person or entity (the 'agent') is able to make decisions that impact on, or on behalf of, another person or entity: the 'principal'. The dilemma exists because there is potential that the agent may be motivated to act in his own best interests rather than those of the principal. The problem arises where the two parties have different interests and asymmetric information (the agent having more information), such that the principal cannot directly ensure that the agent is always acting in its (the principal's) best interests, particularly when activities that are useful to the principal are costly to the agent, and where elements of what the agent does are costly for the principal to observe. Moral hazard and conflict of interest may arise. Indeed, the principal may be sufficiently concerned at the possibility of being exploited by the agent that he chooses not to enter into a transaction at all, when that deal would have actually been in both parties' best interests. See generally John Parkinson, Andrew Gamble and Gavin Kelly, *The Political Economy of the Company* (Oxford: Hart Publishing 2001). For more see chapter 3 of this thesis for detail analysis of agency problems and theories of corporations.

of corruption, bribery, ethnic tensions and rivalries, poorly functioning markets, and lack of adequate infrastructure.[127] In this context, many managers and the directors have been able to use corporate opportunities and resources for their own personal benefits at the expense of the corporations and other stakeholders.[128] A case that demonstrates the reality of the agency problem above as it arises in the Nigerian context was exemplified by the Lever Brothers Nigeria (LBN) Plc, a company listed on the Nigerian Stock Exchange.

2.5.1 Lever Brothers Nigeria Plc

Lever Brothers Nigeria Plc (now Unilever Plc) as a limited liability company incorporated under the nation's laws remains one of the oldest companies in the country and has come to occupy a prominent place given the level of its contribution to the Nigerian economy.[129] However, a shadow was cast on the integrity of the company when on 3rd February 1998, reports revealed corporate abuses by the senior management, including insider dealing, account falsification, share racketeering and the awards of supply contracts in

[127] To be concrete, much political analysis can be made to fit a principal-agent model. For ownership to separate from control, managers must be sufficiently aligned with shareholders. But the ways in which some polities settle conflict - or the ways in which the corporate players team up to work together - can affect the degree to which managers ally with shareholders and, concomitantly, how easy it is for ownership and control to separate. See generally Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (New York: Oxford University Press 2004) pp 231; Mark Roe, 'Can Culture Constrain the Economic Model of Corporate Law?' (2002) 69(3) University of Chicago Law Review 1251-1255; Mark Roe, 'Political Preconditions to Separating Ownership from Corporate Control' (2000) 53 Stanford Law Review 1463; Sunday Kajola, 'Corporate Governance and Firm Performance: The Case of Nigerian Listed Firms' (2008)14 European Journal of Economics, Finance and Administrative Sciences 16-28.
[128] Kajola ibid.
[129] ibid; Not until event began to unfold in 1997, the company over the years enjoyed tremendous goodwill based on the quality of its local and foreign investors. See Chika Ogba, 'LBN Accounts set to open a Can of Worms' *The Nigerian Guardian Newspaper* (Nigeria, 11 February 2000) 11-12.

which senior management had interests but were not declared in line with the statutory provisions and code of corporate governance practices.[130]

Also, the discovery of account manipulation had a serious implication for the Lever Brothers including the investors given that the profits after tax earlier declared for the year 1997 by the company suddenly transformed into a loss.[131] The scandal not only exposed the weaknesses of the regulatory process and institutions for discovering the cover up in the financial statement of Lever Brothers but also showed the ineffectiveness of the Audit Committee in carrying out their statutory functions.[132]

2.5.2 Cadbury Nigeria Plc

Cadbury Nigeria Plc as a limited liability company registered under the country's company laws has carried on business in Nigeria for decades with a very high reputation and excellent corporate image.[133] In 2006, however, it became a public knowledge that the executives had compromised the accounts of the company.[134] The Chairman of Cadbury Nigeria Plc

[130] Reliable sources also disclosed that one of the key officers of the company had more than 18 official cars, while most of all the company's contracts were handled by a company registered in his wife's name. See Nat Ofo, 'Code of Corporate Governance in Nigeria 2011: Its Fourteen Fortes and Faults' <http://www.ssrn.com/abstract=1937896> accessed on 2nd July 2014.
[131] ibid.
[132] ibid; if indeed the auditor's report was presented and thoroughly examined by the Audit Committee, there was the probability that the amount manipulation would be discovered and reported to the regulatory authorities and Annual General Meeting of that year. Although the violation of account regulation and procedure came to the knowledge of the regulatory agencies in 1997, there was no evidence that the company executives and directors were adequately sanctioned for their misdeeds. The Unilever case culminated in serious financial irregularities which led to their suspension by the Nigerian Securities and Exchange Commission for submitting annual returns with misrepresentations and the Lever Brothers' saga was further compromised by the inability of the regulatory bodies to monitor the activities of the listed firms. For more see CAMA 1990, ss 359 (3) and 4; see Chris Ogbechie and Dimitrios Koufopoulos, 'Board Effectiveness in Banking Industry' (2010) Working Paper Lagos Business School Pan African University 4.
[133] See Akinpelu (n 1) 338; as a conglomerate, its parent company is based in the UK.
[134] ibid.

announced some discrepancies in the financial accounts of the company and the decision to suspend the Managing Director.[135] As would be expected, investors who were initially in a state of shock about the developments at Cadbury reacted swiftly by dumping the shares on the Exchange.[136] The revelation of unethical practices and the reaction of the investors caused a panic in the market which impacted negatively on Cadbury shares leading to a rapid fall in price on the Nigeria Stock Exchange.[137]

Similarly, it is on record that, just like in the case of Lever Brothers Plc, none of the personalities involved in the account manipulation saga at Cadbury Nigeria Plc was subjected to any serious sanction by the regulatory institutions under Nigerian corporate and financial laws.[138] The above illustrative cases in subsections 2.5.1 and 2.5.2 raise several issues in the Nigerian corporate governance framework. First, it shows the level of failure of corporate governance in the Nigerian public corporations. Second, but most importantly here, is the inability of the majority shareholders to monitor the management in the Nigerian context.[139] While the Unilever Group in the UK exercised majority ownership and monitors the management, this did not ensure efficient monitoring of the local management in Nigeria.[140]

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[135] ibid; In a swift reaction following the suspension of Mr Bunmi Oni (Former Managing Director of Cadbury in Nigeria) and the replacement by Mr. Wallace Gallantin in December 2006, the majority shareholders, Cadbury Schweppes of the UK announced that, an independent audit firm – Price Waterhouse Coopers would reveal its reports at the London Stock Exchange on 12 December 2006. Cadbury Schweppes had in February 2006 increased its shareholding in Cadbury Nigeria Plc from 46.4% to 50% effectively becoming the majority shareholder.
[136] See Ofo (n 130) 10.
[137] See Kajola (n 127) 12.
[138] ibid; Mr Bunmi Oni's suit challenging his sack as the Former CEO of Cadbury was successful and the High Court in Nigeria declared that his removal from office was unlawful. The Auditors too went to court to challenge the imposition of financial penalty for the role they played in the falsification of the Cadbury's account. See generally Akinpelu (n 1) 338.
[139] See Ofo (n 130) 10.
[140] ibid.

Schleifer and Vishny have argued that the effectiveness of large shareholders' control of management is intimately connected with their ability to enforce voting rights to remove the management.[141] However, this is not the case in Nigeria given the nature of majority ownership including the prevailing social and institutional context companies operate in the country. For instance, in the Group 'C' corporations in Nigeria identified under subsection 2.4 above where the majority shareholders may be the government, foreign investors or local investors, the prevailing social context is unsatisfactory.

In essence, the prevailing social context such as corruption, an uneducated investing public, weak institutional arrangements, poor enforcement mechanisms, weak capital markets and an inefficient judicial system, could facilitate rather than prevent the exploitation of the minority shareholders by the majority shareholders.[142] In other words, the dispersed minority shareholders are unsophisticated with little knowledge of or concern about the running of the internal management of the corporations and few options about the redress when the problems arise.[143] The net result is that the majority shareholders are effectively able to expropriate the benefits control without regard to the interests of the minority shareholders.[144]

2.6 Company law and legal system in Nigeria

Company law outlines what corporations are legally required to do when they make their decisions. On one hand, it plays a major role both in corporate

[141] Andrei Shleifer and Robert Vishny, 'A Survey of the corporate governance' (1997) 52 (20) Journal of Finance 737.
[142] See Kajola (n 127) 12.
[143] ibid.
[144] ibid.

governance and in the legal system given that it sets out the rules and regulations for the internal operations of the corporations including such issues as to shareholders' rights and the organizational structure of the corporations.[145] On the other hand, the legal system is essential for an effective corporate governance practice given that it plays a role in the enforcement of the company law charged with enforcing a wide range of the contracts that corporations make with the various stakeholders including the creditors, suppliers, distributors, partners in the case of joint ventures and even depositors in banks.[146] The shareholders' primacy embodied in the Nigerian company law has traditionally been influenced by the example in the UK and on account of that, shareholders have in principle enjoyed many of the same legal rights as shareholders in the dominant Anglo-American economies.[147] However, what has been lacking is an effective judicial system capable of enforcing the formal rights, underdeveloped market institutions, and a high level of information asymmetries, deep-rooted corruption and high disregard for the rule of law.[148]

For example, in corporations wholly-owned by the government, corporate governance culture is fused with partisan political considerations and this is not surprising owing to several years of military rules couple with corruption that have adversely affected the management of the public sector firms.[149] Appointment to the board as well as senior management positions and even to the lower cadre in corporations are often based on political connections,

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[145] Bolodeoku Ige, 'The Market for Corporate Control: Assessment of the Role of a Target Board in Nigeria' (2004) 18 (2) Temple International and Comparative Law Journal 22.
[146] ibid.
[147] ibid.
[148] See Akinpelu (n 1) 343.
[149] ibid.

ethnic loyalty and/or religious faith as opposed to the consideration of the efficiency, competence and professional qualifications.[150] These problems are further reflected on the group 'C' and part of group 'B' identified under subsection 2.4 above where the government operates joint venture arrangements with foreign multinational corporations.[151] It is posited that the deficits explored and discussed on corporate environment increase the costs of contracting and make business activities a much more risky venture in Nigeria generally. The next section reviews the corporate governance deficits in the Nigerian banking sector so as to identify the specific gaps in the literature which will form the basis of discussions in the subsequent chapters of this thesis.

2.7 Banking sector

This section explores the specific corporate governance issues in the Nigerian banking industry and the aim is to identify the gaps in the literature which will be the major focus on the thesis. The discussions start from reviewing the major global governance issues as it affects the banking industry in particular. The peculiarities of banks' corporate governance culture first became of some interest during and after the Asian crisis in 1997.[152] Since then, and in keeping with more general trend, listed banks and even non-listed institutions globally began to publicly underscore the importance of good corporate governance practices in the banks and even to adopt separate and specific individual Codes.[153] In 1999, specifically, the Basel Committee on Banking Supervision

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[150] See Emeka Nwadioke, 'Global Financial Crisis: Roles and Challenges of Corporate Governance' (2009) 4(4) Zenith Economic Quarterly 28-37.
[151] ibid.
[152] ibid.
[153] ibid.

published the first edition of the afore-mentioned guidelines entitled: 'Enhancing corporate governance for banking organisations'.[154]

Similarly, some national banking supervisors published rules detailing the corporate governance structures and features required by the banks including the Swiss Financial Markets Supervisory Authority [155] and the Banca d'Italia. [156] But, it is worthy to note that research in banks' corporate governance had picked up even before the onset of the financial crisis, as evidenced by the publications of an increasing number of studies and contributions to the theoretical literature.[157]

The World Bank Group as a direct consequence of the experiences during the Asian crisis has taken up the issue of banks' corporate governance from several angles and taking the Basel Committee's guideline as a starting point, it developed a corporate governance methodology in order to assess the legal and regulatory framework for banks' corporate governance in different countries. [158] Similarly, the International Finance Corporation (IFC) concentrates on the corporate governance structure of the individual financial institutions and it bases its decision to invest in a particular bank partly on an

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[154] See Basel Committee on Banking Supervision, *Enhancing corporate governance for banking organisations* (Basel: BIS 2006) < http://www.bis.org/publ/bcbs/122.htm > accessed on 23rd July 2014

[155] FINMA -Formerly Swiss Banking Supervisory Authority.

[156] See Banca d'Italia, 'Supervisory provisions concerning banks' organisations and corporate governance' (Decree of March 4 2008) < http://www.bancaditalia.it/vigilanza/branche/normativa/disposizioni/provv > accessed on 26th July 2014.

[157] See generally Stephen Prowse, 'The Corporate Governance System in Banking: What Do We Know?' (1997) Banca del Lavoro Quarterly 11-40; Kose John and Yiming Qian, 'Incentive Features in the CEO Compensation in Banking Industry' (2003) 9 Economic Policy Review 109-121; Renee Adams and Hamid Mehran, 'Is Corporate Governance Different from Bank Holding Companies?' (2003) 9 Economic Policy Review 123-142; Jonathan Marcey and Maureen O'Hara, 'The Corporate Governance of Banks' (2003) 9 Economic Policy Review 97-109; Ross Levine, 'The Corporate Governance of Banks: A Concise Discussion of Concepts and Evidence' (2004) World Bank Policy Research Paper No 3404 <http://www.wds.worldbank.org > accessed on 8th July 2014.

[158] Luc Laeven and Ross Levine, 'Bank Governance, Regulations and Risk Taking' (2008) SSRN Working Paper <http://www.ssrn.com/absract--1142967> accessed on 12th July 2014.

in-depth due diligence of the bank's corporate governance culture.[159] Furthermore, the OECD Steering Group on Corporate Governance, based on the premise that corporate governance problems of banks are not fundamentally different from those of generic corporations, first commissioned a fact-finding study with respect to four areas of corporate governance including remuneration, risk management, board practices, and exercise of shareholders' rights.[160]

Flowing from the above, the Steering Committee recently published a full report on the key results and main lessons inside and outside of the banking industry, finding, in particular, that there is no immediate need that calls for a revision of the OECD Principles, but a need for a more implementation of the standards already agreed.[161] In the same vein, the G20, at its London Summit in April 2009, acknowledged the importance of the issue as well, albeit somewhat indirectly.[162]

At the European level, the Former EU Commissioner McCreevy declared his commitment to rethink the roles of directors, managers, shareholders of financial institutions with a view to strengthening the role of non-executive directors including shareholders and to prioritizing long-term shareholder value over short-term bonus payments.[163] Also, the High-Level Group on

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[159] See International Finance Corporation (World Bank), 'Corporate Governance in Financial Institutions' <http://www.ifc.org/ifcext/corporategovernance.nsf/Content > accessed on 6th July 2014
[160] Grant Kirkpatrick, 'The Corporate Governance Lessons from the Financial Crisis' (2009) Financial Markets Trends 1-30.
[161] See OECD, 'Corporate Governance and Financial Crisis: Key Findings and Main Messages' (2009) <http://www.oecd.org/document/48/03344en_2649_42192368.htm > accessed on 6th June 2014.
[162] See G20 Working Group 1, 'Enhancing Sound Regulation and Strengthening Transparency' (2009) <http://www.internationalepolitik.de/ip/dossiers/g20/enhancing-sound-regulation-and-strengthening-transparency.htm> accessed on 8th June 2014.
[163] See Charlie McCreevy, 'Address to the Association of European Journalists' (2008) <http://www.ec.europa.eu/ireland/press_office/speeches-press-release-mccreevy-aej-speech_htm > accessed on 8th June 2014.

Financial Supervision in the EU, presided by Jacques de Larosiere, stated in his report that bank's corporate governance practice 'is one of the most important cause of failures in the crises.[164]

At the EU Member States, very similar opinions were voiced in the UK and in particular, the Association of the Chartered Certified Accountants (ACCA) 'believes that the credit crunch can…be viewed in large part as a failure in corporate governance.'[165] Sir David Walker, who was charged with an independent review of the corporate governance in banking industry by the UK government, posited that the 'need is now to bring corporate governance issues to centre stage' since serious deficiencies in prudential oversight and financial regulation in the period before the crisis were accompanied by major governance failures within banks.[166] Even the Financial Services Authority (FSA) reluctantly, probably due to its own track-record in this area, cited "poor corporate governance as…only one of many factors contributing to the crisis…'[167]

The peculiarities of banks and multiplicity of interests involved with respect to bank financiers such as shareholders, depositors and other bondholders

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[164] See the ''Report of the High Level Group on the Financial Supervision in the EU' (2009) <http://www.ec.europa.eu/internal_market/finances/committees/index_en.htm > accessed 6th July 2014.

[165]See Association of the Chartered Certified Accountants, 'Corporate Governance and the Credit Crunch' (2008) <http://www.accaglobal.com/economy/analysis/acca > accessed on 10th July 2014.

[166] See David Walker, 'A review of corporate governance in UK banks and other financial industry entities - Final Recommendations' (2009) < <http://www.hm.treasury.gov.uk/walker_review_information.htm > accessed on 6th June 2014.

[167]See Financial Services Authority, 'Effective corporate governance' (Consultation Paper 10/3 January 2010) <http://www.fsa.gov.uk/pubs/cp/cp103.pdf > accessed on 6th July 2014. However, the Financial Services Authority (FSA) was formerly a quasi-judicial body responsible for the regulation of the financial services industry in the UK between 2001 and 2013. Its board was appointed by the UK Treasury and incorporated as a company limited by guarantee which operated independent of government before it was abolished in 2013[hereinafter Prudential Regulation Authority 'PRA' and Financial Conduct Authority 'FCA']. See the UK Financial Services Act 2012; Nestor Advisors, *Banks Boards and the Financial Crisis* (London, Nestor Advisor 2009) 33; Renee Adams, 'Governance and Financial Crisis' (2009) ECGI Working Paper No. 248/ (2009) <http://www.ssrn.com/abstract-1398583> accessed on 08 June 2014.

make the banks' corporate governance significantly different from other generic firms. Banks require tighter control because of deposit insurance and prudential regulations.[168] Moreover, the thesis does agree that banks' corporate governance cannot operate in isolation working best in conjunction with other institutional and regulatory frameworks to enhance the standard. Next, the thesis examines what makes bank different from other generic firms.

2.7.1 Banks versus firms

While banks are regarded as corporations from the provision of the law, however, there are some notable features that distinguish banks from ordinary firms which call for higher regulations and closer monitoring.[169] First, a bank's main business is to accept voluntarily the mismatch in the term structure of its assets and liabilities. In essence, the existence of banks depends crucially on uninterrupted continuous access to liquidity, be it deposits, short-term funding on inter-bank market, funding on secured financing markets or even funding from central bank as the liquidity provider of last resort.[170] The importance of banks' access to liquidity was demonstrated during the recent financial crisis when all possible sources of liquidity dried up including a number of banks in many 'western' countries and the central banks had to intervene to prevent a total collapse of the banking systems in the countries affected through the bail-out packages.[171] Hence, for the regulators, one of the important lessons of the crisis is to

[168] See Adams ibid.
[169] See BOFIA 2004 s.2 (1).
[170] See Adams (n 167) 1-15.
[171] ibid.

provide for more demanding prudential regulations pertaining to banks' liquidity risk and its management.[172]

Second, as a highly leveraged institutions, banks are compensated for accepting a maturity mismatch by the premium charged by the creditors, in essence, banks' debtors have to pay a higher interest rate than the bank pays for its refinancing.[173] Hence, a bank's profit increases directly in proportion with the volume of lending from creditors and the upper bound for an increase in lending is derived from the marginal cost of a bank's refinancing, given that an increase of the bank's leverage may equally increase its probability of default.[174] Similarly, depositors as well as other debt holders will demand a higher risk premium as a compensation for higher risk of insolvency, and from the minimum capital requirement provided for by the prudential regulation which is not the case in ordinary firms.[175]

Third, banks' balance sheets are more opaque than those of other generic firms in other sectors of the economy and the quality of bank loans is not readily observable while the quality of assets of ordinary industrial firm in particular, physical assets such as plant and machinery is much more easily discernible by the third parties.[176] This is substantially applicable with other assets banks invest especially in securities and it has been argued to a large

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[172] See Basel Committee on Banking Supervision, *Principles for Sound Liquidity Risk Management and Supervision* (Basel, BIS 2008).
[173] ibid.
[174] Committees on European Banking Supervisors, *Consultation Paper on Liquidity Buffers & Survival Periods Consultation Paper* (2009) < http://www.c-bs.org/Publication/Consultation-Papers/All-consultations/CP21-CP30.aspx > accessed on 12th July 2014.
[175] See Eddy Wymeersch, 'Corporate Governance and Financial Stability' (2008) Working Paper, Financial Law Institute University of Ghent 11 <http://www.ssrn.com/abstract-1288631 > accessed on 06 July 2014.
[176] Such as Assets-Backed Securities (ABSs), Collateralized Debt Obligations (CDOs) and Credits Defaults Swaps (CDSs).

extent that, the financial turbulence in the autumn of 2008 was partly caused by these difficulties.[177] For instance, after the collapse of Lehman Brothers the inter-bank-market virtually crashed even for a very short-term lending since, all of a sudden, a very serious distrust developed among banks about the quality of other banks' assets.[178] Similarly, even banks themselves find it difficult sometimes to assess the degree of the riskiness of other banks very accurately.[179]

The above hypothesis is not only supported by the recent financial turmoil but also by some studies that argued that financial analysts disagree more with respect to the quality of bonds issued by the banks than with the quality of bonds issued by other generic firms.[180] In line with that, the Pillar 3 of the Revised Framework of the Basel Agreement (Basel II) sets out disclosure requirement covering quantitative and qualitative aspect of the overall capital adequacy and capital allocation.[181] It also sets out a framework for risk exposure and risk assessment with a view to promoting market discipline which is intended for a better informed market monitoring and controlling activities by the markets participants.[182]

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[177] See Wymeersch (n 175).
[178] ibid.
[179] For a contrary assessment based on bank stocks' trading behaviour see Mark Flannery, Simon Kwan and, Mahendrarajah Nimalendran, 'Markets evidence on the opaqueness of banking firms' assets' (2004) 51 Journal of Financial Economics 419-460; Craig Furfine 'Banks as monitors of other banks: Evidence from the overnight Federal funds markets' (2001) 74 Journal of Business 54.
[180] See Donald Morgan, 'Rating banks: Risk and an uncertainty in an opaque industry' (2002) 92 American Economic Review 874-888.
[181] ibid.
[182] The aim of Pillar 3 is to allow market discipline to operate by requiring institutions to disclose details on the scope of application, capital, risk exposures, risk assessment processes, and the capital adequacy of the institution. It must be consistent with how the senior management, including the board, assess and manage the risks of the institutions. Institutions are also required to create a formal policy on what will be disclosed and controls around them along with the validation and frequency of these disclosures. In general, Pillar 3 of the Basel framework aims to promote market discipline through regulatory disclosure requirements. These requirements enable market participants to assess more effectively key information relating to a bank's regulatory capital and risk exposures in order to instil confidence about a bank's exposure to risk and overall regulatory capital adequacy See Basel Committee on Banking Supervision (BCBS), *International Convergence of Capital Measurement and Capital Standard:*

Fourth, banks do a major part of their businesses with other banks because they are highly interconnected among themselves and the important elements of the inter-bank business are, *inter alia* activities on the inter-bank market which are the over-the-counter (OTC) derivative market and foreign exchange market.[183] Hence, unlike the position in other corporations, from the banking sector perspective, competitors are also important business partners, and hence, pose a counterparty risk.[184] Moreover, the banking system is much more prone to contagion than other generic firms given that problems in one bank may spread to other banks and system-wide at very fast rate.[185] Furthermore, contrary to non-financial firms, a bank holding a substantial portfolio derivatives and securities with embedded options is subject to sharp changes in its risk-profile even if the bank does not take new positions. In essence, this possibility arises from the fact that complex derivatives often have exposure to risk factors that are extremely sensitive to market conditions and, thus, even incremental changes on market may effect a drastic change in the value of derivatives.[186]

Consequently, because of the mismatch on the term structure of asset and liabilities banks are subject to creditors runs. In other words, given that in a run, readily available liquidity could be exhausted very easily and most of a bank's assets may not be readily liquidated, only the very first creditors to

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Revised Framework (Basel: BIS 2005); See BCBS, *Review of the Pillar 3 Disclosure Requirements* (Basel: BIS 2014).

[183] ibid.

[184] See Morgan (n 180).

[185] ibid.

[186] Derivative is merely a contract between two or more parties and its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage including futures contracts, forward contracts, options and swaps. Derivatives are generally used as an instrument to hedge risk, but can also be used for speculative purposes. See Rene Stulz, 'Risk Management failures: What are they and when do they happen?' (2008) 20 Journal of Applied Corporate Finance 4.

withdraw their money may receive a pay-out in full and in time.[187] Given that dispersed creditors such as depositors, bondholders, and other banks face a similar issues, even a solvent bank can become the victim of collective action problem in the form of a run. A run typically is the result of panic and can be started by either (small) depositors, by bondholders, or by other banks in the inter-bank market and once a bank runs into financial distress, all three groups of creditors may withdraw their money.[188] Arguably, while the run on the UK's Northern Rock could be seen more as a 'classical' run of small depositors, the collapse of the Lehman Brothers and the takeover of the Merrill Lynch were more the result of an imminent run on the other banks in the inter-bank market.[189] Similarly, while it can be argued that the deposit insurance can largely mitigate the bank runs, however, its effectiveness in this respect is crucially dependent on the details of the protection accorded and in particular, not only the maximum amount of protection but also the kind of deposits protected can be of pivotal importance. [190]

For instance, prior to the banking turmoil in 2008, most mandatory depositary insurance protection schemes globally were aimed at solely protecting 'small' depositors, but, the 'trust crisis' in the wake of Lehman Brothers' insolvency caused most countries to raise the maximum coverage under existing deposit protection schemes. [191] In essence, many nations establish additional insurance and guarantee schemes that enabled banks to issue state-backed

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[187] ibid.

[188] Giuliano Iannotta, 'Testing for Opaqueness in European Banking Industry: Evidence from Bond Credit Ratings' (2004) SDA Bacconi Working Paper No.122/04 < http://www.ssrn.com/abstract-570483> accessed on 12 June 2014.

[189] ibid.

[190] ibid.

[191] ibid.

new debt.[192] For example, the EU amended Directive 94/19 EC on deposit guarantee schemes to the effect that Member States would have to raise the existing minimum coverage level from 20,000 Euros to 50,000 Euros by June 30, 2009 and to 100,000 Euros by 31st December 2010.[193] In the US, the Federal Deposit Insurance Corporations (FDIC) raised the minimum coverage level from 100,000 US-dollars to temporarily 250,000 US-dollars.[194]

On the whole, because of the systemic importance on one hand and the vulnerability on the other hand, banks are heavily regulated and supervised corporations. Basically, banking regulation limits the amount of the risk a bank may take by stipulating the risk-adjusted minimum capital requirement by linking the required regulatory capital for the bank assets, loans, securities and other assets.[195] Also, the banking regulation and supervision limits the bank's exposure to creditors or group of creditors and addresses the risk from disruptions in the access to the sufficient liquidity by setting out standard for liquidity management.[196] It is because of the above reasons that banking

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[192] ibid.

[193] A minimum coverage of €50, 000 is estimated to cover about 80% of deposits while a coverage of €100, 000 would cover about 90% of deposits in the EU. In line with that, the UK regulatory agency raised the new deposit compensation limit from £50,000 to £85,000 per person, per authorised firm, from 31 December 2010. If depositors feel that a part of their deposits is not covered (that is - is at risk of being lost), they might run on their banks. Even if it was argued that it might be sufficient to protect 80 percent of depositors' wealth, it is rather questionable whether this would already prevent a bank run. If the remaining depositors are not sufficiently covered, the risk of bank runs remains high – and those depositors whose deposits exceed the coverage limit even have a higher impact since they would withdraw very large amounts and thereby dramatically weaken the banks. See Article 7(1a) of Directive 1994/19/EEC as amended by Directive 2009/14/EC; Directive 2009/13/EC amending directive 94/19/EC on deposit guarantee schemes as regards the coverage level and pay-out delay *Official Journal 2009 L 68/3*.

[194] To some extent, it can be argued that only runs caused by depositors can be alleviated by deposit insurance. The really big trouble was caused by bondholders and other banks and also by the market in credit default swaps. See US Federal Deposit Insurance Corporations, 'Temporary Liquidity Guarantee Program' <http://www.fdic.gov/regulations/resources/TLGP/index/.html > accessed on 06 June 2014.

[195] ibid.

[196] See Geneva Association, 'Systemic risk in insurance: An analysis of insurance and financial stability' (2010) <http://www.genevaassociation.org > accessed on 06 July 2014. For more details, see BCBS, *Strengthening the resilience of the banking sector* (Consultative Document: Basel, BIS 2009) <http://www.bis.org/publ/bcbs164.html > accessed on 08 July 2014.

corporations are different and highly regulated and supervised more than other generic firms. Next, will be the overview of the history of banking corporations in Nigeria and the governance deficits (gaps) in the industry.

2.7.2 History of banking in Nigeria

A formal legal structure to banking is a relatively recent invention and prior to 1952 there was no legislation governing banking in Nigeria and a motivation for passage of the 1952 Ordinance was the failure of 21of 25 banks in the period from 1947 to 1952 .[197] The creation of the Central Bank of Nigeria (CBN) by the Central Bank Ordinance of 1958 further strengthened the banking regulatory structure of Nigeria and the CBN began full operations on July 1, 1959.[198] The 1960s and 1970s saw more financial institutions being created and a greater role of the government in regulating and owning banks in Nigeria. The Indigenous Enterprises Promotion Decree of 1972 and 1977 set a policy of government ownership of significant portions of the economy and as a result, the government took ownership of 60% of the equity in the expatriate banks operating in Nigeria including First Bank, Union Bank, and United Bank of Africa.[199] In 1979, both federal and state banks dominated the industry but in 1980s, privately held banks began to emerge leading to the introduction of the Structural Adjustment Program in the mid-1980s.[200]

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[197] In 1892, the British Bank of West Africa ("BBWA") began its operations in Nigeria and in 1917, Barclays Bank became the second expatriate bank to operate in Nigeria after BBWA (Barclays is the predecessor to the current Union Bank of Nigeria). In 1933, the National Bank of Nigeria, the first indigenous bank, was founded and operated successfully, however, after the World War II, British rule over Nigeria weakened with the passage of the 1946 Constitution that gave a majority of the seats in the National Assembly (MPs) to the native Nigeria. The Nigerian government began to regulate banks with the passage of the Banking Ordinance of 1952 and BBWA was the predecessor to the current First Bank of Nigeria. See generally Chibuike Uche, 'Indigenous Banks in Colonial Nigeria' (2010) 43(3) International Journal of African Historical Studies 1-5.

[198] ibid.

[199] See Abel Ezeoha, 'Structural Effects of Banking Industry Consolidation in Nigeria: A Review' (2007) 8 Journal of Banking Regulation 174.

[200] ibid.

In 1986, the government as a condition of an agreement to borrow from the International Monetary Fund, introduced a Structural Adjustment Program that generally required economic liberalization and decreased government regulation and ownership in much of the economy.[201] Bank licensing requirements were significantly eased resulting in a large increase from 40 to 120 banks, the highest number to that point in time.[202] During this period in 1988, the Nigerian Deposit Insurance Corporation (NDIC) was created to offer deposit insurance to the depositors in failed banks.[203] In 1991, the Bank and Other Financial Institutions Decree (now Act)[204] was enacted and this brought the supervision and regulation of all financial institutions, not just banks, under the Central Bank of Nigeria, but, prior to this time, supervision of non-banks was shared between CBN and the Ministry of Finance.[205]

2.7.3 Reforms in Nigerian banking sector

The recent reform efforts by the Former Central Bank Governor of Nigeria, Lamido Sanusi to further examine all the 24 (now 20) banks currently operating in Nigeria follows a significant transformational effort began by his predecessor Charles Soludo in 2004 that resulted in the consolidation of the banking industry in Nigeria.[206] As part of his initiatives to revamp the industry given the decades of failures, Soludo announced a new measure to increase the minimum paid in capital of banks to N25 billion which is equivalent to US $173 million from N2 billion (US$14 million). Banks were

[201] ibid.
[202] ibid.
[203] See NDIC 2006, s .1.
[204] Now cited as Banks and Other Financial Institutions Act (BOFIA), CAP, LFN, 2004 [herein after BOFIA 2004].
[205] See Central Bank of Nigeria, *Bank Supervision Annual Report 44* (2008) <http://www.nignass.org> accessed on 13 July 2014.
[206] The result of the examination showed that five banks were insolvent from the existing 24 banks in Nigeria - Oceanic Bank, Union Bank, Afribank, Finbank and Intercontinental bank.

required to obtain this capital by the end of December 2005, roughly 18 months from the policy announcement and the clear intent of the policy was to consolidate the existing banks into fewer, larger, and financially stronger banks.[207] Before the reforms in 2005, the Nigerian banking industry consisted of 89 banks which were largely fragmented into relatively small, weakly capitalized institutions with most banks having paid in capital of US$10 million or less.[208] The best capitalized bank had capital of US$ 240 million as compared to other developing countries including Malaysia where the least capitalized bank had capital of US$526 million at the time.[209] Most of the banks were family-owned and privately held and the industry was heavily concentrated, with the ten largest banks controlling 50% of the assets and deposits in the Nigerian banking system.[210]

The result of this new, much larger capital requirement was the consolidation of banks into larger entities and during this 18 month period, there were a number of mergers and acquisitions among Nigerian banks in order to meet this new capital requirement. In the end, the 89 banks that existed in 2004 decreased to 24 (now 20) larger, better capitalized banks and thirteen banks did not meet the deadline for increasing their capital and their banking licenses were revoked.[211] The current financial insolvency of the troubled banks in Nigeria has much to do with mismanagement, insider abuses, poor risk management and fraudulent activities of the senior executives of the banks and lack of proper monitoring roles of both the operators and the

[207] See Ezeoha (n 199).
[208] ibid.
[209] See Uche (n 197); Capital adequacy (bank capital requirement) is a ratio used to protect depositors and to promote the stability including efficiency of financial systems around the world.
[210] ibid.
[211] ibid.

regulator which will be discussed within the context of corporate governance framework.

2.8 Banking regulation and regulatory institutions

The role of banking is integral to any economy given that it provides financing for commercial enterprises, access to payment systems, and a variety of retail financial services for the economy at large.[212] Some banks have a broader impact on macro sector of the economy, facilitating the transmission of monetary policy by making credit and liquidity available in difficult market conditions.[213] The integral role that banks play in the national economy is demonstrated by the almost universal practice of states in regulating the banking industry and providing, in many cases, a government safety net to compensate depositors when banks fail.

In other words, banking regulation is necessary because of the multiplier effect that banking activities have on the rest of the economy.[214] The large number of stakeholders (such as shareholders, creditors, depositors, employees, customers, suppliers among others), whose economic wellbeing depends on the health of the banking industry, rely on appropriate regulatory practices and supervision for protection. Indeed, in a healthy banking system, the supervisors and regulators themselves are stakeholders acting on behalf

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[212] Banks are organisations which normally carry out certain financial transaction and perform the twin task of accepting deposits from members of public and make advances to needy and worthy people from the society. When a bank accepts deposits its liabilities increases and it becomes a debtor, but when it makes advances its asset increases and it becomes a creditor. Banking transactions are socially and legally approved and it is responsible for maintaining the deposits of its account holders. Other functions of banking include discounting of bills of exchange, overdraft, investment funding, agency representation and miscellaneous issues. For more see generally Anjan Thakor and Sudipto Bhattacharya, 'Contemporary banking theory' (1993) 3 Journal of Financial Intermediation 2 – 50.

[213] ibid.

[214] Kern Alexander, 'UK Corporate Governance and Banking Regulation: The Regulator's Role as a Stakeholder' (2004) 33 Stetson Law Review 991.

of society at large.[215] Their primary function is to develop substantive standards and other risk management procedures for financial institutions in which regulatory risk measures correspond to the overall economic and operational risk faced by a bank.[216]

Given that banking is vital to the survival and development of any socio-economic system owing to the pride of place it occupies in every economy, the main rationale for banking regulation has traditionally been the safety and soundness of the financial sector and protection of depositors.[217] A safe and sound banking system requires an effective control of systemic risk and systemic risk arises because banks have an incentive to under-price financial risk because they do not incur the full social costs of their risk-taking.[218] The social cost of bank risk-taking can arise from the solvency risks posed by banks because of imprudent lending and trading activity, or from the risks posed to depositors because of inadequate deposit insurance that can induce a bank run.[219]

Systemic risk can also arise from problems with payment and settlement systems or from the type of financial failure that induces economic crisis - gross fiscal deficit and balance of payment issues.[220] The sources of systemic

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[215] ibid.
[216] Kern Alexander, 'Corporate governance and banks: The role of regulation in reducing the principal-agent problem' (2006) 7 Journal of Banking Regulation 17-40.
[217] ibid.
[218] See Gerard Caprio, Luc Laeven and Ross Levin, 'Governance and Bank Evaluation' (2007) 16 Journal of Financial Intermediation 584-617.
[219] ibid.
[220] Where banks and other financial institutions are concerned, a possible cause of economic crisis would be a mismatch between the assets and the liabilities of the bank. For example, modern banks have accounts which allow customers to withdraw cash anytime they want. But the banks are supposed to use the proceeds from these deposits to provide loans which are long term. Chances are that at some point, there will not be enough cash for the bank because the account holders will have withdrawn it all leading to the crisis and can be systemic because of the potential to spread quickly to other banks. See Mathias Dewatripont and Jean Tirole, 'Macro-economic Shocks and Banking Regulation' (2012) Journal of Money, Credit and Banking 44.

risk demonstrate the fragility of banking sector and the need to develop adequate corporate governance arrangements to incentivise bank management and owners to undertake a level of risk that does not create substantial costs for the economy.[221]

Moreover, banking regulation has sought to mitigate these social costs by adopting various prudential measures and other regulatory designs including deposit insurance, lender of last resort (LOLR), capital adequacy requirement, asset composition rules, and fit and proper standards for bank officers, senior management and board members.[222] The main function of bank prudential regulation is to address the social costs that bank risk-taking creates by adopting controls and incentives that induce banks to price financial risk more efficiently.[223]

In essence, incentives such as deposit insurance can provide depositors with substantial insurance but it is a source of moral hazard and these problems are usually presented as one of the reasons for regulating banks.[224] The problem of moral hazard might be caused by the existence of the public 'safety net' (LOLR) which may give managers and investors in financial institutions the tendencies to behave carelessly or be less prudent with risk-taking.[225] The dilemma of moral hazard may arise in two different situations. First, when managers of financial institutions believe that they are protected from crises

[221] ibid.
[222] ibid 35.
[223] Lammertjan Dam and Michael Koetter, 'Bank bailouts, interventions, and moral hazard' (2011) 2 Discussion Paper 10.
[224] ibid.
[225] ibid; a bank safety net is a set of policies designed to prevent or reverse widespread disintermediation from banks, losses in bank capital, and bank failures. Policymakers often argue that the safety net is essential for a healthy banking system and the economy but these measures could lead to moral hazard. These measures include deposit insurance, LOLR, capital adequacy buffers amongst others.

and that they may receive loans from the lender of last resort during the crises time. Second, when the investors of the institution know that they get the same protection from LOLR.[226] In view of the above, it is suggested that the Central Banks whether in the developed or developing economies need to strike a right balance between the risk of contagion in the case of non-assistance to insolvent financial institution and the moral hazard incentives that could increase risk-taking in banks.

A further common rationale for banking regulation is premised on the problems that the separation of ownership from control (management) raises in corporate governance culture.[227] In the case of banks, these problems are further compounded by the fact that depositors are not in a position to monitor the management, as they could be small, dispersed and may be uninformed in developing countries including Nigeria, therefore, they need to be protected by a regulator through regulations.[228] Moreover, because of the importance of regulatory intervention that remains fundamental in addressing the social costs of banks' risk-taking, the thesis argues that the regulator is uniquely positioned to assert and represent the varied interests of other stakeholders in the banks and to balance those interests regarding public interests. Next, this chapter reviews the regulatory institutions in banking governance framework so as to further identify the gaps in the literature that would be discussed in the subsequent chapters.

[226] LOLR is a discretionary provision of liquidity to a financial institution (or the market as a whole) by the Central Bank in reaction to an adverse shock that causes an abnormal increase in demand for liquidity that cannot be met from an alternative source. This function has been performed by many Central Banks since the beginning of the 20th century and the goal is to prevent financial panics and bank runs spreading from one bank to the next due to a lack of liquidity. See Rose Lastra, 'Lender of Last Resort: An International Perspective' (1999) 40 (20) International and Comparative Quarterly 340-360.
[227] ibid.
[228] ibid.

2.8.1 Corporate Affairs Commission

The Corporate Affairs Commission (CAC) is the main regulator of all corporations including banking sector in Nigeria.[229] In carrying out its function as the corporate ombudsman, the CAC is expected to prevent irregularities, mismanagement, fraud and oppression of shareholders in banking sector.[230] However, a thorough assessment of the Commission would show that, apart from its achievement in the areas of registering of companies and attending to filing of corporate documents, its impact has not been effectively felt in the market place.[231] The CAC has been slow in conducting investigation into the affairs of banks in line with the statutory provisions to protect the interests of shareholders and other investing public which largely led to the mismanagement in the sector.[232]

In checking the statutory provisions, the agency is mandated to examine the trading books of the banks including the power to punish the erring bank officers where the interests of the public so demand. However, the CAC remains ineffective, weak and perfunctory as evidence abound where banks and other corporations including auditors get away with flouted legislations.[233] The regulatory enforcement mechanism of this institution is too weak to deter violations and it is further worsened by the corruption and poor record keeping.[234]

[229] CAMA 1990, ss.1 and 7.
[230] ibid.
[231] ibid.
[232] ibid.
[233] Nat Ofo, 'Much Ado About Independent Directors in Nigeria' (2011) International Company and Commercial Law Review 250.
[234] ibid.

2.8.2 Securities and Exchange Commission

The Securities and Exchange Commission (SEC) is the apex regulator of the Nigerian capital market which also regulates securities in the area dealing in Mergers and Acquisitions, Take-Over, Collective Investment Schemes and Unit Trust.[235] However, the recent collapse of the capital market exposed the weaknesses of this institution in regulating compliance and enforcement of the banks and other corporations.[236] For example, before the Nigerian banking crises in 2009-2010, the SEC would have noted early through due diligence exercise that securities markets manipulations and risky trading in banks' shares constitute infringements of the extant laws.[237] SEC should have realised that these infractions of the extant laws could contribute to a systemic financial crisis and collaborate earnestly with other regulators in the industry to facilitate counter-measures to forestall a financial crisis and take disciplinary actions against defaulting intermediaries and /or their officials (bank board and senior officers).[238]

In practice, the Nigerian capital market is weak, poor and underdeveloped and the administrative and civil penalties of this institution is too weak to deter non-compliance.[239] Furthermore, the financial reporting requirements provided by SEC fall short of what is obtainable in other developing economies including South Africa.[240]

[235] Investment and Security Act 2007 [herein after ISA 2007]. ISA 2007 repealed the previous Investment and Security Decree 1999.
[236] See generally Nat Ofo, 'Securities and Exchange Commission of Nigeria's Draft Revised Code of Corporate Governance: An Appraisal' (2011) 55 Journal of African Law 280.
[237] See ISA 2007, ss 45, 46, 113.
[238] ibid ss 60, 61, 65, 114. See also chapter 6 of this thesis for full analysis of regulatory failures.
[239] See Ofo (n 236).
[240] ibid.

2.8.3 Nigerian Stock Exchange

The Nigerian Stock Exchange (NSE) is a self-regulatory body which supports the SEC in the supervision of the securities market by exercising control of the listed firms.[241] Generally, the capital market is small, underdeveloped and illiquid when compared with other emerging markets such as Malaysia and Brazil.[242] Worse still, owing to the fact that the roles of the SEC and NSE are intertwined in Nigeria, the occasional conflict of roles of these institutions calls for further revision of the legislation governing the agencies.[243] Additionally, there remains an inherent risk in the market induced by lack of discipline, unethical practices including lop-sidedness in capitalisation and weak supervisory role in the institution. These major problems of the NSE affect banks in Nigeria generally and punishment for non-compliance in listing rules is ineffective.[244]

2.8.4 Central Bank of Nigeria

The Central Bank of Nigeria (CBN) is the apex regulator of banking sector under the Nigerian legal system.[245] The CBN published the Guidelines for Code of Corporate Governance for Banks in 2006 which remains voluntary but most banks in Nigeria prefer to observe the Code in breach.[246] In practice, the CBN has not really been effective in its supervision and monitoring roles which partly accounts for the deficits of corporate governance in the

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[241] ibid; ISA Act 2007, ss.1-10.
[242] See Ofo (n 236).
[243] ibid.
[244] Mmadu Akpofurere, 'Corporate Governance and Bank Sector Crisis in Nigeria: Rescue Intervention or a Macabre Dance with the Economy?' (2013) 3(1) African Journal of Law and Criminology 83-109.
[245] See BOFIA Act 1991 ss 1-5, 12; CBN Act 2007 ss 1, 2-6, 42.
[246] See Ofo (n 236).

industry.[247] Apart from a major failure in governance culture in the nation's corporations generally, other corporate governance deficits (gaps) in the banking sector have been specifically identified and they are:

1. Loan losses and poor risk management
2. Lack of investors and consumer sophistication.
3. Inadequate disclosure, transparency and accountability about financial positions of banks.
4. Critical gaps in the regulatory framework and regulations.
5. Uneven supervision and enforcement
6. Unstructured governance and management processes at the CBN/Weakness and Corruption within the CBN.
7. Weakness generally in business and investment climate in Nigeria.[248]

The above problems combined with other deficits on corporate governance culture in the banking industry led to the recent collapse of a number of banks in Nigeria.[249]

2.9 Conclusion

This chapter has reviewed the corporate governance framework in Nigerian corporations with the aim of specifically identifying the governance deficits in the banking sector as it relates to the thesis. It is pertinent to point out that in formulating corporate governance principles and other regulatory strategies, countries must account for their specific circumstances. These

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[247] ibid.
[248] See Ofo (n 236).
[249] ibid; The banks included- Intercontinental bank, Oceanic bank, Afri bank and Fin bank. These banks have either been compulsorily acquired or liquidated due to governance and management failure including poor supervisions from supervisory agencies.

include: relevant historical perspectives, corporate ownership structures and characteristics, cultural norms and values, socio-political and economic climates; and the ethical environment of business conduct.[250] Nigeria must therefore re-position her regulatory systems to tackle the particular challenges she faces in the banking industry in the Nigerian context. In this regard, it must be noted that corporate governance practices and regulations in developing countries will differ in ideology, necessity, concerns, complexity and robustness in specific areas than what is basically seen from the developed countries perspectives.[251]

Moreover, corporate governance framework does not operate in isolation working at best in conjunction with effective legal, regulatory and institutional bodies. Usually, there is a synergy between the legal requirements of corporations contained in the company law and the self-regulatory instruments and institutions.[252] Self-regulation is only able to function on an existing legal platform for corporate regulation.[253] While it may be argued that too much regulation of corporations reduces the efficient working of corporate governance practice, however, in the case of banking corporation, regulation is central given the need to protect the stakeholders (depositors) and public owing to the potential systemic risks inherent in the industry which is not the case in ordinary firms.[254] Corporate governance

[250] See Ofo (n 233).
[251] See Cyril Lin*, Private Vices in Public Places: Challenges in Corporate Governance Development in China* (OECD, Development Center 2001); Omkar Goswami, *The Tide Rises, Gradually: Corporate Governance in India* (OECD, Development Centre 2001) 96.
[252] See Charles Oman, *Corporate governance and national development* (OECD, Development Center 2001) 180, 362-388.
[253] Charles Okeahalam, 'Corporate Governance and Disclosure in Africa: Issues and Challenges' (2004) 12 Journal of Financial Regulation 359-370; See Lucian Bebchuk, Alma Cohen and Allen Ferrell, 'What Matters in Corporate Governance?' (2009) 22(2) Review of Financial Studies 783-807
[254] Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* (England: John Wiley &Sons 2005).

regulatory practices borrowed by Nigeria from other jurisdictions or those prescribed to her by organisations such as the World Bank and IMF may fail to tackle the specific regulatory challenges in the industry. The reason is because even the institutions that regulate and supervise the banking sector are lacking basic fundamental values including transparency, rule of law, fairness and accountability that are found in market economies in most democratic societies.[255]

The importance of banking to the survival and development of any socio-economic system is a point that hardly warrants an emphasis. In essence, Nigerian banking sector has received more attention than any other economic sector because the banks occupy a delicate position in the economic equation of the nation such that its (good or bad) performance invariably affects the economy of the country.[256] Poor corporate governance practices have been found to contribute largely to bank failures and consequently result in significant public costs and negative consequences due to their potential to impact on any applicable deposit insurance systems and the possibility of broader macro-economic implications, such as contagion risk and impact on the payment systems. In addition, poor corporate governance culture has led markets to lose confidence in the ability of a bank to properly manage its assets and liabilities, including deposits which in turn triggered a bank run or liquidity crisis.[257] As highlighted earlier in subsection 2.8.4, these corporate

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[255] See OECD, *The OECD Principles of Corporate Governance* (2004); Mary Sullivan, 'Corporate Governance and Globalization' (2000) 570 American Academy of Political Science 23.
[256] Mmadu Akpofurere, 'Corporate Governance and Bank Sector Crisis in Nigeria: Rescue Intervention or a Macabre Dance with the Economy?' (2013) 3(1) African Journal of Law and Criminology 83-109; Chris Ogbechie and Dimitrios Koufopoulos, 'Board Effectiveness in the Banking Industry' (2010) Working Paper, Lagos Business School Pan African University 4.
[257] Chimere Obodo, 'Globalization and corporate governance challenges in Nigeria: A regulatory and institutional perspective' (2014) 4(2) African Journal of Social Science 50-64.

governance deficits included, unethical practices and mismanagement by the board and managers, fraud, poor risk management, large scale insider-abuses and loans that became non-performing and thereby impaired the performance of the institutions.[258] These acts were considered to be in breach of director's statutory duty that they should act as a check on the excesses of the management to protect the stakeholders in banks.[259] The implication of these deficits is that the legal and regulatory frameworks including the institutions for good corporate governance culture in the Nigerian banking sector remain unsatisfactory and below the acceptable global standards.

[258] ibid
[259] ibid; In most cases, it was discovered that the excesses of the management was made possible because it has a strong hold on the non-executive directors.

Chapter Three

Origin, meanings and theories of corporate governance

3.1 Introduction

The previous chapter discussed the governance framework in Nigeria's corporations as well as the socio-political and cultural context of the research in order to identify the major corporate governance deficits (gaps) in the banking industry. These major corporate governance deficits include, unethical practices and mismanagement by the board and managers, poor risk management, fraud, large scale insider-abuses and loans that became non-performing and thereby impaired the performance of the institutions. This chapter, against the backdrop of the above, engages with the origins, meanings, theories and conceptual frameworks of corporate governance. The main essence of this exercise is to highlight the central argument of the thesis that corporate governance theories do not fit in the Nigerian banking context given the potential for systemic risk in the sector which requires regulation to reform the industry. Flowing from the above, it analyses the relevant literature on meanings and historical development of corporate governance, corporate theory, corporate governance and the implications of regulation in banking.

Corporate governance in the developing world has recently received a lot of attention in the literature, yet corporate governance of banks in emerging economies as it relates to the financial services industry has largely been ignored by researchers.[1] Even in developed economies, the corporate

[1] See Cyril Lin, *Private Vices in Public Places: Challenges in Corporate Governance Development in China* (OECD, Development Center 2001); Omkar Goswami, *The Tide Rises, Gradually: Corporate Governance in India* (OECD, Development Centre 2001) 96.

governance of banks has only been discussed recently in the literature.[2] Corporate governance is a crucial issue for the management of banks, which can be viewed from two dimensions. One is the transparency in the corporate function, given the need to protect the investors' interests (reference to agency problem), while the other is concerned with having a sound risk management system in place (special reference to banks).[3]

The Basel Committee on Banking Supervision states that from a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management.[4] This means that improving corporate governance is an important way to promote financial stability.[5] The effectiveness of a bank's internal governance arrangements has a very substantial effect on the ability of a bank to identify, monitor and control its risks.[6]

While banking crises are caused by many factors, some of which are beyond the control of bank management, however, almost every bank failure is at least partially the result of mismanagement within the bank itself and mismanagement is ultimately a failure of internal governance.[7] Supervision and regulation of banks' risk positions can go some way towards countering

[2] See Charles Oman, *Corporate governance and national development* (OECD, Development Center 2001) 180, 362-388.
[3] See Lucian Bebchuk, Alma Cohen and Allen Ferrell, 'What Matters in Corporate Governance?' (2009) 22(2) Review of Financial Studies 783-807.
[4] ibid.
[5] See Gerald Caprio, Luc Leaven and Ross Levine, 'Governance and Bank Valuation' (2007) 16 Journal of Financial Intermediation 584-597.
[6] See Jonathan Marcey and Maureen O'Hara, 'The Corporate Governance of Banks' (2001) 16(2) Economic Policy Review 89-102.
[7] ibid.

the effects of poor governance culture, however, supervision by some external official agency is not a substitute for sound corporate governance practices, which remain with the board and senior management.[8] Ultimately, banking risks are most likely to be reduced by fostering sound risk management practices within individual banks and instilling sound corporate governance practice in banks is a crucial element of achieving this.[9]

This chapter is divided into four Parts with Part I discussing the historical development and the meaning of corporate governance including the concept of corporate personality. Part II discusses the corporate theories and agency relationship. Part III covers stakeholder theory in corporate governance systems and associated problems. Part IV discusses the implication of regulation in corporate governance of bank. Regulation is necessary to protect stakeholders and the public because of the potential systemic risks inherent in banks. In other words, corporate governance theory and its mechanism can further be reformed through regulation to protect the depositors as a result of potential systemic risks and these risks including the danger of contagion require regulatory intervention in banks to protect the public which is hardly the case in non-financial firms.[10] Part V is the conclusion where further

[8] See Rene Adams and Hamid Mehran, 'What Do Board Do? Evidence from Board Committee and Director Compensation' (2003) EFA 4005 <http://www.ssrn.com/abstract=397401> accessed on 20th August 2014.

[9] ibid.

[10] Corporate governance systems involve both internal and external mechanisms. On one hand, the internal mechanism covers the degree to which the law permits the shareholders to exercise control or influence on the board of director. This power is exercisable through their vote in meetings or enforcement of the legal duties owed by corporate directors. On the other hand, the external mechanisms are to be seen from the regulatory environment that provide for prosecution from web of legislation where corporate fraud or insolvency issues are detected. Stock market can also play an essential role in corporate governance mechanisms to control the managers with respect to company's shares. In jurisdictions where corporations are prone to being taken over, 'market for corporate control' is a powerful tool that helps to control or discipline the manager. In extreme cases, managers could be removed under this governance approach in hostile takeover. See generally Ben Pettet, *Company Law* (Second edition, London: Longman 2005) pp 53-54; Julian Frank and Collins Mayer. 'Hostile Takeovers and the Correction of Managerial Failure' (1996) 40 J. Finance Econ 163, contending that there was little evidence of poor performance prior to bids and hostile takeovers do not therefore

suggestions on ways to protect the industry are provided. A further purpose of the chapter is to offer a general theoretical foundation for the thesis in order to provide a better appreciation of the workings of corporate governance systems in modern corporations so as to form a baseline for further research.

3.2 Historical foundation of corporate governance

The foundational argument of corporate governance as seen by both academics as well as other development researchers, can be traced back to the pioneering work of Berle and Means.[11] They observed that the modern corporations having acquired a very large size could create the possibility of separation of ownership from control. In essence, Berle and Means observed the departure of the owners from the actual control of the corporations. This led to the renewed emphasis on the behavioural dimension of the theory of the firm.[12] The importance of corporate governance arises as a result of possible conflicts of interest among the various stakeholders in corporate management.[13] These potential conflicts of interests often regarded as the agency problems are brought to bear from two notable sources.

First, different stakeholders in a corporation have different objectives and preferences. Second, information asymmetry exists among the various participants in relation to their goals and preferences and the problem then arises from the separation of ownership and control including its resulting

perform a disciplining function; see Ira Millstein and Paul MacAvoy, 'The Board of Directors and Large Publicly Traded Corporation' (1998) Col LR 1283.

[11] See Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Macmillan, New York 1932).

[12] ibid.

[13] ibid.

incentives from the misalignment of interests between the principal and the agent. [14] Berle and Means had identified these problems by examining the separation of corporate ownership from corporate control in public corporations and they noted that the separation has the potential to provide executives with the ability to act in their own self-interest rather than in the interest of the shareholders. [15] This foundational argument has a major influence in every modern organisation as a result of the possible conflicts of interests between the principal and the agents.[16]

Flowing from the above, a discussion of the evolution of corporate governance expounds on the development of its philosophical foundations within which the framework for governance of corporations is formed. [17] Similarly, views expressed on evolution of corporate governance are diverse in nature given that corporate governance seems to be a new subject.[18] On one hand, Alo[19] observes that corporate governance is relatively a new area of study, with a growing literature on the concepts, definitions, best practices and standards within cross-country comparisons. On the other hand, Walker[20]

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[14] See Michael Jensen and William Meckling**,** 'Theory of the Firm: Managerial Behaviour, Agency Cost and Capital Structure' (1986) 3 Journal of Economics 305- 360.
[15] ibid.
[16] ibid.
[17] This is because corporate governance is an interdisciplinary subject that cuts across different fields of human endeavours including management, sociology, accounting, finance, corporate law, environmental law and human rights.
[18] It is the argument of the thesis that, reform of corporate governance is not a new issue, only that it is now simply a more compelling and urgent issue, perhaps, because adequate responses were not forthcoming with respect to corporate failures. See John Holcomb, 'Corporate Governance: Sarbanes Oxley Act, Related Legal Issues, and Global Comparisons' (2004) 32 Denv. Journal of International Law and Policy 175.
[19] See Oladimeji Alo, *Issues in Corporate Governance* (Lagos, FITC Publishers 2003) p.14
[20] Walker argued that when viewed from the perspective of Adam Smith on public corporation, there was little new in current problems of corporate governance relating to financial misconduct of chief executive officers (CEOs), chief financial officers (CFOs), the negligence of non-executive board members as well as conflicts of interest among auditors and investment analysts. See generally Christopher Walker, 'Issues in Corporate Governance' (2004) European Economy, European Commission Economic Papers 2.

is of the view that, interest in the subject is traceable at least to the work of economists such as Adam Smith in the Eighteenth Century.[21]

These two opposing views with respect to its evolution, no doubt, provide the gauge for determining the level of corporate governance development in both developed and emerging economies.[22] While Alo seems to be speaking based on the Nigeria's experience, his approach, may not be entirely correct with respect to advanced economies such as in the United Kingdom and United States.[23] Rather, Walker's opinion gives credence to what Okeahalam[24] regards as over-concentration of empirical research on corporate governance in the major industrialised countries.[25] Similarly, Redmond's[26] account of the evolution of corporate governance shows that, while the corporation

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[21] In his book entitled: *An Inquiry into the Nature and Causes of the Wealth of Nations*, Adam Smith in 1776, while commenting on public corporation noted that 'The directors of such (public) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in private firms frequently watch over their own. Negligence and less vigilance must always prevail, more or less, in the management of the affairs of such company.

[22] While issues that bother on sound corporate governance manifested in the Nigerian economy in the 1990s especially the crisis in the banking sector, however, little attention was given to sound corporate governance until 2003 when the Atedo Peterside Committee was constituted to review the corporate governance of the public companies. That review resulted in the adoption of *Code of Corporate Governance for Listed Companies in Nigeria, 2003*. As a follow up, the Central Bank of Nigeria also produced a *Code of Corporate Governance for Banks and other Financial Institutions in Nigeria in 2006* much after the recapitalization of banks in Nigeria. Since the foregoing steps were taken, not much has been said about the issue of corporate governance until lately when the CBN audited the recapitalized banks in the country in 2009. See Olusola Akinpelu, *Corporate Governance Framework in Nigeria: An International Review* (Bloomington, iUniverse Inc 2011) ch 2.

[23] On one hand, taking the Cadbury Report in the United Kingdom in 1992 as the starting point, it is noted that there has been a growing body of articles in many jurisdictions and a burgeoning volume of government initiatives around the world in relation to corporate governance issues, especially in the post-Enron environment. On the other hand, an academic lawyer's argument of the trend of books on the subject is rather conservative given the view that corporate governance has always been part of company law, and that there is nothing new about it. Thus, even recent texts in the 'western' part of the world, such as Austin, Ford and Ramsay, and to lesser extent Farrar tend to approach the subject as a subject of company law particularly those part of company law dealing with the relationship between shareholders and the board and duties of directors. The broader theoretical and policy approaches now being taken, call for an attempt to enunciate a framework of principles within which students and scholars can approach the subject, and policy makers and interested parties can operate. See generally Committee on the Financial Aspects of Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance* (London 1992); Jean-Jacquesdu Plessis, James McConvill and Mirko Bagaric, *Principles of Contemporary Corporate Governance* (Melbourne: Cambridge University Press 2005); RP Austin, John Ford and Ian Ramsay, *Company Directors: Principles of Law and Corporate Governance* (Sydney, LexisNexis 2005); John Farrar, *Corporate Governance in Australia and New Zealand* (Melbourne, Oxford University Press 2001).

[24] Charles Okeahalam, 'Corporate Governance and Disclosure in Africa: Issues and Challenges' (2004) 12 Journal of Financial Regulation 359 – 370.

[25] ibid.

[26] Paul Redmond, *Companies and Securities: Commentary and Materials* (Sydney: LBC, Thomson Law Book 2005).

emerged as the dominant form of business association only in early twentieth century, its antecedents lie eight hundred years earlier in the notion of the corporate entity developed to resolve problems of group relations in religious and social communities.[27] He argued that the medieval approaches were transformed by the application of corporate ideas and practices of the business enterprises that came thereafter.[28]

The above position finds support in the thinking that, corporate governance has been practised for as long as there have been corporate entities.[29] However, recent research demonstrates that the study of the subject is less than half a century old given that the phrase 'corporate governance' was scarcely used until 1980s.[30] While corporate ownership has strong influence on systems of governance, many other factors affect corporate governance development, including legal systems, cultural and religious traditions, the political environment and economic events.[31] All business enterprises require funding to grow and it is the ways in which companies are financed that determine their ownership structures.[32] This explains why, centuries ago individual entrepreneurs and their families who could not provide the finance necessary to undertake development required to fuel economic and industrial growth, had to sell company shares in order to raise the necessary capital.[33]

[27] ibid.
[28] ibid.
[29] ibid.
[30] From the earliest days, corporate governance has been a subject of some controversy, though the term has been emerged recently. See Thomas Clarke, *Theories of corporate governance: The philosophical foundation of corporate governance* (London: Routledge 2008). See Olusola Akinpelu, *Corporate Governance Framework in Nigeria: An International Review* (Bloomington, iUniverse Inc 2011) ch 2
[31] Akinpelu ibid.
[32] See Boniface Ahunwan, 'Corporate governance in Nigeria' (2002) 37 (3) Journal of Business Ethics 267-287.
[33] Chimere Obodo, 'Globalization and corporate governance challenges in Nigeria: A regulatory and institutional perspective' (2014) 4(2) African Journal of Social Science 50-64.

In essence, it becomes an innovation that has proved a cornerstone in the development of economies worldwide.[34]

Viewing it from a different perspective, Herrigel[35] posits that the history of corporate governance arrangements, understood as the constitutive process shaping the relationship between ownership and management enterprises, is relatively a new field of inquiry for business historians.[36] Herrigel confirmed that during 19th Century in America, for instance, corporation laws were structured to enhance the rights of corporate boards to govern without unanimous consent of shareholders in exchange for statutory benefits such as appraisal rights to make corporate governance more efficient.[37] Moreover, in the account of corporate governance development given by Kamesam,[38] the seeds of modern corporate governance were probably sown by the Watergate scandal in the United State.[39]

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[34] ibid.

[35] See Gary Herrigel, 'Corporate Governance' in Geoffrey Jones and Jonathan Zeitlin ed, *Handbook of Business History* (Oxford, Oxford University Press 2005).

[36] ibid.

[37] ibid; In addition, Herrigel observes that, since centuries ago and because most large publicly traded corporations in the United States are incorporated under corporate administration friendly Delaware law, coupled with the fact that the United States' wealth has been increasingly securitised into various corporate entities and institutions, the rights of individual owners and shareholders have become increasingly derivatives and dissipated.

[38] See Vepa Kamesam, 'Corporate Governance and Financial Institutions' (2004) 4 Corporate Governance Journal 7.

[39] ibid; As a result of subsequent investigations, the US regulatory and legislative bodies were able to highlight control failures that had allowed several major corporations to make illegal political contribution and to bribe government officials. This led to the enactment of the Foreign and Corrupt Practices Act of 1977 in the US that contained specific provisions regarding the establishment, maintenance and review of systems of internal control. This was followed in 1979 by the Securities and Exchange Commission proposals for mandatory reporting on internal financial controls. In 1985, following a series of high profile business failures, the most notable one being the Savings and Loans (S&L) collapse, the Treadway Commission was formed. Its primary role was to identify the main cause of the misrepresentation in financial reports and to recommend ways of reducing incidence thereof. The Treadway report published in 1987 underlined the need for a proper control environment, independent audit committees and an objective internal control. Also, it requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve on their controls.

In essence, the evolution of corporate governance development and the practice has existed as long as there have been corporate entities, but the study is relatively of a recent origin.[40] Given the exigencies for internal monitoring, corporate governance principles were introduced in the United States in 1980 under the influence of institutional investors' including the California Public Employees' Retirement System (CalPERs).[41] This step was initially taken in reaction to measures against takeover bids decided unilaterally by company management often against the interests of the shareholders.[42]As the scenario was unfolding in the US, almost contemporaneously, the field of corporate governance was also developing in Great Britain as a consequence of several spectacular bankruptcy cases that aroused mistrust among investors.[43] In response to this, the London Stock Exchange constituted the Cadbury Committee with the mandate to re-establish confidence in the market and to improve the functioning of board of directors and the transparency of company accounts.[44] The Committees' findings as well as the Report published in 1992 completely revolutionised corporate governance practice in Great Britain and had impacted on corporate policies in many jurisdictions including Nigeria.[45]

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[40] See Clark (n 30); see Akinpelu (n 30) ch 2

[41] CalPERS has managed the second largest public pension fund in the United States. Others include Pension fund and the Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA/CREF). See generally Choi Stephen and Jill Fisch, 'On beyond CalPERS: survey evidence on the developing role of public pension funds in corporate governance' (2008) 61(2) Vanderbilt Law Review 315-354.

[42] ibid.

[43] See Akinpelu (n 30) ch 2.

[44] ibid.

[45] As a follow-up to the report, new guidelines were drawn up in numerous industrialised countries on the initiatives of stock market supervisory authorities, shareholders associations and investment managers as well as institutions faced with the problem of responsible investment. See Kaspar Muller, *Corporate Governance and Globalization: The Role and Responsibilities of Investor*s, published in Selected Issues in Corporate Governance, Regional and Country Experiences (UNCTAD /ITE 2003) p.21.

3.2.1 Defining corporate governance

The etymology of the phrase 'corporate governance' is derived from the ancient Greek and Latin and the work of Cadbury is often cited to explain the origin of the concept of corporate governance.[46] In conveying the original meaning of 'governance' which is a well contested concept, Adrian Cadbury succinctly cites Cicero who observed that:

> Governance is a word with a pedigree that dates back to Chaucer and in his days, it carries with it the connotation of wise and responsible, which is appropriate. It means either the action or method of governing and it is in the latter sense that it is used with reference to companies … A quotation which is worth keeping in mind in the context is: 'He that governs sits quietly at the stern and scare is seen to stir'. It appeals to me, because it suggests that governance need not be heavy-handed. The governor should be able to keep the corporate ship on course with a minimum use of the tiller.[47]

There is no universally accepted definition of the term 'corporate governance' given that the phrase is context specific, nevertheless, it may be described as a set of processes and structures for controlling and directing an organisation.[48] Corporate governance is generally concerned with the resolution of collective action problems among dispersed investors and the resolutions of the conflicts of interests among different claimholders.[49] It constitutes a set of rules, which governs the relationships between the management, shareholders and other stakeholders in a corporation.[50]

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[46] While there are similar words in most languages, the word *corporate* is derived from the Latin word *corpus* meaning 'body' and comes from Latin verb *comporare* – meaning to form into one body – hence a 'corporation' represents a body of people. That is, a group of people authorised to act as individuals. The word *governance* is from the Latinised Greek *gubernatio* - meaning management or government and this comes from the ancient Greek *Kybernao* meaning to steer, to guide, to direct and to act as a pilot. See Thomas Clarke, *International Corporate Governance: A Comparative Approach* (London: Routledge 2007).

[47] See generally Adrian Cadbury, *Corporate Governance and Chairmanship* (Oxford, Oxford University Press 2002) 1.

[48] ibid; See the Report of the *UK's Committee on the Financial Aspect of Corporate Governance* (1992).

[49] Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* (England: John Wiley &Sons 2005).

[50] ibid.

Gillan and Stark [51] describe corporate governance as 'the system of laws, rules, and factors that control operations in a company.[52] A firm's governance accordingly, is made up of the set of structures that provide boundaries for the firm's operations. This set of structures comprises participants in the corporate activities such as managers, shareholders, employees, and suppliers of capital; the returns to those participants, and the constraints under which they operate.[53]

Shleifer and Vishny [54] view corporate governance in terms of the economic interests of the participants.[55] In particular, they refer to corporate governance dealing '…with the ways in which suppliers of finance to corporations assure themselves of getting returns on their investments.'[56] The Former World Bank President James Wolfensohn views corporate governance as all about promoting corporate fairness, transparency and accountability.[57] Ajayi [58] considers corporate governance as nothing, but a means of enhancing robust welfare packages and active participatory voices to employees.[59]

Similarly, Barret [60] perceives corporate governance as concerned with holding the balance between economic and social goals and between

[51] See Staurt Gillan and Laura Starks, 'Corporate Governance Proposal and Shareholders Activism: The Role of Institutional Investors' (2000) 57 (2) Journal of Financial Economics 275-305.
[52] ibid.
[53] ibid.
[54] See Andrei Shleifer and Robert Visshny**,** 'A Survey of Corporate Governance' (1997) 57 Journal of Finance 737-775.
[55] ibid.
[56] ibid.
[57] See James Wolfensohn, 'Corporate Governance' *Financial Times* (London, 4 August 1997) 24.
[58] See Olaniwun Ajayi, *Legal Aspects of Finance and Emerging Markets* (Lexis Nexis, Butterworths 2005).
[59] ibid.
[60] Pat Barrett, *Achieving Better Practice: Corporate Governance in Public Sector* (Australia, Canberra, ANAO 2002).

individual and communal goals.[61] To him, corporate governance framework should encourage the efficient use of resources and equally to require accountability for the stewardship of those resources and the use of power by taking into cognizance the interests of individuals, corporations and the society.[62] In essence, the ultimate goal of corporate governance is to align as nearly as possible the interests of individuals, corporations and society. In aligning the goals, there is the need to establish a set of appropriate legal, regulatory and institutional mechanisms that allow companies to thrive as institutions. These legal and regulatory regimes along with institutional structures are important as they do not only advance long-term shareholder value but also enable the institution to be conscious of its responsibilities to stakeholders, the environment and the society in general.[63]

Furthermore, it is the view of Oman [64] that corporate governance is constituted by private and public institutions, including laws, regulations and accepted business practices, which in market economy governs the relationship between corporate managers and entrepreneurs on one hand, and those who invest resources in corporations, on the other hand.[65] This view finds further support by Cornelius [66] who perceives corporate governance as set of interlocking rules by which corporations, shareholders and management govern their behaviour.

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[61] ibid.
[62] ibid.
[63] See Pat Barrett, *The Future Direction of Audit-A National Audit Office Perspective* (Canberra, ANAO 2002).
[64] Oman (n 2) 10.
[65] ibid.
[66] See Peter Cornelius, 'Good Corporate Practices in Poor Corporate Governance System: Some Evidence from the Global Competitive Report' (2005) 3 Corporate Governance 21.

However, these rules are characterised by individual firm attributes and the factors that allow companies to maintain sound governance practices even where public institutions are relatively weak. These factors may include a corporation's ownership structure, its relationship with stakeholders including financial transparency and information disclosure practices as well as the configuration of its managing boards.[67] The stewardship responsibility of the corporate director therefore, is to provide oversight for the goal and strategies of a company and to foster their implementation.[68] Corporate governance is the system by which business corporations are directed and controlled to enhance shareholder value.[69] The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as board of directors, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs.[70] By doing this, it provides the structure through which the company goals are set and the means of achieving those objectives and monitoring the performance realised.[71]

The above definition by the OECD on Principles of Corporate Governance is consistent with the view expressed by the Cadbury Committee on Corporate

[67] ibid

[68] Corporate governance looks at the institutional policy framework for management of corporations – from their beginnings, in entrepreneurs, through their government structures, company law, privatization, insolvency, and to market exit. It is one key element in improving economic efficiency and incorporate a set of relationship between a company's management, its board, its shareholders and other stakeholders. It provides a structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance, are determined. See Victor Kwakwa and Greg Nzeku, 'International Best Practices on Corporate Governance' in Oladimeji Alo (ed) in *Issues in Corporate Governance* (Lagos, FITC 2003) p.19.

[69] See OECD, *The OECD Principles of Corporate Governance*, 2004; Mary Sullivan, 'Corporate Governance and Globalization' (2000) 570 American Academy of Political Science.

[70] See OECD ibid.

[71] ibid.

Governance in UK in 1992.[72] The OECD Principles stipulate that any assessment of corporate governance in any country should encompass the roles, duties and powers of the shareholders, the boards of directors and company management. Also, it should include transparency and disclosure along with the place of corporation in society at large.[73] In essence, good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources in more efficient and judicious ways. The governance framework must not only depend on the legal, regulatory, and institutional environment but also on other factors including business ethics, corporate awareness of the environmental and societal interests of the communities in which it operates.[74]

In another perspective, Arun and Turner [75] contend that there exists a narrow approach to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interests. However, Shleifer and Vishny [76] including Oman[77] posit that there is a broader approach that views the subject as the methods by which suppliers of finance control managers in order to ensure that their capital cannot be expropriated and that they can earn a return on their investment. There is a consensus that the broader view of corporate governance should be adopted

[72] Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (London 1992) p.15.
[73] See OECD 2004 (n 69) Preamble.
[74] All of these interests will definitely have impact on the reputation and the long-term success of a company.
[75] Thankom Arun and John Turner, 'Corporate governance of banks institutions in developing economies: The Indian experience' (2003) 4 South Asian Economic Journal 187-204.
[76] See Shleifer and Vishny (n 54).
[77] See Oman (n 2).

in the banking institutions and the reason is because the peculiar contractual form of banking demands that corporate governance mechanisms for banks should encapsulate shareholders and depositors.[78]

A further reason for that remains that the special nature of banking requires not only a broader view of corporate governance, but also government intervention through regulations in order to restrain and reduce the inappropriate behaviour of bank management. In other words, the nature of banking firm is such that regulation is necessary to protect depositors as well as the overall financial systems given the potential for systemic risk in the sector.[79]

This thesis adopts the broader view and describes corporate governance in the context of banking as the manner in which systems, procedures, processes and practices of a bank are managed so as to allow positive relationships and the exercise of power in the management of bank with aim of advancing shareholders' value and stakeholders' interests together with improved accountability, resources use and transparent administration.

3.2.2 Corporate failures

An important theme of corporate governance is to ensure the accountability of certain individuals in a corporation through mechanisms that try to reduce or eliminate the ownership and control problems.[80] As witnessed in the past, corporate failures had significantly exposed the gap between ownership and control and thereby, increased the awareness for enhanced corporate

[78] See Macey and O'Hara (n 6) 89-102.
[79] ibid.
[80] See Eric Orts, 'Shirking and Sharking: A legal theory of the firm' (1998) 16 Yale L. & Pol' Y Rev.265.

governance practices.[81] Failures, whether public corporations or states owned, are traceable to the activities of the respective agents representing the organizations.[82] Yet, both law and practice support the use of agents for the company's activities because of the company's peculiar nature as a legal entity.[83] Over the years, corporate governance systems have evolved, often in response to corporate failures or systemic crises.[84] The first well-documented failure of governance was the South Sea Bubble in the 1700s given that it revolutionised business laws and practices in England.[85] Ever since, there has been no shortage of other crises such as the secondary banking crisis of the 1970s in United Kingdom, the U.S. saving and loan debacle of the 1980s, East Asian economic and financial crisis in the second half of 1990s.[86]

In addition to these crises, the history of corporate governance systems has also been punctuated by a series of well-known company failures.[87] The height of the situation has been described as follows:

> In 2002 a series of corporate meltdowns, frauds, and other catastrophes led to the destruction of billions dollars of shareholder wealth, the loss of thousands of jobs, the criminal investigation of dozens of executives, and record-breaking bankruptcy filings. Seven of the twelve largest bankruptcy cases in America history were filed in 2002 alone. The names of Enron, Tyco, Adelphia, WoldCom, and Global Crossing have eclipsed past great scandals like the National Student Marketing, Equity Funding,

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[81] ibid.
[82] ibid.
[83] See Companies and Allied Matters Act (CAMA) 1990, ss.63 and 64.
[84] See Orts (n 80) 266.
[85] Similarly, much of the securities laws in the United States were put in place following the stock market crash of 1929.
[86] Ort (n 80).
[87] See generally Maxwell Group raid on pension fund on the Mirror Group of Newspapers as well as the collapse of the Bank of Credit and Commerce International, Baring Bank. The importance of good corporate governance practices became evidently clear in 2002 when the fortune of several flourishing and highly rated companies suddenly changed for the worst due to mismanagement and other poor corporate governance cultures. The failures of large and global corporations from Parmalat in Italy to Enron, WorldCom, Global Crossing and international accountants, Anderson revealed significant and deep-rooted problems in their corporate governance practices. Even the prestigious New York Stock Exchange had to remove its director (Dick Grasso) amidst public condemnation over excessive compensation. See Robert Monks and Nell Minow, *Corporate Governance* (3rd edition, Oxford, Blackwell 2008).

and ZZZZ Best. Part of what made them so arresting was how much money was involved...[88]

The above corporate governance failures were blamed on lack of business ethics, shady accountancy practices, incompetence, fraud and insider abuse and weak regulations.[89] They were a wake-up call for developing countries that no corporation in any jurisdiction is immune from collapse if it operates in poor corporate governance environment.[90] It was in attempt to prevent the recurrence of such business failures that various reforms on corporate governance structure and codes were introduced in many jurisdictions.[91] Next, will be a survey of the concept of corporate personality given that a corporation is legal person.

3.3 Doctrine of corporate personality

The conflict of interest between owners and managers of companies identified and discussed in agency theory draws from the doctrine of corporate personality.[92] The thesis agrees with the acknowledgement by Jensen and Meckling[93] that the principal-agent theory is the general starting point for any conceptual debate on the issue of corporate governance.[94] A number of governance mechanisms have been proposed to ameliorate the principal-agent problem between managers and shareholders such as board size, board composition, chief executive officer pay performance sensitivity, directors' ownership and shareholder rights.[95] Jensen and Meckling further suggested

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[88] Laixiang Sun, *Ownership and Governance of Enterprises: Recent Innovative Development* (United Kingdom: Palgrave Macmillan 2003).
[89] ibid.
[90] See Obodo Chimere, 'Globalization and corporate governance challenges in Nigeria: A regulatory and institutional perspective' (2014) 4(2) African Journal of Social Science 50-64.
[91] See Harwell Well, 'The birth of corporate governance' (2009-2010) 33 Seattle U.L.Rev.3.
[92] Theories of corporation and other agency issues are discussed in Part III and IV of this chapter of the thesis.
[93] See Jensen and Meckling (n 14).
[94] ibid.
[95] Laurence Gower, *Gower's Principles of Modern Company Law* (4th edn, London, Stevens & Sons 1979).

that changing these governance mechanisms would cause managers to better align their interests with that of the shareholders thereby resulting in higher firm value.[96] The fundamental attribute of corporate personality from which all other consequences flow is that the corporation is a legal entity distinct from its members, hence, it is capable of enjoying rights as well as being subject to duties which are not the same as those enjoyed or borne by its members.[97]

In Nigerian context, just like any other common law countries, a company is a legal person endowed with all the powers of a natural person including powers to carry out all the objects set out in its articles and memorandum of association[98] Being an artificial person, it can only function or operate through the instrumentality of its human organs, officers, and agents.[99] This principle is trite and has over the years been given legal backing in a plethora of company law cases.[100] Viscount Heldane L.C. in *Lennards Carrying Co. v Asiatic Petroleum Ltd* [101] said:

> A corporation is an abstraction. It has no mind of its own any more than it has a body of its own. Its active and directing will must consequently be sought in the person or somebody who for some purposes may be called an agent but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation that may be under the direction of the shareholders in general meeting that will be the board of itself or it may be and in some companies it is so, that that person has the authority to co-ordinate with the board of director given to him under the articles of association and is appointed by the general meeting of the company and can only be removed by the general meeting.

[96] See Jensen and Meckling (n 14).
[97] ibid.
[98] See Companies and Allied Matters Act (CAMA) 1990, ss. 37, 63 and 64.
[99] Lord Parker in *Daimler Co. v Continental Tyre and Rubber Co. Ltd* (1916) 2 A.C, was of the opinion that the organs of companies include directors, managers and secretaries.
[100] See *Salomon v Salomon & Co*. (1897) AC 22, H.L; *Lennards Carrying Co. v Asiatic Petroleum Ltd* (1915) A.C.705 and *Bolton Engineering Co. Ltd v Graham & Sons Ltd* (1957) 1 QB 157 C.A.
[101] (1915) A.C.705.

It can be gleaned from the above that the company officers could be regarded as the company for the purposes of its mind and actions and this explains why in a long line of cases the acts of the managing director have been found to be the acts of the company.[102]

The courts in Nigeria have also made pronouncement with respect to human agents responsible for undertaking the activities of corporate entities. In the case of *Trenco (Nig) Ltd v African Real Estate Ltd*,[103] Aniagolu JSC affirmed that 'a company, though having a corporate personality is deemed to have human personality through its officers and agents'. The common law principle in the above case on corporate personality of companies has been codified and now forms a major legal principle under the Nigerian company law.[104] Given that the theory of corporate personality is at the centre of governance debate, the separation of ownership from control remains largely the crux of contemporary corporate governance issues globally.[105]

In practice, the shareholders of public companies delegate the management and control over the affairs of the company to the board, while the board on its part employs the management to oversee the day-to-day affairs of the company in order to attain the stated objectives. This creates the well-known principal-agent problem between the shareholders and the board and is the reason why the focus of internal corporate governance is on the board of

[102] See *Company (Re)* 1980 Ch.139, 144; *Advertising and Addressing Company Property Ltd* (1975) 133 CLR 80. A difficulty however, remains as to the exact tests to be applied in order to identify which individual or individual's act could be attributed to the company. For more on this see *Tesco Supermarkets Ltd v Nattrass* (1971) AC 152.
[103] (1978) 1 F.N.R.
[104] See CAMA 1990, s.37.
[105] The court however disregarded the doctrine of corporate personality in the case of *Gilford Motor Co. Ltd v Horne* (1930) Ch. 935 and this was to enable the court to get at the persons behind the formation of the company – by lifting the veil of incorporation- to make them assume responsibility for their actions.

directors.[106] The main reason is that a board of directors often plays a key role in corporate governance and it is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities.[107]

Thus, where the board of directors fails in their responsibilities, the interests of the shareholders are in jeopardy.[108] This position suggests the reason why corporate governance is concerned with ways in which all parties interested in the wellbeing of the firm (stakeholders) attempt to ensure that managers and other insiders take measures or adopt mechanisms that safeguard the interests of the stakeholders.[109] Such measures are necessitated by the separation of ownership from control (management), which has increasingly become a vital feature of the modern firm.[110]

3.3.1 Division and exercise of powers of companies

At the heart of the corporate governance question is the issue of how corporate powers are shared amongst the different organs of the company, the exercise of the powers and the liabilities arising from the sharing.[111] Since the powers of the company can only be exercised by the human agents, it becomes necessary to assign these functions of the company and its management to the

[106] Klaus Hopt, 'Modern Company and Capital Market Problem: Improving European Corporate Governance after Enron' (2002) European Corporate Governance Institute (ECGI) Law Working Paper 5, 5.
[107] ibid.
[108] Moreover, directors are regarded as the agents of the shareholders/companies. See CAMA 1990 ss. 224 -259.
[109] ibid.
[110] See GA Olawoyin, *Status and Duties of Company Directors* (Nigeria, University of Ife Press 1972) p.8.
[111] ibid.

various organs, agents and officers. At common law, the distribution or allocation of powers depends to a large extent upon the memorandum and articles of association of the company.[112] The question as to who controls the company, the general meeting or the board of directors has been a source of controversy not only in Nigeria but also in other commonwealth countries and has led to the various judicial interpretations.[113]

For instance, it is trite law that the exercise of the powers of the company is the responsibility of both the shareholders in annual general meeting and the board of directors.[114] While the general meeting has the supremacy of legislative authority of the company, the directors are, subject to the articles of association, vested with the power of managing the company on behalf of the shareholders.[115] This position finds support in the case of *Isle of Wight Railway v Tahourdin*[116] in which the English Court of Appeal held that they indeed employ directors as their agents to work for them and ensure that company gets going. This decision has however been reversed in that in 1906, the Court of Appeal made the pronouncement in *Automatic Self-Cleansing Filter Syndicate Co. v Cunninghame*[117] that the division of powers between the board and the company in general meeting would be dependent entirely on the construction of the articles of association and that where powers had been vested in the board the general meeting could not interfere with the exercise.[118]

[112] ibid; Usually the directors have day-to-day management of the corporation.
[113] ibid.
[114] ibid; the usual position is that the directors exercise the powers of the company.
[115] See the Nigerian case of *Yalaju-Amaye v Associated Registered Engineering Contracts Ltd* (1990) 2 NSCC 462.
[116] (1883) 25 Ch.D.320, CA.
[117] (1906) 2.K.B.34, CA.
[118] ibid.

The modern principle of law provides that members at the general meeting cannot give directions or interfere with a board of directors on how to run the company's business unless such matters are specifically reserved for general meeting either by the articles as originally framed or by alteration expressly limiting the powers of directors. The implication of the above is that the articles of association play a fundamental role in the allocation of corporate governance power between the two organs of the company.[119]

Next, will be to discuss the corporate theories (models) and their shortcomings as they relates to the thesis.

3.4 Corporate theories

This section, against the backdrop of the above, engages with theoretical and conceptual frameworks of corporate governance. It reviews the foundational theories of corporation and agency relationship. The origin, existence and functionality of companies can be explained by corporate theories and an adequate understanding of the issues regarding the formation, management and operations of companies cannot be achieved without knowledge of

[119] *Shaw & Son (Salford) Ltd. v. Shaw* (1935) 2. K.B 113, CA. However, *in Breckland Group Holdings v London and Suffolk Properties Ltd & Ors* [1989] B.C.LC 100, a majority shareholder attempted to start litigation in the company's name against the managing director. The board challenged the litigation, arguing it had no authority to do so even with a shareholder resolution. Harmen. J. held that the litigation could not be continued after noting that the responsibility of the board is collective, not individual and the power of the board is invested in the whole and it is not a matter where the general meeting can intervene. In practice, this was a contentious opinion, and most academic treatises view the law to be that in fact a majority shareholder may by ordinary resolution bring litigation. This is seen to follow implicitly from the rule in *Foss v Harbottle* (1843) 67 ER 189, and the House of Lords judgment in *Alexander Ward v Samyang* [1975] SC HL 26. See Companies Act 2006, ss 33, 261-264, 168. See Kenneth Wedderburn, 'Control of Corporate Actions' (1989) 52 Modern Law Review 401. Under the Nigerian Company Law, the Articles of Association regulate the company and together with the Memorandum of Association constitute the Constitution of the company. The Article constitutes a contract among the company and the shareholders and the management, and between the shareholders inter se. Thus, where the Article is not being observed by the Board of Directors, the shareholders whether majority or minority shareholder have the individual right to enforce the observance of the provision of the Articles. Since the Articles of Association regulate management of a company and the power of alteration of the Articles lies in the shareholders, the shareholders can exercise this legal weapon even for their own protection in corporate governance. The Nigerian Supreme Court buttressed this point in *Yalanju-Amaye v. A.R.E.C. Ltd* (1990) 6 S.C.N 157. See generally CAMA 1990, ss 63,213, 249 and 300 (for derivative claims in a company).

relevant corporate theories.[120] Understanding the philosophical underpinnings of corporate theories aids the advancement of arguments for and against the utility of these theories, and provides a platform for the analysis of problems and solutions in relation to the functioning of companies based on those concepts.

Coase's[121] theory of a firm ascribes the reason for the existence of the firm to the fact that an entrepreneur cannot own all the factors of production, and were these factors to be sought outside the architecture of a firm, the entrepreneur would need to engage in a series of contracts, which would invariably result in high transactional costs.[122] Coase's theory is one which is rooted in the notion that the different factors of production have property rights which they exercise contractually as constituents within the firm and the firm is therefore set up to maximise the economic welfare of the constituents.[123]

Alchian and Demsetz[124] refine Coase's theory to the extent that they highlight the voluntariness of the contract between the constituents of the firm and suggest that the firm is actually a portal for team production.[125] Whereas Coase argued that the firm exists to achieve the allocation of resources by authority and direction, Alchian and Demsetz view the firm as a mechanism

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[120] See Demetri Kantarelis, *Theories of the Firm* (2nd edn, Geneve: Inderscience 2007); Alice Belcher, 'The Boundaries of the Firm: The Theories of Coase, Knight and Weitzman' (1997) 17(1) Legal Studies 22-39.
[121] See Ronald Coase, 'The Nature of the Firm' (1937) 4(16) Economica 386-405.
[122] Ronald Coase, 'The Problem of Social Cost' (1960) 1 Journal of Law and Economics 1-44. Ronald Coase, 'The Lighthouse in Economics' (1974) 17 (2) Journal of Law and Economics 357–37.
[123] ibid.
[124] Arman Alchian and Harold Demsetz, 'Production, Information Costs and Economic Organisation' (1972) 62 (5) American Economic Review 777-795.
[125] ibid.

that originates and exists based on joint efforts. They define the firm as a contractual organisation of inputs in which there exist (i) joint input production (ii) several input owners (iii) one party who is common to all the contracts (iv) the common party having rights to renegotiate the contract of an input independent of other contracts (v) the common party holding the residual claim (vi) the common party having the right to sell his residual status.[126]

However, in agreement with Coase, Alchian and Demsetz view the firm essentially from an economic and contractual perspective, therefore, the firm exists to meet economic ends.[127] They acknowledged that their definitions of the firm have minimal substantive content but emphasise on the contractual nature of the firm and these create problems of agency and monitoring costs for these contracts that exist in the firm irrespective of the form of the contracts. [128] In essence, these contractarian theorists posit that the relationship between the managers and shareholders of a public corporation is contractual.[129]

Easterbrook and Fischel [130] are the primary expositors of the contractarian theory. They argued that the rules and practices of corporate law mimic the contractual provisions that investors, managers, and others involved in a corporate enterprise would reach if they could bargain about every

[126] See Eirik Furobotn and Sevetor Pejovich, 'Property Rights and Economic Theory: A Survey of Recent Literature' (1972) 10 Journal of Economic Literature 1137-1162.
[127] ibid.
[128] ibid.
[129] Michael Klausner, 'The Contractarian Theory of Corporate Law: A Generation Later' (2006) 31 J. Corp. L.779; Chapman Bruce, Book Review: The Economic Structure of Corporate Law (1994) 23 Canadian Business Law Journal 145
[130] See Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard, Harvard University Press 1996).

contingency at zero cost and flawlessly enforce their agreements. [131] However, because bargaining and enforcement are costly, corporate law provides the rules and an enforcement mechanism that govern relationship among those who commit their capital or their time to such ventures.[132] These authors work out the reasons for supposing that this is the exclusive function of corporate law and the implication of this perspective for the myriad things that investors, managers, and others do within the framework of the corporate organization.[133]

Similarly, Easterbrook and Fischel model the firm not as an entity, but as an aggregate of various inputs acting together to produce goods or services. In essence, employees provide labour and creditors provide debt capital while shareholders initially provide equity capital and subsequently bear the risk of losses and monitor the performance of management and management monitors the performance of employees as well as co-ordinates the activities of all the firm's inputs.[134] The firm is simply a legal fiction representing the complex set of contractual relationships between these inputs, in other words, the firm is not a thing, but rather a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm.[135] The nexus of contracts model has important implications for a range of corporate law topics and the most obvious of which is the debate over the proper role of mandatory legal rules.[136] Contractarians contend that corporate law is generally comprised of default rules, from which the parties

[131] ibid.
[132] ibid.
[133] ibid.
[134] Melvin Eisenberg, 'The Structure of Corporation Law' (1989) 89 Col. L. Rev 1461, 1486.
[135] Michael Jensen and William Meckling, 'Theory of the Firm, Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3(4) Journal of Financial Economics 305-360
[136] ibid.

to the set of contracts making up the corporation are free to depart, rather than mandatory rules.[137] Thus, it gives the managers freedom to customize their companies' charters with legally enforceable rights and obligations.[138]

However, Clark [139] implicitly rejected the contractarian theory with respect to both the contractual nature of the firm and the role of corporate law.[140] His book describes and analyses corporate law as a regulatory regime and as he explains, the regime responds to problems inherent in three core attributes of the corporation: (a) limited liability, which can be used to shield shareholders from personal liability after they have externalized costs on third parties, particularly tort victims; (b) free transferability of shares, which creates the opportunity for securities fraud; and (c) centralized management, which creates an environment in which agency costs are inevitable.[141]

3.4.1 Assumptions of shareholders primacy

The development of corporate governance is essentially bound with the evolution of the theory of a firm and the issues as well as the rationales for existence including control of the firm have remained a subject of interest and controversy.[142] Adam Smith in the Eighteenth Century noted the 'negligence and profusion' to be expected when managers of joint-stock companies handle 'other people's money'.[143] Much later, but in a similar vein, the work

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[137] ibid.

[138] See Easterbrook and Fischel (n 130). As a normative matter, Easterbrook and Fischel devoted the bulk of their paper in tweaking out these implications across an array of important topics, such as limited liability and insider trading.

[139] Robert Clark, *Corporate Law* (Little, Brown 1986)

[140] ibid.

[141] Robert Clark, 'Contract, Elites, and Traditions in the Making of Corporation Law' (1989) 89 Colum. L. Rev; Robert Clark, 'Major Trends Lead Us Back to Basics' (2006) 31 Journal of Corporate Law 591

[142] Scott Crespi, 'Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace?' (2007) 32 Journal of Corporation Law 381,383, 386.

[143] David Aboody and Baruch Lev, 'Information Asymmetry R &D, and Inside Gains' (2000) 6 Journal of Finance 2747-2766.

of Berle and Means[144] provided one of the fundamental explanations of the investors and corporate relationships and they contended that as countries industrialised and developed their markets, the ownerships and control of the public corporations became separated.[145]

The dominant theory in Anglo-American jurisdictions,[146] as far as determining the objective of large public corporations has been, certainly since the 1970s, the shareholder primacy theory,[147] also known as 'shareholder value'[148] or 'shareholder wealth maximisation.'[149] Nevertheless, it would seem that in the last 20 years the stakeholder theory, which is the other leading theory that addresses the objective of the corporation, has become increasingly popular in many Anglo-American jurisdictions.[150] The doctrine of shareholder value and primacy suggests that a firm must be run primarily to advance the interest of the shareholders.[151] Shareholder primacy has been justified by nexus of contract theory, which contends that a company is a collection of complex private arrangements with each participant free to negotiate in their best interests.[152] Unlike employees, suppliers, customers and creditors, shareholders are bound by the statutory contract which they cannot negotiate and so have the most interest in being able to control the company although this may apply in particular to unlisted companies where

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[144] Aldolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (New York, Macmillan Co 1932).
[145] ibid.
[146] Anglo-America is used in the thesis to refer to jurisdictions where law and practice in the English and American legal tradition are followed.
[147] For example see Lawrence Mitchell, 'Groundwork of the Metaphysics of Corporate Law' (1993) 50 Washington and Lee Law Review 1477, 1485.
[148] The phrase 'shareholder value' was introduced in the 1980s by US consultants who were selling value-based management to corporations already under stock market pressure to increase returns. For more on this see: Karel Williams, 'From shareholder value to present-day capitalism' (2000) 1 Economy and Society1.
[149] Stephen Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 Northwestern University Law Review 547, 574.
[150] ibid.
[151] Andrew Keay, 'Enlightened shareholder value' (2006) L.M.C.L.Q 335, 336.
[152] Frank Easterbrook and Daniel Fischel, 'The Corporate Contract' (1989) 89 Columbia Law Review 1416, 1428.

it can be difficult to sell shares quickly.[153] In addition, shareholders are protected by the fiduciary duties of directors who would be less focussed if they had to consider other stakeholders interests.[154] Proponent argues that shareholder value has been preferred for allowing directors to serve the interests of a fixed group rather than an indeterminable group of stakeholders.[155] Advocates of shareholder value further posit that it gives directors a single, clear objective and that maximising profits for shareholders results in economic efficiency and competitiveness.[156] However, the pluralistic approach requires directors to balance wide-ranging interests, an inherently subjective process, which might encourage them to choose the option of most benefit to themselves.[157]

Professor Millon argued that the point at which the shareholder theory became prominent was not clear given that the theory has been the traditional assumption since the time of Adolf Berle and Gardiner Means, when due to their joint seminal work, and the individual writings of Berle, it gained momentum.[158] Yet, it is probably correct to say that the theory's dominance has fallen and risen ever since the eighteenth century depending on economic and social conditions, with one commentator stating that it was in the mid-nineteenth century when it blossomed.[159] Writing in 1931, Berle had argued that all powers given to the management were exercisable for the benefit of

[153] Keay (n 151).
[154] Janice Dean, 'The Stakeholder and Company Law' (2001) 22 Company Lawyer 66, 67.
[155] Gerald Vinten, 'Shareholder versus stakeholder--is there a governance dilemma?' (2001) 9(1) Corporate Governance 36,
[156] See Keay (n 151)
[157] John Parkinson, 'Models of the Company and the Employment Relationship' (2003) 41(3) British Journal of Industrial Relations 481, 498
[158] David Millon, 'New Directions in Corporation Law: Communitarians, Contractarians and the Crisis in Corporate Law' (1993) 50 Washington and Lee Law Review 1373, 1374.
[159] DG Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporate Law 277 -292.

all of the shareholders as their interest appeared.[160] Shortly thereafter, Merrick Dodd[161] took the view that the public regarded corporations as economic institutions that have a social service role to play as well as making profits for shareholders, and that firms had responsibilities to its shareholders, employees, customers, and to the general public.[162]

But, Dodd noted that it was the traditional view that directors managed a corporation for the private gain of the shareholders.[163] Nevertheless, from the time of Dodd until the 1970s it might be said that forms of stakeholder theory held sway both in academia and practice, however, during this time the shareholder primacy remained popular.[164] While there were clearly times when the theory had impact, its prominence has been the most pronounced since the late 1970s and this was when institutional investors began to support the employment of the theory.[165] It was also the time when the law and economics movement started to gain significant popularity which generally embraced the theory, to the extent that it has been said that any action by directors that was not consistent with shareholder wealth maximization was regarded as 'corporate deviance.'[166]

It has been asserted that since the mid-1980s, much greater emphasis on shareholder value by the directors has been made not only in the US, but also

[160] Adolf Berle, 'Corporate Power as Power of Trust' (1931) 44 Harv L.R. 1049- 1049.
[161] Merric Dodd, 'For Whom are Corporate Managers Trustees?'(1932) 45 Harv L.R 1145, 1148.
[162] ibid.
[163] ibid.
[164] ibid.
[165] Edwin Ruli and Sachs Sybille, 'Practical issues in implementing the stakeholder view as a core competence' (2005) 217-133.
[166] Jonathan Macey, *Corporate Governance* (Princeton, Princeton University Press 2008).

in the UK.[167] While it is not an essential aspect of the contractarian approach to corporation law, contractarians[168] generally have regarded shareholder primacy as the focal point of their view of the public corporations.[169] Whichever point one identified as the time from which the shareholder primacy became much accepted, it has been regarded as the dominant theory in corporation law in Anglo-American jurisdictions.[170] These have been due to such things as the 'globalization of capital markets, the rise of institutional investors, greater shareholder activism and the increasing importance of the corporate governance issues.'[171]

Before the enactment of the UK's Companies Act 2006, directors' duties were based on common law rules and equitable principles that encompasses a duty to act in the 'interests of the company' which could be interpreted to mean acting in the best interests of present and future shareholders.[172] In essence, shareholder value, predominant in Anglo-American corporate law, requires a company to maximise the interests of shareholders above those of other non-shareholders' stakeholders with potential claims by focusing on share value and short-term profit.[173] However, the stakeholder value, that is predominant

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[167] Margret Blair, 'For Whom Should Corporation Be Run?: An Economic Rational for Stakeholder Management' (1998) 31 Long Range Planning195-195; Mohammed Omran, Peter Atrill, and John Pointon, 'Shareholders versus stakeholders: corporate mission statements and investor returns' (2002) 11 Business Ethics: A European Review 318, 326; see The Company Law Review Steering Group, Department of Trade and Industry, *Modern Corporation Law for a Competitive Economy: The Strategic Framework* (London 1990) para 5.1.24.

[168]See Bainbridge (n 149). Stephen Bainbridge would appear to be an exception for while he adheres to shareholder value, he emphasises director primacy, in that he sees directors as being in control of the corporation that is to deliver wealth to the shareholders.

[169] Michael Bradley, Cindy Schipani, Annant Sundaram, and James Walsh, 'The purposes and accountability of the corporation in contemporary society: corporate governance at a crossroad' (1999) 62 Law and Contemporary Problems 9 – 38.

[170] Andrew Gamble and Gavin Kelly, 'Shareholder Value and the Stakeholder Debate in the UK' (2001) 9 Corporate Governance 110, 110.

[171] Roger Mills, *The dynamics of shareholder value* (Lechlade, Mars Business Association 1998) 22.

[172] Andrew Keay, 'Enlightened shareholder value, the reform of the duties of company directors and the corporate objective' [2006] L.M.C.L.Q. 335, 346

[173] Nicholas Grier, 'Enlightened shareholder value: did directors deliver? (2014) Juridical Review; Andrew Keay, 'Directors' duties and creditors' interests' (2014) Law Quarterly Review

in some Continental and Asian jurisdictions and influenced by communitarian principles of teamwork, trust and sustainability, argues for the interests of all those affected by a firm's activities to be considered in its objectives.[174] The UK's company law legislation has developed substantially in the mid-nineteenth century, and has been amended many times since then, however, in a bid to further improve the companies' legislation, the UK's Department of Trade and Industry was commissioned in 1998 to review and formulate proposals for the future reform of company law.[175]

A decade of controversy over the future of English company law ended with the Companies Act 2006 and at the centre of the argument has been a deceptively simple question – in whose interests should company law be formulated?[176] Three options were considered by the Company Law Review Steering Group (CLRSG) which are: maintaining the status quo of shareholder value, a pluralistic approach and a new regime of enlightened shareholder value (ESV).[177] The latter was recommended and adopted by

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[174] Sarah Kiarie, 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' [2006] I.C.C.L.R. 329.

[175] The review was to be overseen by a committee that became known as the Company Law Review Steering Group (CLRSG). The CLRSG published several substantive papers that set out its views and sought responses to questions posed. In July 2001 it submitted a Final Report to the Secretary of State for Trade and Industry. Subsequently the UK government drafted two White Papers that provided its response to the CLRSG's Final Report. After receiving feedback from the community, the Company Law Reform Bill 2005 was introduced into Parliament in November 2005. The Bill was subjected to considerable debate in both Houses of Parliament until it was finally passed. It became the *Companies Act* 2006 (UK) 81 on 8 November 2006, and when all of it is put into operation it will encompass most of the law that affects companies in the UK. The UK's Company Law Review Steering Group did in fact refer to the principle simply as 'shareholder value': See The Company Law Review Steering Group, Department of Trade and Industry, *Modern Company Law for a Competitive Economy*: *The Strategic Framework* (1999) 37 <http://www.berr.gov.uk/files/file23279.pdf > accessed on 20th May 2015; Department of Trade and Industry – Government White Paper, Modernising Company Law', *Command Paper* Cm 5553–1 (Comment) and 'Modernising Company Law: Draft Clauses', *Command Paper* 5553–11 (Draft Companies Bill), Her Majesty's Stationery Office (now Office of Public Sector Information) (2002) available at< http://www.dti.gov.uk/companiesbill/whitepaper.htm > accessed 20th May 2015; *Company Law Review: The Strategic Framework.* 1999.

[176] See Keay (n 173); Deryn Fisher, 'The enlightened shareholder- leaving stakeholders in the dark: Will section 172 (1) of Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2009) International Company and Commercial Law Review; Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' (2007) 29 Sydney Law Review 577

[177] Fisher ibid; Andrew Keay, 'Enlightened shareholder value' [2006] L.M.C.L.Q. 335, 341-346

Parliament under s.172 (1) as part of the new statutory formulations of directors duties.[178] The provision has been criticised as all but impossible to enforce and seen variably as radical move or as making little, if any, practical difference.[179] The question remains - will s.172 make directors consider the interest of third parties? The short answer appears to be 'no', given the difficulty of proving breach even if an action can be brought.[180] While the provision could permit directors to consider other interest, however, their primary objectives remain that of shareholder even if it is seen in an enlightened way.[181] Arguably, while the ultimate objective of the company should be formulated to promote shareholders' interests, it should be stated that the only enlightened element appears to be found is the appreciation that

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[178] The CLRSG stated that adopting the pluralist approach would necessitate substantial reform of the law on directors' duties, and later in another consultation paper, the CLRSG argued that it viewed the pluralist approach as neither workable nor desirable in the UK. Also, the CLRSG explained its approach further, stating that under the ESV directors were obliged to 'achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose' and this involved taking 'a proper balanced view of the short and long term; the need to sustain effective ongoing relationships with employees, customers, suppliers and others' as well as to 'consider the impact of its operations on the community and the environment. See generally The Company Law Review Steering Group, Department of Trade and Industry, *Modern Company Law for a Competitive Economy: Developing the Framework* (2000) at 15 <http://www.berr.gov.uk/bbf/co-act-2006/clr-review/page25086.html> accessed on 18th May 2015; The Company Law Review Steering Group, Department of Trade and Industry, *Modern Company Law for a Competitive Economy: Completing the Structure* (2000) at 34 <http://www.berr.gov.uk/bbf/co-act-2006/clr-review/page25080.html > accessed on 18th May 2015

[179] It has been criticised because the section mandates directors to appreciate that success is best attained by giving consideration to the long- and short-term views including the stakeholder interests. However, directors seem to have 'unfettered discretion' given that they act as they consider most likely to promote success for the benefit of members as no objective criteria are provided. This is surprising given that the drafting referred to "material factors that a person of care and skill would consider relevant" and given the CLRSG's concern that pluralism would leave directors unaccountable. The phrase "have regard to" is not explained so it is unclear whether directors should consider stakeholder interests perse, or only as far as they benefit shareholders. For instance, it does not state whether directors can pick from all options with an equal chance of success or if they must choose for the one most beneficial to shareholders. The list is non-exhaustive, referring to "amongst other matters". This equally could be taken to include creditors, who are notably missing from the provision though referred to in s.172 (3). Ultimately, this may be irrelevant as stakeholders will only be considered as far as it benefits shareholders. Similarly, Section 172(1) does not provide any criterion against which to determine directors' good faith, making their position difficult to determine. At the end, the section is merely a cosmetic repackaging given that directors are only accountable to promote the interest of the shareholders but must act in their best interest of the company. See generally Andrew Keay, 'Section 172(1) of the Companies Act 2006: an interpretation and assessment' (2007) 28 Company Lawyer 106, 108; Demetra Arsalidou, 'Shareholder primacy in cl 173 of the Company Law Bill 2006' (2007) 28 Company Lawyer 67; Andrew Keay, 'Section 172(1) of the Companies Act 2006' (2007) 28 Company Lawyer 106, 109

[180] Fisher (n 176).

[181] See generally The Company Law Review Steering Group, Department of Trade and Industry, *Modern Company Law for a Competitive Economy: Developing the Framework* 2000 (n 178).

directors may take into account material interests, namely those found in s 172(1), if they wish and not be sued for doing so, but this is only provided that the action that they take promotes the success of the company for the benefit of the members as a whole. It must be noted that directors cannot pursue a course of action that might be good for all material interests, unless it ultimately benefits the members. So, this would appear to rule out the possibility of actions such as directors declining to dismiss employees, unless that would ultimately benefit shareholders. It has been submitted that the overall effect of s 172(1) is that ESV can be classified as a 'shareholders first interpretation'.

However, the legislation must be seen in the context of the wider debate about stakeholder value and corporate governance in England. Successful businesses now recognise the importance of brand reputation and are encouraged to behave responsively by ethical investors, pressure group, non-governmental organisations and their customers.[182] They will promote good relationship with suppliers and communities, and may acknowledge employee expertise as among their most valuable commodities. S. 172 cannot guarantee that directors will consider third party interests, however, it must be seen as a normative measure which, combined with stakeholder pressure, the prevailing commercial climate and a few enlightened shareholder, will firmly encourage a more inclusive, longer-term view of what will promote a company's success.[183] Before considering the arguments that have been mounted in favour and against the shareholder primacy, it is germane to look

[182] Fisher (n 176).
[183] ibid

at the proper meaning and what the agency theory stands for given that shareholder value is supported by agency relationship.

3.4.2 Agency relationship

Agency theory emerged from the seminal papers of the Alchian and Demsetz[184] along with Jensen and Meckling [185] explaining the firm as a nexus of contract among the individual factors of production. Agency theory rests upon the contractual view of the firm and the essence of the agency problem is the separation of ownership from control.[186] In principle, it can be argued that since shareholders (principals) have to delegate the control of the corporation to a few directors and managers (agents) to run the company on their behalf, there is a potential risk that directors and managers may pursue their own interest to the detriment of the 'owners' - shareholders.[187] Agency theory suggests that in the absence of either the appropriate incentives or sufficient monitoring, the value of a firm cannot be maximised because managers possess discretions which permit them to expropriate value for themselves and this raises two potential problems. First, the interest of the principals and agents would not coincide, in particular, the principal and the agent could prefer different actions as a result of different attitude toward risk.

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[184] Armen Alchian and Harold Demsetz, 'Production, Information Costs and Economic Organisation' (1972) 63 (5) American Economic Review 777-795.

[185] See Michael Jensen and Williams Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure' (1976) 3 Journal of Financial Economics 305; Eugene Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of Political Economy 228.

[186] Eugene Fama and Michael Jensen, 'Separation of Ownership and Control' (1983) 26 Journal of Law and Economics 301.

[187] See Keay (n 179); On one hand, this argument is based on the premise that shareholders bear the residual risk in corporation and on the other hand, it seems misleading to see shareholders as the sole bearers of residual risk because, while they face losing their cash investment should a company fail, employees may lose their pension contribution and their livelihoods, and their community may be devastated by mass redundancies and suppliers may have invested in specialist machinery to meet their contractual obligation.

Second, it is difficult and expensive for the principal to verify that the agent has behaved appropriately, due to information asymmetry where by the principals and the agents have access to different levels of information given the diffused nature of their shares.[188] This argument appears to be the case in emerging markets including Nigeria where institutional investors are still evolving, dispersed and not well developed.[189] However, in developed economies such as in the UK, the power of the institutional investors to monitor the corporate governance practices of corporation cannot be underestimated given the size of their shareholdings.[190]

Similarly, the Cadbury,[191] Greenbury [192] and Hampel [193] all recommended in their reports that institutional investors should monitor the performance of corporate governance in the corporation.[194] In addition, Jensen and Meckling show how investors in publicly traded corporations incur cost in monitoring and binding managers to best serve the interest of the shareholders.[195] They identified 'agency cost' as being the sum of the cost of: monitoring the management (the agent); binding the agent to the principal

[188] ibid.
[189] ibid.
[190] ibid.
[191] Adrian Cadbury Report, *Committee on the Financial Aspects of Corporate Governance* (London 1992).
[192] Richard Greenbury Report, *Committee on Directors Remuneration* (London, Gee & Co. Ltd 1995).
[193] Ronald Hampel Report, *Committee on UK's Corporate Governance: Final Report* (London, Gee & Co. Ltd 1998).
[194] The role of institutional investors in corporate governance entails monitoring performance on a regular process, clearly communicable and checked periodically for its effectiveness. It would include reviewing annual reports and accounts, circulars and resolutions; and attending company meetings. In particular, institutional shareholders should try to satisfy themselves that the investee company's board and sub-committee structures are effective; that independent directors provide adequate oversight; and maintain a clear audit trail of their meetings and of votes cast on company resolutions, in particular contentious issues. The Institutional Shareholding Committee (ISC) states that these actions should help institutional investors 'to identify problems at an early stage and minimize any loss of shareholder value'. See generally Institutional Shareholders Committee (ISC), *The Responsibilities of institutional shareholders and agents – statement of principles* (London, ISC 2002 -2005); ISC, *Review of the Institutional Shareholders' Committee Statement of Principles on the Responsibilities of Institutional Shareholders and Agents* (London, ISC 2005).
[195] See Jesen and Meckling (n 185).

(shareholder/residual claimants); and residual losses.[196] However, the pertinent question from the above remains: how are the owners of capital able to protect their investments? For agency theory, this question constitutes the corporate governance problems.[197]

In response to the above issues, the shareholder theory offers some appreciable solutions to the agency problems. First, the theory suggests that the restrictions on the factor markets should be removed to encourage competitions.[198] This implies that any external interventions and additional obligations imposed through governmental regulation on corporation may likely distort the free flow of the market mechanisms and should be avoided.[199]

Second, it calls for an introduction of voluntary code of corporate governance for ethical conduct and these codes are usually underpinned by the global business principles of accountability, discipline, fairness, independence, responsibility including transparency to regulate directors and managers.[200] Third, agency theory recommends the strengthening of the managerial incentives by instituting performance-linked executive compensation schemes to help align the shareholder-managerial interests.[201]

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[196] ibid.
[197] ibid.
[198] Steve Letza, Xiuping Sun and James Kirkbird, 'Shareholding Versus Stakeholding: A Critical Review of Corporate Governance' (2004) 2 Corporate Governance: An International Review 242-262
[199] Michael Jensen, 'Self Interest, Altruism, Incentives, and Agency Theory' (1994) 2 Journal of Applied Corporate Finance 40-45; Michael Jensen, 'Value Maximization, Stakeholder Theory and the Corporate Objective Function' (2002) 12(2) Business Ethics Quarterly 235-247.
[200] Kevin Keasey, Steve Thompson, and Mike Wright, *Corporate Governance: Economic Management, and Financial Issues* (Oxford, Oxford University 1997).
[201] Cadbury Report (n 191).

Adopting appropriate incentive system is viewed as one of the key solutions to agency issues which include optimal choice between a behavioural-oriented contract such as salaries and outcome-oriented contract such as commissions, stock options and transfer of the property right in shares.[202] Moreover, a three-tier hierarchical structure of checks and balances was designed which includes the general shareholders' meeting, the board of director as well as executive managers.[203] The directors remain an essential monitoring device given that they conduct performance-based evaluation of the management as well as communicate the shareholders' interests to managers.[204]

By contrast, shareholder model expressly rejects the external interventions and additional obligations imposed by the government through statutory regulation given that it would distort the free flow of market operations.[205] Rather, it sees a firm's existing internal governance arrangements as the result of the bargaining process which has been freely entered into by the corporate insiders and outsiders.[206] As a rational economic model, the theory more specifically assumes that factor markets such as capital, managerial labour

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[202] The first and most obvious reason why those in management should care about the stock market is that they typically have a monetary interest in the company. Nevertheless, it is not unusual for a public company's founder to own a significant number of outstanding shares and it is also not unusual for the company's management to have salary incentives or stock options tied to the company's stock prices. For these two reasons, managers act as stockholders and thus pay attention to their stock prices and performance. Too often, investors forget that stock means ownership and management's job is to produce gains for the shareholders. Although a manager has little or no control of share price in the short run, poor stock performance could, over the long run, be attributed to company's mismanagement. If the stock price consistently underperforms shareholders' expectations, the shareholders will be unhappy with management and look for changes. In extreme cases, shareholders can band together and try to oust current management in a proxy fight. To what extent shareholders can control management is debatable, however, executives must always factor in shareholders' desires since these shareholders are part owners of the company. See Gerald Garvey and Peter Swan, 'The Economics of corporate governance: Beyond the Marshallian Firm' (1994) 1 Journal of Corporate Finance 139-404.

[203] ibid.

[204] Cadbury Report (n 191).

[205] See Garvey and Swan (n 202).

[206] ibid.

and corporate control are efficient and subsequently, self-regulation backed by additional voluntary mechanisms, including voluntary code of corporate governance are more effective in reducing the divergent activities of the management.[207] The rejection of external regulatory intervention but heavy reliance on free markets self-regulation is also based on the core premise that the major source of finance to corporation is equity not debt financing and equity capital is raised mainly from operating capital markets and in such a market, capital is assumed to freely move to investments that offer the highest risk adjusted-returns.[208]

Agency theory became the dominant approach in the theoretical understanding of the corporate governance in the last decades of the twentieth century and has provided insight into the working of the firms.[209] While agency theory re-establishes the importance of incentives and self-interests in the organizational thinking, the theory has some limits and there are a number of criticisms against the simplistic assumptions it makes.[210] For instance, agency theory simplifies a firm by confining the participants to managers and shareholders but, in practice, it can be argued that firms cannot operate in isolation without having regard to the effect of their actions on the various stakeholders.[211] Firms need to be accountable to the shareholders in order to attract and retain equity investment and they also need to give real consideration to the interests of their wider stakeholder constituencies as a

[207] ibid.
[208] At least in theory, equity markets tend to be relatively much developed in Anglo-American countries such as the UK and the US than in the Continental European countries including Germany and France. See Mary Sullivan, 'The innovative enterprise and corporate governance' (2000) 24 Cambridge Journal of Economics 393- 395; Andrew Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 European Company and Financial Law Review 369-413.
[209] See Margret Blair, 'Shareholders Value: A New Standard for Corporation Conduct' in K.Hopt and E. Vermeersch (eds), *Capital Markets and Corporation Law* (Oxford, OUP 2003) 348-349.
[210] Herold Demesetz, 'The structure of ownership and the theory of firm' (1983) 26 Journal of Law and Economics 375-390 Armen Alchian and Harold Demesetz, 'Production, information costs, and economic organisation' (1972) 62 American Economic Review 777-795.
[211] See Blair (n 167).

corporate citizen. In other words, even some advocates of agency theory concede that the theory present a partial view of the world as it does ignore a good bit of the complexity of the modern corporation.[212]

3.4.3 Ownership implication of shareholding

It is often said that a company is owned by its shareholders, however, it is not very clear what people mean when they say this. In reference to that, most legal theorists point to the classic exposition of the nature of ownership developed years ago by Tony Honoré in 1961.[213] Honoré argued that what we mean by ownership of property has varied across times and cultures.[214] But, he concluded that 'there is indeed a substantial similarity in the position of one who "owns" a property in many countries'.[215] Honoré went on to explain that there was no simple definition of ownership: rather there are a series of characteristics of ownership, and if sufficient of these characteristics are identified, it is sensible to describe the resulting relationship as ownership.[216]

However, the notion that the shareholder owns the corporation is still controversial and goes back to the days of the early joint-stock corporations

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[212] Steven Cheung, 'The contractual theory of the firm' (1983) 26 Journal of Law and Economics 1-22; Oliver Hart, 'Corporate Governance: Some Theory and Implications' (1995) 105 The Economic Journal 678-689.

[213] Tony Honoré, 'Ownership' in *Oxford Essays in Jurisprudence,* edited by A. G. Guest (Oxford: Clarendon Press 1961): 107-47; See also Lawrence Becker, *Property Rights: Philosophical Foundations* (London: Routledge & Kegan Paul 1977), chap. 2; James Gruenbaum, *Private Ownership* (London: Routledge and Kegan Paul 1987) chap. 1

[214] Honore ibid

[215] ibid

[216] ibid; Honoré lists eleven such features that include: right to possess, right to use, right to manage, right to the income, right to capital, right to security, right to incidence of transmissibility, prohibition from harmful use, liability to execution, residuary features and incidence dealing with absence of term (that is determinate and indeterminate interest in a property). However, whatever it is that remains special about the company's relationship with its shareholders, it does not seem to meet Honoré's tests of ownership. The obvious conclusion, then, is that no-one completely owns a company but many individuals and groups have rights and obligations around these companies – customers, shareholders, lenders, employees, directors – but none of these claims can plausibly be described as ownership. See generally John Kay and Aubrey Silberston, 'Corporate Governance' (1996) 2 Perspective on Company Law.

when they were, whether incorporated or not, perceived by the law as partnerships, and, of course, partners can be said to own partnership assets.[217] In these joint-stock corporations the shareholders had equitable ownership of the assets and they controlled the directors.[218] However, things have changed with the development of the corporation and in keeping with that, Sheldon Leader has posited that: 'The judges have moved away from protecting the shareholders' property rights in the corporation, to a focus on protecting their property rights in their own shares.'[219]

Nonetheless, even if one posits that shareholders are owners of corporation given that they have property rights, one can still argue that the concept of 'property ownership' is a complex one and it is difficult to say exactly which of many control rights are given to shareholders.[220] The reason is because Berle and Means for instance, argued that there were three elements of the concept of private property namely: having an interest in an enterprise, having power over it, and acting with respect to it.[221] Arguably, the position in which shareholders find themselves does not fulfil these elements and even as a collective, shareholders do not have the control to do what they wish to do, for they have effectively relinquished most of the powers of ownership to the board which controls the corporation.[222] Also, scholars in law and economics contend that shareholders do not have complete control of corporations but a

[217] ibid.
[218] See Isle *of Wight Rly Co v Tahourdin* (1883) 25 Ch D 320.
[219] Sheldon Leader, 'Private Property and Corporate Governance Part I: Defining the Interest' in F. Patfield (ed) *Perspectives on Corporation Law*: 1 (London: Kluwer Law International 1995).
[220] ibid.
[221] ibid.
[222] Ciaran Kelly, 'History begins: shareholder value, accountability and the virtuous state' (2009) 60 Northern Ireland Legal Quarterly 35-37.

'partial' or 'nominal' power of a firm given that shareholders have no ultimate decision-making powers.[223]

It has been argued that the shareholders own the shares including the bundle of rights accruing from the shares thereunder but not the assets of the corporation. If shareholders were the owners of a corporation then, they would own the asset of the corporation.[224] Similarly, even with the appointment of the liquidator to administer the corporate assets, the position of other stakeholders such as the creditors[225] is even considered first before that of the shareholders in settlement of corporate debts from corporate property in bankruptcy proceedings.[226]

However, the above argument notwithstanding given that there is a well-established structure in English law that governs the behaviour of individuals or groups who control and manage assets they do not beneficially own under the concept of trusteeship.[227] The duty of the trustee is to preserve and enhance the value of the assets under his control, and to balance fairly the various claims to the returns which these assets generate.[228] The trusteeship model therefore differs from the agency model in two fundamental ways. First, the responsibility of the trustees is to sustain the corporation's assets.[229]

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[223] Jonathan Marcey and Geoffrey Miller, 'Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States' (1995) 48 Stanford L. Rev 73; Andrew Keay, 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] Journal of Business Law 656.

[224] Jacob Dada, *Principles of Nigerian Company Law and Practice* (Second Edition, Calabar, Wusen Publishers 2005) pp. 302-320; Olakunle Orojo, *Nigerian Company Law and Practice* (Lagos: Mbeyi Associated Press Ltd 1992) 460; Lawrence Gower and Paul Davies, *Principles of Modern Company Law* (7th edition, London, Sweet & Maxwell 2003).

[225] These include all contingent and prospective creditors that have stakes in the corporation.

[226] See Companies and Allied Matters Act 1990 [CAMA 1990] ss. 408- 460.

[227] John Kay and Aubrey Silberston, 'Corporate Governance' (1996) 2 Perspective on Company Law.

[228] John Kay, *Foundation of Corporate Success* (Oxford, University Press 1993).

[229] ibid

This differs from the value of the corporation's shares and the difference comes not only because the stock market may value these assets incorrectly. Rather, it arises because the assets of the corporation, for these purposes, include the skills of its employees, the expectations of customers and suppliers, and the company's reputation in the community.[230]

The objective of managers as trustees therefore relate to the broader purposes of the corporation, and not simply to the financial interests of shareholders.[231] This argument has been seen as appropriate, in pursuit of shareholder value, to dispose entirely of an existing collection of businesses.[232] Thus, the trusteeship model demands, as the agency model does not, the evolutionary development of the corporation around its core skills and activities because it is these skills and activities rather than a set of financial claims, which are the essence of the company.[233] This does not preclude diversification or divestment, but it restricts operations to areas that relate in an obvious way to the firm's distinctive capabilities.[234]

The second fundamental difference between the agency model and the trusteeship model is that while the agency model expects the manager to attach priority to the current shareholder interest, the trustee has to balance the conflicting interests of current stakeholders and additionally to weigh the interests of present and future stakeholders.[235] Thus, future customers and

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[230] ibid
[231] Sanford Grossman and Oliver Hart, 'The costs and benefits of ownership: A theory of vertical and lateral integration' (1986) The Journal of Political Economy 691-719.
[232] ibid.
[233] See Kay and Silberston (n 227).
[234] ibid
[235] ibid

employees, including the future interests of current suppliers, also come into account. These two distinctive distinctions have the joint effect of materially shifting the balance of considerations in management towards long-term development of the capabilities of the business.[236] The implication of this analysis remains that the mere appointment of the liquidator to administer the corporate asset does not change the status of shareholders with respect to the ownership of the corporations.

3.5 Major criticisms of shareholding theory

Despite its dominance as a major corporate governance theory worldwide, the shareholding model suffers from several weaknesses ranging from the shareholder power and democracy, uncertainty, stakeholders interests, social morality and ethics, efficient factor markets including short-termism.[237] First, it has been argued that shareholders lack the sufficient power to control the management so as to prevent the use of the corporate resources for personal objectives.[238] Central to this theory which has been noted previously is the position of the shareholder primacy that presupposes that corporations should mainly be managed for the welfare of the shareholders. Arising out of such a presupposition is that theoretically, a residual power rests with the shareholders to participate in major corporate decision including exercising

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[236] ibid

[237] See Kevin Keasey, Steve Thompson, and Mike Wright, *Corporate Governance: Economic, and Financial Issues* (Oxford: Oxford University Press 1997) 34; Oliver Hart, 'An economist perspective on the theory of the firm' (1989) 89 Columbia Law Review 1757-1773.

[238] See Gerald Vinten, 'Shareholders versus stakeholders – is there a governance dilemma?' (2001) 9(1) Corporate Governance: An International Perspective 36-47.

the power to hiring and firing the board of directors usually at the annual general meeting (AGM).[239]

In practice, however, it has been contended that the ability of shareholders to meaningfully exercise such control over the direction of the corporation is substantially restricted by the very procedures which govern such general meetings and corporate officers elections.[240] For instance, the directors and not the shareholders typically set the agenda of an AGM and by implication directors determine the issues which come up for voting.[241] By contrast, it has been argued that shareholders either find it difficult or impossible to get a binding decision on their favour as a result of the domineering influence of the directors.[242]

Second, and closely associated with the lack of the real power of the shareholders, is that directors who are supposed to be the first line of defence on behalf of the shareholders equally suffer from many defects. [243] Sternberg[244] argued that because executive directors of a corporation are also normally its managers, they are sometimes less willing to recognise, criticize or even correct their own mistakes.[245] Similarly, the non-executive director' accountability to shareholders is usually impaired by the way in which they are nominated, officially appointed or remunerated.[246] For example, in some

[239] ibid.
[240] ibid.
[241] ibid.
[242] Iman Anabtawi, 'Some Skepticism About Increasing Shareholders Power' (2006) 53 UCLA L.Rev 561-568.
[243] ibid.
[244] Elaine Stenberg, *Corporate Governance: Accountability in the Marketplace* (2nd edition, London: Institute of Economic Affairs 2004) 22.
[245] Antoine Reberioux, 'Shareholders Primacy and Managerial Accountability' (2007) Comparative Research in Law and Political Economy 1.
[246] Antoine Reberioux, 'Does shareholder primacy lead to a decline in managerial accountability' (2007) 31(4) Camb. J. Eco 507-524.

Anglo-American model, the appointment procedure is such that most non-executive directors are nominated by the chief executive or by the board themselves and this makes them insufficiently independent to the management and insufficiently accountable to shareholders.[247]

Flowing from the above, the contemporary global practice is to have a majority of the independent non-executive directors on the board of directors and the reason is because if they are not on the majority, they would be ineffective in playing the crucial balancing role expected of them.[248] An independent director is a director that is independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of his unfettered and independent judgement.[249] Such requirement of this nature

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[247] Ruth Aguilera and Cuervo-Cazurra, 'Codes of Good Governance' (2009) 17(3) Corporate Governance: An International Review 376-387.

[248] See for example, sections A.3 and B.1.2 of the Combined Code of Corporate Governance of the United Kingdom 2010; section 303A.01 of the NYSE Listed Company Manual containing its corporate governance rules 2013. But contrast with sections 2.18.1 and 2.18.2 of the King III Report on Corporate Governance Code of South Africa in 2010, which provide that the majority of board members should be non-executive directors and that majority of the non-executive directors should be independent. Similarly, in Nigeria, there are two broad categories of board of directors in banks and these are the executive directors and the non-executive directors. Executive directors are those directors who apart from being members of the board of directors of the corporate body are also its full-time employees. On one hand, executive directors are office-bearers of the company, falling under the statutory and common law duties expected of a 'director'. On the other hand, non-executive directors are directors *simpliciter* that are not employees of the corporate body and thus do not have any contracts of service with it. However, they have the same statutory and common-law duties as executive directors, but they do not work in the company on a full- time basis. Nevertheless, for a board to be independent, it must be composed of a majority of non-executive directors. The rationale being that the non-executive directors, not being employees of the company, would be able to challenge the management at board meetings by exercising their independent judgment and character during board deliberations. This ensures that decisions reached at board meetings would be in the best interest of shareholders as a whole. In line with this thinking, the emerging evidence in Nigeria indicates that having a majority of non-executive directors on boards is not enough given that such directors might have some relationships with the management, majority shareholders or the bank itself which could impede, or be deemed to impede, their independence of character and judgment. The thesis recommends that non-executive directors should not only be on the majority but independent in the board of banks in Nigeria to effectively challenge management decisions in the interest of all bank stakeholders in line with global best practices and international standard. See generally Nat Ofo, 'Securities and Exchange Commission Draft Revised Code of Corporate Governance: An Appraisal' (2011) 55 Journal of African Law 2; Nat Ofo, 'Much Ado About Independent Directors in Nigeria' (2013) International Company and Commercial Law Review 250-257; Nat Ofo, 'What Role for Independent Directors in Nigeria?' (2012) International Company and Commercial Law Review 117-123.

[249] See Nat Ofo, 'Criteria for Determining the Independent Status of Independent Directors in Nigeria: A Critical Evaluation' (2012) International Company and Commercial Law Review 382-393; Nat Ofo,

imposed by the codes of corporate governance on firms has generally improved the board accountability, independence and monitoring of the company executives including the senior management.[250]

3.5.1 Certainty issue

One of the main selling points that is traditionally attributed to shareholder theory, and especially when compared with stakeholder theory remains that it is certain and its aim entails pursuing shareholders' interests.[251] In essence, the model provides for a criterion or metric for determining business success given that it offers guidance for managers in knowing the direction that they should take in managing the business of the corporation.[252] However, in practice, it is doubtful if this remains entirely the position owing to the argument that there appears to be a number of significant uncertainties surrounding the theory and its implementations. The reason is because agency theory built on shareholder primacy does not enable managers to have a guide as to what they should actually do.[253] For instance, what does shareholder primacy mean in the day-to-day management of a corporation? Does it mean directing actions at maximising the share prices? Does it mean that the managers, provided that they are acting within the ambit of the law, are to maximise shareholder value, no matter what? In other words, should they engage in massive downsizing or polluting the environment because

'Draft Revised Code of Corporate Governance for Banks in Nigeria: Bringing Independent Directors on Board' (2012) International Company and Commercial Law Review 202-208.

[250] Charlie Weir and David Laing, 'The Performance-Governance Relationship: The Effects of Cadbury Compliance on UK Quoted Companies' (2000) 4 Journal of Management and Governance 265-281.

[251] ibid.

[252] See Andrew Keay, 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 Modern Law Review 663, 677-681.

[253] ibid 674.

preventative measures would be costly, if either of these actions will benefits the shareholders ultimately? The problem remains that the phrase 'shareholder value maximisation' is vague but many theorists seem to see shareholder value as equivalent to maximising corporation profits.[254]

Flowing from the above, Professor Henry Hu[255] in an investigation of the meaning of shareholder primacy, in the context of the development of new financial products and the process of financial innovation, indicates that shareholder primacy has never been certain.[256] He points out that there are some conflicting ways of understanding shareholder wealth maximization and the first way is what Hu calls 'the classic entity-oriented model.[257] Essentially, this is based on the notion that where the corporation's welfare is enhanced through earnings, the shareholders' interests are furthered.[258] However, Hu dismisses this approach on the basis that 'maximization of total corporate earnings or even earnings per share does not necessarily maximize shareholders wealth.'[259] Second, according to Hu, the 'pure' shareholder wealth maximization model' provides that shareholder wealth is the direct aim of managers and not seen as a derivative of increasing corporate welfare.[260] Under this approach, there is no concern for the independent welfare of the corporation as an entity and Hu criticises this explanation on the basis that this involves some concentration on the trading price of shares, and that price can be far different from the price which rationally reflects the

[254] Christine Kirchner, 'Shareholder Value: A New Standard for Corporation Conduct' in K. Hopt and E. Vermeersch (eds), *Capital Markets and Corporation Law* (Oxford, OUP 2003) 343.
[255] Henry Hu, 'New Financial Products, the Modern Process of Financial Innovation and the puzzle of Shareholder Welfare' (1991) 68 Texas Law Review 1273, 1317.
[256] ibid.
[257] ibid 1279.
[258] ibid.
[259] ibid.
[260] ibid.

information about the purpose of the corporation.[261] In other words, there can be irrational factors that affect the pricing of shares including the potential problem of informational asymmetry, which can lead to a pricing decision that is made without full knowledge of the corporate facts.[262]

It could be argued that the above assessment is consistent with the opinion of many scholars that the objective of the theory is in fact unclear and ill-defined.[263] If that view were to be correct then one could safely conclude that ascertaining whether the corporate objective can be measured is a matter of argument because it is quite possible that many managers do not understand what is meant by the theory.[264] The theory does not provide any definition, even though it gives the connotation of being an objective criterion; it is malleable and can mean many different things, including being used to support or challenge 'any management action by manipulating either the test of profits maximisation or the 'facts' to which the test is applied.[265]

A further problem seems that it is difficult for the courts to assess whether managers have maximised profits because the phrase 'shareholder value' remains inchoate which makes its definite meaning to be illusory.[266] However, many shareholders primacy adherents accept that the shareholder

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[261] ibid 1283.
[262] ibid.
[263] Modigliani Miller, 'The Informational Content of Dividends' in R. Dornbusch, S.Fischer, and J.Bossons (eds) *Macroeconomics and Finance: Essays in Honour of Franco Modigliani* (Cambridge, Massachusetts, MIT Press 1987); Claudi Loderer, Lukas Roth, Urs Waelchli, and Petra. Joerg, 'Shareholder Value: Principles, Declarations, and Actions' (2009) European Corporate Governance Institute Finance Working Paper No 95.
[264] Hu (n 225).
[265] Gerald Frug, 'The Ideology of Bureaucracy in American Law' (1984) 97 Harv LR 1276, 1311.
[266] ibid.

theory is not without its uncertainty, but the response to this uncertainty is that the theory does not produce as much ambiguity as other approaches.[267] Professor Jeffrey MacIntosh[268] argues that: ‘to tout the uncertainty of the wealth maximization standard as a reason for rejecting it is to fall prey to the Nirvana Fallacy: imperfect solutions compete not with perfection, but with other imperfect solutions’.[269] MacIntosh argues that scholars in both law and economics regard the theory as ‘the best we can hope for in an imperfect world’.[270] Accordingly, a major argument in favour of the theory is that managers can focus on one goal and that involves the interests of one group (shareholders only). In other words, proponents of the theory contend that this makes it superior to stakeholder theory as with the latter theory directors are required to balance many interests, and that is said to be vague and indeterminate given the number of stakeholders in the firm.[271]

Nevertheless, it is questionable whether the above assertion is valid given that, in practice, one could argue that in many public corporations, directors who practise shareholders primacy have to engage in balancing as there are different classes of shareholders and their respective interests have to be balanced against one another.[272] A case in reality is that shares come in different shapes and sizes such as common (ordinary) shares,[273] preference shares as well as deferred shares and the duty is incumbent on the directors to

[267] ibid.
[268] Jeffrey MacIntosh, ‘Designing an Efficient Fiduciary Law’ (1993) 43 University of Toronto Law Journal 425,456.
[269] ibid.
[270] ibid; Ronald Green, ‘Shareholders as stakeholders: Changing metaphors of corporate governance’ (1993) Washington and Lee Law Review 1409 -1413.
[271] ibid.
[272] ibid.
[273] ibid; Rutherford Campell and Christopher Frost, ‘Corporate Fiduciary Principles for the Post-Contractarian Era’ (1996) 23 Florida State University Law Review 561.

balance the interests of different kinds of shareholders, so as to act fairly to them [274] as, on some occasions, these different classes of shareholders have opposing interests.[275]

For example, Professors Jonathan Macey and Geoffrey Miller [276] are of the view that some preferred shareholders have interests that resemble those of fixed claimants, such as creditors, more than those associated with ordinary shareholders.[277] Also, some shareholders may intend only to retain shares for short-term while others are in for a long period.[278] Other shareholders hold a diversified portfolio, with their investment spread around a number of corporations, and still others might have all their investment concentrated on one corporation.[279] It is argued that the shareholder primacy theory is not sophisticated enough to allow for the fact that many investors are diversified and will have both the role of shareholder and bondholder in corporations.[280] In essence, those who are diversified in this manner are not going to have the same goal as those who are purely shareholders, for those who have diversified interests will be looking for a more balanced approach with respect to making investment decisions.[281] As a result of this, even in the shareholder model a number of opposing interests are competing among one another that call for the attention of directors to act fairly in balancing the various interests.[282] This implies that managers under shareholder model do

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[274] See *Re BSB Holdings Ltd* (No2) [1996] 1 BCLC 155, 246-249; *Mill v Mill* (1938) 60 CLR 150
[275] Morey McDaniel, 'Bondholders and Stockholders' (1988) 13 J. Corp L 205 – 273.
[276] Macey and Miller (n 223).
[277] ibid.
[278] ibid.
[279] ibid.
[280] Mary Sullivan, 'The innovative enterprise and corporate governance' (2000) 24 Cambridge Journal of Economics 393- 395.
[281] Henry Hansman and Reinier Kraakman, 'End of the History of Corporate Law' (2000) 89 Geo.L.J.439.
[282] ibid.

not entirely focus on one goal given the potential competing interests of the shareholders.

3.5.2 Short-termism

Short-termism denotes the phenomenon by which some corporate managers, responding to pressure from investors or acting to bolster their own position, advert their attention and exert their energies to achieving short-term profitability, virtually eschewing longer-term considerations.[283] It is important to emphasize at the outset that short-termism is not coterminous with holding stocks for short periods by investors. In other words, short-termism refers to the investment approach in which investors push managers to invest in short-term projects in order to keep earnings high.[284] Short-termism promotes a tendency to overvalue short-term rewards, invariably leading to an undervaluation of long-term consequences.[285]

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[283] Short-termism has been further defined as 'a preference for actions in the near-term without due consideration of the long term consequences and it is the excessive focus of some corporate leaders, investors, and analysts on short-term, quarterly earnings and a lack of attention to the strategy, fundamentals, and conventional approaches to long-term value creation. See generally Emeka Duruigbo, 'Tackling the shareholder short-termism and managerial myopia' (2011) 100 Kentucky Law Journal 531.

[284] David Millon, 'Theories of the Corporation' (1990) Duke L.J. 201, 201.

[285] Indeed, some market observers and legal commentators linked the collapse, a few years ago, of giant energy company Enron and some fabled financial firms to investors acting like traders and influencing corporate managers to make policy decisions based on quarterly earnings statements. Some shareholders' penchant for quick returns on investment put pressure on corporate managers to be fixated on short-term results, even at the expense of long-run performance. Besides, shareholders have a tendency to prefer 'exit' to 'voice.' That is, they would rather sell their stock if dissatisfied with corporate management than stay in and affect direction of corporate policy and ultimately, this works against good corporate performance. See generally Lucian Bebchuk and Lars Stole, 'Do Short-Term Objectives Lead to Under-or Overinvestment in Long-Term Projects?' (1993) 48 J. Fin. 719, 719–20; Kevin Laverty, 'Managerial Myopia or Systemic Short-termism? The Importance of Managerial Systems in Valuing the Long Term' (2004) 42 Mgmt. Decision 949, 950; Jill Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' (2006) 31 J. Corp. L. 637, 673.

A number of corporate and securities law scholars view investing with a short-term horizon as hazardous.[286] Their concern stems from the reasoning that corporate policy or practice driven by short-term objectives often translates to the pursuit of investments that are profitable in the short term, but unsustainable in the long run.[287] They see the current activism of hedge funds and other institutional shareholders-focused on immediate gains as detrimental both to the wellbeing of the corporation and the public.[288] The contention is that where management pays undue attention to quarterly earnings per share, it may put on hold or jettison investments that increase long-term value.[289] In essence, the problem with short-termism is when it detrimentally conflicts with the company's long-term interest which may not be in the best interest of all stakeholders.

3.5.3 Long-termism

Long-termism entails that managers as well as shareholders would have interests that go beyond immediate stock price maximization and advocate corporate policies that are in alignment with general societal expectations including overall wellbeing of the corporations.[290] Advocates posit that where companies get fixated on the near-term as well as fail to give proper attention

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[286] See William Bratton and Michael Wachter, 'The Case Against Shareholder Empowerment' (2010) 158 U. Pa. L. Rev. 653, 702; Edward Waitzer, *The Case for Realigning Shareholder Incentives* (Canada, Globe & Mail 2010); Lawrence Mitchell, 'The Sarbanes–Oxley Act and the Reinvention of Corporate Governance?'(2003) 48 Vill. L. Rev. 1189, 1210.
[287]See Waitze ibid.
[288] Daniel Greenwood, 'Fictional Shareholders: For Whom are Corporate Managers Trustees Revisited' (1996) 69 S Cal L Rev 1021- 1023.
[289] Also, the emphasis on short-term results makes it increasingly difficult for the corporation to maintain the long-term focus necessary to its own and society's well-being. See Martin Lipton and Steven Rosenblum, 'A New System of Corporate Governance: The Quinquennial Election of Directors' (1991) 58 U. Chi. L. Rev. 187, 203.
[290] See Cynthia Williams and John Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 Cornell Int'l L.J. 493, 547.

to social, ethical, or environmental issues, it could lead to reputational damage, stock price volatility and increase in the cost of capital.[291] Arguably, long-term investors may be concerned about social and environmental issues, not because of any deep and abiding interest in these issues but because they recognize that ignoring them may ultimately pose a significant danger to their financial bottom line.[292] Considering the problem from that perspective, long-term enthusiasts suggest that public policy should identify with the interests of long-term shareholders and either curtail the power of short horizon investors or attach appropriate responsibility to follow the exercise of that power.[293]

However, critics posit that corporate managers have long relied upon the long horizon argument as a smokescreen to hide their lacklustre performance and ward off activist investors intent on energizing underperforming corporations.[294] Similarly, support for short-term shareholding has also stemmed from the angle that some evidence, indicate that the efforts of short-term shareholders, especially activist hedge funds, can positively affect the fortunes of poorly run target companies.[295] In the same vein, investing for a long term entails greater risks and opportunity costs than investing for the short-term and not every shareholders are prepared to sacrifice the present for the future.[296]

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[291] ibid.

[292] Marleen O'Connor, 'Organized Labor as Shareholder Activist: Building Coalitions to Promote Worker Capitalism' (1997) 31 U. Rich. L. Rev. 1345, 1350.

[293] ibid.

[294] Managers get little or no benefits from planning for the long-term as it is likely to be their successors that will benefit from the rents that come to the corporation and perhaps planning for the long-term could make performance of the today's managers look decidedly average, as the share price may not increase and higher dividends may not be paid as quickly as if short-term plans are implemented. See George Dent, 'Corporate Governance: Still Broke, No Fix in Sight' (2006) 31 J. Corp. L. 39 – 54.

[295] Jeff Schwartz, 'Fairness, Utility, and Market Risk' (2010) 89 Or. L. Rev 175, 201- 08.

[296] Henry Hu, 'Risk, Time, and Fiduciary Principles in Corporate Investment' (1990) 38 UCLA Law Rev 277.

Moreover, some of the defenders of short-termism have argued against long-termism when they relied on the capital markets hypothesis that posits that the present value of a company's long-term position is reflected in the short-term price of its stock markets.[297] However, the financial crisis of 2008 revealed significantly different outcomes for short and long run investors given that it questioned the notion that markets always reflect long run fundamental value or that investors are always purely rational in their approach to short-term trading.[298]

In practice, investors make the balancing decision considering a variety of variables, including the level of market sophistication and tolerance for risk.[299] In addition, it is posited that the interests of long-term and short-term investors can coalesce to impel managers to act in the best interests of the corporation, for instance, by pushing managers to drop capital investments and acquisitions that add little value or to distribute excess cash to investors. Either way, it seems that directors enjoy an appreciable amount of discretion to pursue any agenda that they feel appropriate whether in short-term or in long run.

3.5.4 Ethics and Morality

A further criticism against this model is that it lacks moral basis in its implementation and given that shareholders are merely one group amongst many who are affected by the corporation's actions, the question remains:

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[297] Kuang-Wei Chueh, 'Is Hedge Fund Activism New Hope for the Market?' (2008) Colum. Bus. L. Rev. 724, 743; Julian Velasco, 'Taking Shareholder Rights Seriously' (2007) 41 U.C. Davis. L. Rev. 605, 637.

[298] Nina Walton, 'On the Optimal Allocation of Power Between Shareholders and Managers' (2010) 11 Univ. of S. Cal. Law, Econ., & Org 10.

[299] Stephen Bainbridge, *Corporation Law and Economics* (New York, Foundation Press 2002).

why should they benefit in priority to others? The emphasis on shareholder interests does not emanate from any moral reason, but from the desire to be efficient which is even doubtful given the recent financial crisis.[300] There is no consideration for fairness, equality, justice and the concern is that the approach tends to ignore reality as managing a corporation involves other matters besides the interests of shareholders.[301] The fact remains that society values more than just maximization of profit;[302] it is concerned about how wealth is distributed, the creation of jobs, family time, the effect in the environment and amongst others.[303]

Notwithstanding that the theory does not involve bad ethics, however, concerns over the ethical basis of the theory have been expressed on many occasions and flowing from that, it has been stated that the incentive remuneration schemes for managers, that are linked to share price performance may prejudice the ethical standing that managers should take.[304] As a result, many see the theory as cold and uncaring and totally omitting the human dimension that is critical to all facets of life, including business.[305] In the next section, stakeholder theory and its assumptions including the criticisms will be explored.

[300] Brett McDonnell, 'Corporate Constituency Statutes and Employee Governance' (2004) 30 William Mitchell Law Review
[301] ibid.
[302] ibid.
[303] Daniel Greenwood, 'Markets and Democracy: The Illegitimacy of Corporate Law' (2005) 74 UMKC L Rev 41-50.
[304] Lynne Dallas, 'A Preliminary Inquiry into the Responsibility of Corporations and their Directors and Officers for Corporate Climate: The Psychology of Enron's Demise' (2003) 35 Rutgers Law Journal.
[305] Robert Anthony, 'The Trouble with Profit Maximization' [1960] Harvard Business Review 126-132.

3.6 Stakeholder theory

This section aims to discuss the assumptions of stakeholder theory and its criticisms as it relates to the thesis. A stakeholder is defined as any group or individual who can affect or is affected by the operations of the organization's objectives.[306] Those that are directly affected by the company's activities are regarded as primary stakeholders and they include: shareholders, creditors, depositors (bank), customers, suppliers, managers, employees, the state and communities; while secondary stakeholders include those that can be less obviously or directly affected by a company's success or failure such as regulators, competitors, media and civil institutions.[307]

Freeman [308] laid the groundwork for developing the stakeholder model as a theory when he initiated a new way of thinking about business organisation by explaining the relationship of the firm to its external environment.[309] Clarkson [310] posited that the firm is a system of stakeholders operating within the larger system of host society that provides the necessary legal and markets infrastructure for the firm's activities.[311] The purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services.[312] Stakeholder theory is derived from the combination of the

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[306] Thomas Donaldson and Lee Preston, 'The Stakeholder Theory of Corporation: Concepts, Evidence Implication' (1995) 20(1) Academy of Management Review 65.
[307] Shann Turnbull, 'Stakeholder Governance: a cybernetic and property rights analysis' (1997f) 5(1) Corporate Governance: An International Review 11-23.
[308] Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston, Pitman 1984).
[309] ibid.
[310] Max Clarkson, *A Risk Based Model of Stakeholder Theory* (University of Toronto, Centre for Corporate Social Performance & Ethics 1994).
[311] ibid.
[312] The stakeholder theory is usually found in the Continental Europe such as in Germany, France and other Asian countries including Japan.

sociological and organizational disciplines incorporating philosophy, ethics, political theory, economics, law and organizational science.[313]

Unlike agency theory where the managers are working and serving mainly the interests of shareholders, the stakeholder theory suggests that managers in organization have a network of relationship to serve the interests of all stakeholders.[314] It has been argued that stakeholder theory was developed in opposition to the prevailing system of corporate governance, in which shareholders or stockholders are thought to have a privileged position.[315] Stakeholder theorists object to the alleged special status of shareholders on the ground that many other groups have legitimate claim or stake in a corporation and specifically, they contend that all stakeholders' interests ought to be taken into account in corporate decisions.[316]

Thus, Donaldson and Preston[317] rejected what they called 'management serving the shareholder model' because it violates the principle that the 'interests of all stakeholders are of intrinsic value' which is to say that each group 'merits consideration for its own sake'.[318] The central assumption of stakeholder theory rejects the main proposition of the prevailing system in the shareholder model that corporation should be governed for the sole interest of the shareholders. Rather, it argues for the followings: (1) that stakeholders

[313] David Wheeler, Barry Colbert and Edward Freeman, 'Focusing on Value: Reconciling Corporate Social Responsibility, Sustainability And A Stakeholder Approach In A Network World' (2003) 28 Journal of General Management 1-28.
[314] ibid 66.
[315] Shann Turnbull, 'Stakeholder Co-operation' (1997e) 29 Journal of Co-operative Studies: Society for Corporate Studies Manchester 3, (88), 18-52.
[316] ibid 68.
[317] Donaldson and Preston (n 306).
[318] ibid.

have a right to participate in corporate decisions that affect them,[319] (2) that managers have a fiduciary duty to serve the interests of all stakeholders groups and (3) the objective of the firm ought to be the promotion of all interests and not those of shareholders alone.[320]

Past stakeholder theorists have offered classical exposition of the 'inclusive' governance concept because they argue that a firm consist of social groups in which each group can be seen as supplying the firm with important resources (contributions) and in return expect its interests to be promoted and protected.[321] For instance, shareholders supply capital to the firm, in exchange, they expect to maximise the risk-adjusted return on their investments; creditors provide the firm with loans, and in return, they expect their loans to be repaid in time and depositors provide the banking firm with deposits, and in return, they expect their banks to be sound and healthy for safe withdrawals.[322]

Similarly, communities supply the firm with location and local infrastructure, and in exchange, they expect the firm to improve the quality of their lives as a corporate citizen and managers including the employees provide the firm with time and skills, and in return, they expect to receive substantial and sustainable income.[323] This has been the position with every conceivable constituency of the modern corporation and this is why the proponents of the

[319] ibid 70.
[320] ibid 72.
[321] Charles Hill and Thomas Jones, 'Stakeholder Agency Theory' (1992) 19 Journal of Management Studies 131-154; David Millon, 'Theories of the Corporation' (1990) Duke Law Journal 201-262.
[322] ibid.
[323] Letza Steve, Xiuping Sun, and James Kirkbride, 'Shareholding versus stakeholding: a critical review of corporate governance' (2004) 12 Corporate Governance: An International Review 3, 242-262; Hartwig Hummel, 'Organizational Ethics: A Stakeholder Debate' (1998) 17 Journal of Business Ethics 1403-1419.

theory unlike the shareholder model posit that the governance problem in the corporation arises out of either the absence of broader stakeholder participation in the running of public corporation or lack of their involvement in making corporate decisions.[324]

Stakeholder model has been categorised into three types: descriptive, instrumental and normative and according to Donaldson and Preston, the theory is descriptive when it is used to describe and sometimes used to explain specific corporate characteristics and behaviours.[325] Second, the theory is instrumental when it identifies the connections or lack of connections between the stakeholder management and the achievement of traditional corporate objectives.[326] Also, the theory can be normative when it involves the interpretation of the function of the corporation by identifying the moral and philosophical guidelines of the corporate operations.[327] While the three perspectives of the theory share the same core proposition of stakeholder approach, however, they are distinguishable in some important respect. For example, as the main theory of stakeholder model, the instrumental theory legitimises the value of stakeholders on the grounds that stakeholding is an effective means in improving efficiency, profitability, competition and economic success of a corporation.[328]

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[324] John Kay and Aubrey Silberston, 'Corporate Governance' (1995) 84 National Institute of Economic Review 84-97; Mark Latham, 'The Corporate Monitoring Firm' (1999) 7 Corporate Governance 12-20; Gavin Kelly and John Parkinson, 'The Conceptual Foundations of the Corporation: A Pluralist Approach' (1998) 2 Company Financial and Insolvency Law Review 174-197.
[325] Donaldson and Preston (n 306).
[326] Thomas Jones, 'Instrumental stakeholder theory: A synthesis of ethics and economics' (1995) 20(2) Academy of Management Review 404-437; John Parkinson and Gavin Kelly, 'The Combined Code on corporate governance' (1999) 70(1) The Political Quarterly 101-107.
[327] ibid 103.
[328] Andrew Campbell, 'Stakeholder: The case in favour' (1997) 30 Long Range Planning.

The normative theory emphasises the intrinsic value of the interests of the stakeholders given that managerial relationships with stakeholders are based on moral commitment rather than on a desire to use those stakeholders solely to maximise profits.[329] This is because a firm establishes certain moral principles to guide how it does businesses, particularly on how it treats her stakeholders and the justification for the intrinsic value should depend on ethical beliefs and social norms rather than on factual realities.[330] Stakeholder theory has mainly been covered from a normative perspective, which relates to the framing of the normative stakeholder theory as the core and most central interpretation of the theory.[331]

Flowing from the above, Jones [332] argued that the instrumental benefits of the model result only from the genuine commitment to ethical considerations and firms which create and sustain stakeholder relationships based on that will have a competitive advantage over other firms that do not act in this way.[333] More importantly, the normative theory provides a basis upon which concepts such as corporate social responsibility, corporate social responsiveness and corporate social performance can be analysed using a framework based on the management of a corporation's relationship with its stakeholders.[334] Clarkson posits that they may provide a strong argument for the phenomenon that stakeholder theory has gained considerable ground in the recent years not

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[329] Edward Freeman, 'Response: Divergent stakeholder theory' (1999) 24 Academy of Management 233- 4.
[330] Jeff Frooman, 'Stakeholders influence strategies' (1999) 24 Academy of Management Review 199-205.
[331] ibid.
[332] See Jones (n 326).
[333] IM Jawahar and Gary Mclaughlin, 'Toward a descriptive stakeholder theory: An Organizational Life Cycle Approach' (2001) 26(2) Academy of Management Review 397-414.
[334] See Thomas Jones and Andrew Wicks, 'Convergent Stakeholder theory' (1999) 24(2) Academy of Management Review 206-221.

only in the field of corporate strategy, economics and public policy but also in business ethics and law.[335]

While the argument remains that stakeholder theory has been developed in opposition to shareholder model, it has been posited that both theories share a common feature with agency theory that the firm is regarded as a nexus of contracts where managers are the agents of the principal.[336] In line with this thinking, it is contended that stakeholder theory is not entirely in conflict with agency theory given that the theory agrees with the separation of the ownership from control in public corporation which is a central assumption in agency theory that results in agency conflict which can be reduced by the firm through a nexus of contract among the various stakeholders.[337] By contrast, stakeholder theory rejects the assumption that shareholders and managers are the only important participants in the corporate relationships and while it shares the assumptions that market may be efficient, it nonetheless appreciates the existence of the short to medium-run inefficiencies in the market.[338] The theory recommends that there may be a need for occasional external interventions, including statutory legislations to establish market equilibrium in order to maximise the broader societal good.[339]

In recognition of the possible agency problem as a result of the separation of the ownership from control in the public corporations, the stakeholder theory

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[335] Edward Clarkson, 'A stakeholder framework for analysing and evaluating corporate social performance' (1995) 20 Academy of Management Review 65-91.
[336] ibid.
[337] ibid 416.
[338] See Jeroen Weimer and Joost Pape, 'A Taxonomy of Systems of Corporate Governance' (1999) 7(2) Corporate Governance: An International Perspective 152-166.
[339] ibid.

offers some solutions which warrant discussions. Unlike in most common law jurisdictions with a unitary board system including Nigeria, an ideal stakeholder corporate governance framework such as in Germany, companies will normally have a dual board structure (codetermination) such as the Management board; and a Supervisory board.[340] On one hand, the management board is vested with statutory powers to run the company including to manage its day-to-day businesses and it is within the purview of the management board to strategize and formulate policies that will guide the company into its future.[341]

On the other hand, the supervisory board is usually constituted by many stakeholders including shareholder/creditors/banks, employees (union groups), suppliers, customers, and government appointees representing the broader segment of the society.[342] In line with that, the theory mandates the managing board to run the company in the best interests of all stakeholders and this implies that the interest of the shareholders should only be pursued to the extent that they are not detrimental to the interests of the other stakeholders in the firm.[343]

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[340] One of the most fundamental features of German corporate governance model, in contrast with some common law jurisdictions, is that the company law is federal in nature and regulates the internal organisation of companies, with provision for dual board structure consisting of management board (Vorstand) and a supervisory board (Aufsichstrat). This peculiar system is known as 'codetermination' and is sustained by both corporate and labour statute at the federal level. See generally Florian Schilling, 'Corporate Governance in Germany: The Move to Shareholder Value' (2001) 9(3) Corporate Governance: An International Review 148-151.

[341] Christine Mallin, *Corporate Governance* (2nd Edition, Oxford, Oxford University Press 2007).

[342] ibid.

[343] The German model has not been without criticisms given that the Commission that drafted the Code had to deal with two board systems. The reason being that, many international investors were neither used to nor familiar with, the idea of two boards in the governance of a company. Similarly, there is a potential for inadequate independence of supervisory board because they are appointed by both shareholders and employees who may have competing or opposing interests in the firm. The German supervisory board has no power to direct the management board as its power is only advisory. By way of contrast, non-executive directors in the UK and other common law jurisdictions have directors who can attend board meetings and take part in meaningful decision making. See generally Gary Gorton and Frank Schmid, 'Capital, Labour and the Firm: A Study of German Codetermination' (2004) 2(3) Journal of European Economic Association 863-900; Shann Turnbull, 'Corporate Governance' (1995b)

Furthermore, the stakeholder model encourages corporate management to focus on building trust and long term contractual relationships between the firm and its stakeholders. In particular, it supports inter-firm corporation, including cross-shareholdings (especially in Japan) and employee participation in decision-making through the supervisory board (particularly among German firms).[344] Similarly, it encourages closer contact with shareholders, creditors, managers, employees and suppliers as well as the integration of the business ethics as a solution to achieving a balance among the various stakeholders' interests.[345]

However, one consequence of the model's insistence on balancing the interests of various stakeholders is that it may render it less appealing to equity investors and as such, companies tend to rely heavily on debt rather than equity markets as major sources of finance.[346] The equity markets (stock exchanges) in countries where stakeholder model is embraced tend to be less developed relative to debt markets (bank) with relatively high level of involvement by credit granting banks in providing capital for public corporations.[347] La Porta and others[348] argue that Anglo-American countries have dispersed ownership with higher investor protection in comparison with Continental-European-Asian (Civil and Scandinavian law origin) countries which tend to have relatively high ownership concentration with a weaker

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Harvard Business Review 169-70. Shann Turnbull, 'Stakeholder Governance: Redesigning the Governance of Firms and Bureaucracies' (1994) 23 Journal of Socio-Economics 321-361.

[344] Gerald Vinten, 'Shareholder versus Stakeholder - Is There a Governance Dilemma?' (2001) 9 Corporate Governance 36-47.

[345] Shann Turnbull, 'Competitiveness and Corporate Governance' (1994c) 2(2) Corporate Governance: An International Review 90-6.

[346] Weimer and Pape (n 196) 169.

[347] ibid.

[348] Rafael Laporta, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert Vishy, 'Investor Protection and Corporate Valuation' (2002) 57(3) Journal of Finance 1147-1170.

investor protection.[349] Stakeholder theory has also received some criticisms despite its recognition in many countries and these criticisms will be examined in the next subsection.

3.6.1 Major criticisms of stakeholder theory

First, a central criticism of the stakeholder governance model remains that it is not compatible with the concept of business because it proposes that corporation must strive to achieve a fair balance in distributing the benefits of the firm to a number of stakeholders, and as such prevents the firm from pursuing the single objective functions that favours the particular groups.[350] This is, however, not consistent with the notion of business which involves the investments of one's capital in a commercial firm for profit maximization.[351] In other words, it has been argued that if a business is prevented from operating so as to focus on maximising the 'owners' profits, it will simply collapse (a corporation is not a charity) and such collapse could negatively affect the social value and the welfare of all the stakeholders.[352]

Second, the definition of the 'stakeholders' appears to be vague and imprecise sometimes in the context of corporate governance.[353] For example, since the stakeholders involve all those who can affect or are affected by organisation, the number of the people whose benefits need to be taken into account is infinite and balancing all stakeholders' benefits are arguably an unworkable

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[349] Rafael Laporta, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert Vishny, 'Corporate ownership around the world' (1999) 54(2) Journal of Finance 471-517.
[350] ibid 251.
[351] ibid.
[352] Ronald Mitchell and Bradley Agle, 'Toward a theory of stakeholder identification and salience: Defining the principle who and what really counts' (1997) 22(40) Academy of Management Review 853-886.
[353] ibid 11.

objective.[354] For a balance to be struck, their number must somehow be limited and definite, but stakeholder theory offers no guidance as to how the appropriate individuals or groups should be selected.[355]

Moreover, individuals are often members of more than one form of stakeholder group but stakeholder theory does not indicate in which capacity or capacities are they to be included in determination.[356] Similarly, even if the benefits may be fairly identified, stakeholder theory provides no pattern as to how the balance is to be struck.[357] Given the divergent interests of the different stakeholder groups, that which benefits one group may often harm another, stakeholder theory does not provide which of these benefits is to be preferred or how the conflicting interests are to be balanced. For instance, are stakeholders interests all strictly equal? Are some more important than the others? If so, which are they? And when, and by how much, and why? Stakeholder theory gives no clue as to how to rank or reconcile the normally conflicting interests of numerous stakeholders.[358]

Consequently, associated with the above criticism is the argument that the theory provides no effective objective criterion against which the corporate agents such as managers and senior officers can be judged.[359] For instance, corporate agents are mandated to run the business primarily to balance all

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[354] ibid 12.
[355] Allen Sykes, 'Proposals for Internationally Competitive Corporate Governance in Britain and America' (1994) 2 Corporate Governance 187-195.
[356] ibid.
[357] ibid.
[358] Christopher Stoney and Diana Winstanley, 'Stakeholding: Confusion or Utopia? Mapping the Conceptual Terrain' (2001) 38 Journal of Management Studies 603-626.
[359] ibid.

stakeholders' interests but it does not serve as an effective objective performance measure given that it allows corporate agents responsible for its interpretation and implementation as well as excessive freedom to pursue their narrow interests, including perquisites consumptions and other private benefits of control.[360] Similarly, hiding under the vague notion of maximising and balancing all stakeholders' interests, some corporate agents are able to strongly oppose takeover bids that arguably may benefits the shareholders since it provides exit routes for shareholders where managers have poorly performed.[361] Instead, the model allows the corporate agents the pursuit of costly and unprofitable empire-building acquisitions, which weaken the markets for managerial and corporate control.[362]

Furthermore, it can be argued that the stakeholding model is incompatible with the notion of corporate governance given that a key corporate governance concept is accountability.[363] In other words, corporate governance is about the accountability of the directors to shareholders; the accountability of managers to directors; and the accountability of the corporate employees and other corporate agents to the shareholders through managers and directors.[364] Stakeholder theory, however, suggests that firms should be accountable to all their stakeholders rather than to the shareholders alone.[365] By contrast, it has been argued that multiple accountabilities work

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[360] Jill Solomon, *Corporate Governance and Accountability*, (2nd edition, Chichester, UK, John Wiley and Sons Ltd 2007).
[361] Jill Solomon, *Corporate Governance and Accountability*, (1st edition, Chichester, UK, John Wiley and Sons Ltd 2004).
[362] LE Preston and HJ Sapienza, 'Stakeholder Management and Corporate Performance' (1990) 19(4) Journal of Behavioural Economics 361-375.
[363] GJ Rossouw, 'Business Ethics and Corporate Governance in Africa' (2005a) 44(1) Business and Society 94-106.
[364] Solomon (n 360) 20.
[365] ibid 108.

well if the purpose is unambiguous to all members involved. However an organisation that is accountable to everyone is accountable to no one and an accountability that is too vague as well as diffused is effectively non-existent and unworkable in governance terms .[366]

A further criticism against this model is that stakeholder theory undermines private property, agency relation and wealth creation.[367] In particular, it is essential to point out that the theory undermines two of the most fundamental features that characterise human society: private property and the duty that the agent owes to the principal.[368] Stakeholder theory undermines private property right because it denies 'corporate owners' the right to determine how their property will be used and in so far as the assets are held or utilised by the organisations, stakeholder theory stipulates that those assets should be used for the benefit of all stakeholders.[369] The 'owners' of those assets are thereby prevented from devoting their property rights unequivocally to the ends of their choice even if such could maximise the 'owners' (shareholders) value. [370] Similarly, stakeholder theorists sometimes attempt to justify curtailing property rights by arguing that property rights should not be total, but, one can argue that for the mere reason that some limitations may apply in property right is not a justification for violating them. In essence, the fact

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[366] GJ Rossouw, 'The Philosophical Premises of the Second King Report on Corporate Governance' (2005b) 70(4) Koers745-748.

[367] Marguerite Scheider, 'A Stakeholder Model of Organizational Leadership' (2002)13(2) Organisational Science 209-220; Jean Tirole, 'Corporate Governance' (2001) 69 (1) Econometrica 1-35.

[368] Elaine Sternberg, 'The Defects of Stakeholder Theory' (1997) 5(1) Corporate Governance 3-10*;* Mark Starik, 'Reflections on Stakeholder Theory' (1994) 33 Business and Society 82-131.

[369] Robert Philips, Edward Freeman and Andrew Wicks, 'What Stakeholder Theory is Not' (2003) 13(4) Business Quarterly 479-502; Jonathan Marcey and Geoffrey Miller, 'Corporate Stakeholders: A Contractual Perspectives' (19930 43(3) University of Toronto Law Journal 401- 424.

[370] Margret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85(2) Virginia Law Review 247-328*;* Eric Orts and Allen Strudler, 'The Ethical and Environmental Limits of Stakeholder Theory' (2002) 12(2) Business Ethics Quarterly 215-233.

that shareholders are most times unwilling or unable to actively protect their interests do not entitle other stakeholders to commandeer corporate property.[371]

Furthermore, stakeholder theory denies the duties that agents owe to the principal, however, from the law of agency, it is argued that whenever one entrusts assets or affairs to another, an agency relationship between the agent and the principal is invoked and it arises between the company and the shareholders ('share owners'), and even between corporate managers and corporate directors.[372] Also, it arises in every case of employment whatever the form of an establishment.[373] But stakeholder theory makes this critical relationship unworkable by denying that agents have any special or particular relationship with the principal and this is because according to the stakeholder theory, organisational agents are equally accountable to all stakeholders - and thus to no one in particular.[374] It is difficult to entirely accept the stakeholder's argument given the pervasive importance of the agency relationship and the central role private property may assume in promoting economic activities in the modern corporation.

The chapter has been examining the two leading and competing theories and their assumptions in corporate governance practices. Neither the shareholder

[371] Thomas Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' (1995) 20(2) Academy of Management Review 404-601.
[372] Eric Orts, 'The Complexity and Legitimacy of Corporate Law' (1993) 50 Washington and Lee Law and Policy Review 265-329.
[373] Agent duty to the principal is central to the conduct of civil servants and armies, investment managers and lawyers, school teachers and motor mechanic. See Eric Orts, 'Shirking and Sharking: A legal Theory of the Firm' (1998) 16(2) Yale Law and Policy Review.
[374] Jeffrey Harrison and Caron John, 'Managing and Partnering with External Stakeholder' (1993) 10(2) Academy of Management Executive 46-60.

model which is the dominant theory in common law countries including Nigeria nor the stakeholder model which prevails in Continental European countries can neatly apply in practice without some element of the other as can be seen from the theoretical literature surveyed. Furthermore, contemporary studies among scholars demonstrate that these two competing systems and models may be converging to one system as a result of globalization, mergers and acquisitions, take over regulations, including the cross-listing rules on stock exchanges in many jurisdictions.[375] In what follows, regulation will be briefly discussed with respect to its relevance in theories of corporate governance in banks as it relates to the thesis. The main essence is to highlight the lack of fit between corporate governance theories and the institution called a bank given the potential for systemic risk in the sector.

[375] For convergence debate on corporate governance systems see generally Henry Hansmann and Reinier Kraakman 'The End of the History for Corporate Law' (2001) 89 Georgetown Law Journal 439-468; Amir Licht, 'Cross-Listing and Corporate Governance: Bonding or Avoiding?' (2003) Chicago Journal of International Law 4; Roberto Romano, 'A Cautionary Note on Drawing Lessons from Comparative Corporate Law' (1993) 102 Yale L.J 2021, 2031; Jens Koke, 'The Market for corporate control in bank-based economy: a governance device?' (2004) 10 Journal of Corporate Finance 53-80; Robert Daines, 'Does Delaware Law improve the firm value? (2001) 52 Journal of Financial Economics 525-558; Arturo Bris and Christos Cabolis, 'Corporate Governance Convergence by Contract: Evidence from Cross-Border Mergers' (2002) Yale School of Management Working Papers 293; Ronald Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (2001) 49 American Journal of Comparative Law 2, 329-357; Stephen Bainbridge, 'The Politics of the Corporate Governance' (1994) 18 Harv. J.L & Pub Pol'y, 671,712-13; Joseph McCahery, Piet Moerland, Theo. Raaijmakers and Luc Renneboog, *Corporate governance regimes: convergence and diversity* (Oxford, Oxford University Press 2002); Jeffery Gordon, 'Pathways to Corporate Convergence? Two Steps on the Road to Shareholders Capitalism in Germany' (1999) 5 Colum J.EUR.L 219; Brian Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan via Toronto' (1999) 10 Duke J. Comp & Int' L .L 5, 6; Mark Roe, 'The Shareholders Wealth Maximization Norm and Industrial Organization' (2001) 149 U.PA L. Rev 2063, 20; Erik Berglof and Mike Burkart, 'European Takeover Regulations' (2003) 18 Economic Policy 171-213; Marco Becht, 'European Corporate Governance: Trading Off Liquidity against Control' (1999) 43 European Economic; Marco Pagano, Alis Roell and Josef Zechner, 'The Geography of the Equity Listing: Why Do Companies List Abroad?' (2002) 57(6) Journal of Finance 2651-2694; Lucian Bebchuk and Allen Ferrell, 'A New Approach to Takeover Law and Regulatory Competition' (2001) 87 Virginia Law Review 1167.

3.7 Implications for corporate governance theories in banks

This section briefly examines why corporate governance theories are inadequate with respect to banking sector and the aim is to indicate why regulation is relevant in governance of banks unlike in other non-financial firms. While a great deal of theoretical and empirical research exists on corporate governance theories generally, very few of them concern the behaviour of the managers and owners of the banks given that a number of these studies assume that bank neatly conforms to the concept of the firm used in agency theory.[376] The thesis argues that there are limitations to these assumptions which require an alternative conceptual framework that are more suitable to the analysis because the commercial banks are distinguished by a more complex structure of information asymmetry arising from the presence of regulation.

In essence, while regulation is an external governance force, it remains necessary in bank to protect the public including the economy (that is, ensuring the integrity of the banking system and prevention of the systemic risk).[377] However, its presence limits the power of the market to discipline the banks, its managers and the owners that theoretically alters the parameters of corporate governance in banks by introducing the third party - the regulator.[378] The presence of regulation in bank creates a strong theoretical motive for further research and by defining a conceptual framework

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[376] Stephen Prowse, 'The Corporate Governance System in Banking: What Do We Know?' (1997) Banca Nazionale del Lavora Quaterly Review 23.
[377] ibid.
[378] Stephen Prowse, 'Alternative Methods of Corporate Control in Commercial Banks' (1995) Economic Review Quarterly 23.

appropriate to governance in banks, it will contribute to further development of corporate governance of the banks.[379]

Flowing from the above, regulation has at least four effects on the banking system. First, the presence of regulation implies the existence of an external force, independent of the markets, which affects both the owners and the managers.[380] Second, because the market in which banking firms act is regulated, the regulations aimed at markets implicitly create an external governance force on the firm.[381] Third, the existence of both the regulator and the regulations implies that the markets forces will discipline both managers and owners in different way than that in unregulated firms. Moreover, in order to prevent the systemic risk leading to lender of last resort, the current banking regulation means that a second and external party is sharing the bank's risk.[382]

Furthermore, to illustrate the lack of fit between standard agency models and the firm known as a bank, it will be useful to review its assumptions and make comparison with the characteristics of banks. Agency theory in a conventional firm makes at least three assumptions and: (i) one is that it is normal or competitive markets (ii) the nexus of information asymmetry is the principal-agent relationship between owners and managers (iii) optimal capital structure requires limited gearing.

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[379] Stephen Prowse, 'Corporate Control in Commercial Banks' (1997) (20(4) Journal of Financial Research 509-27.
[380] ibid.
[381] Gary Gorton and George Pannacchi, 'Financial Intermediation and Liquidity Creation' (1990) 45(1) Journal of Finance 49-72.
[382] Gary Gorton and Richard Rosen, 'Corporate control, portfolio choice and the decline of banking' (1995) Journal of Finance 50.

In contrast, one finds that commercial banks function: (a) in regulated or administered markets (b) the agency problem is more complex (c) capital structure is highly geared reflecting the bank's function as an intermediary and owners hardly contribute more than 20% - 40% of the funds loaned; the bondholders and depositors provide the rest.[383]

For governance, the more complex agency problem is of particular importance and in addition to information asymmetry between owners and managers, there exists at least three additional complex asymmetric information in banks and these are: (1) between depositors, the bank and the regulator (2) between owner, managers and the regulator (3) between borrowers, managers and the regulator.[384]

The importance of this additional complex information asymmetry suggests that the nature of the firm called a bank is qualitatively different from the nature of a firm implied by the normal agency theory.[385] First, the reason is that in an ideal literature on corporate governance, the market is the only external governance force with the power to discipline the agents.[386] However, in the banking sector, the existence of regulation means that there is additional external force with power to discipline the agent that is quite different from the market and it acts in both macro-economic level (at the banking sector sphere) and micro-economic level (at the level of individual banks).[387] This implies that the power of regulation has different origin and

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[383] Penny Ciancanelli, and Reyes Gonzalez, 'Corporate Governance in Banking: A Conceptual Framework' (2002) <http://www.papers.ssrn.com/paper.taf?abstract_id=253714 > accessed on 26th July 2014.
[384] ibid 6.
[385] ibid 7-10 - the regulator 'insures' the depositor in order to limit systemic risk in bank.
[386] Xavier Freixas and Jean Rochet, *Microeconomics of Banking*, (USA, MIT Press 1997).
[387] Jean Rochet, *Why Are There So Many Banking Crises?: The Politics and Policy of Bank Regulation* (Princeton, New Jersey, Princeton University Press 2008).

different parameters, and therefore different effects to those produced by the markets.[388]

Second, banking regulation shows the existence of interest separate and distinct from the private interests of the firm and as a governance force, regulation is aimed at serving the interest of the public, particularly the interest of the consumers of the banking services.[389] Third, an agent of the public interest – the regulator, enforces the regulation and this agent does not have any contractual relationship with either the firm's principal or with the banking organisations as an interest distinct from the principal.[390] The import of this is that at the formal institutional level, the regulator is acting as the agent of the public interest and not only for shareholders, therefore, with respect to banking, it is in central focus and not subordinate position.[391]

In view of that, the external forces affecting corporate governance on banks include not only distinctive market forces but also regulation and the presence of regulation means that corporate governance on bank must be concerned with the interest of the owners and shareholders including depositors and the public.[392] In addition, regulations including its agents, regulators have a different relationship with the firm, the market, the bank management as well as bank owners. In essence, this relationship is not restricted to potential

[388] ibid 45.
[389] ibid.
[390] Franklin Edwards, 'Managerial objectives in regulated industries: Expense preference behaviour in banking' (1977) Journal of Political Economy.
[391] Keith Macmillan and Steve Downing, 'Governance and Performance: Good Hunting' (1999) 24 Journal of General Management 3.
[392] ibid 4-10.

financial contracts existing between the principal and the agents given that regulation aims at protecting the interests of the public.[393]

Consequently, regulation creates constraints on market processes by restricting their nature and scope as well as subjects all banking firms to the threat of an administrative action through the regulators.[394] In conventional corporate governance theories and models, it is argued that markets have considerable power over the firms because it is a staging ground for significant threats to corporate and managerial control by allowing new entrants in the markets through mergers, acquisitions and takeovers.[395] Also, the market in managerial labour is another ideal ground for threat against managerial misbehaviour, however, in the banking firm, the existence of specific control on mergers, acquisitions including the risk-taking all limit the disciplinary power of markets.[396] The disposition of the regulatory power will hardly happen without the reference to and consideration of issues, structures, processes and concerns articulated by both the markets and individual firms.[397]

In this connection, it is argued that public interest is deemed to be the overriding purpose considered in the deliberations by the regulator and not the interests of shareholders alone.[398] In light of this, regulation is associated with the resolution of the alleged market failure including provision of public

[393] ibid 15.
[394] ibid.
[395] Gustavo Visentini, 'Corporate Governance: The Case of Banking' (1997) Banca Nazionale del Lavoro Quarterly Review 2.
[396] Garry Stoker, *Governance as Theory: five propositions* (UNESCO, Black Publisher 1998).
[397] ibid.
[398] Anthony Ogus, *Regulation, Legal Form and Economic Theory* (Oxford, Clarendon Law Series, Oxford University Press 1994).

goods and financial stability.[399] Whether specific regulations satisfy this function or not, the mere presence of the regulation necessarily changes the parameters of competitions among the regulated firms in corporate governance of banks.[400] In other words, the characteristic limitation imposed by regulation is not necessarily concerned with the market structure per se such as barriers to entry or market monopoly power as a means to ensure competition. Rather, the restrictions imposed in most countries could even attempt the opposite by restricting price and other forms of competitions. In essence, banking regulators sometimes seek to restrain new entries, prevent mergers, acquisitions and takeovers, and in general, encourage only the mergers and acquisitions that assist in reducing the systemic risks.[401]

In addition, regulation often establishes minimum qualifications and requires character references including other evidence on probity for persons considered for management positions within the banks.[402] Given that banking and financial services sector assume the features of administered markets, it can be argued that regulations are primarily intended to restore a welfare system instead of a competitive equilibrium.[403] Furthermore, in a standard corporate governance of a firm found in financial management theory, attention is mainly focused on identifying what will be characterized as those interests internal to the organization and these include such things as the

[399] Armen Alchian, 'Uncertainty, evolution and economic theory' (1950) 58 Journal of Political Economy 211-21.
[400] ibid 23.
[401] Renee Adams and Hamid Mehrah, 'Is Corporate Governance different from bank holding companies?' (2003) 9 Economic Policy Review 132-142.
[402] ibid.
[403] Donald Morgan, 'Rating banks: Risk and uncertainty in an opaque industry' (2002) 92 American Economic Review 874-88.

maximisation of wealth as the principal's primary interests.[404] In order to fulfil this interest, the agent has a well-specified objective function, which is the maximisation of the shareholders wealth.[405] The manager is expected to act and take decisions on behalf of the owner's interests and the implication is that any system or method of corporate governance system ought to take as their objective safeguarding the interests of the principal, which arguably means maximising the shareholders' wealth. [406]

However, in the banking corporation, there exists another interest - that of the regulator acting as an agent for the public interest and this interest exists outside of the firm and is not necessarily associated, in an immediate and direct way, to maximization of the bank's profits.[407] The mere existence of this outside interest will have a profound effect on the construction of interests internal to the firm.[408] Thus, because the public interest plays a major role in banking, pursuit of interests internal to the firm requires individual banks to attend to interests external to the firm and this implies a wide range of potential conflict of interests than is found in non-banking corporations.[409] Similarly, in banking corporate governance, the agent should respond not only to the owners but also to the public interests expressed by the regulations through administrative rules, codes, ordinances and even financial prescriptions.[410]

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[404] Stewart Myers, 'Determinants of corporate borrowing' (1977) 5 Journal Financial Economics 147-75.
[405] Ross Levine, 'Financial development and economic growth: Views and agenda' (1997) 35 Journal of Economic Literature 688-726.
[406] ibid 730.
[407] ibid 733.
[408] ibid 735.
[409] James Barth, Gerald Caprio and Ross Lavine, 'Bank supervision and regulation: What works best?' (2003) Journal of Financial Intermediation 3.
[410] ibid.

In order to protect the public interest, regulation imposes a form of external governance on the agent and the agent is monitored by the regulator in order to prevent misconduct. This includes the ability of the regulator to impose penalties and fines against the agent where there are breaches of statutory provisions.[411] In other words, if the manager does not act in accordance with the regulations, he or she can be disciplined through extra market administrative action including the possibility of being excluded from the employment in the sector altogether.[412] The implication of the above is that the bank's management must function in the light of two separate sets of interests and one is the private interest internal to the firm while the other is the interests external to the firm and from the perspective of corporate governance, the agent will seek to ensure that the behaviour beneficial to the firm's internal interest does not compromise the public interests.[413]

Moreover, a centrepiece in analysis of agency theory is the proposition that the owner's interest may be affected by the self-regarding actions of the agent and the main function the principal delegates to the agent is the lending decisions and the shareholders are thought to bear the risk-taking. [414] This argument, together with the delegation of the management to the agent, creates the rationale for the so-called agency theory and as the contingent claimant in the organisation resources, shareholders bear any business risk that the firm faces in its everyday of the operations.[415] Similarly, it is often

[411] Linda Allen and Sinan Cebenoyan, 'Bank acquisitions and Ownerships structure: Theory and Evidence' (1991) Journal of Banking and Finance 15.
[412] ibid 17.
[413] ibid 20.
[414] Adrian Cadbury, 'The Future for Governance: The Rules of the Game' (1998) 24 Journal of General Management 1.
[415] Ciancanelli and Gonzalez (n 383).

assumed that on average owners and investors are the risk averse claimant and the investor seeks to minimize risk for a given level of return.[416] Therefore, one of the main objectives of the corporate governance is the creation of the decision structure that prevents the agent from engaging in activities that expose the investor to a higher level of risk than that desired by the shareholders.[417] Basically, the proper governance is deemed to require systems that prevent this problem, such that the agents find it difficult to take higher risks than desire by the owners.[418]

In banks, the framework of action as well as motivation is quite different, because current banking regulation is concerned first and foremost with the existence of systemic risk, and regulation applies those policy instruments deemed effective in limiting systemic risk.[419] Of those instruments, the lender of last resort (LOLR) and system of deposit insurance are the ones deemed to be the best means to prevent contagion, bank runs, and other anticipated threats to systemic integrity on financial systems.[420] From the standard corporate governance perspective, the presence of these policy instruments including the safety nets evidently changes the relationship between the agent and the principal in banks and the conceptual framework required to understand the corporate governance in banks.[421]

In furtherance of the above, these standard policies of systemic risk limitation imply that bank owners are in a risk sharing relationship with an external

[416] ibid.
[417] ibid 10.
[418] ibid.
[419] Anthony Crawford, John Ezzell, and James Miles, 'Banks CEO pay-performance relations and the effects of deregulations' (1995) Journal of Business 68.
[420] ibid.
[421] ibid.

authority and the business risk that would have been borne totally in ordinary firms by the shareholders are now partially assumed by them.[422] In ordinary firms, creditors and other commercial entities take some risk with any firm they do business with.[423] However, because the firm called a bank is in a risk sharing relationship, it has the potential to assume much higher level of risks than in the unregulated firms. In essence, excessive risk-taking in lending is the most rational course of action by banking firms precisely because if the risk-taking leads to a very high return, the bank gleans excess profits.[424] Nevertheless, if the risk-taking results in bankruptcy that is perceived to be a threat to the system, the bank owners will be bailed out.[425] It has been contended in the banking literature of many countries that some banks are 'too big to fail' and regardless of the risky lending behaviour they engaged in, they are inevitably bailed out because without doing that the entire banking system could be affected because of bank inter-connectivity.[426]

Regarding risk-taking in banks, this problem is usually presented as one of the reasons for regulating banks given the potential for moral hazard.[427] The problem of moral hazard could be caused by the existence of the public 'safety net' (LOLR) which may give managers and investors in financial institutions the tendencies to behave carelessly or be less prudent with risks.[428] The

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[422] Franklin Edwards and Frederic Mishkin, 'The Decline of Traditional Banking: Implications for Financial Stability and Regulatory Policy' (1995) 1 Economic Policy Review 2.
[423] ibid.
[424] JF Houston and CM James, 'CEO compensation and bank risk: Is compensation in banking structure to promote risk taking?' (1995) 36 Journal of Monetary Economics 2.
[425] ibid.
[426] ibid.
[427] See Lammertjan Dam and Michael Koetter, 'Bank bailouts, interventions, and moral hazard' (2011) 2 Discussion Paper 10.
[428] ibid - a bank safety net can be defined as a set of policies designed to prevent or reverse widespread disintermediation from banks, losses in bank capital, and bank failures and policymakers often argue that the safety net is essential for a healthy banking system and the economy such as deposit insurance, LOLR, capital adequacy buffers amongst others.

dilemma of moral hazard could arise in two different situations and first is when managers of financial institutions believe that they are protected from any crisis and that they may receive loans from the lender of last resort during times of crisis. Second, when the investors of the institution know that they get the same protection from LOLR.[429] In view of that, it is suggested that the Central Bank whether in the developed or developing economies needs to strike a right balance between the risk of contagion in the case of non-assistance to insolvent financial institution and the moral hazard incentives.[430]

3.8 Conclusion

This chapter has reviewed the dominant theories on corporate governance and its deficits from which the foundational basis of the thesis is drawn. The main argument of the thesis remains that given the inadequacies of corporate governance theories, regulation is necessary to complement and reform the governance mechanisms because of the potential for systemic risk in banks. The dominant corporate governance theories are shareholder model and stakeholder approach, however, given that the corporate environment is continually changing with uncertain future, it is argued that the split between shareholding and stakeholding in current theorising of corporate governance is less valuable. This is because the material conditions and ideological perceptions of these models have changed significantly making the

[429] LOLR is a discretionary provision of liquidity to a financial institution (or the market as a whole) by the Central Bank in reaction to an adverse shock which causes an abnormal increase in demand for liquidity which cannot be met from an alternative source. The function has been performed by many Central Banks since the beginning of the 20th century. The goal is to prevent financial panics and bank runs spreading from one bank to the next due to a lack of liquidity. See Rose Lastra, 'Lender of Last Resort: An International Perspective' (1999) 40 (20) International and Comparative Quarterly 339-361.
[430] ibid.

polarisation of shareholding and stakeholding now somewhat redundant.[431] For instance, in order to make the theories universally justifiable, both the shareholding and stakeholding perspectives attempt to generalise and simplify theories, even though corporate governance practice is very dynamic, complex and context specific.[432]

The assumptions and presuppositions of these theories tend to abstract and fix reality and ignore or neglect the flux and heterogeneity of corporate governance in practice.[433] In so doing, however, the advocates seem rather puzzled about the lack of evidence in support of their theoretical models.[434] The most popular approach in corporate governance research is economic analysis and this is manifested in both the shareholder model and stakeholder approach and underpinning both model is the continuous search for the optimal governance structure which purportedly lies in the most efficient form.[435] While the shareholder and stakeholder perspectives are different, however, common to both models are the notions of profit maximization, an increasing market value and economic rationality or efficiency. [436] Nonetheless, the economic rationale employed in the governance debate ignores the basic fact that corporate governance is a social process, which cannot be isolated from social and other non-economic factors including power, legislation, social relationship and institutional contexts.[437] Theories grounded on economic rationality alone tend to neglect or marginalise the

[431] Ort and Strudler (n 370).
[432] ibid.
[433] ibid.
[434] ibid.
[435] Blair and Stout (n 370).
[436] ibid.
[437] ibid.

importance of irrationality, emotion, value, belief and ideology which often play a significant role in the process of decision-making and governance. [438]

Corporate governance functions only through human action, which itself is affected by a high number of changing and interacting variables and any single model and structure of corporate governance cannot work well for all firms at all times. [439] Corporate governance needs to be flexible, adaptable and innovative and for theoretical models to be workable and explicable in practice there is need to develop new approaches and models which better explain the idiosyncratic workings of local corporate governance.[440] There is need for a new mode of thinking in the analysis of corporate governance which goes beyond the conventional static approaches. In essence, a new mode of thinking that would explain some important phenomena in corporate governance contrary to the current conventional theoretical assumptions.[441]

For example, whereas shareholder perspective regards the corporation as an extension of individual private property and nexus of free exchange, however, corporate legal relationships show that the corporation is actually an independent organisation with its own rights and liabilities separate from its members/shareholders.[442] The traditional rationale for private ownership has been transformed and the process of incorporation (for both public and private companies) can no longer be viewed as a purely private ownership matter in

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[438] Stenberg (n 368).
[439] ibid.
[440] ibid.
[441] Stenberg (n 368).
[442] ibid.

the traditional sense.[443] Shareholders do not have individual free rights and claims on the corporation, they bear only very limited liability and risk especially in the corporations. The entire liability and risk of corporation are shared by many stakeholders including shareholders, bondholders, depositors, creditors, employees, suppliers, the government and the public at large. In this sense, all companies have some public character.[444] The current shareholder perspective based on purely economic and financial analysis that totally ignores corporate legal relationships cannot explain the nature of incorporation. [445]

Similarly, the current stakeholder model regards the corporation as a discrete social entity and is compatible with the 'real personality' assertion and this logically supposes that the corporation is a real person, independent of its members, and draws the image of an empty entity where all stakeholders are external to and influential on the corporation. This simply ignores the actual process of incorporation, where the corporation is a constituent of its members. [446] Without its members, no corporation can exist in law (throughout the world, a corporation must have at least one member).[447] In company law, the corporation is seen as a complex rather than a simple phenomenon where it is seen as both the association of its members and a legal person separate from its members and a simple stakeholding model ignores this complexity.[448] Both shareholder and stakeholder perspectives

[443] ibid.
[444] Steve, Sun and Kirkbride (n 323).
[445] ibid.
[446] ibid.
[447] ibid.
[448] Nat Ofo, 'Corporate Governance in Nigeria: Prospect and Problems' (2010) 1(4) Apogee Journal of Business, Property and Constitutional Law 15, 21-22.

claim superiority of their models respectively, however, in practice, there have been a dynamic shift with both models becoming increasingly mutually attractive all over the world in the last two decades but a paradigmatic shift of theories that will include both internal and external governance is the argument of this chapter.

Flowing from the above, current corporate governance theories are relevant in the thesis but deficient and inadequate in explaining the complexity and heterogeneity of banking corporations.[449] Given that the banking corporation operates much more on regulated and administered markets, neither the shareholder model nor stakeholder theory recognised the centrality of the regulation in the banking industry. Both theories are deficient given that they assume that banks strictly conform to the concept of corporate governance as observed in non-financial firms, which is not exactly the case.

One of the central arguments of this thesis is that the above assumption of these models is not the case given that regulation in banking governance imposes constraints on markets forces and because the regulator acts on behalf of the public through regulations to share the risk. In other words, in banking, protection of the public (especially the depositors) along with stability in financial system is paramount in view of the potential systemic risk inherent in the system unlike in non-financial firms where maximization of shareholders values seem to be the priority.[450]

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[449] Ogus (n 398).
[450] ibid.

Basically, corporate governance of banks must be seen to be different from that of the average or typical firm because of government regulation and the regulator.[451] In bank, it is expected that (i) the problem of governance will be more complex (ii) the relationship between the agent and the principal is unique in being mediated by an external force (iii) the owners may be considered as the single most important source of moral hazard.[452] Therefore, theories on corporate governance in bank must appreciate that: (a) regulation as an external governance force is separate and distinct from the markets (b) regulation of the market itself as a distinct and separate dimension of decision making within banks (c) regulation as constituting the presence of an additional interest external to and separate from the firm's interest (d) regulation as constituting an external party that is in a risk sharing relationship with the individual banking firm.[453]

Theories of corporate governance in banking which ignore regulation will misunderstand the agency problem specific to banks. In other words, regulatory model is necessary to complement and reform the efforts of corporate governance theories in banks given the centrality of the role regulation plays with respect to the structure and dynamics of the principal/agent relationship in banks.[454]

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[451] Morgan (403).
[452] ibid.
[453] Ciancanelli and Gonzalez (n 383).
[454] Regulatory theory and its strategies on banks are discussed in chapter 5 of this thesis.

Chapter Four

Legal and regulatory regimes in Nigerian banking sector

4. 1 Introduction

This chapter discusses the corporate governance structures, challenges and prospects in Nigerian banking in line with global best practices as it relates to the thesis.[1] The frameworks for good corporate governance in Nigeria are partly mandatory and voluntary either in the form of an Act of the National Assembly (MPs) or Codes.[2] The corporate terrain in Nigeria has been struggling for survival since 1980s and 1990s and even in today's world as distress can still be seen haunting the financial sector.[3] This chapter is divided into three parts. Part I reviews the corporate governance issues, challenges and prospect in the Nigerian banking. Part II examines the governance challenges in the UK banking sector with respect to the failure of RBS. The reference to RBS as an illustrative case is relevant to the thesis so as to draw lessons from other jurisdictions that remain useful in the Nigerian context.

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[1] 'Best practice' can be loosely seen as a form of program evaluation in public policy. It entails reviewing policy alternatives that have been effective in addressing similar issues in the past and could be applied to a current problem. However, determining "Best" practices to address a particular policy problem is a commonly used but little understood tool of analysis because the concept is vague and should therefore be viewed with caution. Vagueness stems from the term "best" which is subjective. While some research and evidence must go into determining a practice as the "best" it is more helpful to simply determine if a practice has worked exceptionally well and why. Instead of it being "the best", a practice might simply be a smart practice, a good practice, or a promising practice. This allows for a mix and match approach for making recommendations that might encompass pieces of many good practices. See generally Eugene Bardach, *A practical guide for policy analysis: The eightfold path to more effective problem solving* (Seven Bridge Press 2000); Christopher Bogan and Michael English, *Benchmarking for Best Practices: Winning Through Innovative Adaptation* (McGraw Hill Higher Education 1994); Stuart Bretschneider, Frederick Marc-Aurele, and Jiannan Wu, 'Best practices' research: A methodology guide for the perplexed' (2005) 2(15) Journal of Public Administration Research and Theory 307-32. See Victor Kwakwa and Greg Nzeku, 'International Best Practices on Corporate Governance' in Oladimeji Alo (ed) in *Issues in Corporate Governance* (Lagos, FITC 2003) p.19.

[2] For mandatory legal regimes see CAMA 1990; Bank and Other Financial Institutions Act (BOFIA) Cap B3 1991; Investment and Securities Act (ISA) 2007; Central Bank of Nigeria Act 2007 and for voluntary Codes, see *Code of Corporate Governance for Banks in Nigeria 2006*; *Code of Corporate Governance for Public Companies 2011* (Revised SEC Code 2011).

[3] See Lamido Sanusi, 'The Nigerian banking industry: What went wrong and the way forward' (2010) <http://www.cenbank.org> accessed on 04 July 2014.

Part III is the conclusion with further suggestions as to the ways forward in the industry.

The banking sector experienced failures with the most recent resulting from factors such as economic instability caused by large and sudden capital inflows and major failures in corporate governance practices including mismanagement, poor risk management, insider abuses and fraud and poor supervision.[4] Others include inadequate disclosure and transparency about the financial position of the banks, critical gaps in regulatory framework and regulations and weaknesses in business environment in the country.[5] Owing to these governance deficits, it is necessary that the activities of corporate executives are under constant, vigorous and public scrutiny, because those activities are crucial to the economic well-being of society.[6] Contrary to the argument that directors and auditors protect and serve the public interests, they may be, if not properly supervised, wholly responsible for the causes of distress and the collapse of the corporation in the industry.[7]

4.2 Companies and Allied Matters Act (CAMA)

The CAMA 1990 remains a mandatory legal framework for all companies in Nigeria and an instrument that provides for the duties and functions of directors, [8] the shareholders,[9] and audit committee [10] as the key players in corporate governance in the country. The Act further provides for disclosures

[4] ibid.
[5] ibid.
[6] See Olakunle Orojo, *Company law and practice in Nigeria* (5th Edition, South Africa, Lexis Butterworths 2008) p.33.
[7] ibid.
[8] CAMA 1990, ss.1, 279-283.
[9] ibid s.81.
[10] ibid ss.357-369.

and financial statements,[11] including control of the board by the shareholders through a mandatory annual general meeting and its venue for easy access to shareholders.[12] However, contemporary practice requires further than just the directors' traditional duties of care, due diligence, to effective monitoring of the management by the board.[13] The board is accountable to the company as well as the shareholders and ensures a strategic guidance of the company including the statutory duty to act at all time, in the best interest of the company.[14]

In practice, this regulatory regime has been criticised for not recommending stiffer punishment against corporate defaulters given that inappropriate penalty would encourage weak corporate governance practices and deter directors' from acting in the best interest of the company.[15] Similarly, the Corporate Affairs Commission (CAC) which is the institution that administers CAMA has been criticised for not being active in the enforcement functions owing to its inability to penalize and prosecute offenders who violate company legislations.[16]

4.3 Investment and Securities Act (ISA)

The Investment and Securities Act 2007 provides for the continued existence of the Securities and Exchange Commission (SEC) as the apex regulatory

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[11] ibid ss.335-341. Management position imposes the responsibility of accountability and disclosure through the preparation of financial statement. Companies are mandated to comply with the accounting standards issued by the Nigerian Accounting Standards Boards (NASB) for auditing, though, this can be said not to be in conformity with international accounting standards following the World Bank report on the observance of standards of Codes 2004 wherein institutional weaknesses in the areas of regulation, compliance and enforcement due to lack of human and financial resources were identified. See generally World Bank, *Report on the Observance of Standard and Codes (ROSC*) (2004) <http://www.worldbank.org/ifa/rosc.nga > accessed on 05 July 2014.

[12] A company in Nigeria shall act through its members in a general meeting or its board of directors and the general meeting acts as the company's legislative authority. Failure of members in general meeting to use, and exercise their powers could lead to abuse of power by the Board and a defeat to the intent and aim of the provisions of this Act. See CAMA 1990 ss. 41, 63 and 216.

[13] ibid.

[14] ibid s.279 (3).

[15] ibid s.348.

[16] ibid s.7 (a)-(e); Elewechi Okike, 'Corporate Governance in Nigeria: The Status quo' (2007) 15(2) Corporate Governance International Review 176.

authority in the Nigerian capital market.[17] The Commission ensures the protection of investors, maintains fair, efficient and transparent market institutions and aims to deliver the reduction of systemic risk. To ensure adequate protection of investors, the ISA specifically provided for businesses to be registered in accordance with this Act.[18] In a bid to frustrate fraudulent activities and to promote transparency and accountability, the Act provides further that no securities exchange or capital trade point as defined in s. 315 of this Act shall commence operation unless it is registered with the Commission.[19] The Act places the responsibility of ensuring the integrity of the financial control and reporting, on the board of directors as well as mandates the auditors to be registered with the Commission.[20]

The SEC requires every company that participates in the capital market to comply with the provisions of CAMA and Nigerian Accounting Standards Boards (NASB) including mandatory periodical filing of audited financial statements.[21] However, weak enforcement mechanism has been the bane of the institution especially in the operation of capital market.[22] In essence, the Nigerian capital market is poor and underdeveloped and the financial reporting requirements is less than satisfactory when compared with what obtains in other emerging economies such as in South Africa, China and Brazil.[23] Also, the penalty provisions in the Act are too weak to deter non-compliance by banks and other corporations.[24]

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[17] The Act repealed the Investment and Security Act 1999. See ISA 2007 s.38.
[18] ibid.
[19] ibid s. 28.
[20] ibid s.62.
[21] ibid.
[22] See Nat Ofo, 'Securities and Exchange Commission of Nigeria's Draft Revised Code of Corporate Governance: An Appraisal' (2011) 55 Journal of African Law 280.
[23] ibid.
[24] ibid.

4.4 Banks and Other Financial Institutions Act (BOFIA)

The Central Bank of Nigeria (CBN) remains the main statutory body in the sector charged with the responsibility of supervising and monitoring the activities of banks in Nigeria with powers to make subordinate legislations and regulations.[25] Over the years, bank failures have plagued the financial sector which result to monetary losses to shareholders, depositors and creditors including the public.[26] Insider trading and poor risk management have been identified as the major factors that causes failures in banks and other financial systems in the country, even though, the Act provided for criminal prosecution of any director for non-compliance with the provisions of the Act.[27]

4.5 CBN Code of Corporate Governance in banks

Following the success of the banking sector consolidation in 2005 that was intended to raise the liquidity level, the CBN realised the need for adequate control of the banks and thus, drafted a Code of Corporate Governance for banks in Nigeria.[28] The CBN Code acknowledges certain challenges and weaknesses of corporate governance practices to include: passive shareholders,[29] insider abuses,[30] technical incompetence, poor leadership and administrative ability,[31] ineffective board and statutory audit committee [32]

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[25] BOFIA 2004 s.55.

[26] ibid ss.26 and 27. It is mandatory for banks to keep and maintain books of account which must be in compliance with accounting standards as may be prescribed by the Act or other legislations and appointment of the auditor who shall be approved by the bank. See generally Oduntan Adetunji, 'Nigeria's banking rules on insider related credits' (2004) J.I.B.L.R. 382.

[27] ibid.

[28] See *Principles of Code of Corporate Governance for Bank*s in Nigeria 2006 <http://www.cenbank.gov.ng> accessed 02 July 2014.

[29] ibid Principle 2.8.

[30] ibid Principle 2.10.

[31] ibid Principice 2.13.

[32] ibid Principle 3.12.

transparency issues and inadequate disclosure of information,[33] rendition of false returns.[34] Similarly, the Code failed to provide for penalties that could avert its non-compliance including being silent on the qualifications required for auditors and as a result of that, many banks are only paying lip service to the compliance with many sections of the Code.[35]

4.6 SEC Code of Corporate Governance in Nigeria

The SEC Code 2011 which is voluntary and self-regulatory in nature applies to all public companies in Nigeria including banks.[36] The Code is an outcome of the work of the National Committee for the Review of the Code of Best Practices on Corporate Governance 2003, inaugurated by the SEC in 2008 and charged with the responsibility of examining and recommending ways of effecting greater compliance with good corporate governance practices by the public companies in Nigeria.[37] The aim of the Code is to address the three major areas of corporate governance, which are the board of directors, the shareholders and the audit committee.

4.6.1 Directors and Board Size

The powers, duties and functions of directors are the most evident means of control and management of corporations and good corporate governance practices should be shown in all actions and decisions of the board such as in disclosure, risk management, and reporting functions.[38] Board functions

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[33] ibid Principle 3.16.
[34] ibid Principle 3.10.
[35] ibid
[36] See SEC, *Code on Corporate Governance for Public Companies in Nigeria* 2011 <http://www.sec.gov.ng> accessed on 3rd July 2014.
[37] ibid Principle 1.3.
[38] GJ Rossouw, 'Business ethics and corporate governance in Africa' (2005) 44(1) Business and society 101.

include strategic planning, selection, performance appraisal and compensation of senior executives, succession planning, communication of ethical standards and other laws of Nigeria to the management.[39] Under the Code, the board is saddled with the responsibility for ensuring good corporate governance practice in every public company and to ensure maximum performance by the leadership of the company.[40] The Code provides for flexible board size that is relative to the complexity of the company's operation and recommended remuneration sufficient to attract and retain skilled and qualified persons. [41]

The requirement for a remuneration committee, which consists solely of non-executive directors, for decisions regarding remuneration of executive directors is an advantage over the director's power to fix and take whatever amount of investors' money as they wish, however, whether this is attainable in practice remains an issue for the shareholders.[42] In other words, the non-executive directors are supposed to act as a watchdog to executive directors to ensure transparency and accountability in the board decisions. Nonetheless, failures of the non-executive directors to challenge the executive board has recently been attributed to the causes of corporate governance failures given that they owe the same extent of duties to the company.[43] In essence, almost all reported cases of corporate failures point to some kind of inadequacies and inefficiencies of the directors in the discharge of their duties.[44]

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[39] Ola Oladebe, 'Should corporate governance disclosure and controls in Nigeria be permissive or mandatory' (2008) 200 International Company and Commercial Law Review 7.
[40] ibid.
[41] See SEC Code 2011, Principle 13.
[42] ibid Principle 14; The role of non-executive directors (NEDs) is supposed to provide for a method of creating independently formulated proposals for remuneration while the shareholders are the ones who approve it in the general meeting.
[43] See Oladebe (n 39).
[44] ibid.

It can also be deduced that corporate governance reforms lie hugely at the discretion of directors' given their power to act *bona fide* in the interest of the company.[45] Therefore, good corporate governance must put in place strong internal and external control mechanisms as a check to enhance oversight functions of the board.[46] An appropriate mechanism in place shall encourage accountability and transparency as well as discourage deliberate accounting fraud and inaccurate financial reporting, which has in the past led to corporate failures in Nigeria.[47]

4.6.2 Board and CEO

Given the centrality of the board of directors in the entrenchment of good corporate governance practice, the 2011 SEC Code provides for separation of powers between the Chairman of the Board and the Chief Executive Officer of the same company. For instance, Principle 5.1(b) of SEC Code provides that the positions of the Chairmen of the Board and CEO shall be separate and be held by different individuals and the Chairman of the Board should not be involved in the day-to-day operation of the company. The day-to-day responsibility of running the company is vested on the Managing Director/CEO and his executive management team.[48] The recommendation that the roles of Chairman and MD/CEO should be separated first came to prominence in the Code of Best Practice set out in the Cadbury Report in 1992 in the UK.[49] The main rationale behind the separation is to avoid over-concentration of powers in the hands of an individual given the potential

[45] Anu Arora, 'The corporate governance failings in financial institutions and directors' legal liability' (2011) 3 Comp Law 2.
[46] ibid.
[47] ibid.
[48] SEC Code 2011, Principles 5.1(a), 5.2(d) and 5.3(b).
[49] Financial Reporting Council, *Comply or explain: 20th anniversary of the UK corporate governance code* (London: FRC 2012).

danger an extremely powerful CEO poses to a company.[50] Splitting the roles of the Chairman/CEO ensures that a system of checks and balances exists in the running of the affairs of the company and curtails abuse of power by an all-powerful CEO.[51]

However, there seems to be some doubt about the efficacy of the separation roles given the contention that the benefits of separating the two roles are less certain.[52] In countries with two-tier board structure particularly in Continental Europe, the separation of the function is commonplace since the chairman of the supervisory board is not usually the head of the management board.[53] In particular, the Chairman-CEO duality concerns principally arise in countries with the unitary board structure.[54] Even then, in such countries, there appears to be a near unanimity in their corporate governance codes that the same person should not perform the same roles of the Chairman of the board of directors and MD/CEO. [55] The separation of the roles of the Chairman and that of the MD/CEO in companies operating in Nigeria is in line with the best international practices and global standards.[56]

[50] Grant Thornton, *The Chemistry of governance – a catalyst for change: corporate governance review 2012* (London: Grant Thornton 2012).
[51] ibid.
[52] Khaled Elsayed, 'Does CEO Duality Really Affect Corporate Performance?' (2007) 15(6) Corporate Governance: An International Review 1203-1214.
[53] ibid.
[54] In the UK and other common law jurisdictions, characterised by dispersed share structures, the one-tier system is preferred to two-tier structure, while in Germany, and some other parts of Continental Europe, with less liquid capital markets, two-tier board structures are very common.
[55] See s.2.16 of King III Report 2010 (South Africa), ss 14 &16 of the Corporate Governance Guidelines on Best Practices 2010 (Ghana), s.A.2.1 of the UK Corporate Governance Code 2010 (UK), s.3.1 of the Corporate Governance Code of the Listed Companies 2008 (France), s.2.10 of the Code of Best Practice of Corporate Governance 2009 (Brazil), Recommendation 2.3 of the Corporate Governance Principles and Recommendations 2010 (Australia), s.2.5 Principles and Guidelines of Corporate Governance 2004 (New Zealand) and s.A.2 of the Corporate Governance Voluntary Guidelines 2009 (India).
[56] See SEC Code 2011, Principles 5.2.1 ; CBN Code 2006, Principles 4.1.8.

4.6.3 Shareholders

The relationship between the company and the shareholders was recommended to facilitate the participation of shareholders' at general meetings for interaction between the shareholders, management and the board, hence, venue for the general meeting should be accessible and affordable as to enable the shareholders' participate accordingly.[57] This provision is in agreement with the shareholders' value principle and in tandem with Milton Friedman's idea of the responsibility of a corporation.[58] Nigerian company law adopts a shareholder value approach to corporate governance, but, the lack of involvement of shareholders in the company's affairs has contributed largely to the problems of corporate governance issues as same would leave the powers of the management unchecked, resulting in constant abuse of power and deficit in governance practice.[59]

Similarly, shareholders' activism in Nigeria can be said to be reactive instead of proactive given the degree of shareholder passivity, however, an improved, enlightened, informed and educated shareholders can effectively act as a check to the powers of the directors.[60] In other words, the average Nigerian investor need to be educated, informed and reoriented, more responsible, responsive and enlightened so as to make an informed contributions regarding corporate management.[61]

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[57] ibid.

[58] See Milton Friedman, 'The social responsibility of business is to increase profit' *The New York Times Magazine* (USA, 13 September 1970) p.10.

[59] Adrian Davis, *Best Practice in Corporate Governance: Building Reputation and Sustainable Success* (Gower, Aldershot 2006) p. 7.

[60] Anu Arora, 'The global financial crisis: a new global regulatory order?' (2010) 670 J. B. L. 14.

[61] ibid.

4.6.4 Audit Committee

The audit committee is paramount for effective corporate governance standard given that it is necessary to monitor the integrity of financial statements and review internal financial controls and management systems.[62] It monitors and reviews the internal audit function, assists in the appointment of external auditors and their remuneration package.[63] Also, an audit committee monitors and reviews the independence, objectivity and the effectiveness of external auditors, and devise and implement a policy to govern non-audit work provided by the external auditors.[64] The audit committee's composition under CAMA seems to have a fair and balance representation given the representatives of the shareholders, which is in line with international standards and requirements.[65] Similarly, the Code provided for equal number of directors and representatives of the shareholders of the company who shall examine the auditors' reports and make recommendations to the annual general meeting.[66]

Nigeria, like the United States, has a system of mandatory corporate governance disclosure which calls for credibility of financial disclosures by the Committee, and public companies are enjoined to establish a system of internal controls over its financial systems to ensure the integrity of the company's financial controls and reporting.[67] Auditors lend credence to annual accounts through their independent examination of the company's records and financial accounts given that audit function is part of the

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[62] ibid.
[63] ibid.
[64] ibid.
[65] CAMA 1990 s. 359(4).
[66] SEC Code 2011 (n 2) Principles 30.1.
[67] ibid.

mechanisms for enhancing confidence, accountability and control in corporate annual reports. Hence, auditors should have the requisite training and experience, be ethically bound in the conduct of their duties in accordance with recognised procedures and standards.[68] Auditors of a company must be appointed in annual general meetings by the shareholders and they should hold office to the next annual general meeting and must be a member of a body of accountants in Nigeria established from time to time by an Act.[69]

While CAMA provided for punishment of dishonest and incompetent auditors, the prosecution along with enforcement has hardly taken place against these perceived breaches.[70] The role played by auditors in corporate failures call for more realistic disciplinary measures in the ethics of their professional conduct against unreliable and erring members and it is time to criminalize auditors' inefficiencies in both the company legislation and the governance codes.[71] Furthermore, Nigeria lacks adequate securities regulations to support the sudden growth of its capital market as evidenced in weak accounting standards and lack of disclosure and regardless of the standard applied, inadequate disclosures by companies and auditors could prolong Nigeria's recovery from financial crisis.[72]

4.7 Other challenges of corporate governance in banks in Nigeria

Over the years, the Nigerian company law has suffered depravity in terms of implementations as well as review and this has affected her economic strength

[68] ISA 2007 s.67.
[69] CAMA 1990 s. 357.
[70] ibid ss. 358 and 643.
[71] See Bede Nwete, 'The auditor's liability for business failures in Nigeria: a comparative analysis' (2006) 175 International Company and Commercial Law Review 9.
[72] ibid.

and reputation.[73] With the emergence of a democratic government in 1999, the need for the country to participate favourably in international market and ensure that acceptable corporate governance standards are adhered to, were re-echoed.[74] There remains no doubt that enforcement is largely the hub of all corporate governance rules and principles and whereby there is little or no guarantee of corporate governance implementation and enforcement, the Laws, Codes and Principles are largely defeated.[75]

It is contended that corporate governance challenges and shortcomings basically come from the mechanisms for enforcement and compliance, which are so far weak and ineffective in Nigeria.[76] Hence, government participation in company law and corporate governance practice requires more than investors' protection to ensure that conflicts and abuses are judged and timely adjudicated and that strong enforcement mechanisms including structures and processes are in place. While CAMA and ISA provided for penalties for non-compliance with certain provisions, some of the punishments are not strict and others are weak, and cannot deter major corporate actors from committing such abuses.[77]

[73] Kajola Sunday, 'Corporate governance and firm performance: The case of Nigerian Listed Firms' (2008) 14 European Journal of Economics, Finance and Administrative Sciences 17.
[74] Efforts made to ensure effective corporate governance in Nigeria can also be said to be commendable given that these reflect some of the key highlights of the OECD. OECD emphasised the need for the separation of the role of the CEO and the board chairman, improved quality and performance of board membership, protection of shareholders rights and privileges, transparency, disclosure and due process, transparency on financial reports, defining the composition, role and duties of the audit committee and the prescription of executive and non-executive directors on the board.
[75] Sunday (n 73).
[76] See *World Bank Report on the Observance of Standards and Codes in Nigeria* (2004) <http://www.worldbank.org/ifa/rosc_aa_nga.pdf> accessed on 05 July 2014.
[77] For instance, see s. 378 of CAMA 1990, for a fine of N1, 000 (equivalent to $5 in the US) for non-compliance with mandatory annual returns provisions. Given that the fine is inadequate and insufficient to serve as a deterrence, companies and banks prefer to observe the statutory provisions in breach.

4.7.1 Risk management

Effective corporate governance culture cannot be isolated from the theory of a strong risk management structure in banks because risk management principle obliges directors to identify and monitor risk areas and key performance indicators and then formulate strategies to implement the chosen regimes.[78] However, poor risk management and ineffective management of information are among major weaknesses that led to the failures of Nigerian banks.[79] Under this context, there is a dire need for an institutionalized robust risk management system that is transparent as well as ethical for a sound corporate governance practice and the reason is because risk management performance hangs on the issues of skills and knowledge including the expertise of directors. [80] The absence of these prerequisites affects a company's risk management strategies along with demands and practices because risk management requires the involvement of management with appropriate communication process for effective risk information transmission. In essence, the Governance Code mandates a risk management unit headed by a senior executive to oversee and manage policies on risk in line with the directives of the Board Risk Management Committee but many banks do not even have risk governance structures in Nigeria.[81]

Moreover, the legal system of a country plays a key role in the corporate management and the foundational structures upon which any robust capital market is based remains an effective legal system that adequately protects and

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[78] See chapter 6 of the thesis for a thorough analysis of risk management in Nigerian banks.
[79] Emily Makuta, 'Towards good corporate governance in state-owned industries: The accountability of directors' (2009) 3 Malawi Law Journal 67.
[80] ibid.
[81] CBN Code 2006 (n 2) Principles 2.9.

enforces property rights in a speedy manner including a consistent application of the rule of law.[82] The rules and guidelines are provided by company law and codes of corporate governance for the operation of a company, thereby pushing its enforceability to the courts.[83] The importance of the legal system to company law does not only cover corporate governance, but also the company's relationship and transactions with third parties, in essence, an effective judicial system that is capable of enforcing rights would enhance a strong corporate governance practice.[84]

However, Nigeria lacks an effective judicial system with an economy characterized by underdeveloped market institutions, deep-rooted corruption and a general disregard of the rule of law.[85] In other words, the country does not have a regulatory and enforcement regimes as developed and effective as in the United Kingdom and United States and courts are slow, expensive and ineffective in adjudicating commercial disputes.[86] Thus, shareholders and stakeholders are discouraged from instituting actions against the directors for alleged corporate abuse, misconducts, non-compliance and corruption.[87]
Moreover, the government needs to step up in its crucial role by providing the legal framework for incorporation as well as defining the parameter for business activities with a view to monitoring their operations to ensure conformity with established standards along with meeting obligations to all

[82] Anu Arora, 'The global financial crisis: a new global regulatory order?' (2010) 670 J. B. L.14, 2.
[83] ibid.
[84] ibid.
[85] Iwa Salami, 'The effect of the financial crisis on the Nigerian capital market: a proper regulatory response' (2009) 612 Journal of International Business Law and Regulation 14.
[86] ibid.
[87] ibid; Corruption is another big obstacle which frustrates the implementation of a sound corporate governance structure and corrupt practices by office holders are not alien to Nigeria. A global corruption Report of 2008 by Transparency International (TI) ranked Nigeria the 121st most corrupt nation in the world and the absence of provisions dealing with corrupt practices in the Codes and CAMA suggests that regulators have a lot of work to do to reassure, rekindle, lure and win back the confidence of investors in the Nigerian banking sector.

stakeholders.[88] Inadequate laws and regulations for the control and management of companies are also the foundation for bad corporate governance practice.[89] Furthermore, other challenges of good corporate governance practice include the behaviour of investors and attitude of regulators-combined, insider dealing, share price manipulations, connected lending and fraud.[90] To further illustrate the above corporate malpractices as part of the governance problems in the sector, two cases of bank fraud and insider abuses would be used in the analysis and these banks are: Oceanic Bank Plc and Intercontinental Bank Plc.

4.7.2 Oceanic Bank Plc (now Eco Bank Plc)

Corporate fraud is one of the major issues of corporate governance practices in the Nigerian banking sector given the scale of misappropriation and diversion of shareholders' and depositors' funds.[91] Oceanic Bank Plc was a limited liability company duly incorporated under the CAMA which offered individual, corporate and commercial banking services before it was acquired by the Eco Bank Plc in 2011.[92] The acquisition by Eco Bank followed the glaring fraud and financial crimes perpetrated against the bank by its former Chief Executive Officer and Managing Director of the bank - Mrs Cecilia Ibru.[93] In *EFCC v Mrs Cicilia Ibru*,[94] the Federal High Court in Lagos, Nigeria under Justice Dan Abutu sentenced Mrs Cicilia Ibru to an 18 month jail term and ordered the former bank chief to forfeit properties based in

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[88] Salami (n 85).
[89] Inam Wilson, 'Regulatory and institutional challenges of corporate governance in Nigerian post banking consolidation' (2006) 12(2) Nigerian Economic Summit Group Economic Indicators 5.
[90] ibid.
[91] ibid.
[92] See CAMA 1990 ss.35-39. Eco Bank Plc is a limited liability company duly registered under the Nigerian company law which currently operates in the Nigerian banking sector.
[93] Salami (n 85).
[94] *EFCC v Cecilia Ibru* Case No - FHC/L/CS/57/10.

Nigeria, United States and Dubai.[95] In addition, she was to forfeit her shares in over 100 firms listed and unlisted in the Nigerian Stock Exchange (NSE) as well as assets valued at N191 billion (approximately $1.2 billion US dollars) belonging to the shareholders and depositors.[96] This was a sequel to her decision to plead guilty through plea bargaining to the alleged abuse of office and mismanagement of depositors' funds levelled against her by the Economic and Financial Crimes Commission (EFCC).[97] Similarly, Mrs Ibru granted a further credit facility to the tune of 20 million US dollars and another 13 million US dollars belonging to the bank to Petosan Farms Limited (a local company owned by her agents) without adequate security and in contravention of the Act.[98]

4.7.3 Intercontinental Bank (now Access Bank Plc)

Intercontinental Bank Plc was a company duly incorporated under the Nigerian company law and provided individual, corporate and commercial banking services before it was acquired by the Access Bank Plc in 2011.[99] In 2009, a special audit of the commercial banks in Nigeria by the CBN, found nine of the banks to be under-capitalized and badly managed. [100] Intercontinental Bank Plc was one of the troubled banks as a result of deficits

[95] ibid.
[96] ibid.
[97] EFCC remains the main Nigeria's anti-graft agency under EFCC Act 2004 s.1. Investigation revealed that owing to a plea bargain agreement with the EFCC, the former banker released a small portion of the properties and assets for lesser convictions. Plea bargaining is an agreement in a criminal case between the prosecutor and defendant whereby the defendant agrees to plead guilty to a particular charge in return for some concession from the prosecutor. Plea bargaining may be accepted as an integral part of the criminal justice system, but such an agreement is significantly based on public policy, and only if the circumstance suggests that it is in the best interest of the public but it does not have a place under the Nigerian criminal jurisprudence. For generally on plea bargaining see Arts 5 and 6 of the European Convention of Human Right incorporated in the UK's Human Rights Act 1998; US Federal Rules of Criminal Procedures s.11; India Criminal Law (Amendment) Act 2005.
[98] See Failed Bank and Financial Malpractices in Banking Act s. 15; EFCC Act 2004 ss. 24-28; BOFIA 2004, s.18.
[99] CAMA 1990 ss.35-36.
[100] Salami (n 85).

in governance practices including mismanagement of depositors' funds by its former CEO, Erastus Akingbola, before the injection of capital (bank bailout) by the Government of Nigeria to maintain its solvency.[101]

In *Access Bank Plc v Erastus Akingbola and Others*,[102] a London court found former CEO of the defunct Intercontinental Bank (IB) Plc, Erastus Akingbola liable for stealing and diversion of billions of depositors' funds.[103] The court held that Akingbola used the funds to buy properties in the United Kingdom and acquire shares for himself in order to manipulate the company's shares price in the Nigerian stock market.[104] These share purchase claims and the diversion of the depositors' funds to manipulate stock market are in contravention of Nigerian laws.[105] The position under the Nigerian company law with certain exceptions is that 'a company may not purchase or otherwise acquire shares issued by it'.[106] Also, s.159 of CAMA provides for the prohibition of financial assistance by company for acquisitions of its shares with some exceptions.[107]

Sub-section (3) of s.159 of CAMA provides that:

> Nothing in the subsection (1) of this section shall be taken to prohibit (a) the lending of money by the company in the ordinary course of its business, where the lending of money is part of the ordinary business of a company... and (c) the making by a company of loans to persons, other than directors, bona fide in the employment of the company or

[101] CBN Act 2007 ss 1, 2, 3.
[102] [2012] EWHC 2148 (Comm).
[103] ibid.
[104] In a landmark judgment delivered by Mr Justice Burton of the Royal Courts of Justice, Queen Bench Division (Commercial Court), Strand, London, in a suit instituted by IB Plc soon after the EFCC charged him for fraud in 2010, Akingbola was ordered to refund about N165 billion - approximately $1 billion US dollars then belonging to Nigerian shareholders and depositors and through help of the London Court, these funds are now to be paid to the new owners of IB Plc, that is, Access Bank Plc <http://www.ireports-ng.com/2012/07/31/london-court-finds-rogue-banker-erastus akingbola/guiltyoflooting> accessed on 23rd July 2014.
[105] BOFIA ss. 17, 18; CAMA ss.159, 160, 283.
[106] CAMA 1990 s.160.
[107] Financial assistance includes a gift, guarantee, security or indemnity, loan, any form of credit and any financial assistance given by a company, the net assets of which are thereby reduced to a material extent or which has no net assets. See CAMA 1990 s.159.

> its holding company, to be held by themselves by way of beneficial ownership...[108]

It is common ground that if the Defendant was a party to an unlawful scheme, resulting in unlawful expenditure of at least N140bn of IB's funds (approximately US$960,000), then s.283 of CAMA would apply and the Act provides thus:

> Directors are trustees of the company's money, properties and their powers and as such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the interest of the company and all the shareholders, and not in their own or sectional interest.[109]

Burton J. was no doubt correct in holding that Akingbola was liable and breached the fiduciary duties of director under the Nigerian company law by using the company's money under his trust to buy the IB shares for his own company outside the ordinary course of business.[110] The above section of this chapter has discussed the corporate governance deficits and some of the prospects in the Nigerian banking sector as it relates to the thesis. Next, it briefly explores the challenges of corporate governance system in the UK and Royal Bank of Scotland (RBS) will be used in the illustrations.

4.8 Governance deficit in UK banking

This section briefly discusses the governance deficits in UK banking industry and RBS would be used in the analysis. The reason for using RBS in illustration is to determine what lessons have been learnt from other jurisdictions which could prove beneficial in further improving the Nigerian banking sector, bearing in mind that every situation is different and corporate governance practice is context specific. Event surrounding the collapse of

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[108] ibid s.159 (3) (c).
[109] ibid s. 283 (1).
[110] For more on the power of limited companies to purchase its own shares, see generally CAMA 1990, ss 159, 160, 283; see UK Companies Act 1948 s.54 (1); UK Companies Act 2006 ss.690-708, 733.

Northern Rock in the wake of the sub-prime crisis that emerged in the United States in the summer of 2000, revealed the inherent fragility of the UK banking sector and the flaws in domestic financial regulation.[111] Such events demonstrated the need for a drastic overhaul of domestic financial regulation and supervisory arrangements.[112]

Given the development in the deposit-taking industry after the nationalisation of Northern Rock, Lord Turner conceded that:

> The FSA had traditionally focussed on the supervision of individual institutions rather than the whole system; on ensuring that systems and processes were correctly defined, rather than on challenging business models and strategies; and on the probity of approved persons, rather than on an assessment of their technical skills. Moreover the organisation was biased in favour of conduct of business regulation compared with prudential regulation, with bank prudential being dominated by consideration associated with the agreement and implementation of Basel II. As a result emerging problems such as the rapid build-up in trading book risk and liquidity risks were missed.[113]

Lord Turner contended that the financial regulatory body was cowed into acceptance of often-repeated political demands for 'light touch' regulation deemed necessary if the City of London was to maintain its pre-eminent status among financial hubs globally.[114] Such political/industry 'capture' of the regulator was evident in the days when the bank had responsibility for

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[111] The event, however, proved to be the start of the United Kingdom's financial woes, as a whole series of domestically incorporated financial institutions – including the Bradford and Bingley, the Alliance and Leicester, Halifax bank of Scotland (HBOS) and a number of building societies – subsequently succumbed to either nationalisation or officially brokered takeover rescues. This *ad hoc* development of failure resolution policy gave way to a system-wide, comprehensive approach that saw the introduction of industry-wide bank bailout schemes in October 2008 and January 2009, the costs of which would be felt by the UK taxpayers for many years to come. See generally Maximillan Hall, 'The reform of UK financial regulation' (2009) 11 Journal of Banking Regulation 31-75.

[112] Maximillan Hall, 'The sub-prime crisis, the credit squeeze and Northern Rock: The lessons to be learnt' (2008) 16 (1) Journal of Financial Regulation and Compliance 19-34.

[113] Lord Turner was a member of the UK's Financial Policy Committee, and the Chairman of the Financial Services Authority (FSA) until its abolition in March 2013. The 'Turner Review' - see FSA, 'A Regulatory Response to the Banking Crisis' (the 'Turner Review') 18th March, (2009) and the accompanying Discussion paper – FSA, 'A regulatory response to the global banking crisis' (2009b) Discussion Paper 32 <http://www.fsa.gov.uk/publs/other/turner_review.pdf> accessed on 20th June 2014.

[114] Due to perceived regulatory failure and poor governance standard during the financial crisis in 2007-2008, the UK government decided to restructure its financial regulation by abolishing FSA. On the 19th of December 2012, the Financial Services Act 2012 received a Royal Assent abolishing the FSA with effect from 1 April, 2013. Its responsibilities were now split into two agencies: the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA') and the Bank of England. <http://www.bankofengland.co.uk> accessed on 15 June 2014 and <http://www.fca.org.uk> accessed on 15 June 2014.

banking supervision – witness their failings with respect to BCCI and Barings.[115] The above hint would help explain the FSA's reluctance to challenge a bank's strategic objectives, especially the 'Northern Rock' saga or by merger – RBS takeover of ABN Amro (Dutch bank).[116] In essence, the FSA was hesitant to bring the party to a premature end given the apparent wealth creation that had occurred during the boom period of 1993-2007.[117]

4.8.1 RBS's failure

RBS is one of the retail banking subsidiaries of the Royal Bank of Scotland Group Plc that provides banking facilities throughout the UK and Ireland.[118] RBS acquired part of ABN AMRO (a Dutch bank) without appropriate heed to the risk involved and with inadequate due diligence.[119] Poor capital and inadequate liquidity regulation made it more likely that there would be a systemic crisis and thus set the context for the failure given the managements' poor decisions and the regulator's failures to ascertain the asset quality of the RBS and its risks profile before the acquisition.[120]

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[115] Maximillan Hall, 'Bank Bailout Mark II: Will it work?' (2009) 10(3) Journal of Banking Regulation 215-220.

[116] ABN AMRO Bank N.V**.** is a Dutch state-owned bank with headquarters in Amsterdam. This bank was re-established, in its current form in 2009, following the acquisition and break-up of the original ABN AMRO by a banking consortium consisting of Royal Bank of Scotland Group, Santander Group and Fortis. Following the collapse of Fortis, which acquired the Dutch business, it was nationalized by the Dutch government along with Fortis Bank Nederland.

[117] The Treasury Committee's views on what should be done to reform corporate governance and pay in the City are contained in House of Commons, 'Banking Crisis: Reforming Corporate Governance and Pay in the City' in House of Commons Treasury Committee: *Ninth Report of Session 2008-09* HC 51, Stationary Office Limited May 12 <http://www.publications.parliament.uk/pa/cm200809/cmselect/.../519/519.pdf> accessed on 22 June 2014.

[118] ibid.

[119] At the end of 2008 in the UK, with total assets of over $ 3.5 trillion, the Royal Bank of Scotland (RBS) was the largest bank in the world by assets and fifth largest by market capitalisation. The failure of RBS in October 2008 gave rise to what HM Treasury (HMT) has described as 'the biggest bail-out in history'. The reason is because the UK government single-handedly injected £45.5 billion of equity capital and £282 billion of taxpayers' money which was exposed via the Asset Protection Scheme. See generally Gillian Garcia, 'Ignoring the lessons for effective prudential supervision, failed bank resolution and depositor protection' (2009) 17 (3) Journal of Financial Regulation and Compliance 210-239.

[120] HM Treasury & Department for Business, Innovation & Skills, *The Government Response to the Independent Commission on Banking*, December 2011 <http://www.fsa.gov.uk/pubs/others/rbs.pdf> accessed on 13 June 2014.

The culpability of senior FSA management for the flawed regulatory framework was explicitly acknowledged in the Report of the Select Committee for the FSA's report into the failure of RBS that:

> The fact that the Supervision Team was largely doing what was expected of it but was following a deficient supervisory approach, in turn clearly implies however, that the senior management of FSA who determined those resources, processes and practices must have made design decisions which were, in retrospect, seriously mistaken.[121]

The FSA Report described a series of failures and misjudgements in supervision ranging from the failure to analyse and understand balance sheet risks relating to capital, liquidity and asset quality, to decision not to intervene in RBS's calamitous acquisition of part of ABN AMRO.[122] The failure of RBS can be explained and summarised by a combination of six factors: (i) the first is the significant weakness in RBS's capital position during the review period, as a result of management decisions and permitted by an inadequate regulatory capital framework (ii) the over-reliance on risky short-term wholesale funding (iii) the concerns and uncertainties about RBS's underlying asset quality, which in turn was subject to little fundamental analysis by the FSA (iv) the substantial losses in credit trading activities, which eroded market confidence. Both RBS's strategy and the FSA's supervisory approach underestimated how bad losses associated with structured credit might be (v) also, the ABN AMRO acquisition, on which RBS proceeded without appropriate heed to risks involved and with

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[121] Financial Services Authority, *The failure of the Royal Bank of Scotland: Financial Services Authority Board Report,* December 2011, p 254; A list of FSA board members and executive committee members for the review period can be found on pp 344-345 of this same document <http://www.fsa.gov.uk/library/other_publication/miscellaneous/2011/rbs.shtml> accessed on 15 July 2014.

[122] Evidence to the Treasury Select Committee by Bill Knight and Sir David Walker, specialist advisers to the Committee in relation to the Report by the Financial Services Authority into *The failure of The Royal Bank of Scotland,* December, 2011 P.5. For more see <http://www.hm-treasure.gov.uk/consult_sanctions_directors_banks.htm> accessed on 15 July 2014.

inadequate due diligence; and (vi) similarly, an overall systemic crisis in which the banks in worse relative position were extremely vulnerable to failure and RBS was one such bank.[123]

Although poor capital and inadequate liquidity regulation made it more likely that there would be a systemic crisis and thus set the context for the failure, and while a flawed supervisory approach provided insufficient challenge, nonetheless, ultimate responsibility for poor decision and failure must lie with the board.[124] The poor decisions that RBS made suggest that there were likely to have been underlying deficiencies in RBS's management, governance and culture which made it prone to make poor decisions given that potential areas of concern about RBS's management, governance and culture were identified by the FSA Supervision Team during the Review Period.[125] The degree of supervisory intensity applied to these issues, however, while consistent with the FSA's prevailing practices and approach, was less than the FSA now considers appropriate.[126]

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[123] See House of Commons Treasury Committee, *The FSA's report into the failure of RBS*: *Fifth Report of Session* 2012-13 <http://www.publications.parliament.uk/pa/cm201213/cmselect/.../640/640.pdf> accessed 24 July 2014.
[124] ibid.
[125] ibid 21.
[126] It was noted by the Select Committee in the British House of Commons that some of the causes of RBS's failures were equally systemic – common to many banks or the consequences of unstable features of the entire financial system including a deficient global framework for bank capital regulation, together with an FSA supervisory approach which assigned a relatively low priority to liquidity, created conditions in which some form of systemic crisis was more likely to occur. In retrospect, it appeared that poor decision by the RBS's management and Board during 2006 and 2007 were crucial to RBS's failure. <http://www.publications.parliament.uk/pa/cm201213/cmselect/.../640/640.pdf> accessed 24 July 2014.

4.8.2 RBS's lessons to banks in Nigeria

First, in the wake of the financial crisis, a considerable amount of activity was taking place at the global arena to improve capital and liquidity regulations. For instance, the Basel III rules published in December 2010 and revised in July 2011 could, once implemented, considerably strengthen the global capital framework and introduce a new international liquidity standard.[127] In essence, it is worth noting that RBS prior to its failure would not have met either the capital or liquidity standards after its calamitous acquisition of the part of ABN Amro under the proposed Basel III arrangement.[128] On one hand, it shows that bank capital and liquidity regulation is still relevant in determining the safety and soundness of a bank in both developed and emerging markets including Nigeria. On the other hand, it demonstrates a regulator's laxity and a flawed supervisory approach given the FSA's mistaken belief that markets were inherently stabilising and efficient.[129]

Second, this section of the chapter is in agreement with the views of Lord Turner in the foreword to the FSA Report, that bank directors bear responsibility to the public that go beyond those of other private sector directors in ordinary firm. The reason is because banks are different given the excessive risk-taking in the business (for instance through an aggressive

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[127] Basel III is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision, governance, transparency, disclosures including risk management of the banking sector. These measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress. Basel III is part of the Committee's continuous effort to enhance the banking regulatory framework. It builds on the International Convergence of Capital Measurement and Capital Standards. See generally BCBS, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Basel: BIS 2013).

[128] Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking system* (2010) <http://www.bis.org/pub/bcbs238.pdf> accessed 25 July 2014.

[129] ibid.

acquisition) and if not properly monitored by the regulator can result in bank failure, taxpayer losses, and wider economic harm.[130] Their failure is of public concern (stakeholders), not just the concern for shareholders alone and there is therefore a strong public interest in ensuring that bank executives and boards strike a balance between risk and return than is acceptable in non-financial companies.[131]

Third, on failure of governance in bank as a result of the poor decisions by the board and with a reference to the inability of the regulator to bring an enforcement action against individuals at RBS, Lord Turner raised the question:

> If harm has been imposed on society, surely someone can and should be held responsible... It is a matter of considerable surprise to the Committee that nobody with the partial exception of Mr Jonny Cameron, RBS Executive Director and Chairman of RBS's Global Banking and Markets Division has been held meaningfully accountable for the failures of the RBS. [132]

Where public money (taxpayers' money) is used to support a business in the private sector there is need for accountability and the need for a full public explanation.[133] The FSA initially felt that a 289-word statement about RBS's failure was sufficient explanation. This reflects serious flaws in the culture and governance of the regulator and a fundamental misunderstanding of its duty to account for its actions to the public and the government.[134]

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[130] ibid.
[131] FSA, *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report* (2011) <http://www.fsa.gov.uk/library/other_publication/miscellaneous/2011/rbs.shtml> accessed 26 June 2014.
[132] FSA, *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report,* 2011, p.33 <http://www.fsa.gov.uk/library/other_publication/miscellaneous/2011/rbs.shtml> accessed 20 June 2014.
[133] ibid.
[134] ibid 100.

As to the governance failure with regard to poor decisions by the boards, Lord Turner further suggested that existing law could be changed to allow sanctions of some sort against directors of failed banks and he proposed two possible mechanisms through which this might be achieved. The first is a legal sanction-based approach, introducing a currently absent 'strict liability' of executives and board members for the adverse consequences of poor decisions, and making it more likely that a bank failure like RBS would be followed by successful enforcement actions, including fines and bans against some directors. The second is an automatic incentive based approach which would not rely on bringing enforcement cases which proved personal culpability, but would rather seek to ensure that executives and boards automatically faced downside consequences from bank failure and option here could include: establishing rules which could automatically ban senior executives and directors of failing banks from future positions of responsibility in financial services industry unless they could positively demonstrate that they were active in identifying, arguing against and seeking to rectify the causes of failure.

Also, regulating remuneration arrangements of executives and non-executives directors so that a significant proportion of remuneration is deferred and forfeited in the event of bank failure through their poor decisions. While regulation of this form may not really be new, however, increasing both the proportion of pay deferred and the period of deferral could further strengthen it.[135]

[135] ibid 8.

On the flip side, it could be argued that a ‘strict liability’ legal sanction based approach raises complex legal issues relating to burden of proof and human rights.[136] It might in particular cases result in injustice, and could discourage some high quality and high integrity people from being willing to work in banks, given the large potential liability involved. Automatic sanctions have the potential of not requiring expensive and contentious legal process, but may be insufficient to produce a major shift in personal incentives.[137]

While corporate governance practice remains context specific, it is posited that these few worthy lessons from RBS’s failure are important not just to the regulators in the UK’s financial services sector but also to the future regulation in Nigerian banking industry. This is because both the operators and regulators in the sector could draw from the above regarding the merits and demerits of possible legal sanctions against the directors and managers with respect to corporate management.

4.9 Conclusion

This chapter has discussed the corporate governance contemporary and emerging issues including structures, challenges and prospects in the Nigerian banking as it relates to the thesis. A common thread in corporate failures in Nigerian banking sector is the poor corporate governance culture such as poor regulation and enforcement, poor and inexperienced management, insider abuses, corruption and fraud by management and board and poor risk management.[138] As an emerging market, it is noted that the institutions,

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[136] ibid.
[137] ibid 9.
[138] Wilson (n 89).

structures and legal framework for corporate governance practices are still developing in the industry, however, these structures and framework remain inadequate with respect to the global best practices.[139]

Effective and efficient corporate governance culture in Nigeria cannot be realistic if the underlying legal, institutional and regulatory framework remains weak, inefficient and inadequate.[140] The responsibility of monitoring the compliance of corporate governance rules requires institutional dedication and human resources, which is less than satisfactory in the industry.[141] An effective legal, regulatory as well as institutional framework is of utmost importance to the success of the governance practices in the industry which should be complemented by sound judicial systems that enforce property rights coupled with speedy resolution of commercial disputes in a fair manner. This has the potential to impact positively on corporate governance cultures in order to boost the confidence of the shareholders and other prospective investors in the sector.

Accordingly, the following recommendations are needed to improve corporate governance in the Nigerian banking: First, a review of the legislation in BOFIA and CAMA dealing with governance issues due to lack of and their inability to provide adequate penalties and punishment for non-compliance of several corporate governance provisions. These penalties are neither seen as prohibitive nor deterrent and remain major causes of institutional weaknesses in the enforcement of corporate governance rules.

[139] ibid.
[140] ibid.
[141] ibid.

Second, on qualifications of the auditors, a standard should be provided for by CAMA and strict penalties provided to promote compliance with ethics and international standards. Hence a review of all necessary laws that regulate all aspects of accounting practices and audit in Nigeria to unify the various accounting bodies in the country and provide for a common disciplinary body and punishment of offenders. Third, given the voluntary nature of the SEC and CBN Codes, compliance is not assured and as a result of that it is recommended that certain provisions of the Codes be made mandatory in which compliance shall be reported to a regulatory body periodically to ensure compliance and to achieve this, there is a need for a collaboration of all regulatory bodies for effective corporate governance regulations.

Moreover, a competent board must be encouraged by appointing persons with requisite knowledge and skills for the job and an adequate and regular training should be made mandatory for directors and other officers of the company to make them more conversant and effective in their oversight functions in line with global best practices.[142] Where a person appointed lacks the requisite knowledge, skills, and competence, he shall be held liable and be made to refund all entitlements and benefits taken when acting as a director. The onus of requisite knowledge and competence should be on the would-be director to disclose qualification and competence and not on the company. Furthermore, shareholders' activism and participation must be encouraged as provided in CAMA.[143] For instance, the law makes some provisions for access to the court for redress for minority shareholders and this includes

[142] For general meaning of 'best practices' see (n 1).
[143] See CAMA 1990 ss. 300 -320

actions brought by an aggrieved shareholder for wrongs done to him personally or to take a derivative action in the name of the company.[144] Furthermore, CAMA permits a shareholder to institute an action on the ground of unfairly prejudicial and oppressive conduct with the court having a wide range of relief to choose from.[145] However, despite the legal provisions, there are many obstacles, which have discouraged a co-ordinated shareholder activism in Nigeria. There are practical issues such as inadequacy of notices of statutory meetings, inaccessible venue of meetings and inappropriate conducts of meetings. Other problems include lack of information, apathy on the shareholder and a weak judicial system.[146]

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[144] ibid

[145] ibid ss.310-312

[146] See generally Olufemi Amao and Kenneth Amaeshi. 'Galvanising shareholder activism: A prerequisite for effective corporate governance and accountability in Nigeria' (2008) (82(1) Journal of Business Ethics 119-130; Emmanuel Adegbite, Kenneth Amaeshi, and Olufemi Amao, 'The politics of shareholder activism in Nigeria' (2012) 105(3) Journal of business ethics 389-402.

Chapter Five

Theories and strategies of regulation in Nigerian banking sector

5.1 Introduction

Chapter four reviewed the corporate governance legal and regulatory issues and shortcomings including the prospects in Nigerian banking. In light of the above, this thesis proposes that regulation is necessary to complement and reform the application of corporate governance in the sector. In furtherance of that, this chapter examines the theories and strategies of regulation that may reform corporate governance culture in the banking sector. In essence, it aims to examine how theories and strategies of regulation may complement and reform the corporate governance practices in the sector.

Theories of regulation including its designs are pivotal in the research given that neither the shareholder model nor stakeholder approach captures the centrality of the role regulation plays as a result of the inherent systemic risk and social cost in event of bank collapse.[1] Regulation is necessary in addressing one of the research questions in the thesis because the application of its strategies and designs can assist the regulator to reduce the systemic risk and other externalities inherent in the industry, which do not occur in non-financial firms.[2] Regulation in banking is special and necessary because experience has shown that failure in the sector has consequences beyond the shareholders.[3] This does not mean that the simultaneous failure of non-

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[1] For full analysis of theories of regulation see generally Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (Second Edition, Oxford, Oxford University Press 2012) Part I

[2] Lewis Spellman, *The depository firm and industry: Theory, history and regulation* (New York, Academic Press 1982).

[3] PW Cooke, 'The role of the banking supervisor' (1982) 22 Bank of England Quarterly Bulletin p. 547

financial firms as a result of poor corporate governance practices may not affect the non-shareholders stakeholders. However, the argument is that banking system is much more prone to contagion than other generic firms given that problems in one bank may spread to other banks and system-wide at very fast rate.[4]

The chapter is divided into three Parts with Part I reviewing the two main theoretical frameworks in regulation - public interest theories and private theories – and their shortcomings. Part II explores the contemporary regulatory governance designs, which include the tools and strategies available to the regulators' of the banking industry. Under this, it will be argued that the regulator(s) need to combine and enrol a number of regulatory designs and strategies such as principles based, risk-based approaches including criminal sanctions when it is necessary to enforce compliance. Part III is the conclusion, which summarises and links the chapter to the wider arguments of the thesis.

5.2 Aims of regulation in banks

The concern to safeguard the viability of the depository industry arose from the fact that financial failure had significant external effects that reached beyond the stockholders to include depositors as well as the public in financial firms.[5] The regulation of banks, unlike other non-financial industries arises

[4] See generally Anjan Thakor and Sudipto Bhattacharya, 'Contemporary banking theory' (1993) 3 Journal of Financial Intermediation 2 – 50; Donald Morgan, 'Rating banks: Risk and an uncertainty in an opaque industry' (2002) 92 American Economic Review 874-888; Lammertjan Dam and Michael Koetter, 'Bank bailouts, interventions, and moral hazard' (2011) 2 Discussion Paper 10; ; Penny Ciancanelli and Reyes Gonzalez, 'Corporate Governance in Banking: A Conceptual Framework' (2000) University of Strathclyde – Department of Accountancy and Finance <http://papers.ssrn.com/paper.taf?abstract_id=253714 > accessed on 20th May 2015.

[5] Morgan ibid; Ciancanelli and Gonzalez ibid.

from the responsibility that bankers assume when they accept other people's money for safekeeping.[6] It is not surprising that the defining activity for statutory control is usually the act of deposit but the losses of depository failure are, however, not constrained to the depositors and deposits alone because the external effects are usually large and affect both the public and the country's economic outlook.[7] The depository institution plays an important role as the main conduit in both the payment system as well as the savings and investment processes.[8] To further protect and safeguard such depository firms, it is usual for the regulating bodies to set up entry barriers into such activities in form of regulations. For instance, a licence is required before any individual or body corporate can engage in banking function and the licencing conditions usually include: a minimum paid up capital, security clearance of the directors, availability of competent and skilled manpower and the overall economic goal of a country among others.[9]

The financial institutions also come under scrutiny because they are subjected to various checks by the sectorial regulators regarding their capital adequacy profile, liquidity, reserve, risk management and lending regulations.[10]

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[6] In *Edward Thomas Foley v Thomas Hill and Others* (1848) 2 HLC 28, 9 E.R. 1002, the court held that the relationship between a banker and customer, who pays money into the bank, is the ordinary relation of debtor and creditor, with a superadded obligation arising out of the custom of bankers to honour the customer's drafts; and that relation is not altered by an agreement by the banker to allow the interest on the balances in the Bank. The relationship of banker and customer does not partake of a fiduciary character, nor bear analogy to the relation between Principal and Factor or Agent, who is quasi trustee for the principal in respect of the particular matter for which he is appointed factor or agent. See also United Nations Centre for Transnational Corporations (UNCTC), *Transnational banks: Operations, strategies and their effects on developing countries* (New York, UN 1981).

[7] ibid.

[8] PW Cooke, 'The role of banking supervisor' (1982) 22 Bank of England Quarterly Bulletin 547; GE Blunder, 'International co-operation in banking supervision' (1977) 17 Bank of England Quarterly Bulletin 325.

[9] Malvin Eisenberg, 'Duty of Care of Corporate Directors' and Officers' (1989) 51 The U. Pitt. L. Rev 945; Alan Palmiter, 'Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence' (1988) 67Tex. L. Rev 1351. See the recent Paul Flower's saga in the UK's co-operative bank <http://www.dailymail.**co**.uk/.../**paul-flowers**-former-**co-op**-bank-chairman-arrest> accessed on 20 May 2014.

[10] ibid.

Furthermore, regulation is justified in the banks because developments such as the rise in interbank lending and various money market operations, propelled mainly by the spirit of competitions have also added to the contagion problem.[11] The danger of contagion and potential for systemic risk is particularly acute in banking system - and this means the widespread deposit runs that could overflow to other depository firms in the financial system.[12] It is posited that in order to maintain public confidence in the sector regulation has a crucial supportive role to play in banks and aims to complement and reform the corporate governance theories and structures in the industry.

5.2.1 Understanding regulation

As the theories of regulation evolve over time and are not unified, there is no fixed definition of the term 'regulation' in both legal and economic literature. Regulation generally suggests some form of intervention in any activity, and ranges from explicit legal control to informal peer group authoritative body.[13] On one end of the spectrum, Hertog describes regulation as a set of rules

[11] Bank of England, 'The business of financial supervision' (1984) 24 Bank of England Quarterly 49.
[12] Margret Reid, 'Lessons for bank supervision from the secondary banking crisis' in Gardener E. (ed.) *UK banking supervision: Evolution, practice and issues* (London, Allen, and Unwin 1986); Richard Dale, *International banking deregulation: The great banking experiment* (Oxford, Blackwell Publishers 1992).
[13] A distinction is often made between economic and social regulation but economic regulation consists of two types of regulations: structural regulation and conduct regulation. 'Structural regulation' is used for regulating market structure and examples are restrictions on entry and exit and rules against individuals supplying professional services in the absence of recognized qualifications. 'Conduct regulation' is used for regulating behaviour in the market and examples are price control, rules against advertising and minimum quality standards. Economic regulation is mainly exercised on natural monopolies and market structures with limited or excessive competition. Social regulation comprises regulation in the area of the environment, labour conditions (occupational health and safety), consumer protection and labour (equal opportunities and so on). For more see Anthony Ogus, *Regulation: Legal Form and Economic Theory* (Oxford, Clarendon Press 1994); Michael Moran, 'Understanding the Regulatory State' (2002) 32 British Journal of Political Science 391-431; Barry Mitnick, *The Political Economy of Regulation* (New York, Columbia University Press 1980) ch 1.

pronounced under statute.[14] However, Black criticised this definition for being too simplistic and narrow as it excludes processes, actors and differences between regulations from other bodies of rules.[15] On the other end, regulation is referred to as any mechanism of social control and influence.[16] Whilst this approach is less legalistic, it appears to embrace almost all non-law concepts which may be too wide to define the scope of the regulation in the context of this research.[17]

Black's definition is apposite in this context given that she defines 'regulation' to be 'the intentional, goal-directed, problem-solving attempts at ordering undertaking by both the state and non-state actors'.[18] Accordingly, the goal of regulation is not to be detrimental to markets, but rather, it is often necessary to bring markets into existence and to maintain them by state and non-state actors.[19] The central point of regulation is the interaction between the regulator and policies, law, and the regulated including affected parties.[20] Taking cognisance of the definition offered by Black and the arguments therein, regulation would appear to include government regulation and intervention, which include all of the government-imposed restriction and requirement on people, firms and organisations.[21]

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[14] Johan Hertog, 'General theories of regulation' in *Encyclopedia of Law and Economics* (Edward Elgar 1999) pp. 223 – 270.
[15] Julia Black, 'Decentring regulation: understanding the role of regulation and self-regulation in a "post-regulatory" world' (2001) 54(1) Current Legal Problems 103-146
[16] ibid.
[17] ibid.
[18] ibid
[19] ibid.
[20] Julia Black, 'Critical Reflection on Regulation' (2002) 27 Australian J. Leg Phil 1.
[21] ibid.

In this chapter, 'regulation' means a set of binding rules issued by either a private or public body.[22] In other words, regulation refers to those rules that are applied by all regulators in carrying out their duties and in the financial services sector, they involve such prudential rules as those influencing the condition of access to the market as well as those aimed to control the risks associated with financial activities, corporate governance and internal control system, conduct of business rules and methods of supervision.[23] With respect to market failures, regulation is justifiable given that unregulated marketplace will fail to produce behaviour or result in accordance with public interests.[24] In banking and other financial institutions, a key reason for regulation is to reduce the frequency of the banking crises.[25] In some sectors, regulation can be justified given that there may be an absence of market or ineffective market,[26] or as a result of welfare consideration,[27] monopoly power,[28] externality,[29] or information inadequacies.[30]

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[22] See International Compliance Association, *International Diploma in Compliance Manual* 1 (International Compliance Association 2003).

[23] ibid; see Kenneth Mwenda, *Legal aspects of financial services regulation and the concept of a unified regulator* (Washington D.C: World Bank 2006) Ch 1.

[24] Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (Second Edition, Oxford, Oxford University Press 2012) Part I; John Francis, *The Politics of Regulation* (Oxford, 1993) Ch 1.

[25] See Luc Laeven and Fabian Valencia, *Systemic Banking Crises: A New Database* IMF Working Paper (IMF Washington D C 2008).

[26] See Baldwin, Cave and Lodge (n 24).

[27] Regulating for welfare reasons is as a result of the need to protect people especially where information is limited or costly to obtain. In banking, this is dealt with mainly through the provision of deposit insurance. Nevertheless, the presence of moral hazard among banks and depositors entails that regulators require banks to hold some minimum capital. See generally Stephen Valdez and Philip Molyneux, *An introduction to global financial markets* (7th Edition, Palgrave Macmillan 2013).

[28]ibid; regulation is provided to prevent banks from manipulating competition if they have monopoly power especially where they dominate the markets. For instance, mergers between already large financial institutions to avoid bank failures after 2007-2008 banking crisis entail that markets may even be more concentrated especially with JP Chase/ Bear Stearns; Lloyd/HBOS. The argument remains that regulators should be tougher with large systemic banks and this could be the direction the regulation of global banking is going in the nearest future.

[29] ibid; the riskiness of an individual bank is the responsibility of bank's managers, owners and debt holders, except insofar as the bank's failure impacts on the wider systems through spillover externalities. That is, the fact that a bank fails and its effects can affect the large societal costs. An instance is the informational contagion where the failure of one bank creates doubt on the solvency of similar banks. The failure of Lehman created doubt about Merrill Lynch; Northern Rock's difficulties led to doubt about Bradford and Bingley.

[30] ibid- this could lead to information asymmetries which occurs when the party to one side of an economic transaction has more information than the other party leading to adverse selection and moral hazard.

Furthermore, regulation can be forced on corporations to observe certain prices, to supply certain goods, to stay out of certain markets, to apply particular techniques in the production process or to pay the legal minimum wage.[31] It can be used to impose sanction which may include fines, the publicizing of violations, imprisonment or an order to make specific arrangements, including an injunction against withholding certain actions as well as closing down the business.[32]

5.3 Theories of regulation

Since the recent global financial crisis, interest has rekindled in both developed and emerging economies in regulating the market, and with it, in the debate are those who call for the regulation of the private sector and those who hold that such steps would be damaging to the economy.[33] The key issue in the debate remains whether regulation successfully serves the interest of the public or injures it by distorting the market, undermining efficiency or serving the sole interest of the regulated group.[34] Over the years, two main conflicting theories have evolved in an attempt to explain regulation and the practice of regulation and these are: the public interest theories and interest group theories otherwise called economic and capture theories.[35]

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[31] BM Hutter, *Compliance: Regulation and Environment* (Oxford 1997) 32; Neil Gunnigham, 'Enforcement and Compliance Strategies' in R. Baldwin, M. Cave, and M. Lodge (eds), *The Oxford Handbook of Regulation* (Oxford 2010) 12

[32] See Christopher Stone, 'Controlling Corporate Misconduct' (1977) Public Interest 55; Brent Fisse, 'Sentencing Options against Corporations' (1990) Criminal Law Forum 211.

[33] For full discussions relating to global financial crisis and other oversight regulatory regimes see generally Eilis Ferran, Niamh Maloney, Jennifer Hill and John Coffee, *The Regulatory Aftermath of the Global Financial Crisis: International Corporate and Financial Market Regulation* (Cambridge: Cambridge University Press 2012); Eddy Wymeersch, Klaus Hopt, and Guido Ferrariniet, *Financial Regulation and Supervision: A Post-Crisis Analysis,* (Oxford: Oxford University Press 2012); George Ugeux, *International Finance Regulation: The Quest for Financial Stability* (Wiley 2014); Eilis Ferran, 'Crisis-Driven EU Financial Regulatory Reform' (2012) Legal Studies Research Paper, Faculty of Law, University of Cambridge

[34] Ferran ibid

[35] For full review of myriad varieties of regulatory theory see generally Baldwin and Cave (n 24); Robert Hortwitz, *The Irony of Regulatory Reform: The Deregulation of the American*

5.3.1 Public interest theories

Public interest theories argue that those seeking to institute or develop regulation do so in pursuit of public interest-related objectives rather than group, sectorial or individual self-interests.[36] The proponents argue that public interest theories offer the best possible allocation of scarce resources for individual and collective good.[37] In western economies, the allocation of scarce resource is to a significant extent co-ordinated by the market mechanism.[38] In theory, it could even be argued that under certain circumstances, the allocation of resources by means of the market mechanism is optimal, however, because these conditions are frequently not adhered to in practice, the allocation of resources is not optimal and a demand for methods for improving the allocations arises.[39] One of the methods of attaining efficiency in the allocation of resources is through regulation.[40] According to public interest theory, government regulation is the instrument for overcoming the disadvantages of imperfect competition, imbalance market operation, missing market and undesirable market results.[41]

The public interest theory holds that regulation is applied in response to demand of the public for the correction of inefficient or inequitable market

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Telecommunication Industry (Oxford 1989); Hal Anna Gelpern, *International Finance: Law and Regulation* (3rd edn 2012).

[36] See Michael Hantke-Domas, 'The Public Interest Theory of Regulation: Non-Existence or Misinterpretation?' (2003) 15 European Journal of Law and Economics; Gilbert Becker, 'The Public Interest Hypothesis Revisited: A New Tests of Peltzman's Theory of Regulation' (1986) 49 Public Choice 233-234; For a British public interest account, see Iain McLean and Christopher Foster, 'The Political Economy of Regulation: Interests, Ideology, Voters and the UK Regulation of Railways Act 1844' (1992) 70 Public Administration 313-31.

[37] Kenneth Arrow, 'The Potential and Limits of Markets in Resource Allocation' in Feiwel G.R(ed), *Issues in Contemporary Microeconomics and Welfare* (London, Macmillan Press 1985) 107-124.

[38] ibid.

[39] Harvey Averch and Leland Johnson, 'Behaviour of the Firm under Regulatory Constraints' (1962) 52 American Economic Review 1052-1069.

[40] James Chesney, 'The Politics of Regulation: An Assessment of Winners and Losers' (1982) 19 Inquiry 235-245.

[41] Martin Shubik, 'On Different Methods for Allocating Resources' (1970) 13 Kyklos, 332-338.

practices.[42] It is therefore not surprising that economists regard the growth of regulation as an attempt by government to improve upon the allocation of resources which would occur in unregulated markets. This belief was based on the implicit assumptions that some forms of activities, business or otherwise, do not always function in the public interest without supervision or control.[43] This view could have a historical antecedent given that regulation in the past and perhaps in the recent years had almost always followed some form of crisis or public dissent and the implication of this is that a number of regulations are sometimes inspired as a result of an earlier crisis in the affected industry.[44]

A further assumption of the public interest theory remains that regulation is aimed at protecting the public, and to achieve this purpose, regulation based on the above principle should aim at equipping the public with all relevant information necessary for decision-making.[45] Regulation in the public interest should also strive to protect the public from monopolies and industries that generate substantial social costs or benefits, however, this does

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[42] Sam Peltzman, 'The economic theory of regulation after a decade of deregulation' in Bailey, M.N. and Winston, C (eds), *The Brookings Papers of Economic Activity* (Washington, Brookings Institution 1989) p. 4.
[43] ibid.
[44] For instance, the establishment of the Securities and Exchange Commission (SEC) in the US following the manipulation of markets prices by investment companies to the advantages of insiders and at the detriment of the outsiders is an example of a crisis-driven regulation. Examples of the crisis-inspired legislation in the UK include the Royal Exchange and London Assurance Corporation Act (Bubble Act) of 1719. This Act, which outlawed the joint stock companies of the time, was a direct consequence of the widespread abuse of the system, mainly in the form of fraudulent promotion of such companies, culminating in the famous South Sea Company Scandal. For more on crisis-led regulations, see generally Michael Reagan, *Regulation*: *The politics and policy*, (Boston, Little Brown and Company 1987) 32; Samuel Huntington, 'The marasmus of the ICC' (1952) 61 Yale Law Journal 467-509; Peter Temin, 'The origin of compulsory drug prescriptions' (1979) 2 Journal of Law and Economics and Management Science 94-95; John Edwards, *British company legislation and company accounts, 1844-1976* (New York, Arno Press 1980) 5; Neil Gunningham, *Pollution, social interest and law* (London, Martin Robertson and Company 1974) 59.
[45] ibid.

not always happen in practice.[46] Indeed, had this theory been all that right, one would also not expect any support for regulation from the regulated industry? [47]

It could be argued that the image of government as costless and reliable instrument for altering market behaviour has also been extensively questioned.[48] This is because costs are incurred in the provision of data and information to regulators and it is also possible for regulation to reduce the reactivity and flexibility of companies to adapt to changing environments.[49] Regulation could even affect the management style, for instance, management may become more oriented towards satisfying the regulators than towards meeting its proper business demands and objectives.[50] Based on the above, there has been this argument that the costs of regulation rather than the benefits are greater than any welfare losses arising from inefficiencies in market-based allocation of wealth.[51] Empirical studies consequent on these seemingly contradictions in the public good theory show little evidence that government regulation, especially in the form of state intervention, is entirely beneficial to the public.[52]

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[46] Richard Posner, 'Theories of economic regulation' (1974) 5 Bell Journal of Economic and Management Science 336; Richard Posner, 'A Statistical study of antitrust enforcement' (1970) 13 Journal of Law and Economics 365- 419.

[47] An implicit assumption of the public interest theory of regulation is that public interest and the interest of regulatees are dissimilar. For more see JW Roxbee Cox, 'The Appeal to the Public Interest' (1973) 3 British Journal of Political Science 229-41.

[48] RW Gerwig, 'Natural gas production: A study of costs of regulation' (1962) 5 Journal of Law and Economics 69-92.

[49] See Bronwen Morgan and Karen Yeung, *An Introduction to Law and Regulation* (Cambridge 2007) ch 2.

[50] ibid.

[51] Edward Gardener, 'Supervision in the United Kingdom' in Gardener, P.M.(ed) *UK banking supervision: Evolution, practice and issues* (London, Alen and Unwin 1986) 29; George Stigler, 'Public regulation of the securities markets' (1964) 37 Journal of Business 117-142.

[52] Chibuike Uche, 'The theory of regulation: A review article' (2001) 9(1) Journal of Financial Regulation and Compliance 67-80; Chibuike Uche, 'Banking Regulation in an Era of Structural Adjustment: The Case of Nigeria' (2000a) 8(2) Journal of Financial Regulation and Compliance 157-169.

A further problem with public interest theory stems from the doubts concerning the disinterestedness, expertise, and efficiency that the public interest approach attributes to regulation.[53] This is because regulators could succumb to venality and might be corrupted by opportunities for personal gains so that even regulation becomes prejudiced by the pursuit of personal interest by the regulators.[54] Also, doubts could be cast on the competence of the regulators, which may not be sufficiently high to meet public interest requirement from the public perception.[55] However, this does not mean that the public interest theory is not relevant to the thesis because the fact that the theory aims at least in principle, to protect the public by attempting to reduce the social costs through resource allocations makes it much more relevant to both the operators and regulators in banking industry which is at the heart of the research. Nevertheless, given the higher informational demands required to regulate and the fact that the regulator could sometimes have a separate or private interest which seems less than satisfactory in the public perceptions, it is argued that reliance alone on the public interest theory is not enough in regulation.[56]

5.3.2 Interest group theories

This theory stresses the extent to which regulatory developments are driven not by the pursuit of public interest but by the particularistic concerns of interest groups and one of the most prominent among these accounts is the

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[53] Chibuike Uche, 'Regulating Finance Companies in Nigeria' (2001d) 2(4) Journal of International Banking Regulation 75-86.
[54] See John Francis, *The Politics of Regulation: A Comparative Perspective* (Oxford 1993).
[55] See Cass Sunstein, 'Paradoxes of the Regulatory State' (1990) 57 University of Chicago Law Review 407; Cass Sunstein, *After the Rights Revolution* (Cambridge, MA 1990) 10.
[56] ibid.

capture argument.[57] The notion of capture is primarily associated with George Stigler who suggested that: ‘as a rule regulation is acquired by the industry and is designed and operated primarily for its benefits’ and this proposition has come to be known as the capture theory of regulation.[58] According to the orthodox accounts of economic theory of regulation, where there is a failure of competition or the existence of monopoly, there will be monopoly profit and the legislature will give the regulator the power to dispose of these economic monopoly rents.[59] The regulated industry will have an incentive to influence the regulator so as to benefit from the ‘regulatory rent’ and there will be market for regulation. In essence, the regulatory agencies are captured by the industry they are supposed to be regulating.[60] Regulation, far from supporting the general public interest by achieving efficiency gains, is enacted and implemented in the interest of specialist producer groups.[61]

Proponents of this theory argue that people in their political behaviour cannot be assumed to be motivated by fundamentally different forces than in their private choice-making behaviour.[62] Self-interest is usually put above all other interests and the industry which seeks regulation must be prepared to pay with

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[57] This theory has most prominently been associated with the so-called ‘economic theory of regulation’, private interest, Chicago/Virginia school, public choice, special interest and capture. For more see generally Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation, Theory, Strategy, and Practice* (Second Edition, Oxford, Oxford University Press 2012) 41-67; Sam Peltzman, ‘Towards a More General Theory of Regulation’ (1976) 19 Journal of Law and Economics 211.

[58] The capture theory was not new in 1971 when Stigler came with the idea of capture argument, nevertheless, what was new was its broad appeal to economists based on the accumulating evidence of empirical research. See for instance George Stigler, ‘Theory of Economic Regulation’ (1971) 2 Bell Journal of Economics 3; Richard Posner, ‘Natural Monopoly and Regulation’ (1969) 21 Stanford Law Review 548; Marver Bernstein, *Regulating business by independent commission* (Princeton, Princeton University Press 1955) 39 – 50; Louis Jaffe, ‘The Independent Agency: A New Scapegoat’ (1956) 65 Yale L J 1068.

[59] Stigler ibid.

[60] WA Jordan, ‘Producer Protection, Prior Markets Structure and the Effects of Government Regulation’ (1992) 15 Journal of Law and Economics 151.

[61] ibid 54.

[62] Peltzman (n 57).

two things a political party needs: votes and resources.[63] The choice, therefore, between market and political action is essentially an economic one and will depend upon the relative costs involved and the chances of success in each case.[64] Nevertheless, a number of modifications and variations in the economic theory of regulation have been put forward. For instance, Peltzman argues that the complete capture of any agency by any group would imply that the activities of the agency were run exclusively in the interest of that group.[65] Such a policy must inevitably arouse opposition from other groups who are adversely affected, and a more likely outcome of the regulatory process would be a balancing of opposing interests, which will then reflect in wider social interests.[66] The point of political equilibrium in the Peltzman's model will depend upon the organisational cost faced by the two opposing groups.[67] On one hand, Becker,[68] argued that once an industry has successfully captured the monopoly rents from any particular regulatory intervention, this will trigger countervailing interest to mobilize to contest the acquired rent; in the end, no 'monopoly rent' will survive.[69] On the other hand, the view of interest mobilizing and counter-mobilizing underestimates the power of capture and sometimes are viewed with considerable scepticism.[70]

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[63] ibid.
[64] Martin Ricketts and KP Shaw 'The theory of regulation' in Peacock, A, Ricketts, M. and Robinson, J. (eds) *The regulation game: How British and West German companies bargain with government* (Oxford, Basil Blackwell Publishers 1984) 14.
[65] See Peltzman (n 57).
[66] Sam Peltzman, 'The Economic Theory of Regulation after a Decade of Regulation' (1989) Brookings Papers in Macroeconomics 1.
[67] ibid.
[68] Gary Becker, 'A Theory of Competition among Pressure Groups for Political Influence' (1983) 98 Quarterly Journal of Economics 371.
[69] ibid
[70] See Mancur Olson, *Logic of Collective Action* (Cambridge, MA 1974).

Contextually, it is argued that in the banking institution where the proximity of the regulator and the regulatees relationship is sometimes associated with command and control techniques, the regulatory agencies might be thought to be particularly conducive for capture.[71] This is because when drawing up the enforcing rules agencies must rely to some extent on co-operation of the regulated firms for regulation.[72] Owing to the fact that information is a valuable asset for regulation and because a misinformation or wrong information to the public has a potential to cause panic or a run on the bank, the regulators require a reliable and accurate information in order to carry out their functions.[73] In view of that, the primary and best source of such information will often be from the regulated industry given that the regulator requires some assistance from the regulated firms in order to make the regulation work.[74] This gives the regulated firms a degree of leverage over regulatory procedure and objectives; leverage that, over time produces capture.[75] In all, there has been recent suggestion for a synthesis of the two regulatory theories for better applications and while synthesising the best ideas of both theories is a step in the right direction in the banking industry, they should be complemented by the mixture of other contemporary regulatory tools and strategies available for regulatory governance enforcement.[76]

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[71] ibid.
[72] On command and control as well as its alternatives, see Robert Baldwin, 'Regulation: After Command and Control' in K. Hawkins (ed), *The Human Face of Law* (Oxford 1997) 32.
[73] ibid.
[74] Becker (n 68).
[75] ibid 34.
[76] See Michael Levine and Jennifer Forrence, 'Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis' (1990) 6 Journal of Law and Economics & Organisation 167-198.

In principle, the fact that both 'public interests' and 'capture' theories aim to protect various public and private interests in the industry demonstrates their relevance to the research. Nevertheless, the argument of this section is that the theoretical assumptions must be complemented with other current regulatory governance designs available to regulators with a focus on understanding the organisational settings, political and cultural contexts under which the regulated industry operates.[77] Some of the current regulatory governance strategies include: principles based regulation, meta-regulation and risk-based approaches, which will be explored in the next section.

5.4 Regulatory strategies in banking

This section aims to analyse the 'new governance' regulatory strategies, which have been praised in the recent years as superior in many ways to traditional 'command and control' (C&C) regulation. According to Professor Julia Black, the 'new governance regulatory strategies' are those new techniques of regulation in the period leading up to the financial crisis in 2008-200[78] These regulatory techniques include: principled-based regulation, risk-based regulation, meta-regulation and enrolment.[79] While they may not be the only existing strategies in regulation, however, they have been strategically selected on the ground that they are more responsive and flexible than 'command and control regulatory mechanism' in enrolling other approaches in regulatory project and applications. [80]

[77] ibid.
[78] See Julia Black, 'Paradoxes and Failure: 'New Governance' Techniques and Financial Crisis' (2012) 75(6) Modern Law Review 1037-1063.
[79] ibid
[80] Command and Control (C & C) regulation refers to 'the direct regulation of an industry or activity by legislation that states what is permitted and what is illegal. The 'command' is the presentation of quality standards/targets by a government authority that must be complied with while the 'control' part

Nevertheless, because the command and control mechanism is still prevalent in financial regulation the section will briefly discuss this strategic framework noting its merits and demerits in practice.[81]

5.4.1 Paradoxes in regulatory governance

While regulation may not be the only cause of the crisis it certainly played a role as can be seen from the analysis of the new regulatory strategies in this chapter.[82] But failings were made by state and non-state regulators as well as market actors at the global, EU and national level, ranging from transnational regulatory committees to financial institutions and their internal corporate governance structures.[83] However, there is significant literature by both regulators and commentators analysing just what went wrong and the causes of the financial meltdown.[84] Before proceeding to analyse the above-

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signifies the negative sanctions that may result from non-compliance including prosecution. C&C encompasses a variety of methods that influences behaviour through: laws, incentives, threats, contracts and agreements. In C&C, there is a perception of a problem and the solution for its control is developed and subsequently implemented. To deliver its objectives, direct regulation must ensure the highest level of compliance possible. This can be achieved through appropriate implementation and enforcement. Non-compliance to C&C regulation presents a serious challenge to its effectiveness and the manner in which C&C is enforced differs between countries. For example, in the USA, some regulators who are tasked with implementing C&C techniques are given rule-making powers. Whereas in the UK, regulatory standards are more commonly set by departments of government. This is achieved through both primary and secondary legislation which is subsequently exacted by regulatory bureaucracies. See generally Carolyn Abbot, 'The Regulatory Enforcement and Sanctions ACT 2008' (2009) Environmental Law Review 38; Phil McManus, *Environmental Regulation* (Australia: Elsevier Ltd 2009); Robert Baldwin; Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (2nd edn. Oxford: Oxford University Press 2012). Neil Gunningham and Peter Grabosky, *Smart Regulation: Designing Environmental Policy* (Oxford: Oxford University Press 1998).

[81] Nathaniel Keohane, Richard Revesz, and Robert Stavins, 'The Choice of Regulatory Instruments in Environmental Policy' (1998) 22 Harvard Environmental Law Review 313-67.

[82] ibid

[83] See Financial Stability Board (FSB), *Improving Financial Regulation –Report of the FSB to G20 Leaders* (Basel: FSB 2009); Financial Stability Forum (FSF), *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience* (Basel: FSF 2008).

[84] For instance, Davies identified a number of different causes of the crisis from the prevailing literature ranging from the macro to the micro economic policies to global imbalances to loose monetary policy to practices of US mortgage brokers, credit ratings issues. But the story that is told regarding the causes of the financial crisis can vary with the position of the narrator. See generally Howard Davies, *The Financial Crisis – Who is to Blame*? (Cambridge: Polity Press 2010); Julie Froud, Adrian Nilsson, Michael Moran and Karel Williams, 'Stories and Interests in Finance: Agendas of Governance Before and After the Financial Crisis' (2012) 25(1) Governance 35. For full analysis of global financial crisis see generally Eilis Ferran, Niamh Moloney, Jennifer Hill and John Coffee, *The Regulatory Aftermath of the Global Financial Crisis: International Corporate and Financial Market Regulation* (Cambridge: Cambridge University Press 2012); Eddy Wymeersch, Klaus Hopt, and Guido Ferrariniet, *Financial*

mentioned strategies and tools in regulatory governance, it is germane to note that regulation is a complex and multidimensional activity and failures in any of these dimensions can create points of vulnerability, such that the carefully fashioned technique may simply not function as intended.[85] Instead, it is transformed in the very process of its performance, resulting in a number of paradoxes.[86]

Paradoxes and ironies are prevalent in the performance of regulation, which could lead to failures in that regulation not only fails to change behaviour, manage risk or attain any other targeted goals, but actually produces the opposite effects from those intended.[87] This can be the situation no matter the combination of regulatory strategies adopted and whether in developed or emerging economies.[88] For instance, regulation to enhance disclosure in a bank may have the potential to scuttle it and warning that a particular bank is likely to fail can create a run on the bank as a result of panic, so causing actual failure and this can create an opportunity cost and can lead to negative spillover effects.[89]

Regulation and Supervision: A Post-Crisis Analysis (Oxford: Oxford University Press 2012); Eilis Ferran, 'Crisis-Driven EU Financial Regulatory Reform' (2012) Legal Research Paper, Faculty of Law University of Cambridge, UK); Stephen Valdez and Philip Molyneux, *An introduction to global financial markets* (7th Edition, Palgrave Macmillan 2013).

[85] See generally Peter Grabosky, 'Counterproductive Regulation' (1995) 23 International Journal of Sociology of Law 347; Russell Morgan and Ronald Clarke, 'Legislation and Unintended Consequences for Crime' (2007) 12 European Journal of Criminal Policy and Research 189.

[86] Thomas Lemieux, 'Alcohol, Marijuana and American Youth: The Unintended Consequences of Government Regulation' (2001) 20 Journal of Health Economics 99.

[87] Professor Black argued that paradox in performance of regulation can occur in implementing these new regulatory strategies given that in some cases regulation suffers from internal contradictions by producing the opposite of what is intended and regulation to minimize a risk may end up increasing the risk. See generally Julia Black, 'Paradoxes and Failure: 'New Governance' Techniques and Financial Crisis' (2012) 75(6) Modern Law Review 1037-1063; Peter Grabosky, 'Counterproductive Regulation' (1995) 23 International Journal of Sociology of Law 347; Russell Morgan and Ronald Clarke, 'Legislation and Unintended Consequences for Crime' (2007) 12 European Journal of Criminal Policy and Research 189; Fiona Haines, *The Paradox of Regulation: What Regulation can Achieve and What it Cannot* (Cheltenham: Edward Elgar 2011).

[88] Black ibid.

[89] Anil Arya, Jonathan Glover, Brian Mittendorf, and Ganapathi,Narayanamoorthy, 'Unintended consequences of regulation disclosures: The Case of Regulation Fair Disclosure' (2005) 24 Journal of Accounting & Public Policy 234.

Furthermore, regulation leads to over-deterrence as well as creating some deviance, for example, through labelling otherwise compliant firms as potential deviants and regulation to minimise risks can accidently lead to greater risks.[90] Similarly, safety regulation may create moral hazard and can even increase risk-taking activities in banks.[91] In other words, the bailout saga in the aftermath of financial crisis also created a significant degree of moral hazard for the banking industry.[92] In essence, this is in the further working out of these paradoxes in regulation in that banks are now finding that the effects can work in reverse: in the midst of the US and EU sovereign debt crisis, where markets do not think that their governments will be able to rescue them, banks' share prices would plummet rapidly.[93] Many of these ironies and paradoxes in regulation were witnessed in both developed and emerging markets during the recent financial crisis despite the combination of many regulatory strategies and tools in the financial circles by the regulators.[94]

The above arguments notwithstanding, this section still posits that effective combination of regulatory governance design that is responsive to identified risk and flexible in approach can reduce the crisis in Nigerian banking sector. In view of that, the main governance strategies and tools will now be

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[90] ibid.

[91] Doreen McBarnet and Christopher Whelan, 'The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control' (1991) 54 MLR 848; Ian Ayers and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debt* (Oxford, OUP 1992).

[92] Gordon Rauser, Stephen Hamilton, Marty Kovach and Ryan Stifter, 'Unintended consequences: The spillover effects of common property regulations' (2009) 54 MLR 848.

[93] ibid.

[94] ibid.

discussed in comparison with command and control (C&C) framework as they apply in practice.

5.4.2 Command and control (C&C) approach

The essence of C&C regulation is the exercise of influence by imposing standards backed by criminal sanctions, but could also be administrative including the withdrawal of licences and permits against the regulated industry.[95] This adversarial method of control is often administered through government parastatals or agencies and such framework is usually backed by statutory regulations.[96] These rules are intended, in all stages of their application, to be interpreted and enforced by the courts and such laws usually prescribe punishments. Similarly, there are sanctions for non-compliance and the force of law is used to prohibit certain forms of conduct, to demand some positive actions or to lay down conditions for entry into a sector .[97] Regulators who operate within a C&C framework such as in the US are sometimes equipped with rule-making powers unlike the principles-based approach in the UK.[98] The strength of this regulatory framework is that the force of law can be used to impose fixed standards with immediacy and to prohibit activity not conforming to such standard.[99]

Government control in some activities remains necessary and this is especially the case in the area of social regulation where externalities are

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[95] Haines (n 73).
[96] Bank of England, 'Regulation in the City and the Bank of England's Role' (1978b) 18 Bank of England Quarterly Bulletin 380.
[97] ibid.
[98] Richard Stewart, 'The Discontents of Legalism: Interest Group Relations in Administrative Regulation' (1985) Wisconsin Law Review 687.
[99] ibid.

widespread such as in banking industry where a run on a bank could be widespread and has the potential to damage the public confidence reposed in the industry.[100] Such a loss results in substantial social cost both to the investing public and overall financial system in an economy and in such a case, a statute-backed regulatory regime can reduce both the information and enforcement costs.[101] Moreover, government regulation entails the maintenance of the separation of power doctrine and this ensures the separation of the function of adjudication and enforcement of rules from the regulated industry.[102] It can be argued that government regulation protects the public interest and advisable for achieving social goals as well as to fight externalities.[103]

Nevertheless, it has been criticised for being inflexible, sometimes expensive and costly as well as tending to write inefficient rules with minimum standard; and such an incentive for companies just to adhere to the minimum standard is often inadequate.[104] Similarly, an inherent feature of statute law is that it tends to be its letter not its spirit that the courts interpret and enforce in practice.[105] For the above reasons, statute law particularly where it relates to the administration of regulation is sometimes framed in a manner which gives some degree of discretionary authority to the regulator.[106] Furthermore, C&C approach lacks force in a country where court sanctioning is weak and the

[100] This is the term generally used to refer to regulation which typically affects a number of industries and is intended to promote a general societal good. For more see Graham Wilson, 'Social regulation and explanations for regulatory failure' (1984) 32 Political Studies 203.
[101] ibid.
[102] But this may not hold when the regulatory authority is 'captured' by the industry as it then becomes a front for the industry.
[103] See Neil Gunningham, *Pollution, social interest and the law* (London, Martin Robertson and Company 1974).
[104] ibid.
[105] ibid 65.
[106] Stewart (n 84).

rules, as a result, fail to pose a credible deterrence.[107] In such a situation, there may be problems because adversarial industry to regulator's relationships could develop and this produces poor information flows to the regulator and a climate of defiance and resistance from the industry that produces poor compliance.[108] It is the above difficulties that make self-regulations attractive to some parties.[109]

5.4.3 Self-regulation

This regulatory framework is variously described in academic literature as 'meta-regulation', 'management-based regulation', 'enforced self-regulation' or the regulation of firms' own self-regulation.[110] Self-regulation (SR) involves non-governmental organisation, specific sector or group of industries that impose regulation on its members and allow its authority to control their behaviour.[111] Under this strategy, regulators do not prescribe how regulatees should comply, but require them to develop their own systems for compliance and to demonstrate that compliance to the regulator.[112] Whilst it is not exclusively dependent on the state, self-regulation can also 'occur in the three traditional components of legislation, enforcement and adjudication, and can be as complex as government regulation.[113] However, even self-

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[107] ibid.

[108] Neil Gunningham and PN Grabosky, *Smart Regulation* (Oxford 1998) ch 6; John Braithwaite and Toni Makkai, 'Trust and Compliance' (1994) 4 Policy and Society 1.

[109] According to the National Consumer Council in the UK (NCC), self-regulation means that: 'rules which govern behaviour in the market are developed, administered and enforced by the people (or their direct representatives) whose behaviour is to be governed'. For more see NCC, *Self- regulation* (London, National Consumer Council 1986) 1.

[110] In this research: self-regulation, meta-regulation, enforced self-regulation and management-based regulation will be used interchangeably with the same meaning.

[111] See generally Julian Black, 'Constitutionalising Self-Regulation' (1996) 59 MLR 24; Anthony Ogus, 'Rethinking Self-Regulation' (1995) 15 OJLS 97; Alan Page, 'Self-Regulation: The Constitutional Dimension' (1986) 49 MLR 141; Alan Page, 'Financial Services: The Self-Regulatory Alternatives' in R. Baldwin and C. McCrudden, *Regulation and Public Law* (London 1987) 23; Ian Ayers and John Braithwaite, *Responsive Regulation* (Oxford 1992) ch 4.

[112] See Christine Parker, *The Open Corporation: Effective Self-regulation and Democracy* (Cambridge: CUP 2002).

[113] ibid.

regulation is partly dependent on the government, which aims to ensure that SR remains 'responsive to public interests'.[114] For instance, government could monitor self-regulation, approve industry codes of practice, exercise oversight and control over SR, or coerce self-regulation by threatening formal government regulation if certain rules are not followed.[115]

Meta-regulation is fundamentally reliant on the simultaneous presence of four elements: on firms having the appropriate culture to support the compliance systems which are put in place; on having the right incentives to pursue public objectives as well as private profits; on regulators possessing sufficient skills and industry experience to evaluate firms, and having sufficient courage and political support to challenge them.[116] The benefits of a self-regulatory framework could be immense and the arguments in support of this framework are that it gives firm greater flexibility, enables them to design systems and processes which are better suited to ensuring compliance with their own organisations than could be done by generic and prescriptive rules.[117] Similarly, it places the burden and responsibility on firms themselves to demonstrate compliance, rather than shifting the onus on regulator to show non-compliance.[118]

Specifically, for instance, by reducing reliance on statute, self-regulation appears to offer a much flexible and faster approach in setting standards and

[114] Rob Baggott, 'Regulatory Reform in Britain: The Changing Face of Self-Regulation' (1989) 67 Public Administration 435.
[115] ibid 199.
[116] ibid.
[117] ibid.
[118] Carry Coglianese and David Lazer, 'Management-Based Regulation: Prescribing Private Management to Achieve Public Goals' (2003) 37 Law and Society Review 691; John Braithwaite, *Regulatory Capitalism: How it Works, Ideas for Making it Works Better* (Cheltenham: Edward Elgar 2008) 10.

principles such as industry' code of corporate governance; and integrates sector-specific knowledge of those involved in the industry.[119] Also, it could be argued that by utilising the skills of those involved in the business, self-regulatory approach is able to overcome the informational problems sometimes faced by government regulatory bodies, leading to conceivably higher standard than the statute scheme.[120] Self-regulation appears to be more cost-effective since the costs for the government are naturally much lower without enacting laws and maintaining its large-scale enforcement couple with the fact that the cost of self-regulation regimes are normally internalised in the trade or activity which is exposed in government regulation.[121]

However, owing to the variety of interests that impact on self-regulation, in practice, it has not been without blemish. While in principle the strategy is commendable because regulators always rely on firms' internal systems to ensure compliance, its fundamental weakness is that firms' systems and processes are often designed to attain their goals, and not necessarily those of regulators.[122] In other words, compliance systems therefore could end up running parallel to the organisations' core operations, rather than being integral to them.[123]

The traditional concern regarding self-regulation has been that the industry's codes could harm outsiders by generating a cartel, monopoly or otherwise

[119] This explains the proliferations of codes of corporate governance practices in banks and other industries around the world. See generally Colin Boyd, 'Ethics and corporate governance: The issues raised by the Cadbury report in the United Kingdom' (1996) 15(2) Journal of Business Ethics 167-182; Michael Moran, *The Politics of the Financial Services Revolution* (London 1991) 12; Julian Black, *Rules and Regulators* (Oxford 1997) 32-37.
[120] Office of Fair Trading (OFT), *Voluntary Codes of Practice* (London 1996) 8-20.
[121] Boyd (n 105).
[122] ibid.
[123] ibid.

exercising its market powers in expense of the public.[124] Self-regulation even lacks sufficient enforcement power compared to government regulation (C&C) since they are merely non-binding principles and it has poor records of enforcing its standards against disobedient members.[125] In the UK financial services industry, meta-regulation was adopted as a specific regulation technique under the capital adequacy rules, where firms were allowed to use their own internal risk model to provide the basis for setting their capital requirements.[126]

The key regulatory instrument, referred to globally as Basel II, defined the parameters of the models banks were to use, which then had to be approved by the regulators.[127] Their introduction was controversial and they were demonstrated to have significantly under-estimated the inherent risks to which banks were exposed and other unsustainable elements in the banks.[128] The reliance on senior management was a key part of the substantive dimension of principles based regulation with respect to prudential supervision in the UK.[129] In part, this was due to the statutory requirement that the regulator should take into consideration the responsibilities for firms'

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[124] OFT, *Raising the Standard of Consumer Care: Progressing Beyond Codes of Practice* (London 1998) 10.

[125] It might be argued that if the banking industry was to adhere strongly to self-regulation and non-complaint, banks would suffer exclusion from the inter-bank lending market, or face higher rates of interest. See James Barth, Gerald Caprio and Ross Lavine, 'Bank supervision and regulation: What works best?' (2003) Journal of Financial Intermediation 3; Wolfgang Streeck and Philippe Schmitter (ed), Private *Interests Government: Beyond Market and State* (London 1985) 22-5.

[126] See Financial Services Authority (FSA), *The Turner Review: A regulatory response to the global banking crisis* (London: FSA 2009); Her Majesty's Treasury (HM Treasury), *A new approach to financial regulation: the blueprint for reform* (London: Stationery Office 2011).

[127] Basel Committee on Banking Supervision (BCBS), *International convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel: Bank for International Settlements 2006).

[128] Nonetheless, meta-regulation still has a central role to play in financial services sector regarding the global capital requirements and leverage ratio under Basel III. See generally Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (Washington DC, Petersen Institute for International Economics 2008).

[129] Treasury Select Committee, *Banking crisis-regulation and supervision*: Oral Evidence (HC 144-1) (London: Stationery Office 2009).

senior management, which it interpreted as meaning that it could not challenge the business decisions of the firms.[130] It was based on the assumption, which the regulator was not alone in holding, that as it remained in the firms' interests to properly manage its risks, the regulators could rely on banks' own internal management to ensure this, overseen by effective boards and monitored by shareholders.[131]

These assumptions were based on cognitive capture rather than straightforward interest group capture.[132] However, the recent crisis has demonstrated that these beliefs and suppositions were deeply flawed.[133] In the UK and Nigeria, regulators have now recognised that banking firms are not as competent in managing themselves as either regulators or the firms themselves had assumed, and that their incentives are not well aligned with those of the regulators.[134] Similarly, management-based framework was further shown to be myth-based regulation given that at the height of the crisis, regulators found that banks did not have the systems models and information to effectively carry out stress tests.[135] It became apparent that past requests from regulators that banks performed stress tests had been based on

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[130] The DNB (the Dutch Banking Supervisor) felt similarly restricted, according to findings of the De wit Commission (2010), cited in J. Kremers and D. Shoenmaker, *Twin peaks: Experience in the Netherland* (London: London School of Economics and Political Science 2010).

[131] The FSA's approach (before its demise) shifted rapidly in the wake of the crisis to one of 'intrusive supervision' and 'credible deterrence'. However, the Bank of England proposed that the Prudential Regulation Authority (PRA – a subsidiary of the Bank of England which took over prudential supervision of banks from FSA with the enactment of Financial Services Act 2013) will be a 'judgement-led supervisor, which is not so far from the descriptions of principles based regulation (PBR) before the crisis. For more see FSA, *Prudential Regulation Authority: The Future Approach to Banking Supervision* (London: FSA 2011).

[132] James Anderson, 'The Public Utility Commission of Texas: A Case of Capture or Rapture?' (1982) 1 Reviews of Policy Research 484; OECD, *Corporate Governance and Financial Crisis: Key Findings and Main Messages* (Paris: OECD 2009).

[133] FSA, *Observations on Risk Management Practices during the Recent Market Turbulence* (London: FSA 2008); FSB, *FSF Principles for Sound Compensation Practices* (Basel: FSB 2009).

[134] Walker Review, *A Review of Corporate Governance in UK Banks and other Financial Industry Entities* (London: Stationery Office 2009).

[135] A stress test in banking terminology is an analysis or simulation designed to determine the ability of a given financial instrument or financial institution to deal with an economic crisis.

largely fictional models purely for benefit of the regulators.[136] Clarke posited that stress tests had been a way for banks to manage regulators, and not to manage themselves.[137]

Furthermore, FSA's supervision of Royal Bank of Scotland (RBS) concluded that RBS earned its 'regulatory dividend' not on the basis of its internal controls, but as a result of the co-operative stance of its compliance personnel, which accords strongly with 'responsive' regulation but nonetheless proved in this case to be indulgent regulation.[138] While this regulatory strategy may be deficient, it is posited that the option to jettison this approach in the nearest future is not viable given that 'meta-regulation' is pretty much relevant in the banking industry in both developed and emerging economies. The reason is because the fundamental inter-dependence of regulator and regulatees (banks) means that reliance on the framework is present and necessary.[139] Basically, regulators cannot be present at all times and in all places and even under C&C regimes, they still have to rely on firms complying with regulation continually, not just when the inspectors and supervisors call on them.[140]

5.4.4 Principles based regulation (PBR)

This strategy remains closely linked with 'meta-regulation' but the principles here are set by the regulators unlike in meta-regulation where the regulators allow the firms to design processes and systems for compliance.[141] PBR uses

[136] William Laufer, 'Corporate Liability, Risk Shifting, and the Paradox of Compliance' (1999) 54 Vanderbilt Law Review 1343.
[137] Lee Clarke, *Mission Improbable: Using Fantasy Documents to tame Disaster* (Chicago: University of Chicago Press 1999).
[138] FSA, *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report* (London: FSA 2011).
[139] Andrew Haldane, *Why Banks Failed the Stress Test* (London 2009).
[140] ibid.
[141] ibid.

broad set of principles of conduct set out by the financial services regulator and these principles are then left to regulated industry to decide how to most appropriately implement them.[142] This differs from rule-based regulation which leaves less to the regulated parties to decide and requires the regulator to set out a more specific rule book.[143] The regulator's strategy to supervision will rely increasingly on principles and outcome-focused rules rather than detailed rules prescribing how outcomes must be achieved.[144] A number of PBR, notably the focus on risk and outcomes, have strong affinity with outcomes-focused or outcomes-based approaches to regulation that a number of UK regulators are currently adopting and the spirit of PBR appears to remain even though the branding may have been altered.[145]

Analytically, PBR can take one or both of two forms: rulebook PBR, which is how the rulebook or code of conduct are written, and operational PBR, which is how the regulator performs its tasks.[146] PBR involves formulating rules which are broad, general and purposive in approach and its principle forms the 'backstop' to those more detailed provision, and acts as a guide to the interpretation and application in particular instances.[147] PBR has been equated with 'light touch regulation' across all sectors in the UK with the regulator increasingly pursuing a strategy of taking enforcement actions on

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[142] FSA, *Principles Based Regulation: Focusing on the outcomes that matter* (London: FSA 2007).
[143] ibid.
[144] In the UK, principle-based regulation (PBR), which was praised so highly by the regulator and the UK government just before the financial crisis, was seen in the immediate aftermath to have suffered a fatal blow. For instance, in the words of Hector Sants, the then chief executive of the FSA, '[a] principle-based approach does not work with people who have no principles'. For more on the critique of this approach see Hector Sants, 'Delivering Intensive Supervision and Credible Deterrence' speech presented at Reuters Newsmakers Event, London, March, 2009.
[145] See Financial Reporting Council (FRC), *Strategic Framework* (London: FRC 2007); Care Quality Commission, *COQ Strategy 2010-2015* (London: Care Quality Commission 2010); Tenant Services Authority, *The regulatory framework for social housing in England from April 2010* (London: Tenant Services Authority 2010).
[146] ibid.
[147] Lawrence Cunningham, 'A Prescription to Retire the Rhetoric of Principles Based Systems in Corporate Law, Securities Regulation and Accounting' (2007) Vanderbilt Law Review 1411-1493.

the basis of breach of a principle alone.[148] However, with regard to prudential supervision in the financial industry the supervision before the crisis was less intense, with fewer regulatory resources dedicated to it and more dependence on firms' internal systems and controls.[149] Consequently, one of the main reasons for regulatory failure (leaving aside the technical aspects of the rules regulating banks' capital requirements) was that regulators placed too much trust in financial institutions.[150] Nevertheless, it is necessary to point out that regulators in the UK financial industry were sometimes under pressure from the government not to be too rigorous with the industry in enforcement to enable the City of London retains its prime position as the financial nerve-centre globally.[151]

Lord Turner contended that the financial regulatory body – formerly FSA – was cowed into acceptance of often repeated political demands for 'light touch' regulation deemed necessary for the City of London to preserve its traditional pre-eminent status among financial centres. [152] Such political/industry 'capture' of the regulator was evident in the days when the bank had responsibility for banking supervision – such as the failings with respect to BCCI and Barings.[153] This implies that regulator could be captured in an attempt to keep up with the demand of the politicians or even the industry to be regulated and the above hint would help explain the FSA's

[148] ibid.
[149] Julia Black, 'The Rise, Fall and Fate of Principles Based Regulation' in K Alexander and N. Maloney (eds), *Law Reform and Financial Markets* (Cheltenhalm: Edward Elgar 2011).
[150] ibid.
[151] Sharon Gilad, 'Institutionalizing Fairness in Financial Markets: Mission Impossible' (2011) 5 Regulation and Governance 309.
[152] Lord Turner was a member of the UK's Financial Policy Committee, and the Chairman of the Financial Services Authority (FSA) until its abolition in March 2013. The 'Turner Review' - see FSA, 'A Regulatory Response to the Banking Crisis' (the 'Turner Review') 18th March, (2009) and the accompanying *Discussion paper* – FSA, 'A regulatory response to the global banking crisis' *Discussion paper* (2009b) <http://www.fsa.gov.uk/publs/other/turner_review.pdf> accessed on 20th March 2014.
[153] ibid.

reluctance to challenge bank's strategic objectives, especially the 'Northern Rock' saga or by merger – RBS takeover of ABN Amro (Dutch Bank).[154] In other words, the FSA was hesitant to bring the party to a premature end given the apparent wealth creation that had occurred during the boom period of 1993.[155]

However, in the aftermath of the financial crisis, the UK's financial services regulator (FSA) had been roundly condemned for being too soft, less intense and less rigorous in its approach and in part, this led to the abolition of the FSA under the current regimes.[156]While there remains a lively debate on the effectiveness of different rule types as regulatory instruments, there appears to be no evidence in the practice that regulation through detailed rules fared any better than principles based framework.[157] Even in the US, where the Securities and Exchange Commission (SEC), for example, regulates mainly through prescriptive and detailed rules and with an aggressive approach to enforcement, it notoriously failed to detect the Madoff fraud, sixteen years from the first warning signs.[158]

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[154] Gillian Garcia, 'Ignoring the lessons for effective prudential supervision, failed bank resolution and depositor protection' (2009) 17 (3) Journal of Financial Regulation and Compliance 210-239.
[155] ibid.
[156] Due to perceived regulatory failure and poor governance standard during the financial crisis in 2007-2008, the UK government decided to restructure its financial regulation by abolishing FSA. On the 19th of December 2012, the Financial Services Act 2012 received a Royal Assent abolishing the FSA with effect from 1st April, 2013. Its responsibilities were now split into two agencies: the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA') and the Bank of England <http://www.bankofengland.co.uk> accessed on 15 January 2014 and <http://www.fca.org.uk> accessed on 15 January 2014.
[157] Robert Baldwin, 'Why Rules Don't Work' (1990) 53 MLR 321; Russell Korobkin, 'Behavioural Analysis and Legal Form: Rules vs Principles Revisited' (2000) 79 Oregon Law Review 23; John Braithwaite 'Rules and Principles: A Theory of legal Certainty' (2002) 27 Australian Journal of Legal Philosophy 47.
[158] Bernard Lawrence "Bernie" Madoff is an American convicted of fraud and a former stockbroker, investment advisor and financier. He is the former non-executive Chairman of the NASDAQ stock market and the admitted operator of a Ponzi scheme that is considered to be the largest financial fraud in U.S. history. For more see US Securities and Exchange Commission (SEC), *Investigating of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme – Public Version* (Washington, DC: US Government Printing Office 2009) 41.

The point here is that, there can be as many detailed rules or even principles as lawyers and lawmakers would want to write, but if those responsible for enforcing them do not understand the activity they would not work effectively. In other words, where the rules that are in place and the operational dynamics of the industry to be regulated are not well appreciated by the regulators, then it does not matter what form the rules or principles take, they may be poorly enforced or unintended consequences could result.[159]

5.4.5 Enrolment – gatekeeper and standard

This governance strategy is characterised by various pattern of enrolment, in which organisations – transnational or national, public or private, have differential regulatory capacities and can enhance that position by enrolling others to perform some functions.[160] One method which appears to be successful in the context of regulatory governance is to enrol gatekeepers.[161] 'Gatekeepers' remain those who are not directly the subject of regulation, but who have a strategic position over those who are; and the benefits of using gatekeepers in regulatory framework are that they can leverage off the control that such actors have over the regulatees.[162] Similarly, the gatekeeper actors themselves have no particular incentives not to comply with the regulatory requirements as they would not benefits directly from non-compliance.[163]

[159] Frederic Schauer, *Playing By the Rules: A Philosophical Examination of Rule-Based Decision-Making in Law and Life* (Oxford, Clarendon Law 1993).
[160] Julia Black, 'Enrolling Actors in Regulatory Processes: Examples from UK Financial Services Regulation' (2003) PL 62.
[161] ibid.
[162] Gatekeepers are professionals better placed to give expert advice to firms and regulators because of the presumed neutrality of their incentive structures- eg accountants, auditors, securities experts and credit rating agencies. See Julia Black, 'Mapping the Contours of Contemporary Financial Services Regulation' (2002) 2 Journal of Corporate Law Studies 253.
[163] Reiner Kraakman, 'Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy' (1986) 2 Journal of Law, Economics & Organization 53.

However, the incentive structures of gatekeepers may not always be so neutral given that auditors who sign off false accounts do not gain from the increase in the share prices, but could benefit from continued business with the firm.[164] In other words, as the corporate accounting scandals as well as frauds in Enron, Worldcom, Parmalat and their ilk demonstrated, those relied upon to act as gatekeepers can be less than reliable, and need not to have performed the role that regulators assumed they would play and, in part, these failings arose from the lawyers and accountants.[165]

In the financial markets, the main substantial failures arose from the credit rating agencies (CRAs) and the experience of enrolling CRAs illustrated that gatekeeper framework is a potentially useful regulatory strategy in banks. However, in practice, whether the method is successful depends on the motivation, regulatory capacity, and most importantly, the broader market context and culture as well as incentives from those being relied upon to act as gatekeepers.[166] Credit rating agencies normally rate creditworthiness of corporations as they have a long history due to their growth owing to the combination of the markets and regulatory factors.[167] They are dominated by an oligarchy of three agencies (such as Fitch, Moody and Standard & Poors) but through the structure of global capital regulation, their ratings have assumed a privileged status, which creates incentives for issuers to acquire ratings.[168]

[164] ibid.
[165] John Coffee, *Gatekeepers: The Role of the Profession in Corporate Governance* (Oxford: OUP 2006).
[166] ibid
[167] Frank Partnoy, 'The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies' (1991) 77 Washington University LR 620.
[168] ibid.

That notwithstanding, the role played by the CRAs in the recent financial crisis is now well known in both the legal and economic literature.[169] The banks which were creating asset-backed securities and products based on them paid ratings agencies to rate the securitised products in order to improve their marketability to investors.[170] These agencies might not have directly benefitted from whether the rating they gave was high or low, but, they did benefit from the revenue stream that came from giving ratings; revenue streams that were directly linked to the level of rating they gave.[171] In order to secure business, agencies rated products without really understanding what they were ratings and caring even less, and often with the involvement of the bank structuring the products.[172] Regulators enrolled not only the ratings agencies but the models and standards they employed to devise their ratings and in significant areas of regulation, and notably with respect to capital requirements, credit ratings are hardwired into the regulatory regime.[173] For instance, in Basel II regime, such rating has be used to determine the risk exposures and debt profile of banks.[174]

The Central Banks have also relied on credit ratings to determine what could be their sovereign debt positions and what they will accept as a collateral.[175]

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[169] Timorthy Sinclair, *The New Masters of Capital: American Bond Ratings Agencies and the Politics of Creditworthiness* (Ithaca: Cornell University Press 2005); SEC, *Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credits Rating Agencies* (Washington, DC: US Government Printing Office 2008).
[170] SEC ibid.
[171] ibid.
[172] ibid.
[173] Erik Gerding, 'Code, Crash and Open Source: The Outsourcing of Financial Regulation to Risk Models and the Global Financial Crisis' (2009) 84 Washington & Lee LR 128.
[174] ibid - for example, the European Central Bank only accepted A-rated products; however, as the Greek crisis has demonstrated, in times of crisis this strict stance may have to be adjusted, and the ECB has had to say it will accept bonds regardless of their rating.
[175] FSF, *Joint FSF-CGFS Working Group - The role of valuation and leverage in procyclicality* (Basel: FSB 2009); FSB, *Joint FSF – BCBS Working Group – Reducing Procylicality arising from the bank capital* framework (Basel: FSB 2009).

Similarly, one of the global rating agencies (Fitch) rated Nigerian banks recently as 'BB' (negative) - meaning that the country's economic outlook appears to be in a stable condition barring all difficulties.[176] In theory, this could sound encouraging to the Nigerian government as an emerging market, however, the practical dimension of the rating raises some question. For instance, to what extent does such rating impact on the country's economic climate or on the standard of living of the Nigerian citizens since, fundamental inaccuracies in external rating of securitised products could be injected straight into regulatory operation?[177] In practice, regulators should not be too complacent simply because of good rating from the agency; after all these institutions paid to be rated.[178]

Enrolment can confer benefits, extending regulatory capacity, however, as the role of credit ratings in the crisis has demonstrated, it can create significant dependencies and vulnerabilities to banks because of frequent reliance on the agencies.[179] It can also create opportunities for manipulation (gaming) of the regulatory rules: for example, banks guaranteed the liabilities of their special purposes vehicles (SPVs), which gained high credit rating to reduce their capital requirements.[180] The role of credit-rating agencies as gatekeepers is being significantly re-evaluated.[181] For example, while credit rating agencies

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[176] Obi Chima and James Emejo, 'Fitch affirms Nigeria's 'BB' Rating, Stable outlook' 17th October, 2013 <http://www.thisdaylive.com> accessed on 20 June 2014.
[177] ibid.
[178] ibid.
[179] FSF 2009 (n 175).
[180] The revised rules now introduced a ban on banks recognising ratings gained through such guarantees. For more see, BIS, *Enhancements to the Basel II Framework* (Basel: Bank for International Settlements 2009).
[181] FSB, *FSB Report on Principles for Reducing Reliance on CRA Ratings* (Basel: FSB 2010); Patrick Van Roy, Credit *Ratings and the Standardised Approach to Credit Ratings in Basel II* (Frankfurt: European Central Bank 2005).

are now to be regulated within the EU,[182] regulators and Central Banks around the world are withdrawing their sole reliance on them for regulatory purposes.[183]

It is posited that while enrolling the rating agencies as 'gatekeepers' is relevant in the research as one of the contemporary strategies in governance framework, in practice, the Nigerian Central Bank should always view agency ratings with suspicion and caution in keeping with current global trends in financial regulations. Similarly, in order to demonstrate that some lessons have been learnt from the recent global financial crisis, it is further argued that both the regulators and investors should not place undue reliance on credit ratings without performing their own due diligence exercise in industry and this recommendation applies to both the developed and emerging economies.

5.4.6 Risk-based regulation

As one of the contemporary governance framework, risk-based regulation enables the regulator to identify the different risks to their objectives and focus resources and regulatory effort on addressing those that they see as critical.[184] Risk-based regulation has an immediate appeal for those seeking

[182] See EU Regulation No 1060/2009; US *Dodd-Frank Wall Street Reform and Consumer* Protection *(Dodd-Frank Act*) Pub L No. 111 -203, 124 State.1376 (2010).
[183] EU Regulation 2009 ibid.
[184] Risk-based regulation is not unique to financial regulation, it has been increasingly adopted by regulators in areas as diverse as the environment, food safety, health and safety, legal services and financial regulations and by a wide number of OECD countries. For more see Bridge Hutter*, The attraction of risk-based regulation: accounting for the emergence of risk ideas in regulation* (London: Centre for analysis of risk and regulation 2005); Julia Black, 'The Emergence of Risk-Based Regulation and the New Public Risk Management in the UK' (2005) PL 512; Julia Black and Robert Baldwin, 'Really Responsive Risk- Based Regulation' (2010) 32 Law and Policy 181.

to organise and prioritize regulatory action, holding out the promise that regulators can manage uncertainty in the industry to be regulated.[185] Critically, risk-based regulation in practice entails the management of the three 'Rs': risk, resources and reputation.[186] Managing each of these elements appears to be demanding as each one of them has the potential to pull in different directions.[187] In the UK, risk-based approach was institutionally endorsed in 2005 when the Hampton review recommended that all UK regulators should operate a risked-based system.[188] As a strategy for managing limited resources, risk-based regulation demands that the regulator should clearly identify its objectives and the risks that the regulated organizations may present and channel the limited resources in achieving those objectives.[189] In principle, resources should follow risks; but risks are often contested, leaving current resource allocation decisions open to challenge on the basis of differences in perceptions of risks and social or political priorities.[190]

Risk-based regulation is sometimes adopted as a strategy to protect or enhance the regulator's reputation and legitimacy.[191] As argued under public interest theory in Part I of this chapter, all regulators need political support if they are to act robustly against firms but the logic of rationalisation and prioritization of risk-based approach sometimes does not entirely fit well with

[185] Michael Power, *Organized Uncertainty: Designing and World of Risk Management* (Oxford: OUP 2007).
[186] ibid.
[187] ibid.
[188] Philip Hampton, *Reduction in Administrative Burdens: Effective Inspection and Enforcement* (London: HM Treasury 2005) [hereinafter Hampton Review].
[189] ibid.
[190] ibid.
[191] Daniel Carpenter, *Reputation and Power* (Princeton NJ: Prince UP 2010).

public and political expectations for universal protection.[192] Reducing regulatory intensity for some risks can sometimes be a difficult thing for risk-averse official to do, and for the public and politician to accept.[193] Similarly, there is a potential that resources could be allocated alone to those risks classified as 'high risk' in expense of 'low risk' in order to impress the politicians.[194] Nevertheless, if regulators were to pay only attention to greatest risks and refuse to worry about the low risks as might be expected by the public and politicians simply because they do not assume the risks threshold for such priority attention, there could be a problem. The potential problem could be that the 'forgotten' regulatees become slack managers of their risks because they have not been contacted by the regulators due to the frequency of risks.[195] As a result, the risks could pile up and such firms could become higher risks-creators that are liable to escape attention unless the regulator operates review mechanisms that will pick up such changes.[196]

A further organisational challenge in risk-based regulation could stem from the broader institutional and political contexts that regulators occupy and these are often critical to the performance of a risk-based regime and certain regulators may experience special difficulties in dealing with these settings.[197] For example, it could be argued that at least some of the failures of the UK's financial services regulatory framework in the period up to the credit crisis could be put down to key aspects of the institutional environment within

[192] Julia Black, 'Managing the Financial: the Constitutional Dimension' (2010) LSE Law, Society and Economy Working Papers 12.
[193] ibid.
[194] FSA, *The supervision of Northern Rock: a lessons learned review* (London: FSA 2008).
[195] Julia Black and Robert Baldwin, 'When risk-based regulation aims low: Approaches and challenges' (2012) 6 Regulation and Governance 2-22; Julia Black and Robert Baldwin, 'When risk-based regulation aims low: A strategic framework' (2012) 6 Regulation and Governance 131-148.
[196] ibid.
[197] Mervy King's evidence in response to Q 2354 HC Treasury Select Committee Feb 26, 2009.

which the regulators worked.[198] Notably, the way the UK's government 'light touch' philosophy shaped supervisory interactions and understanding about the appropriateness of regulatory demands is a factor.[199] Another factor is the extent to which domestic regulators considered themselves constrained by competition within the international institutional environment.[200]

However, in fairness to the context of financial regulation around the world, the risk-based models of the Canadian and Australian banking supervisors including the UK, have a number of elements in common and these models have provided the springboard for the development of risk-based approaches by supervisors in a number of different countries.[201] In practice, there is no identified correlation between the adoption of a risk-based system of supervision per se, and the presence of regulatory failure before or during the crisis.[202] While their models have much in common, as practised by the UK and the Dutch Central Banks, risk-based framework had a limited success.[203]

In contrast, as witnessed in Australia and Canada, it was apparently more resilient and successful. [204] In view of this, the Prudential Regulation Authority (PRA) which has taken over the FSA's functions of prudential regulation has indicated interests to have a revised risk-based approach which

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[198] ibid.
[199] Adrian Turner, *A Regulatory Response to the Global Banking Crisis* (London 2009).
[200] G20, *Declaration – Summit on the Financial Markets and World Economy*, November 2009 (Washington, DC 2009).
[201] Joana Gay, 'What Next for Risk-Based Financial Regulation?' in I. MacNeil and J. O'Brien (eds), *The Future of Financial Regulation* (Oxford: Hart Publishing 2010).
[202] Julian Black, *Risk-Based Regulation: Choices, Practices and Lessons Learnt' in Risk and Regulatory Policy: Improving the Governance of Risk* (Paris: OECD 2010).
[203] De Nederlandsche Bank (DNB) *Annual Report 2009* (Amesterdam: DNB 2010); DNB, *Supervisory Strategy 2010-2014 and Themes 2010* (Amsterdam: DNB 2010).
[204] Ben Hunt and Dmitiy Rozhkov, *Australian Banks: Selected Issues* (Washington, DC: International Monetary Fund 2008) Lev Ratnovski and Rocco Huang, *Why are Canadian Banks More Resilient*? (Washington, DC, IMF 2009).

would clearly draw inspiration from the Canadian and Australian models in developing new 'proactive intervention framework'.[205] Nevertheless, the degree to which supervisory practices in Australia and Canada were the reason for their banks' relative resilience, as opposed to other factors such as banks' high deposit base, non-reliance on wholesale funding, strong local lending, and restrictions on the mortgage market is still a matter of argument.[206]

A further organisational difficulty for risk-based regulators may arise when their powers are shared with other bodies.[207] Thus, the effectiveness of the UK's regulation in the lead up to credit crisis was undermined by the fragmentary nature of regulatory powers shared among the Treasury, the Bank of England, and FSA (now PRA).[208] It could be difficult especially for regulators to adhere to the logic of risk-based systems when they are faced with divergence between the various networked regulators' aims and objectives, and institutional environments and these difficulties are as a result of variations in regulatory cultures, skills, and resources and varying capacities to modify their operations.[209] On one hand, it could be argued that the dispersion of the authority and resources for regulators appear to be a weakness in risk-based regimes. On the other hand, this same weakness could be a source of its strength. For instance, if supervisory authority is dispersed

[205] HM Treasury, *Reforming Financial Markets* (London: HM Treasury 2009).
[206] Andrea Beltratti and Rene Stulz, *Why Did Some Banks Perform Better during the Credit Crisis? A Cross-Country Study of the Governance and Regulation* (Brussels: European Corporate Governance Institute 2009).
[207] On the network in which regulation is 'decentred' rather than simple and focused, see, Julia Black, 'Decentred Regulation: The Role of Regulation and Self-Regulation in a 'Post-Regulatory World' (2001) Current Legal Problems 103-46; For the challenges of network co-ordinations see Walter Kickert, Erik Klijn, and Franciscus Koppenjan (eds) *Managing Complex Networks* (London1997).
[208] Eugene Bardach, *Getting Agencies to Work Together* (Washington, DC 2009).
[209] ibid.

as against concentrated then regulatory capture in the industry becomes onerous and the positive side of this argument is that it makes capture difficult given the technical matter of identifying who to capture, and putting in place the capture of multiple institutions at one time.[210] Furthermore, given the fragmentary and overlapping nature of authority it makes the detection of and compensation for capture of one actor within the space more straightforward which is good in the industry.[211]

5.5 Risk-based framework in Nigerian banking

This section posits that risk-based regulation that is premised on risk management remains necessary to support the corporate governance theories and mechanisms in Nigerian banks. In essence, risk management is the identification, assessment, and prioritization of risks followed by the co-ordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events.[212] With respect to the theories of corporate governance, the shareholder model is deficient because it aims to protect shareholder interests in the firms and at the expense of other stakeholders even where some depositors and creditors have funds in excess of the shareholders investments in banks.[213]

Similarly, the stakeholder approach was criticised given that in an attempt to favour all stakeholders in a firm, it fails to state how all stakeholders should

[210] ibid.

[211] Colin Scott, 'Accountability in the Regulatory State' (2007) 27 J. Law & Soc 38; Colin Scott, 'Analysing regulatory space: fragmented resources and institutional design' (2001) PL 329-353; Colin Scott, 'Criminalising the Trader to Protect the Consumer: The Fragmentation and Consolidation of Trading Standards Regulation' in I. Loveland (ed), Frontiers *of Criminal Law* (1995).

[212] The discussion of risk management as a regulatory governance mechanism in Nigerian banking will be expanded in chapter 6.

[213] See chapters 3 and 4 of the thesis for arguments on corporate governance deficits and why regulatory theory is necessary in banks.

be protected. For instance, whether a supplier or local community as stakeholders should have equal protection with the shareholders, depositors and creditors in event of bank run or failures with their little resources invested in the bank or even where no investment was made by the local community and if so how? And why? [214] The above unresolved issues demonstrate that corporate governance theories are relevant in principle in the thesis but require the support of practical intervention of regulatory framework to address their deficiencies in the research questions as regards the theoretical and regulatory issues in respect of Nigerian banking industry.

Moreover, even if the corporate governance theories and mechanisms were to be perfect, there would still be need for regulation in corporate governance of banks given that there is potential for a systemic risk or a run on the industry (contagion).[215] Furthermore, corporate governance will need to be supported by regulation with respect to external governance dealing with the protection of depositors and the public through the sectorial regulators because bank is different from other non-financial firms.[216] Building upon relevant corporate and regulatory theories; and incorporating current realities as they relate to the regulation of companies, this thesis suggests a regulatory model that is based on risk management as an approach to managing risks in corporate governance and as part of the corporate governance resolution process.

[214] ibid.
[215] See OECD, *Principles of Corporate Governance* 2004; Edward Freeman, 'Stakeholder Theory of the Modern Corporation' in Tom L. Beauchamp and Normal E. Bowie (eds), *Ethical Theory and Business* (6th edition, Upper Saddle River: Prentice Hall Inc 2001).
[216] OECD ibid.

Similarly, the Nigerian banking industry needs a risk-based framework which is premised on risk management because the industry has never had any governance model apart from relying on information from agency ratings as a regulatory strategy which has often failed to reduce the spate of bank failures.[217] Total reliance on information from the agency rating is deficient and inadequate because the institution pays to be rated and such reliance on rating agencies which is currently the case in Nigeria banking sector should not be a substitute for the due diligence exercise of the regulators. In the same vein, rating agencies suffer from accountability deficit and this is the reason why most countries in the developed world regulate the publications of the rating institutions.[218]

Risk-based framework which is based on risk management is not entirely a fool proof solution to banking crisis. However, given that poor risk management structures and insider abuses such as unsecured loans and loan losses were identified in the thesis as part of the corporate governance issues as well as existing gaps in the literatures in the nation's banking sector, risk-

[217] This risk-based supervision which is premised on risk management will involve assessing the safety and soundness of regulated financial institutions, providing feedback to the institutions, and using supervisory powers to intervene in a timely manner to achieve supervisory objectives. The CBN should start the implementation of risk-based supervision which is predicated upon a co-ordinated action plan in the lifecycle of a financial institution. This process includes on-going/off-site monitoring and on–site examination of the institutions. Offsite monitoring, for instance, provides an early warning of the potential areas of concern or risk exposure as well as macro information about the banking industry. The on-site examination, on the other hand, enhances the sustenance of public confidence and the integrity of the banking system. On-site examination also provides the best means of determining the institution's adherence to laws and regulations and helps to prevent problem situations from remaining uncorrected and deteriorating to the point that resolution is required. For more on the rudimentary stage of risk-management in Nigerian banking, see CBN, *Supervisory Intervention Guidelines-General Supervisory Approach Part 1* 2011 <http://www.cenbank.org/.cbn%20supervisory%20intervention> accessed on 29th January 2014; For earlier arguments on the need to introduce this regulatory approach as a governance strategy in the Nigerian banking, see Babajide, Komolafe, 'Risk-Based Supervision: CBN to Conduct Pilot Examination of Banks' 2009 <http://www.vangaurdngr.com/2009/07/risk-based-supervision.pdf > accessed on 29 January 2014.

[218] See EU Regulation No 1060/2009; US *Dodd-Frank Wall Street Reform and Consumer* Protection *(Dodd-Frank Act*) Pub L No. 111 -203, 124 State.1376 (2010).

based framework is necessary because it has nexus with identified sectorial risks.

5.6 Conclusion

This chapter has examined the various theoretical and regulatory issues in banking sector in line with global best practices with respect to its relevance in the thesis. The special nature of banking shows that shareholder model and stakeholder arguments remain deficient in practice but still relevant in the research in principle. Regulatory framework is essential in addressing one of the research questions in the thesis given that corporate governance theories and its mechanisms fall short to recognise the centrality role regulation can play when it comes to banking unlike in non-financial firms.[219] The peculiar nature of banking demands some regulatory designs and strategies to support the weak governance structures and to reduce the potential and actual systemic risk, bank run and contagion because banking failures have significant external effects that go beyond the shareholders, depositors and stockholders of the financial firm to include the public.[220]

The danger of contagion is particularly acute in banking because the failure of individual firms in the depository industry can lead to widespread deposits runs that could overflow to other banking firms unlike in ordinary firms.[221] Therefore, no matter how small a financial institution could be, the impact of its failure could be far-reaching for the entire financial system and even

[219] ibid.
[220] ibid.
[221] ibid.

perfect corporate governance theories and its mechanisms cannot cure the systemic risk which is inherent in banks and this is the basis for regulation in corporate governance in Nigerian banks.

However, regulation does not substitute the primary role and responsibilities of the board and management in corporate governance.[222] Regulation only plays a supportive and reformative role in ensuring that all stakeholders and the general public are protected with respect to the externalities and inherent risks in banking through the regulator. This regulator ensures that all corporate stakeholders both internal and external comply with statutory provisions with respect to the governance of banks and this supervisor can even impose sanctions and administrative penalties against any defaulting corporate stakeholders including directors and managers to effect regulatory compliance.

Furthermore, the chapter has argued that the Nigerian banking sector needs a risk-based framework which is premised on risk management as the future regulatory model.[223] The reason is because the banking sector has frequently relied on publications from agency ratings as regulatory model which has not been able to reduce the spate of banking failures.[224] This is more so at a time when agency rating is embroiled in credibility deficits and this is why their publications are being regulated in the developed world. Risk-based framework which is premised on risk management is recommended and its adoption will enable the bank directors and managers including the regulators

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[222] ibid.
[223] Kenneth Ajibo, 'Risk-based regulation: The future of Nigerian banking industry' (2015) 57(3) International Journal of Law and Management 201-216.
[224] ibid.

to first of all identify the nature of the risk and apply the best combination of the framework and other strategies (such as C&C, PBR, and Meta-regulation) that have the nexus with the sectorial risks.[225]

[225] Discussions on why risk management as a regulatory governance model remain the future of Nigerian banking sector will be the focus of the next chapter.

Chapter Six

The future of Nigerian banking sector: Risk management and accountability

6.1 Introduction

This chapter discusses the risk management in Nigerian banking sector as a governance mechanism and it aims to determine how effective the risk management approach and supervisory accountability may enhance the corporate governance structures in the sector. Chapter 5 posited that given the deficits on corporate governance theories, Nigerian banking sector requires the support of regulatory governance framework to reform the industry which should be risk-based that is premised on risk management. The reason is because corporate governance models cannot cure the potential systemic risk inherent in banks. In light of the above, the central argument of the thesis remains that risk management as a regulatory governance mechanism is necessary to protect the depositors and the public from banking failures.

The legal personality of a corporation is fundamental to all jurisdictions and is conferred by the statute that permit the entity to hold property in its own right without reference to any particular real person which results in the perpetual existence that characterises the modern corporation. [1] The governance of this corporation involves internal and external mechanisms.[2] On one hand, the internal mechanism empowers the shareholders to exercise control or influence on the boards of directors in the decision making which is usually provided in corporate charter or articles and memorandum of association. On the other hand, the external mechanisms deal with regulatory

[1] Goergen Marc, *International Corporate Governance* (Prentice Hall 2012); Oliver Williamson, 'Corporate Finance and Corporate Governance' (1988) 3(3) Journal of Finance 567-591

[2] Ben Pettet, *Company Law* (Second edition, London: Longman 2005) pp 53-54

environment and enforcement of web of legislation including the issues relating to corporate control.[3] The interaction between coalitions of internal and external actors as well as the board members is pivotal in enhancing the corporation's value creation.[4] While there has never been a consensus regarding corporate governance model around the world, however, it can be argued that regardless of whichever specific theory of corporate governance that is adopted by a country as guiding principles, the company managers will still be required to be controlled so as to attain whatever has been stated and chosen to be corporate objective, be it shareholder value maximisation or stakeholder approach.[5]

Given that the behavioural issues of corporate managers and directors can contribute to corporate failures, and therefore constitute a risk in corporate governance mechanism, it is essential to understand the meaning of risk.[6] Understanding the meaning of risk and risk management process is essential in determining the solution that has the potential to address the perceived risk in corporate governance.[7] The Turnbull Report emphasised the relationship

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[3] ibid; See Julian Frank and Collins Mayer, 'Hostile Takeovers and the Correction of Managerial Failure' (1996) 40 J. Finance Econ 163, contending that there was little evidence of poor performance prior to bids and hostile takeovers do not therefore perform a disciplining function. See Ira Millstein and Paul MacAvoy, 'The Board of Directors and Large Publicly Traded Corporation' (1998) Col LR 1283

[4] Internal actors are described as those who make decision and take action on behalf of the corporation while external actors are those who seek to affect the decision.

[5] See Ngozi Okoye, 'The Personality of Company Directors As A Behavioural Risk Contributor in the Corporate Governance Process: Regulatory Intervention As A Risk Management Mechanism' (PhD Thesis, University of Dundee 2012).

[6] Some examples of corporate failures and scandal around the world include the corporate collapses of the Bank of Credit and Commerce (BCCI), Maxwell Group, Polly Peck and Barings Bank in the United Kingdom; WorldCom and Enron in the United States; HIH in Australia; and the corporate scandals involving Eurotunnel and the Shell Group. More recent examples include the collapses and near collapses of various banks and financial institutions in Europe and the United States and other emerging economies including Nigeria. See Lucian Bebchuk, Alma Cohen, and Holger Spamann, 'Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008' (2010) 27 Yale J. on Reg 257. Behavioural issue in this research refers to actions and decisions taken in the corporate governance process by company directors that can impact on corporate objectives. Corporate failures can occur as a result of, or be significantly contributed towards by behavioural issues relating to company directors, and therefore behavioural issues constitute risks to be addressed by corporate governance processes and mechanisms. Management of behavioural risks issues are considered to be a problematic area in corporate governance as evidenced from investigations and reports on corporate failures above.

[7] Annex 4 of the Walker Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations, 26th November 2009 stated, in relation to the causes of the financial

between internal control and risk management by stating that 'a company's system of internal control has a key role in the management of risk that are significant to the fulfilment of its business objectives.[8]

The banking industry is one of the most regulated sectors worldwide given that it is frequently associated with risks and these risks must be properly assessed, prioritized and managed to avoid waste in time and resources in dealing with them otherwise they may adversely impact on the bank's profits.[9] Commercial banks are in the risk business because in the process of providing services, they assume various kinds of financial risks and this is why risk management has become a necessity not an option.[10] In the Basel II Accord, risk management is divided into credit risk, market risk as well as operational risk and effective risk management requires frank and timely internal communication within the bank about risk and through reporting to the board and senior management.[11] In essence, risk management as an integral part of decision-making process by the board of directors along with

crisis, to the fact that even though there were material deficiencies in financial regulation and prudential oversight, there were also material deficiencies in the effectiveness and oversight of company boards. The effectiveness and oversight of company directors are issues which are connected with their behaviour. The Institute of Chartered Secretaries and Administrators (ICSA) in their report in 2009 highlighted that the effectiveness of corporate governance systems is undermined by inappropriate boardroom behaviours. Behavioural issues can, therefore, be viewed as risks to the corporate governance process, and these risks are significant and need to be managed because they have the potential to result in corporate failures.

[8] The Turnbull Guidance in the UK was promulgated by the Turnbull Committee which was set up to investigate internal control and risk management practices in companies, and it sets out best practice in this regard for companies in UK. See generally The Turnbull Guidance-*Internal Control: Guidance for Directors on the Combined Code*-1999, 4

[9] Bumi Adeleye, Fenio Annansingh and Miguel Nunes, 'Risk management practices is outsourcing: an investigation into the commercial banks in Nigeria' (2004) 24 (2) International Journal of Information Management 167-180.

[10] Oluchukwu Njogo, 'Risk management in the Nigerian banking industry' (2012) 1 (10) Kuwait Chapter of Arabian Journal of Business and Management Review 100-108.

[11] Ray Barrell, Ian Hurst and Simon Birby, 'The Current Financial Crisis and the Economic Impact of Future Regulatory Reform' in Ian MacNeil and Justin O'Brien (eds) *The Future of Financial Regulation* (Oxford and Portland, Oregon, Hart Publishing 2010) pp 51-66; BCBS, *The Principles for Enhancing Corporate Governance and Risk Management Practices in Banks* 2008 <http://www.bis.org/publ/bcbs176.pdf> accessed on 24 March 2014; BCBS, *The Principles for the management of credit risk* (2000) <http://www.bis.org/publ/bcbs54.htm> accessed on 24 March 2014.

the management has the potential to improve the governance of the banks as well as minimize the potential for banking failures.[12]

With respect to Nigerian banking sector, risk management practices remain unsatisfactory following the Central Bank of Nigeria's (CBN) intervention to avert massive bank collapse in 2009.[13] In other words, practice suggests that risk management in the nation's financial services industry is at the rudimentary stage with many banks lacking risk governance structures.[14] This position is further exacerbated by the poor supervisory oversight and accountability deficits that contribute to the poor governance standard in the industry.[15]

To achieve the aim of this chapter, it is divided into three Parts. Part I reviews the risk management challenges in Nigerian banking industry. It discusses further the supervisory initiatives to promote risk management and argue that effective supervisions through oversight functions add regulatory pressure to bank board and management, which is necessary to complement and deepen the corporate governance of banks in Nigeria. Part II will explore how poor

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[12] Iain MacNeil, 'Risk Control Strategies: An Assessment in the Context of the Credit Crisis' in Ian MacNeil and Justin O'Brien (eds) *The Future of Financial Regulation* (Oxford and Portland, Oregon, Hart Publishing 2010), 141-160; Doreen McBarnet, 'Financial engineering or legal engineering ? Legal work, Legal integrity and the banking crisis' in J O'Brien and Iain Macneil (eds), *The future of financial regulation* (Hart Publishing 2009).

[13] CBN, *Prudential Guidelines for Deposit Money Banks in Nigeria,* 2010 <http://www.ndic.org.ng> accessed on 24 March 2014; Lamido Sanusi, 'Banking Reforms and its Impact in the Nigerian Economy', being a Paper delivered at University of Warwick's Economic Summit, UK, held on 2/17/2012 at University of Warwick, United Kingdom <http://www.cenbank.org.ng> accessed on 24 March 2014.

[14] Lamido Sanusi, 'Banks in Nigeria and National Economic Development: A Critical Review', being a Paper delivered at a Seminar on "Becoming An Economic Driver While Applying Banking Regulations", organized by the Canadian High Commission in Joint Collaboration with the Chartered Institute of Bankers of Nigeria (CIBN) and the Royal Bank of Canada (RBC) on March 7th, 2011 held on 3rd July /2011 <http://www.cenbank.org.ng> accessed on 23rd March 2014.

[15] Lamido Sanusi, 'The Nigerian banking industry: what went wrong and the way forward', being a Paper delivered at Annual Convocation Ceremony of Bayero University, Kano held on 3rd January 2010 at Convocation Square, Bayero University, Kano State, Nigeria <http://www.cenbank.org.ng> accessed on 24 March 2014.

accountability in supervisory process provided fertile grounds for supervisory failures that enabled the bank board and management to engage in bad governance and poor management practices that ultimately led to the crisis. The last Part is the conclusion, which provides the ways forward in the Nigerian banking industry and attempt to link the chapter to the main argument of the thesis.

6.2 Understanding risk

The etymology of the word 'risk' remains traceable to Arabic, Greek and Latin origins which is generally referred to chances of outcomes whether positive or negative.[16] The English word in itself was derived from the French word *risqué* which has mostly negative but sometimes positive connotations, however, the connotation associated with risk has become that of negativity given the possibility of occurrence of undesirable outcomes.[17] There is no universally accepted definition of the term 'risk' but a number of definitions of risk offer an idea of its connotation. For instance, risk has been variously defined as the potential for unwanted negative consequences of an event or activity;[18] the chancing of a negative outcome;[19] the numerous types of threats caused by environment, technology, human, organisation or politics.[20] It could entail a probability or threat of damage, injury, liability, loss or other occurrence that is caused by external or internal vulnerabilities, and that may

[16] See Tani Merna and Faisal Al-Thani, *Corporate Risk Management* (2nd edn Chichester: John Wiley & Sons 2008).
[17] See FH Knight, *Risk, Uncertainty, and Profit* (Boston, MA: Hart, Schaffner & Marx; Houghton Mifflin Co 1921); WD Rowe, *An Anatomy of Risk* (New York: John Wiley & Sons 1977).
[18] ibid.
[19] See Ortwin Renn, 'Three Decades of Risk Research: Accomplishments and Challenges' (1998) 1(1) Journal of Risk Research 49-71.
[20] See RC Agrawal, *Risk Management* (Jaipur, India: Global Media 2009) 35.

be neutralised through pre-emptive action.[21] It could also mean a measurable uncertainty;[22] events with a negative impact that can prevent value creation or erode existing value;[23] the possibility of deviation in the results from expected goals.[24]

These definitions mostly highlight the fact that risk connotes the possibility of an outcome which is undesirable, unexpected, unwanted and therefore elicits the need to be influenced by prevention or minimisation of its effects. From the above, it can be gleaned that risk is a term that refers to the potentiality of negativism resulting from actions and/or inactions.[25] Risk is associated with uncertainty as the event may or may not occur; and a decision to do nothing explicitly avoids the opportunities that exist and leave the threat unmanaged.[26] There can be overlaps between the use of the terms 'risk' and 'uncertainties', but risk is particularly used to denote situations where the probability of outcomes is relatively known whereas uncertainties refer to cases in which the consequences of actions as well as the probability of occurrence are relatively unknown.[27] For instance, there is a probability of death or injury resulting from drunk driving and so that risk can be identified and managed by establishing regulations to protect against it.[28] Nevertheless,

[21] ibid.
[22] ibid.
[23] AE Waring and AI Glendon, *Managing Risk* (London: International Thompson Business Press 1998).
[24] ibid.
[25] David Hillson, 'What is risk? Toward a common definition' (2002) Journal of the Institute of Risk Management 11-12.
[26] ibid.
[27] See Nicholas Rescher, *Risk: A Philosophical Introduction to the Theory of Risk Evaluation and Management* (Lanham, MD: University Press of America 1983).
[28] See Pat O'Reilly, *Harnessing the Unicorn: How to Create Opportunity and Manage Risk* (London: Gower Publishing Ltd 1998).

there might be no reasonable probability of the effects of a natural disaster and the extent of its consequences as those situations are usually uncertain.[29]

The connotation that is given to these terms can also depend on the context and so people may view risk and uncertainties differently depending on their situations. Risk can be classified and framed in different ways and this classification is necessary for directing the priorities and attentions of risk managers and for developing the structures for risk management.[30] The cause of risk may also be complex and interrelated; therefore, it is essential to ensure that risks that are related are managed accordingly, as that is one of the ways for efficient use of limited resources that generate overall effectiveness in the risk management process.[31]

6.2.1 Risk management in banking

Any discussion of risk management in banking must appreciate and understand that banks partly exist for the purpose of taking risk, and the objective of supervision is certainly not to completely eliminate risk-taking.[32] Rather, the aim of supervision of banks is to assist in the management of risk.[33] Arguably, one should not lose sight of the fact that banks' willingness

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[29] ibid.
[30] See SA Drew and Terry Kendrick, 'Risk Management: The Five Pillars of Corporate Governance' (2005) 31(2) Journal of General Management 21, 19-36 21.
[31] ibid; in banking and financial services sector, 'risk' means the probability that an actual return on an investment will be lower than the expected return. Financial risk is divided into the following categories: Basic risk, Capital risk, Country risk, Default risk, Delivery risk, Economic risk, Exchange rate risk, Interest rate risk, Liquidity risk, Operations risk, Payment system risk, Political risk, Refinancing risk, Reinvestment risk, Settlement risk, Sovereign risk, and Underwriting risk.
[32] See Remarks by Vice Chairman Roger Ferguson, 'Basel II: A case study in risk management' Workshop for Regulation, Washington D.C April 28, 2003 <http://ww.federalreserve.gov/boarddocs> accessed on 16th March 2014.
[33] ibid.

and ability to take risk, in turn, have allowed them to contribute substantially to economic growth by funding households and businesses.[34] Nonetheless, this economic function, particularly when conducted with a relatively small capital base and using funds that have been borrowed on short-term basis partly led to periodic rounds of bank failures.[35] Such a history has often led to proposals for a dramatic overhaul of the business of banking, however, even with the presence or otherwise of the potential for a collapse, it has not changed the risk-taking function of banking nor the need for risk management.[36] Similarly, even in modern banking, with professional management largely divorced from the owners, the desire of management to have the institution survive is still a major impetus to proper risk management.[37]

Risk management is a human activity that integrates the recognition and identification of risk, assessment of risk, developing strategies to manage risk mitigation using managerial resources.[38] In other words, risk management is the identification, assessment, and prioritization of risks followed by the co-ordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events.[39] It introduces the idea that the likelihood of an event happening can be reduced, or its

[34] ibid.
[35] ibid.
[36] Olusesan Oluyide, 'Legal Issues Relating to Charging of Interest on Bank Lending in Nigeria' (2011) 11 International Company and Commercial Law Review 343.
[37] See Olusesan Oliyide, 'Critic of Banks and Other Financial Institutions (Amendment) Decree 1997' (2001) 2 Nigerian Journal of Private and Commercial Law 378, 381.
[38] ibid.
[39] See Olajide Fadun, 'Risk Management and Risk Management Failure: Lessons for Business Enterprises' (2013) 3(2) International Journal of Academic Research in Business and Social Sciences 225-239; James Garvan, 'Risk management: The unifying framework for business scholarship' (2007) 10(1) Management and Insurance Review 1-12.

consequences minimized.[40] Risk management is also a pervasive part of an organisational strategy, with profound implications for the success or failure of any business undertaking.[41]

Risk management enables a company to deal effectively with identifiable events that can have an adverse effect on a company and it incorporates the definition of management as to the planning, organisation, co-ordination, control, and direction of resources toward defined objectives.[42] In essence, this is particularly relevant to banking business regarding its three main functions – financial intermediation,[43] asset transformation,[44] and money creation[45]and these roles are fraught with obvious risks.[46] As pointed out previously, risk has been viewed as negative consequences and unfavourable events, however, the consideration of risk from the negative perspective is restrictive and arguably appears to be misleading for two major reasons. First, uncertainty may manifest in either negative (threat) or positive (opportunity) form, or, both.[47] Second, the way a risk is perceived influences the manner in

[40] David Hillson and Wurray-Webster, 'Using risk appetite and risk attitude to support appropriate risk taking: A new taxonomy and model' (2011) 2 (1) Journal of Project, Program & Portfolio Management 29-46.
[41] See Alex Hindson, 'Developing a risk culture' (2011) 12 Risk Management Journal 22-29.
[42] Robert Hoyt and Andre Libenberg, 'The value of enterprise risk management' (2011) 78 (4) Journal of Risk and Insurance 795-822.
[43] Financial intermediation is the process in which money deposited in banks for safe keeping by individual or organisations is loaned out to borrowers, and may be affected by the risk that depositors demand their money at a rate faster and larger than the reserve the bank has kept from deposited funds.
[44] Asset transformation which is the process of creating new assets (loans) from liabilities (deposits) runs the risk that a change in market interest rates may dilute the profits a bank makes in its loans since a bank must charge interest on its loans that is higher than the interest it pays on its deposits.
[45] And money creation, the process in which additional money is generated in the financial system by the repeated lending of an initial deposit in a bank through the principle of fractional reserve, which can create inflationary or other macro-economic risks as the amount of money created in a fractional reserve banking system depends on the level of reserves banks are required to maintain from deposits.
[46] Risk-taking is an integral part of and constitutes a major feature of banking business.
[47] Fadun (n 39) 225-226.

which it is handled and managing risks from a negative perspective may result to complete omission of opportunities that come with risk-taking.[48]

However, viewpoints on risk differ, as the risk definition depends on and is affected by the risk observer. Moreover, risk sometimes entails some economic benefits, as firms may derive considerable gains by taking risk and business grows greater through risk-taking and the greater the risk, the higher the potential returns.[49] Risk management is integral to opportunities and threats that may adversely affect an action or outcome and getting rid of risk undermines the source of value creation that truncates potential opportunities. Therefore, risk management in a banking business must strike a balance between the threat and opportunities posed by risk-taking.[50] Risk management covers all processes involved in identifying, assessing and judging risks, assigning ownership, taking actions to mitigate or anticipate them as well as monitoring and reviewing progress.[51]

From the definitions and explanations of what risk management entails, it becomes evident that the first step in risk management process is the identification of risk itself given that risk can only be effectively managed when it has been identified.[52] Owing to the fact that the meaning of risk is associated with a negative outcome, it is therefore a risk in itself for a risk element not to be identified, as that would mean that the chances of effective

[48] ibid.
[49] Hindson (n 41) 28.
[50] Lisa Meulbroek, 'The Promise and Challenge of Integrated Risk Management' (2002) 5(1) Risk Management and Insurance Review 55-66.
[51] See The Conference Board, *Emerging Governance Practices in Enterprise Risk Management* (2005).
[52] ibid.

assessment and management are reduced.[53] After identification, risk assessment and risk management processes follow and the issues involved in risk assessment and analysis require: (a) defining the undesirable outcome (b) identifying the probability of occurrence; and (c) measuring the consequences/severity of impact of occurrence.[54]

In furtherance of that, Enterprise Risk Management (ERM) has also developed a framework which elevates risk discussions and management to strategic levels in companies and ERM entails basically the identification and assessment of the collective risks that affect firm value and the implementation of a firm-wide strategy to manage those risks.[55] Similarly, the Committee of Sponsoring Organisation of the Treadway Commission (COSO) has issued an integrated framework to provide a model for ERM.[56] The framework defines ERM as 'a process effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, provide reasonable assurance regarding the achievement of entity objectives'.[57] From the

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[53] See John Graham and Jonathan Wiener**,** *Risk versus Risk: Trade-Offs in Protecting Health and the Environment* (Cambridge: Harvard University Press 1995).

[54] See Robert Kaplan, 'Risk Assessment and Risk Management: Basic Concepts and Terminology' in Risk Management (eds) *Expanding Horizons in Nuclear Power and Other Industries* (Boston, MA: Hemisphere Publishing Corp 1991) 11.

[55] See The Committee of Sponsoring Organisations of the Treadway Commission (COSO), *Enterprise Risk Management-Integrated Framework* (2004).

[56] The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is an organization dedicated to providing a thoughtful leadership and guidance on internal control as well as enterprise risk management including fraud deterrence. COSO has published a paper entitled 'Improving Organizational Performance and Governance: How the COSO Frameworks Can Help' to illustrate how the enterprise risk management (ERM) and internal control frameworks can contribute to enhancing organizational performance and governance for sustainable success and add value to governance strategies and business planning. For more see <http://www.coso.org> accessed on 5 March 2014

[57] ibid; the COSO framework also defines risk as the possibility that an event will occur and adversely affect the achievement of [entity] objective.

foregoing, it can be deduced that risk represents factors which may prevent a company from achieving its objectives and part of ensuring that companies attain their objective is preventing corporate failures, in essence, it also means that the risk which contributes to corporate failures should be effectively managed.[58] In the case of banks in Nigeria, the crux of the matter remains whether corporate governance structure is strong enough and adequate to manage risk or should be complemented with a regulatory framework that addresses the issue of risk management? In what follows, it will review the risk practices in the Nigerian banking industry as well as provide how and why regulatory action through oversight function is necessary to complement and deepen the culture of governance standard and accountability.

6.2.2 A review of risk management practices

Crises in the Nigerian banking industry have shown that not only do banks often take excessive risks but they differ across banks and some managers are more prudent and would be able to contain and manage risk issues than the others.[59] As a way to stem the tide, the Central Bank of Nigeria (CBN) on July 6, 2004, introduced banking consolidation measures [60] to make the entire banking system a safe, sound and stable environment that could sustain and inspire public confidence in the sector.[61] Professor Soludo [62] argued that the

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[58] ibid.

[59] John Ugoani, 'Poor credit risk management and bank failures in Nigeria' (2012) <http://www.ssrn.com/abstract=2185013> accessed on 25 March 2014.

[60] Part of these measures included the compulsory re-capitalization of all commercial banks before 31st of December, 2005 and the overall purpose of this initiative was to ensure a safe and sounding banking in the nation's sector.

[61] Charles Soludo, 'The Safety and Soundness of Banking System' being a Paper delivered at Press Briefing by the Governor of the Central Bank of Nigeria held on 6/12/2007 at Central Bank of Nigeria, Abuja <http://www.cenbank.org.ng> accessed 24 January 2014.

[62] Professor Charles Soludo is a Nigerian professor of economics and the former Governor and Chairman of the Board of Directors of the Central Bank of Nigeria (CBN) from 2004-2009. He was succeeded by Lamido Sanusi, who was recently removed on the allegation bordering on governance

aim was to set up a structure that could create a strong base relative to the kind of economy that would operate where banks become channels to do proper intermediation.[63] Similarly, as a follow-up to this recapitalization exercise, the CBN further announced a 13-point agenda to stabilize the base of the banking industry and the essence of the reform policy was to consolidate the banking institutions through mergers and acquisitions.[64] While initially the policy appeared to have raised some dust and heated debates among different strata of the Nigerian society, it is to be seen that at the end of the day, 25 of the 89 commercial banks operating in the country emerged consolidated through re-capitalization to the tune of N25 billion.[65]

Flowing from the above, since the emergence of consolidated 25 (now 20) commercial banks in Nigeria, the industry players and other stakeholders have been confronted with how best to manage the post-consolidation challenges that squarely face the Nigerian banking industry and by extension the nation's economy.[66] This is the compelling reason why operators and regulators of the banking system in Nigeria are further challenged to take more seriously the important issue of risk management, which is often the point at which bankers fall into or easily escape the trap of greed.[67] The objective of risk management for operators is risk mitigation, which

issues and financial misconduct. For more on the requirements for removal of CBN Governor see generally CBN Act 2007 ss.11 (2) (c - f).

[63] ibid.

[64] The key element in this exercise included the compulsory re-capitalization requirements to the tune of N25billion (equivalent to $126, 861,000) for all commercial banks operating in Nigeria. See Charles Soludo, 'Beyond banking sector consolidation' being a Paper delivered at London Roadshow: Global Banking Conference on Nigerian Banking Reforms held on 4/11/2006 at The Dorchester Hotel, London <http://www.cenbank.org.ng> accessed on 24 July 2014.

[65] ibid.

[66] See Lamido Sanusi, 'Consolidating the Gains of the Banking Sector Reform' being a Paper delivered at a Lecture To The Sylvester Monye Foundation held on 7/9/2010 at Asaba, Delta State, Nigeria <http://www.cenbank.org.ng> accessed on 24th July 2014.

[67] ibid.

emphasises the protection of the bank's assets and by extension depositors' funds and capital.[68]

As noted previously, the banking business by its nature is a high-risk environment and it is risky in the sense that it is one of the businesses where the proportion of borrowed funds is far higher than the owners' equity.[69] A high level of financial leverage is usually associated with high risk and this can easily be seen in a situation where adverse rumours, whether founded or unfounded could trigger financial panic and by extension a run on a bank.[70] Few banks are able to withstand a persistent run, even in the presence of a good lender of last resort. For instance, as depositors take out their funds, the bank suffers and in the absence of a liquidity support, the bank is forced eventually to close its business.[71] Thus, the risks faced by banks are endogenous which is associated with the nature of banking business itself, while others are exogenous to the banking system.[72]

While there may be some improvement in risk management practices in some Nigerian banks following the intervention of the CBN to avert massive bank

[68] ibid.
[69] Olusesan Oliyide, 'Banking regulation in Nigeria since the revolution' (2013) Journal of International Banking Law and Regulation 1-18.
[70] Olusesan Oliyide, 'Legal Framework for Financial Disintermediation in Nigeria' in I.E Sagay and O. Oliyide (eds) *Current Development in Nigerian Commercial Law* (Lagos, Throne-of Grace Pubs Ltd 1998) pp 120-121; Ebenezer Adodo, 'Legal Challenges of Universal Banking in Nigeria' (2002) 6(3-4) Modern Practice Journal of Finance & Investment Law 398-406.
[71] Ebenezer Adodo, 'Where is the Protection of Bankers under Universal Banking in Nigeria?' (2007) Igbinedion University Law Journal 231-251.
[72] Some of the risks that could arise in the course of business of banking that operators and regulators should be mindful of include amongst others – credit risk, liquidity risk, reputation risk, legal risk, operational risk, customer satisfaction risk. On the other hand, the risks that are exogenous to the banking system which equally pose problem to bankers include regulatory risk, industry risk, government policies risk, sovereign risk and market risk. For more see Adekunle Owojori, Ishola Akintoye, and Felix Adidu, 'The challenges of risk management in Nigerian banks in the post consolidation era' (2011) 3(2) Journal of Accounting and Taxation 23-31.

failures in 2009-2010, however, practice suggests that risk management in the nation's financial services industry is still at the rudimentary stage and is facing a number of challenges.[73] One of these challenges is the acute dearth of knowledgeable and skilled risk professionals.[74] Most of the available risk experts appear to be engaged by few banks, yet even in these institutions, those with risk experience may not be fully involved in the major strategic decisions.[75] This situation is further exacerbated by the poor knowledge of risk management by the members of the board of many banks as revealed by the result of the diagnostic study commissioned by the CBN in the wake of the banking sector crisis in 2009.[76]

In retrospect, it was apparent that the senior management and many directors did not clearly appreciate the nexus between their banks' business strategies and risk appetite and the implications for risk management within the organisation.[77] A number of factors may have accounted for this less than satisfactory state of affairs in the industry. First, the absence of the formal training institutions offering risk management courses and industry-recognised risk management practitioners with formal qualifications and technical depth to foster the development of professional talent in the different areas of risk management such as credit, operational, liquidity, and

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[73] ibid.
[74] See GO Nwankwo, *The Nigerian Financial System* (Macmillan Pub 1987) p.47.
[75] Duncan Alford, 'Nigerian Banking Reform: Recent Actions and Future Prospects' (2010) 25 Journal of Banking & L. Regulation 337.
[76] ibid.
[77] ibid; this issue was identified as one of the weaknesses of corporate governance practices in banks operating in Nigeria. This sort of problem requires that directors and managers undergo regular training to be kept abreast on latest risk management mechanisms. For more see Olusola Akinpelu, *Corporate Governance Framework in Nigeria: An International Review* (Indiana, Bloomington, iUniverse Inc 2011) ch 5.

market risks.[78] Second, the absence of holistic, well-structured and well-co-ordinated framework to support capacity development in these banks particularly in the area of risk management and corporate governance for members of the board and management is a challenge.[79]

Furthermore, evidence from the liquidated banks showed that inability to collect loans and advances extended to customers and directors or companies related to directors/managers and their associates were a major cause of the distress of liquidated banks.[80] In a collaborative study by the CBN and Nigerian Deposit Insurance Corporation (NDIC), operators of financial institutions confirmed that bad loans and advances contributed most to the banking distress.[81] In their assessment of factors responsible for the distress, the operators ranked excessive risk-taking such as bad loans (un-serviced loans or loans without collateral) with contribution of 60%.[82] This development provokes some pertinent questions for the research. In particular: what lessons can be learned from the experiences of the liquidated

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[78] Former Deputy Governor, Financial System Stability, Central Bank of Nigeria (CBN), Dr Chiedu Moghalu, recently spoke on 'Risk-Ability: Risk Management Knowledge and Infrastructure for Nigeria's Financial Services Industry' at a Chief Risk Officers Retreat in Abuja, Nigerian capital on May, 2012 <http://www.thisdaylive.com/articles/risk-management> accessed on 25 March 2014.

[79] ibid.

[80] At the height of the distress in 1995, when 60 out of 115 operating banks were distressed, the ratio of the distressed banks' non-performing loans and leases was 67%. The ratio deteriorated to 79% in 1996; to 82 % in 1997 and between 2002- 2004 to 23.08% and the licenses of 35 of the distressed banks were revoked subsequently. For more see Biodun Adedipe, 'Post-consolidation challenges' (2005) 29 (2) CBN Bullion 37-41; Olisa Agbakoba, *Issues of bank consolidation and recapitalization* (Lagos, CALAD National 2005) 12. With respect to deliberate and wilful granting of loans and facilities to customers and directors without adequate collateral or with defective collateral, the Nigerian laws have criminalised such conduct and are punishable upon conviction in line with the extant laws. See BOFIA 1991, ss.18, 20; see Failed Bank (Recovery of Debts) and Financial Malpractices in Banks Act 2004, ss 15, 16, 17. Similarly, in *Federal Republic of Nigeria v Mohammed Sheriff &2 Others* (1998) 2 F.B.T.L.R.196, the accused persons were charged and convicted for granting facilities to companies – some of these accused persons at the material time were directors – without adequate collateral security.

[81] The collaborative study by these agencies (CBN and NDIC) was meant to determine the extent banks adhered to legal regimes with respect to risk management in the sector.

[82] Financial distress is a condition where a bank cannot meet or has difficulty paying off its financial obligations to its creditors and depositors and the chance of financial distress increases when a firm has high fixed costs, illiquid assets, or revenues that are sensitive to economic downturns. See CBN/NDIC, *Distress in the Nigerian Financial Services Industry* CBN/NDIC Collaborative Study <http://www.ndic.org.ng> accessed on 26 January 2014.

banks in this regard? To answer this question, this research will examine the administration of loans and advances that contributed partly to the crisis in order to determine the extent banks comply with legal regimes regarding risk management and the possible risk mitigation strategy that could have been applied.

With respect to risk management in Nigeria, specifically, banks are expected to have credit policies that should guide them in credit administration. For example, section 18 (1) (b) of the Bank and Other Financial Institutions Act (BOFIA) of 2004 forbids a bank from granting any advance, loan or credit facility to any person, unless it is authorised in accordance with the extant rules and regulations of banks and this provision also directs a bank to obtain adequate securities for advances, loans, or credit facilities.[83]

Furthermore, section 18 (1) (a) prohibits a manager or any officer of a bank from having personal interests in any advance, loan, or credit facility, and if they do, such should be declared. However, evidence has revealed that while most of the liquidated banks' officers flouted these provisions with impunity, the practice continues even after the sector's restructuring.[84] While banks have had their minimum shareholders' funds increased to N25billion (then equivalent to US $173 million) with effect from December 31st 2005, as part of banking reform initiatives, at least to solve the problem of inadequate capital base, nevertheless, events unfolding in the sector have shown that the

[83] BOFIA Act 2004 s.18.
[84] See Emeka Offor, 'A critical review of distress syndrome in Nigerian banks with a view to preventing recurrence'009, Working Paper <http://www.ssrn.com/abstract=1508335> accessed on 26 March 2014.

issue of poor corporate governance culture is far from being resolved.[85] For example, nine out of 24 banks recently had their Managing/Executive Directors removed and were replaced by a new set of experienced personnel by the regulatory authority.[86] Their offence was that they exhibited a number of poor corporate governance practices in their various banks, which culminated in the granting of huge non-performing loans and persistent illiquidity.[87]

The apex regulator further claimed that one of the banks, that was supposed to be a net placer of funds in the inter-bank market, became a net taker and even the Expanded Discount Window created because of these ailing banks could not solve their grave liquidity problem.[88] The CBN was compelled to embark on a bail-out initiative by injecting N600 billion (approximately £2.6 billion) into the banks to take care of their negative capital and improper

[85] ibid.

[86] In 2009, the CBN empanelled a special joint committee of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation (NDIC) to conduct a special examination of 24 banks in Nigeria. On August 14, 2009, the CBN announced the results of the examination of 10 banks and determined that five banks were insolvent (unable to meet its primary obligations as banks) and these banks are – Oceanic Bank, Union Bank, Afribank, Finbank and Intercontinental Bank. The aggregate percentage of non-performing loans of these five banks was 40.81 percent. In addition, these banks were chronic borrowers at the Expanded Discount Window (EDW) of the CBN, indicating that they had little cash on hand. To improve the banks' liquidity, the CBN, as the lender of last resort, injected N420 billion (roughly $2.8 billion) into these banks in the form of subordinated loan. These banks in aggregate represented significant systemic risk as they held approximately 30 percent of the deposits in the Nigerian banking system. For more see Babalola Adeyemi and AO Olowu, 'Corporate Governance: Has the Nigerian Banking Sector Learnt Any Lesson?' (2013) 3(2) International Journal of Business and Social Research 49-57; Adebayo Adewakun, 'Poor Corporate Governance, Bane of Nigerian Banks' *Nigeria Tribune* (Lagos, 29 September, 2010) 15. For more see generally Inam Wilson, 'Regulatory and institutional challenges of corporate governance in Nigeria post banking consolidation' (2006) 12(2) Nigerian Economic Summit Group Economic Indicators 1-10.

[87] See Adewakun ibid.

[88] ibid; as a result of the audit which exposed the corporate governance rot in the banking industry, the CBN further dismissed the CEOs of three additional insolvent banks – Bank PHB, Spring Bank and Equatorial Trust Bank- and injected an additional N200 billion (of taxpayers money) into these banks. A fourth bank, Unity Bank, was determined to be insolvent but had sufficient liquidity to meet its current obligations. For more see AM Yusuf, 'A report that exposed the rot in the banking sector' (2010) <http://economicconfidential.et/new/financial/monetary/315-audit> accessed on 4 March 2014

behaviour of the directors and managers of these banks in order to prevent another round of bank failures in the country in 2010.[89]

While the Nigerian banking and financial laws criminalize any facility without collateral, these failed banks granted loans without collateral and loan disbursements in many instances were known to have been effected even before conditions precedent to draw down were made.[90] In essence, these banks were (and some are still) reckless in disbursing facilities before loan applications and/or acceptance letter were received.[91] It is difficult to imagine how such customers could be made to repay the facilities if the simple but important contract documents that are in tandem with the extant laws were not executed at the onset of the credit relationships.[92] Similarly, Section 20 (1) (a) of BOFIA further seeks to limit the credit exposure of banks to single obligors as a means of avoiding undue credit concentration which has the potential to mitigate credit risk.

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[89] ibid; thus far, eight banks have received N620 billion or approximately $4.1 billion from the CBN representing 2.5 percent of Nigeria's entire 2010 GDP of $169 billion. Following the special examination and during the period between 2009 and 2010, Nigerian banks wrote off loans equivalent to 66 percent of their total capital; most of these write offs occurred in the eight banks receiving loans from CBN. This research posits that these problems were as a result of poor judgement and decisions in risk-taking by the board and management, unethical and improper conduct of corporate officers and belated regulatory oversight of the regulatory institutions in the industry. For more see Babalola Adeyemi 'Corporate governance in banks: The Nigerian experience' (2010) 7(4) Corporate, Ownership and Control International Journal, Ukraine, Special Conference Issue 34-41; Lai Oso and Bello Semiu, 'The Concept and Practice of Corporate Governance in Nigeria: The Need for Public Relations and Effective Corporate Communications' (2012) 3(1) Journal of Communication 1-16.

[90] See BOFIA 1991, ss.18, 20; see Failed Bank (Recovery of Debts) and Financial Malpractices in Banks Act 2004, ss 15, 16, 17; *Federal Republic of Nigeria v Mohammed Sheriff &2 Others* (1998) 2 F.B.T.L.R.196.

[91] S.18 (3) of BOFIA 2004 imposes a duty on a director who is directly or indirectly interested in the grant of a loan, advance or credit facility, to declare the nature of the interest to a meeting of the board of directors for banks. However, it is necessary to note that, by virtue of s.18 (6) the provision of subsection (3) shall not apply, especially (a) where the interest of director consists only of being a person holding less than 5 percent of the shares of the company which is seeking an advance, a loan or credit facility and, (b) if the interest of the director in question may be properly regarded by the CBN as immaterial. For more see generally AA Adekoye, 'Corporate Governance Reforms in Nigeria: Challenges and Suggested Solutions' (2011) 6(1) Journal of Business Systems, Governance and Ethics 1-13.

[92] ibid.

However, practice in the industry indicated that most of these failed banks flagrantly violated 20% of shareholders' funds unimpaired by losses limit (lending limit).[93] Given that the oversight functions of the CBN appear to be suspect, it does give the banks the leeway to engage in such unwholesome practices in contravention of the extant laws.[94] It is argued that such practices hardly reflect and indicate that the affected banks in particular and the industry at large have learned any worthy lessons in this regard from the experiences of the failed banks. This is because by wantonly exceeding the lending limit without approval, such banks have consciously (unconsciously) laid foundations for distress, in addition to being labelled as non-compliant.[95]

Furthermore, directors of banks are also not allowed to have outstanding unsecured loans, advances or unsecure credit facilities in their names and/or in the name of associated companies without prior approval in writing by the CBN.[96] Similarly, the Code of Conduct for directors of licensed banks issued by the CBN and endorsed by every bank director warns that a director shall 'be disqualified if any of his loans in a bank is classified lost by the Bank Examiners of the Regulatory Authorities'.[97] The provisions of the Act and those of the Codes of Conduct are intended to keep directors and managers

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[93] A single obligor limit is the maximum amount a bank is allowed to lend a single borrower or individual in relation to the total shareholders' fund of that bank. For more see NDIC, *Annual Reports and Accounts of Banks Submitted to NDIC from 2007-2009* <http://www.ndic.org.ng> accessed on 27 March 2014.

[94] Although, the CBN guidelines for banking have raised the limit to 35% (credit exposure limit), some banks are known to have been exceeding the limit without seeking approval from the CBN as required by the law. See BOFIA Act 2004 s.20; NDIC, *Annual Reports and Accounts of Banks Submitted to NDIC from 2010-2012* <http://www.ndic.org.ng> accessed on 27 March 2014.

[95] ibid.

[96] Bank and Other Financial Institution Act (BOFIA 2004) ss. 12 and 17 -18; see also CBN Act 2007 ss.2 (d), 17.

[97] CBN, *Code of Corporate Governance for banks and other financial institutions in Nigeria post consolidation* 2006 <http://www.cenbank.org.ng/publication/corp.govpost%2006.pdf> accessed on 26 March 2014.

above board in their banks' credit administration.[98] The Chartered Institute of Bankers in Nigeria (CIBN) enjoins directors and managers to be exemplary in this important aspect of banking operations.[99] Nevertheless, evidence suggests otherwise given that most of the loans in these banks are insider-related and are easily extended to directors and managers in contravention of the laws.[100] These loans remained un-serviced and piled up for years and most times are written off by the supposedly debtors (board members and senior officers) without legal repercussions for the defaulting bank directors and managers.[101]

In practice, to the extent that such loans were not performing, it would have been surprising for these banks to survive and given the importance of credit allocation in a bank and the potential risks associated with credit, few of these banks have what appeared to be credit committees with the board having the highest level, but short of the banks' single obligors limit.[102] Consequently, in many of these failed banks mentioned above, the board credit committees had been presided over by the board chairmen until the CBN put a stop to this practice recently.[103] However, it is argued that such an arrangement where the

[98] See Nat Ofo, 'Corporate governance in Nigeria: Prospects and Problems' <http://www.ssrn.com/abstract=1618600> accessed on 27 March 2014.

[99] The Chartered Institute of Bankers in Nigeria (CIBN) is the umbrella professional body for bankers in Nigeria. It was incorporated in 1976 as the Nigerian Institute of Bankers and was chartered in 1990. It recommends the policies, rules and regulations of practice of banking in the country in collaboration with the CBN in line with extant laws in the industry (CBN Act 2007 and BOFIA 2004).

[100] ibid; see CIBN Act No 5 of 2007 s.16.

[101] See Nat Ofo, 'Code of Corporate Governance for Banks in Nigeria Post-Consolidation 2006: Revision Required' <http://www.ssrn.com/abstract=1751460> accessed on 28 March 2014.

[102] Nigerian Deposit Insurance Corporation (NDIC) has recommended a downward review of the single obligor limit, which is at present pegged above 20 percent of shareholders' fund, given the huge shareholders' funds capacity of many of the consolidated banks. As pointed out before, single obligor limit is the maximum amount a bank is allowed to lend a single borrower or an individual in relation to the total shareholders' fund of that bank. The recommendation came as the Central Bank of Nigeria (CBN) unveiled the timeframe for the implementation of the Financial Sector Strategy (FSS) 2020, which is designed to help transform Nigeria into an international financial centre by 2020. For more see the CBN 'prudential guidelines for money deposit banks in Nigeria' <http://www.ndic.org.ng/prudential%20guidelines> accessed on 28 March 2014.

[103] ibid.

board chairman acts as the chairman of credit review committee is not the best of practice. This is because such an arrangement amounts to the board chairmen reporting to themselves which is bad for practice and to a great extent, it effectively compromised the independent appraisal of credit that the committees' members would have given the board.[104] In spite of the major reason for speed of credit approval adduced to justify the practice, it could not have been in the best overall interest of the banks that had the practice.[105]

It is suggested that senior management oversight of leading function, involving regular and periodic loan review, done independently of the lending officers, is good credit risk management practice. Such credit periodic review can actually or potentially reveal weaknesses inherent in outstanding facilities and could allow for quick intervention or remedial measures to prevent the extension of bad loans or at worst, minimize such losses.[106] However, despite that these failed banks claim to have credit review committees, in practice, it is only symbolic given that nothing concrete is done by the bank to enforce these committees' recommendations.[107] This implies that, rather than make provisions for loan losses as prescribed by the review committees, these banks are known to have sidelined such recommendations in favour of year-end profits.[108]

[104] See Owojori, Akintoye and Adidu 2011 (n 72) 2.
[105] ibid 5.
[106] PN Umoh, 'An overview of risk management practices in Nigerian banking industry' (2002) 12 (4) NDIC Quarterly 36-48.
[107] ibid 40.
[108] See NDIC, *Annual Reports and Accounts of Banks Submitted to NDIC from 2007-2010* <http://www.ndic.org.ng/publications> accessed on 28 March 2014.

It is the argument of the thesis that in order to further strengthen good risk management practices in banks in Nigeria, it is necessary that the board of directors and managers should imbibe and adhere to the Code of Corporate Governance standards with respect to risk administration.[109] The main principle of the Code with regard to risk management is that, the board of directors must identify key risk areas and key performance indicators of the business enterprise and monitor these factors.[110] The board has the responsibility to first understand and fully appreciate the business risk issues and the key performance indicators affecting the ability of the institutions to achieve its purpose.[111] This would require that the business risks and key performance indicators should be benchmarked against industry's norms and code of practice, so that the institutional performance could be further evaluated.[112]

It is important that all banks in Nigeria should set up risk management committees to provide oversight of management activities in managing credit, market, liquidity, operational, legal and other risks of the institutions.[113] In addition, there is requirement that directors and senior management should be trained to enable them understand the institution's business, nature of the risks, the consequences of risks being inadequately managed and an appreciation of the techniques of managing the risks effectively.[114] It is a

[109] See *Principle 8 of the Code of Corporate Governance for Banks and other Financial Institutions in Nigeria*, 2006 (n 97) 15; see Securities and Exchange Commission (SEC), 'Code of Corporate Governance in Nigeria 2011' <http://www.sec.org.ng> accessed on 28 March 2014; see also Nat Ofo, 'Code of Corporate Governance in Nigeria 2011: Its Fourteen Fortes and Faults' <http://www.ssrn.com/abstract=1937896> accessed on 28 March 2018.
[110] See *Code of Corporate Governance for Banks 2006* (n 97) Principle 8.1.
[111] ibid 8.2.
[112] ibid 8.3, 8.4.
[113] ibid 8.5.
[114] ibid 8.6.

good practice that the institution's risk management be subjected to periodic review and the results should be reported to the board. In turn, the board ought to satisfy itself that the institution's material business risk are being effectively identified, quantified, monitored, controlled and that the systems in place to achieve this are operating effectively at all times.[115]

6.3 Suggested measures for good risk management in banks

In order to promote good risk management and as part of the on-going reforms in banking sector, the CBN should commence the implementation of risk-based supervision to entrench the good governance and management standard in banks in Nigeria.[116] To complement this, the CBN should adopt and implement the Basel II/III Capital Accord in the industry.[117] While Basel II Capital Accord emphasises that corporate governance squarely lies with the board and management, nevertheless, it is the argument of the thesis that regulatory pressure through oversight functions in form of supervision is necessary to make directors and management to be responsive in their duties.

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[115] ibid.

[116] This risk-based supervision which is premised on risk management involves assessing the safety and soundness of regulated financial institutions, providing feedback to the institutions, and using supervisory powers to intervene in a timely manner to achieve supervisory objectives. The CBN should start the implementation of risk-based supervision which is predicated upon a co-ordinated action plan in the lifecycle of a financial institution and this process includes on-going/off-site monitoring and on–site examination of the institutions. Off-site monitoring, for instance, provides an early warning of the potential areas of concern or risk exposure as well as macro-information about the banking industry. The on-site examination, on the other hand, enhances the sustenance of public confidence and the integrity of the banking system. On-site examination also provides the best means of determining the institution's adherence to laws and regulations and helps to prevent problem situations from remaining uncorrected and deteriorating to the point that resolution is required. For more on the rudimentary stage of risk-management in Nigerian banking see CBN, *Supervisory Intervention Guidelines-General Supervisory Approach Part 1* 2011 <http://www.cenbank.org/.cbn%20supervisory%20intervention> accessed on 29 March 2014; For earlier arguments on the need to introduce this supervisory and governance strategy in the Nigerian banking, see Babajide, Komolafe, 'Risk-Based Supervision: CBN to Conduct Pilot Examination of Banks' (2009) <http://www.vangaurdngr.com/2009/07/risk-based-supervision.pdf > accessed on 29 March 2014.

[117] BCBS, *Enhancing Corporate Governance of Banking Organisation* 1999 <http://www.bis.org/publ/bcbs56.pdf> accessed on 28 March 2014; BCBS, *Enhancing Corporate Governance of Banking Organisation* 2006 <http://www.bis.org/publ/bcbs122.pdf> accessed on 28 March 2014.

The adoption and implementation of these initiatives could foster and further deepen risk management and corporate governance in banks as well as improve regulatory supervision including industry transparency and this has positive effect on the roles and responsibilities of bank board and senior management.[118]

Second, the Committee of Governors of the CBN should institute a process of regular dialogue between the banks' leadership and chief risk officers, chairmen of the board risk committees and credit committees of the banks.[119] The collaborations of these committees are necessary as their dialogues will enable the regulator to provide effective policy guidance to bank risk managers. There should also be an effort to set up a forum of Chief Risk Officers (CROs) of banks to provide a platform to periodically discuss risk issues in the industry at large.[120] Similarly, the CBN should strengthen the supervision of offshore Nigerian banks which will require an on-going cross-border supervisory co-operation and co-ordination with other jurisdictions where Nigerian banks have some presence.[121] In this regard, there is need for the creation of, and recruitment for a specialist Risk Management Team in the Bank's Banking Supervision Department that houses the regulator's bank examiners for proper oversight functions.[122]

[118] ibid.
[119] CBN *Supervisory Intervention Guidelines* 2011 (n 116) 1-2
[120] ibid
[121] ibid
[122] See Owojori, Akintoye and Adidu 2011 (n 72) 2

Third, the credit risk management bureau of the CBN that provides information on prospective borrowers can be a viable medium for credit risk mitigation strategy given that the information from the bureau is intended to assist lending officers in forming opinions as to the credit worthiness of intending borrowers.[123] It is obvious that the services provided by the bureau, which in any case will benefit the bankers and operators, are to assist banks in fighting the menace of 'professional' borrowers who move from bank to bank, securing credit facilities with no intention to repay.[124]

In the same vein, there is also, the use of risk quality ratings of both internal and external ratings systems to provide some information on the risk quality of bank borrowers.[125] Internal risk systems entail ranking customers in accordance with information available to the banker about the credit quality of the customers, whereas external rating usually relies on published information from credit rating agencies.[126] Unfortunately, many of these failed banks have consciously or unconsciously refused to avail themselves of the services provided by this regulatory medium.[127] This is why the thesis posits that regulators need to effect pressure through its oversight functions to ensure that banks adhere to the regulatory standard to rekindle the much needed confidence in banking for the investing public and the nation's economy.

[123] See Umoh (n 106) 40
[124] ibid.
[125] BCBS, *Enhancing the Corporate Governance in Banking 2006* (n 117) 2-10.
[126] BCBS, *Basel Committee on Risk Management* <http://www.bis.org/list/bcbs/tid_50/index.htm> accessed on 29 March 2014.
[127] ibid; see Owojori, Akintoye, and Adidu 2011 (n 72) 2.

In practice, it is argued that regulation is necessary and interfaces with management of banks but regulatory oversight does not substitute for the primary role of board and management in corporate governance. However, pressure from these regulatory institutions will assist and complement the effort of the board and management to deepen the management standards and governance in the industry.[128] This is because banks' corporate governance framework should include systems for ensuring that all statutory and regulatory requirements are being complied with and to identify potential, or, actual breaches, if and when they occur. [129] This is why the research has argued that regulation is necessary and plays a complementary role in reforming the corporate governance of banks.

Furthermore, the CBN needs to pressure the Banker's Committees to develop an effective competency framework and capacity development in the country's financial services industry.[130] Competency framework and capacity development in professional risk management has the potential to enable strategic partnerships and collaborations with global professional associations[131] to leverage cutting-edge best practices in risk management. On the domestic plane, similar partnership should be forged with local professionals associations, corporate learning centres, industry learning

[128] ibid; CBN, *Supervisory Intervention Guidelines* 2011 (n 116) 1-2.
[129] See CBN, *Code of Corporate Governance for Banks in Nigeria* 2006 (n 97), Principles 8.6 and 9. This stipulation on financial disclosure is expected to further reinforce the statutory requirements on board accountability as contained in the extant laws.
[130] CBN, *Supervisory Intervention Guidelines* 2011 (n 116) 1-2.
[131] Such as the Global Association of Risk Professional (GARP) and other agencies like the Institute of Risk Management (IRM) in the United Kingdom.

organisations and industry regulators toward capacity development to raise the standard of the industry.[132]

The move by the CBN to introduce a risk-based supervision that involves an effective risk management is a welcome development and represents a paradigmatic shift because it demonstrates that some lessons have been learned after the banking crisis.[133] Before the crisis, the industry did not have any known regulatory model in regulation as the regulators only applied the extant laws as enshrined in statute, which in many occasions did not have any bearing with the crisis (risk) in the sector.[134] The CBN is now increasingly focused on risk-based approach and encourage strong risk management in banks and other financial services institutions under bank's new regulatory paradigm.[135] The operators and regulators in the industry will now have to be proactive rather than reactive to risk and this entails that the risk-based framework will now have to be applied in determination, assessment and management of risks.[136]

It is argued that all banks in Nigeria should embrace this new regulatory model and while it is acknowledged that the risk-based approach is not the only solution or a fool proof to all possible bank crisis (risks), the approach is recommended because it enables the industry to have a uniform mode of risk

[132] ibid.
[133] See CBN, *Supervisory Intervention Guidelines* 2011 (n 116) 1-2.
[134] ibid.
[135] ibid.
[136] ibid; BCBS, *Enhancing the Corporate Governance in Banking 2006* (n 117) 2-10; See Owojori, Akintoye and Adidu 2011 (n 72) 2; BCBS, *Enhancing Corporate Governance of Banking Organisation* 1999 (n 117) 3.

control.[137] In other words, it enables the regulators and operators alike to have a uniform mode of risk identification, assessment, management and application of resources that has the closest connection with the identified problems.[138] It also enables the operators and regulators to adopt the best possible combinations of regulatory strategies including hard and soft laws when the risk is properly identified.[139] The essence is to prioritise and channel resources properly in management of risk so as to save cost.[140] In the next section, it will discuss the need for accountability of regulatory institutions and why and how such accountability can further enhance the governance standard of the banking industry.

6.4 Supervisory accountability in banking industry

This section examines the global best practices on public sector and financial regulation accountability to demonstrate that regulatory pressure through oversight functions is necessary to assist and complement the corporate governance of the board and management in the industry. It discusses the key factors for regulatory accountability in line with the best practices to show how they could have averted the Nigerian banking crisis from 2008 – 2010 if the supervisors were alive to their duties. The essence is to further demonstrate the need for supervisory oversight that imposes pressure upon the board and management to entrench a high standard of governance and managerial duties. In other words, as previously highlighted, effective

[137] Kenneth Ajibo, 'Risk-based regulation: The future of Nigerian banking industry' (2015) 57(3) International Journal of Law and Management 201-216.
[138] ibid.
[139] ibid.
[140] ibid.

regulatory action is necessary to play a complementary role in corporate governance of banks in Nigeria.

Generally, accountability means the need for public officials to show that oversight functions have been carried out in keeping with the extant rules and standards and to report fairly and accurately on the performance results with respect to the mandated roles and/or plans.[141] It entails the need to appreciate and understand the institution responsible for regulatory issues;[142] including the need to make public officials answerable for their behaviour and responsive to the body from which they derive their authority.[143] In other words, it extends to the setting up of criteria to measure performance of public officials couple with oversight mechanisms to ensure that standards are met.[144] With respect to financial services industry, accountability includes the need to have sound governance and be answerable for the discharge of officials' duties and the use of resources. Regarding oversight functions of the financial institutions, some key factors in accountability mechanism could be constructed with respect to these best practice propositions.[145] These propositions are: (a) collaborative discharge of inter-agency responsibilities (b) several intra-agency responsibilities to prevent regulatory failure; and (c)

[141] Organisation for Economic Co-operation and Development (OECD), *Public Sector Transparency and Accountability: Making it Happen (*OECD 2002) 7.
[142] Eric Pan, 'Structural Reform of Financial Regulation' (2011) 19 Transnational Law & Contemporary Problems 796, 809.
[143] ibid; Doreen MacBarnet 'The New Corporate Accountability' in W. Cragg and C.Koggle (eds), *Contemporary Moral Issues* (McGraw Hill Ryerson, Toronto 2005).
[144] See Australian Council of Auditors-General, 'Effective Public Sector Accountability' <http://www.acag.org.au/epsa.htm> accessed 29 April 2014.
[145] See Basel Committee on Banking Supervision (BCBS), *Core Principles of Effective Banking Supervision* (Basel, Bank for International Settlement 2012) Principle 2, 10-22.

institutional liability for regulatory failure.[146] The following sub-sections demonstrate how these factors could have averted the Nigerian banking crisis.

6.4.1 Collaborative discharge of inter-agency responsibilities

Collaborative inter-agency responsibility entails that financial regulatory institutions, would connect their regulatory and supervisory powers over financial intermediaries, to scrutinize and avert matters that could cause sub-optimal performance or staggering of the regulatory system.[147] It imposes an incidental duty on agencies to bridge a gap, provide inter-agency regulatory assistance to each other, and recommend improvements to the supervisory processes of each institution, with a view to limiting opportunities for regulatory inadequacies.[148] In essence, it eliminates or reduces regulatory competition, which could be exploited by financial intermediaries for regulatory arbitrage purposes.[149] Collective inter-agency responsibility could give rise to the emergence of a financial regulatory network, in which each regulator not only acknowledges and acts consistently with the wider systemic consequences of its functions and powers, but also appreciates the need to mainstream all financial laws and rules.[150]

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[146] See Olumide Famuyiwa, 'The Nigerian Financial Crisis: A Reductionist Diagnosis' (2013) 2 (1) Journal of Sustainable Development Law and Policy 36-64; Gabriel Onagoruwa, 'Early intervention regime under the bank resolution framework in Nigeria: Resolving the divergent interests' (2013) 1 (1) Journal of Sustainable Development Law and Policy, 114-131; BCBS, *Reports and Recommendations of the Cross-Border Bank Resolution Group* (BIS 2009) 3.
[147] Famuyiwa ibid 48-55.
[148] ibid.
[149] In this context, regulatory arbitrage arises, where financial intermediaries structure their operation to exploit perceived weaknesses in the regulatory framework and this should be distinguished from transactional arbitrage, namely, the profitable exploitation of exchange rate or price difference across markets. For example, Felsenfeld and Glass posit that US banks are comfortable with a multiple (functional) regulatory structure, where each agency feels a responsibility for the banks under its care and even a competitive position relative to other regulators, with the result that no regulator wants to fall behind its competitor, neither does it want 'its' banks to fall behind their competitors. For more see, Carl Felsenfeld and David Glass, *Banking Regulation in the United States* (Third Edition, New York: Juris Publishing 2011) 48-9.
[150] ibid.

Flowing from the above, the implications of the analysis for the Nigerian banking system after re-capitalization in 2005 are two-fold. First, the regulators and supervisors in the industry (CBN, SEC, and NDIC) at least would have appreciated the need for collective responsibility for the consolidated supervision of Nigerian banks particularly to avert regulatory failure. They could have done this through the Financial Services Regulatory Co-ordinating Committees (FSRCC).[151]

Similarly, s.52 (5) of the NDIC Act imposes a duty of co-operation on the NDIC on the issues affecting any licensed institution. Second, these supervisors would have perceived the banking law (s) within their several regulatory remits as crucial aspect of the monolithic financial regulatory system, the various parts of which must be harmonised to attain effective regulatory vigilance. For example, the SEC would have noted early through due diligence exercise that securities markets manipulations and risky trading in banks' shares constitute infringements of the extant laws (ISA).[152] SEC should have realised that these infractions of the extant laws could contribute to a systemic financial crisis and collaborate earnestly with other regulators in the industry to facilitate counter-measures to forestall a financial crisis and

[151]The Financial Services Regulatory Co-ordinating Committees (FSRCC) is a statutory committee comprising of the regulators and supervisors in the Nigerian Financial Services Industry and the Chairman of the Committee is the Central Bank Governor. The Committee is set up primarily to co-ordinate the regulatory and supervisory standards in the financial services industry, to provide a platform to share information, review development in the financial system, identify risks that are capable of posing a threat to the financial industry stability and recommend and take appropriate measures to minimize the risks. For more see <http://www.fsrcc.gov.ng.htm> accessed on 30 March 2014.

[152] The Securities and Exchange Commission in Nigeria, (SEC) is a government agency mandated to regulate and develop the Nigerian capital market. The Commission provides a set of new market infrastructures and wide-ranging system of regulation of investment and securities business in Nigeria, especially in the area of Mergers, Acquisitions and Take-Over, and Collective Investment Schemes and others in the financial market. For more see, Investment and Securities Act (ISA) 2007 which repealed the previous Investment and Securities Act 1999. In this context, Investment and Securities Act 2007 will be hereinafter 'ISA Act 2007'.

take disciplinary actions against defaulting intermediaries and/or their officials (bank board and other senior officers).[153]

6.4.2 Several intra-agency responsibilities to prevent supervisory failure

A proposal that follows a collaborative discharge of inter-agency duties is several intra-agency obligations towards other regulators to prevent regulatory failure from occurring under their watch.[154] This means that an agency would work to eliminate or reduce internal inefficiencies regarding the activities of its officials and those of other institutional agencies through sustain collaboration so as to eliminate or reduce the possibility of regulatory failure.[155] It means also that an agency would appreciate the need for a process driven regulation that manifests in regulatory thoroughness and effective cross-collaboration among regulatory officials.[156] By extension, where an institution has an express or implied statutory responsibility to initiate a process, a meeting, or an action in conjunction with other institutions, it would do so with right level of seriousness and regularity needed for that process, meeting and action to be effective.[157] Furthermore, given that much of the routine supervision of financial intermediation is often devolved to middle level officers, instilling regulatory accountability at this level would enhance the understanding of an incidental public service duty.

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[153] These could have been possible under the extant laws dealing with penalty provisions. For more see ISA Act 2007, ss 46, 47, 60, 61, 65.
[154] Felsenfeld and Glass (n 149) 49.
[155] Famuyiwa (n 146) 50.
[156] ibid.
[157] Felsenfeld and Glass (n 149) 49.

This means working together, to detect regulatory infractions, which might be difficult, if not impossible for officials of one agency to discover.[158]

Applying the foregoing analysis to the Nigerian banking context, the CBN, SEC and NDIC should have appreciated their duties to maintain a sound banking system by facilitating policies and processes that permit little or no room for regulatory failure within each institution.[159] For instance, the CBN as the apex supervisor of banks should have initiated a higher responsibility to discover the actual or potential abuses by these financial intermediaries that could cause a systemic crisis and this could have been possible through FSRCC mechanism within the CBN.[160] They could have appreciated the need for the Director of Banking Supervision and its examiners to work in conjunction with the officials of other agencies.[161] This would have assisted not only for the purposes of consolidated supervision, but also to detect elusive abuses of financial and corporate laws by these intermediaries, in the enforcement of the banking consolidation programme.[162]

Similarly, the Director-General of the SEC would have discovered the necessity for its officers to connect their supervision of securities subsidiaries and that of the supervision of the banking affiliates with other officers.[163] It is argued that this middle level partnership across supervisory institutions

[158] ibid.
[159] Famuyiwa (n 146) 50.
[160] See CBN Act 2007, ss. 2 (d), 17.
[161] The NDIC Act (2006) imposes a duty to NDIC as a supervisor and other supervisors for co-operation in matter affecting any insured banking and financial institutions. For more see NDIC Act 2006, ss. 52 (5).
[162] ibid.
[163] ISA Act 2007 ss. 13, 100, 105, 106.

would have helped an early diagnosis and prevention of the securities manipulations especially with regard to bank shares.[164] For example, it would have helped the summation of the information provided in a fragmentary manner separately to the CBN, the SEC and the NDIC, which could have facilitated a clearer picture of the reporting entity's position, and thus shown the need to intervene earlier or avert the abuses that led to the crisis.[165]

In retrospect, it should be emphasised that two statutory objects of the CBN are to ensure monetary stability and promote a sound financial system in Nigeria.[166] Furthermore, where a bank, its staff or directors have engaged in unsafe, unwholesome and unethical practices or even infringed banking law (s), the NDIC could direct that bank to take corrective measures or facilitate such measures in conjunction with the CBN.[167] Similarly, the SEC is mandated to safeguard the integrity of the securities market against all forms of infractions including insider dealing and fraudulent and unfair trade practices relating to the securities industry.[168] The SEC especially is empowered to regulate excessive use of credit for the purchase of securities by dealers or member companies of the Nigerian Stock Exchanges (NSE).[169] The CBN also has power to initiate a financial surveillance unit partly to monitor the solvency of financial intermediaries.[170]

[164] ibid ss. 106, 107, 108, 109, 111.
[165] See Famuyiwa (n 146) 50.
[166] See CBN Act 2007, ss.12, 27.
[167] See NDIC Act 2006, ss. 52 (5).
[168] See ISA Act 2007, ss.110, 111.
[169] ibid, ss.105, 106, 108.
[170] The Nigerian Financial Intelligence Unit (NFIU) is the Nigerian arm of the global financial intelligence unit (FIU) and is domiciled within the Economic and Financial Crimes Commission (EFCC) as an autonomous unit. The setting up of the NFIU is part of the efforts of the federal government in combating money laundering, and the financing of terrorist activities in Nigeria and is a precondition for the removal of Nigeria from the Financial Action Task Force (FATF list of Non-co-operation countries and territories (NCCTs). For more see EFCC Act 2004 ss.14, 15, 18, 27, and 34.

What could be deduced above is that the Nigerian financial laws were capable of preventing macro-economic instability and the banking crisis caused by the banking and securities malfeasance, if the CBN, NDIC and the SEC had implemented the relevant statutory provisions well in advance of the 2009 crises.[171] This argument is further bolstered with the position that, in practice, banks are required to report monthly and quarterly to the CBN about credit losses and exposures to the different sectors of the Nigerian economy.[172] In 2007 and early 2008-2009, most of these mandatory reports showed excessive exposures and massive losses to the stock market, yet, no meaningful regulatory action was taken by the authorities .[173]

The deduction from the analysis is that the regulators in the industry knew, or ought to have known, the financial health of the insolvent banks in advance of their crashes between 2008- 2009.[174] If this is the case, the pertinent issue remains why these regulators (CBN, NDIC, and SEC) fail to instruct these banks to take corrective measures, failing which these regulators could have taken such corrective actions in line with the extant laws and rules? A question such as this appears explicable on the basis of supervisory failure which is imputable to lack of accountability consequences attaching to their failure to take prompt corrective measures against banks excessive exposures to stock market malfeasance and loan losses.[175] To further support this

[171] ibid.
[172] ISA 2007 s.104.
[173] See NDIC, *Annual Reports and Accounts of Banks Submitted to NDIC from 2007-2010* <http://www.ndic.org.ng/publications> accessed on 28 March 2014.
[174] See Seth Apati, *The Nigerian Banking Sector Reforms: Power and Politics* (Basingstoke: Palgrave Macmillan 2012) 18-140. This article offers an engaging commentary on the socio-political background to the crisis. For more see Tunde Ogowewo, and Chibuike Uche, 'Misusing Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) 50 (2) Journal of African Law 161.
[175] The five affected insolvent banks were Oceanic Bank, Union Bank, Afribank, Finbank and Intercontinental Bank and apart from Union Bank, these other banks have either failed or have been compulsorily acquired due to the crisis in this period of review. For more see Chuke Nwude, 'The Crash

argument, the Nigerian banking regulators are subject to further supervision of the Minister of Finance and legislative oversight of the National Assembly (MPs).[176] However, neither the Minister nor the Assembly conducted an accountability review of the activities of these agencies with respect to stock market issues and loan losses in 2007 or early 2008, when it appeared obvious that these malpractices had been the order of the day in the industry.[177]

6.4.3 Culpability for governance and institutional failures

Culpability for governance and institutional failure is the liability of the supervisors, where their inactions or omissions are adjudged to be the major cause of the banking collapse. In essence, culpability for the collapse here is grounded on the accountability consequences attaching to the failure, provided it can be proved that the failure principally or substantially engendered the vulnerabilities that facilitated the collapse.[178] This would arguably permit the investors and other stakeholders (especially depositors) or other financial intermediaries affected by such collapse to initiate individual or collective claims (class actions) against financial supervisory agencies culpable for the crisis.

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of the Nigerian Stock Market: What went wrong, Consequences and the Panacea' (2012) 2 Developing Country Studies, 109-11; Lucky Fiakpa, 'If a Bank is Sick, the Signs Are Self-Evident says Sansui' *Thisday* (Lagos, 16 August, 2009) 1.

[176] The House of Representatives in Nigeria (MPs in the Lower Chambers) did attempt to investigate why the supervisors and regulators did not take proper actions to avert banking crisis, however, this action in 2012 by the House Committee on Banking and Capital Market would appear to be belated given the magnitude of the loss and the bad reputation it created in the industry. For more see the *Report of the Ad-Hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital Market*, National Assembly (MPs), Abuja, Resolutions No (HR70/2012) <http://www.nass.org.ng> accessed on 5 March 2014.

[177] ibid.

[178] Organisation for Economic Co-operation and Development (OECD), *Public Sector Transparency and Accountability: Making it Happen* (OECD 2002) 7.

Ideally, the liability claim (s) should notionally be based on two grounds, namely: that such is a right of action in the extant laws and that but for the failure of the institutions or agencies sued, the crisis and the damage suffered by the claimant(s) would not have happened.[179] Applying the analysis to the Nigerian context, it is to be noted that one statutory impediment in the exercise of the right of this action advocated herein is the protection against the adverse claims with which these supervisory institutions appear to be covered.[180] The usual train of thought (viewpoint) is that these institutions and their officers cannot be sued for anything done in pursuance of their statutory powers except where they have acted in bad faith.[181]

Arguably, a number of propositions can be put forward in support of this justification and the first argument is that adverse claims might cause supervisors to act defensively or make their work risky and less interesting.[182] The second is that the potential large compensatory pay-outs sequel to such actions would substantially draw on the limited resources of the State.[183] The third is that the externalities of bank failure such as runs on other banks, inter-bank freeze, assets fire sales, are not easily determinable and controllable by regulators and supervisors as such to permit their exposure to adverse actions on the damage inflicted by third parties from these externalities.[184] The fourth is that without some protection supervisors are potentially culpable for

[179] See Famuyiwa (n 146) 50. In other words, this liability model propounded here in the thesis should enable the potential claimants (such as shareholders and other stakeholders especially the depositors) to bring actions against the banking regulators. This civil action is grounded on negligence or bad faith against the regulators (that is where the deliberate actions or inactions or omissions of regulators substantially or principally lead to banking failures).
[180] See CBN Act 2007, s.52.
[181] See BOFIA 2004 s.53; ISA 2007, s.302.
[182] This is otherwise known as 'the chilling effect argument'.
[183] This is the 'limited resource argument'.
[184] This is called 'the uncontrollable externalities argument'.

indeterminate and indefinable lapses and at the suit of indefinite category of potential claimants.[185]

6.4.4 Examination of policy justifications

Flowing from the above, this subsection will now examine the policy justifications in support of these arguments in light of international best practices in the banking industry. Attractive as these foregoing policy rationales highlighted above might appear, it is apposite at this juncture to raise the question whether these policy proposals are actually fool proof in a system such as Nigeria's banking industry characterized by weak regulatory and supervisory accountability.[186] First, the 'chilling effect argument' could be true if supervisors are sued even where they have acted diligently and pro-actively. Nevertheless, where regulators are not so sued or when sued could hardly prove that they have acted diligently within the purview of their statutory powers, their protection against adverse actions is not necessarily justifiable.[187]

It is posited that a better argument for protection against adverse claims for regulators is the reputation for diligence and supervisory due process. It is further argued that where a supervisor has been evidently and consistently negligent in a banking system where regulatory accountability is weak, the protection against adverse actions on the basis of 'the chilling effect

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[185] This is a 'floodgate argument'.
[186] See Apati (n 174) 50-60.
[187] ibid.

argument' is an unjustifiable protection, which effectively denies aggrieved claimants justice as well as an impediment to accountability process.[188]

Second, it is posited that the 'limited resource argument' remains a fault-based proposition given that the State is generally responsible for compensating victims of wrongs committed by its servants and agents in the course of their employment or where the act leading to the wrongs is closely linked to what they (servants and agents) are authorised to do.[189] It is difficult to accept that compensatory pay-out as a result of the inaction or omission of supervisors would cost State more from its 'limited resources' when compared with the remuneration the State could pay for ordinary wrong of its officials.[190] Rather than committing 'limited resources' to compensate for wrongs or failures, a much better argument would be for State to institute a strict accountability mechanism for financial regulatory institutions and their officials, to enhance their diligence.[191] In essence, this would restrict the occasions where compensation would be paid to victims of supervisory failure than for these institutions and their officials to be protected from adverse claims.[192]

It is submitted that where the State has failed to initiate a strict accountability process for its regulatory institutions and officials to avert supervisory failure, it is unjustifiable to protect these supervisory institutions and officials from

[188] See Famuyiwa (n 146) 51-54.
[189] ibid 52; see MacBarnet (n 143).
[190] See Apati (n 174) 50-60.
[191] See OECD 2002 (n 178).
[192] See Apati (n 174) 80-91.

adverse claims on 'the limited resources argument'. This is because, in practice, adverse claims here should be permissive with respect to 'limited resources argument' given that State is only paying in such actions for its failures to enforce its primary duties of oversight functions.[193]

Third, the idea about 'uncontrollable externality argument' presupposes that banking crisis and its failures are neither easily determinable nor controllable by supervisors and for these reasons, it would be unjust and unfair to prosecute supervisors when a crisis happens.[194] However, contextualizing this argument in the Nigerian banking environment, it appears hardly tenable and convincing given that from January to December 2007, the price of banks' traded shares went up by 167 percent as against the Nigerian stock market average of 75 percent and 31-35 percent average for emerging markets.[195] Similarly, in 2007 and early 2008, the profit declaration by 24 banks in Nigeria amounted to $10billion.[196] Yet, a report by J. P. Morgan in the same year indicated that a number of the leading banks in these emerging markets were highly overvalued by as much as 50 percent.[197]

Nevertheless, from January 2006 to December 2007, Nigeria's economy recorded merely a marginal increase in real Gross Domestic Product (GDP)

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[193] Famuyiwa (n 146) 52.
[194] ibid.
[195] Central Bank of Nigeria, *50 Years of Central Banking in Nigeria: 1950-2008* (Abuja, Research Department, CBN 2008 -2010) 120 -129.
[196] ibid.
[197] International Monetary Fund, *Global Financial Stability Report* Washington, DC: IMF 2010; JP Morgan, *Global Developed Markets Strategy Dashboards*, July 4, 2011; World Bank, *Global Development Horizons 2011: Multipolarity: The New Global Economy* Washington, DC, 2011.

growth, from 6.2 percent in 2006 to 7 percent in 2007.[198] However, the price increase in the banks' shares and the combined huge profit declared by the banks did not match with the overall increase in the nation's productivity in economic terms. Arguably, this fundamental mismatch should have alerted the supervisors that the strange economic prosperity of these banks in 2007-2009 was a classic boom that most often comes before failure.[199]

Furthermore, the supervisors should have been alerted given the fact that in the time under review, there were 'allegations of unwholesome practices' behind the performance of banks. For example, Apati opined that three inappropriate practices were remarkable in the banks even before the crisis began: first was the practice of trading in their own shares through their employees; second was insider trading through stock broker and even using depositor funds to manipulate the stock market; and third was practice of warehousing and dumping other banks' stock to depress their price.[200] With this background in the Nigerian banking environment coupled with other corporate governance problems and challenges pointed out earlier, it is hardly justifiable to argue in favour of the protection against adverse claims at least in the context of the Nigerian banking crisis on the ground of 'uncontrollable externality argument'.[201]

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[198] See Global Finance, *Country Economic Report & GDP Data* <http://www.gfmag.com/gdp-data-reports/207-nigeria-gdp-country-report.htm> accessed on 8 March 2014; Ojukwu Ogba, 'Contemporary banking reforms in Nigeria under the Central Bank of Nigeria: a critical appraisal' (2011) Journal of International Banking Law and Regulation 1-12.
[199] ibid.
[200] Apati (n 174) 92-93.
[201] ibid.

It is submitted that where there are signs that the banking crisis is looming and imminent, as could be seen from the Nigerian context, and the supervisors failed to act diligently to prevent the collapse, it is unjustifiable to protect supervisors from adverse claims from the third party (especially the shareholders and depositors). The argument remains that actions should be permissible especially where the authorities had clear opportunities to prevent the crises but owing to their failure it resulted to proven third party losses in the industry.

Fourth, the 'floodgate argument' entails the protection against adverse actions and the potential claims for which supervisors may be culpable and only allows those founded on bad faith to go for prosecution.[202] This argument is faulty and can hardly stand because it attempts to conflate good faith with due diligence.[203] However, what has been canvassed here that has the potential to reduce the risk of banking is not so much a greater measure of good faith but well-fortified and improved supervisory diligence. In other words, an action by depositors against a regulatory agency for supervisory failures should not require an allegation of bad faith any more than an action against a governmental institution should be defensible by a plea of good faith.[204] In essence, where the law makes a provision for a duty to prevent supervisory failure and provides a right of action for investors including other financial intermediaries, consequent on its breach; the infringement of that duty should be combined with the conduct at variance with good faith.[205] This is because

[202] Famuyiwa (n 146) 54.
[203] ibid.
[204] Emeka Offor, 'A Critical Evaluation of the Role of the Central Bank of Nigeria in Ensuring Corporate Governance in Nigerian Banking Post Consolidation' (2008) <http://www.ssrn.com> accessed on 21 April 2014.
[205] Apati (n 174) 92-93.

a regulator can act negligently in a good faith, therefore, the crux of the argument is that adverse action premised on supervisory failure should be a provable incidence of negligence against the regulator, which occasioned pecuniary loss to depositors and other investors, or financial intermediary and should be enough for them(investors) to initiative claims.[206]

It is submitted that negligence here should be construed as a breach of an institutional public service obligation to ensure the safety and soundness of the financial system, severally and jointly by regulatory institutions. Furthermore, the gist of the argument is that the occurrence of a financial crisis might not necessarily implicate the breach of this duty, but it should be possible for aggrieved depositors and other investors including the financial intermediaries to initiate individual or aggregate (collective) actions where they could connect their losses to supervisory failure such as in the scenario in Nigerian banking.

6.5 Conclusion

This chapter has discussed the risk management in Nigerian banking and how effective risk management approach and supervisory accountability can enhance and further deepen the governance structures in the industry. The board of directors is responsible for the company's system of internal control.[207] For instance, in corporate governance, internal controls provide for specific situations in relation to operational risk and corporate risk.[208] A company's internal control process might specify that every single board member must approve investment target above a certain monetary value,

[206] ibid.
[207] See Offor (n 204); See *Code of Corporate Governance for banks in Nigeria* 2006 (n 97).
[208] See Offor ibid.

thereby aiming to manage risks in relation to that situation.[209] The approach that is adopted in the corporate decision is an issue as much as the management of risk itself. For instance, the adoption of voluntary mechanism in the management of risks as against the establishment of mandatory process is likely to impact on the overall effectiveness of risk management process.[210]

Risk management is still at the rudimentary stage in Nigeria and many banks do not have risk governance structure. Owing to the fact that inappropriate and unethical practices associated with the behaviour of the directors and managers were highlighted as point of concern in the recent banking failures, it is imperative that banks in Nigeria have risk-based framework as regulatory model regarding corporate governance issues. This is more so that behavioural risk issues of corporate officers contributed to corporate collapse.[211] Similarly, focusing on risk-based structures could enable banks to be proactive rather than reactive to risks in the sector.[212] While the Code of Corporate Governance for banks in Nigeria does acknowledge poor risk management and excessive risk-taking as corporate governance infraction in the industry, it fails to provide what action to be taken in such situations.[213] Similarly, the Principles of the Code are merely optional which do not go far enough to curtail director and management in excessive risk-taking and loan

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[209] ibid; Articles of Association of a bank may provide for the investment target in a particular financial year.

[210] See Christopher Van der Elst and Marijn Van Daelen, 'Risk Management in European and American Corporate Law' (2009) ECGI Working Paper no 122/2009 <http://ssrn.com/abstract=1399647> accessed on 5 April 2014.

[211] See Financial Reporting Council Act 2011 in Nigeria which replaced the Nigerian Accounting Standards Board Act, No.22 of 2003 ss.2, 3, 10. 12.

[212] As pointed out previously, the Financial Services Regulatory Co-ordinating Committees (FSRCC) is a statutory Committee comprising of the regulators and supervisors in the Nigerian Financial Services Industry and the Chairman of the Committee is the Central Bank Governor. The Committee is set up primarily to co-ordinate the regulatory and supervisory standards in the financial services industry, to provide a platform to share information, review development in the financial system, identify risks that are capable of posing a threat in the industry stability so as to recommend and take appropriate measures to minimize the risks. For more see <http://www.fsrcc.gov.ng.htm> accessed on 5 April 2014.

[213] See *Code of Corporate Governance for banks in Nigeria* 2006 (n 97).

losses.[214] The problems associated with personality and behavioural risks in respect of corporate governance processes require that mechanisms are developed to manage those risks if effectiveness is to be achieved.[215] One of the possible options and the one suggested in this thesis is regulatory intervention that is risk-based.

While self-regulation and non-law mechanisms are necessary, in practice, it has proven inefficient and ineffective in protecting the shareholders and stakeholders from expropriation, necessitating statutory intervention by way of government regulation which is not only desirable but needed in the banking industry to protect the public.[216] In other words, neither the shareholder model nor stakeholder approach is enough to protect all shareholders and stakeholders in the bank.[217] Regulatory intervention through risk management mechanisms fills the gaps emanating from the shortcoming of these corporate governance models and codes.[218] Regulation plays a complementary role to ensure that all the extant laws, rules, principles, standard necessary for effective performance of the firms are adhere to by the board and management and this is carried out by the industry regulators in form of supervisory oversight.[219] These oversight duties enable the regulators to even impose corrective measures or punitive actions against the bank officers where there are breaches of extant laws.[220]

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[214] ibid.

[215] See Ian Ayres & James Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press 1992) 19-25.

[216] See Eilis Ferran, 'Corporate Law, Codes and Social Norms-Finding the Right Regulatory Combination and Institutional Structure' (2001) 1 Journal of Corporate Law Studies 381-409, 386

[217] See chapters 3 and 4 for discussions on the shortcomings of corporate governance model which is the reason for regulatory intervention as a risk management mechanism to complement and reform the governance framework in banks in Nigeria.

[218] See James Kirkbride and Steve Letza, 'Corporate Governance and Gatekeeper Liability: The Lessons from Public Authorities' (2003) 11 Corporate Governance: An International Review 262-271.

[219] See Lois Musikali, 'Why Criminal Sanctions Still Matter in Corporate Governance' (2009) 20(4) International Company and Commercial Law Review 133-141.

[220] ibid.

For instance, in Nigeria, these banking regulators (CBN, NDIC, and SEC) are empowered by the statute to inspect the trading books to determine the lending structure of the bank. The aim is to ascertain whether directors have complied with the extant laws in disclosing their vested interests in bank facility where directors lend money to themselves or to their associates or fail to disclose their interests at all.[221] Similarly, supervisors are also empowered to examine if banks have complied with the laws in filing of returns on quarterly and yearly basis and whether disclosure of information to the investing public is misleading or false.[222] In all these, the industry regulators through their oversight function can take necessary action against the bank in line with statutory provisions.[223] The implication for practice remains that regulation is necessary in Nigerian banking to entrench and further deepen the governance standard in industry. This chapter has further argued that accountability in the banking regulatory institution is necessary if the interest in banking is to be rekindled. Accountability has the potential to foster regulatory diligence and responsibility, in that certainty of institutional indictment for supervisory failure would most likely instil greater seriousness in the operations of regulatory institutions and their officers and one remarkable effect of this should be a reduction in the cycle of banking crisis.[224] Where the cycle of financial crisis is reduced, it follows that public safety nets such as capital guarantee, deposit insurance and lender of last

[221] See NDIC Act 2006 s. 27 (1); see ISA 2007 ss 13(k), 85, 86.

[222] The CBN also has extensive disclosure and transparency enforcement powers against banks under the Act in sections 27 (1) (2); 28 (1) (2); 31 (1) (2) (b) (c) ; 33 (1) (a) (d) of the BOFIA; see also sections 33 (1) (a) (b) of the CBN Act 2007; see particularly NDIC Act 2006 s. 27 (1); see ISA 2007 ss 13(k), 85, 86. All these statutory provisions are geared towards deepening the governance and management standard in the industry which is why regulation plays complementary roles to corporate governance structures in banks.

[223] Morten Huse, 'Accountability and Creating Accountability: A Framework for Exploring Behavioural Perspectives of Corporate Governance' (2005) 16 British Journal of Management 65-80.

[224] See Offor (n 204) 13.

resort facility will not be activated so often, to rescue systematically significant financial institutions.[225] Similarly, this could also reduce the large compensatory pay-out to depositors and other investors and one practical implication for this is that it would have been possible to hold CBN, SEC and NDIC, culpable either through litigation or by public enquiry, if it could be established by investors that regulatory failure under their watch substantially caused or contributed to the crisis.[226]

[225] See Apati (n 174) 92-93.

[226] As highlighted in this chapter, this liability model propounded here should be based on negligence or bad faith against the banking regulators. In furtherance of that, the stakeholders especially the depositors should be able to initiate individual or class actions against the regulators in the sector where the claimants can connect or prove that the regulators' inactions or deliberate omissions to carry out their regulatory oversight as provided in the Nigerian laws contributed largely to banking failures. In this way, accountability and investors' confidence will further be deepened in industry.

Chapter Seven

Conclusions

Major findings - contributions and recommendations (core arguments)

With respect to the foregoing analysis, the followings are the major contributions and recommendations of the thesis: (a) regulation is necessary to complement and reform the efforts of corporate governance theories and its mechanisms in banks operating in Nigeria. The peculiarity of banks shows that even a perfect corporate governance theory and its mechanisms cannot cure the potential systemic risks inherent in the sector. The danger of systemic risk and potential for contagion is so acute that it goes beyond the shareholders to affect other stakeholders especially the depositors and the public and this is why regulatory framework is necessary to protect both the shareholders and stakeholders in banks. Regulatory intervention, in this regard, does not substitute for corporate governance primary role and responsibility, which lie with the board and managers of banks. Regulation through the oversight functions of the regulators only assists and ensures that all possible laws, rules, principles and codes necessary for improved governance standard are carried out and it mandates the regulators and supervisors to monitor compliance and apply sanctions including penalties where breaches occur.

(b) A risk-based regulatory framework which emphasises on risk-management should be adopted in the industry. The reason is because banks in Nigeria have always relied on publications from agency ratings as a governance framework but such reliance has failed to reduce the spate of bank

failures.[1] Reliance on agency ratings is inadequate and should not be a substitute for due diligence functions of supervisors.[2] It can be argued that rating agencies suffer from accountability deficits and this is why they are now being regulated in the developed world.[3] Risk management is not the only solution to all possible crises in banking. However, given that bad loans and loan losses including poor risk management were identified as major corporate governance issues in Nigerian banks, it is posited that effective risk management should enable bank directors and management including the regulators to identify the nature of risk and apply the best possible combination of governance framework and strategy that suit the sectorial problems.

(c) In order to manage risks effectively, a conceptual framework would entail examining all the factors that would enable the achievement of the desired aim. In designing an appropriate mechanism, regard must be had to corporate theories as they provide the basis for understanding how companies exist and function. Regard must also be had to regulatory theories as they provide the underlying foundation upon which regulatory interventions rest. Building upon relevant corporate and regulatory theories; and incorporating current realities as they relate to the regulation of companies, this thesis suggests a regulatory model that is based on risk management as an approach to managing risks in corporate governance and as part of the corporate

[1] See Kenneth Ajibo, 'Risk-based regulation: The future of Nigerian banking industry' (2015) 57(3) International Journal of Law and Management 201-216.
[2] ibid.
[3] See Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ L 302, 17.11.2009. . Regulation (EC) No 1060/2009 is often referred to as CRA I Regulation; Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009. Regulation (EU) No 513/2011 is often referred to as CRA II Regulation.http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:145:0030:0056:EN:PDF accessed on 10 October 2014.

governance resolution process. Regulatory intervention in the management of risks is further justifiable because its aim is to protect society from corporate failures. A regulatory model comprising hard law provisions in the areas in which they would prove most effective and soft law provisions in the areas in which flexibility is required is argued to be another effective means of managing risks. The overall purpose is to prioritise resources and save cost of governance in the industry.[4]

(d) Accountability in Nigerian banking should go beyond the board of directors and management to include regulatory institutions in order to rekindle the confidence in banking. However, criminal sanctions should only be permissive to both the investors and other stakeholders (depositors and the public) where there is a proven allegation of lack of prosecution as a result of bad faith and negligence from regulators and supervisors.[5]

(e) A competent board of directors must be encouraged by appointing persons with requisite knowledge and skills for the job. Adequate and regular training should be made mandatory for directors and other officers of the banks to make them more conversant and effective in their oversight functions in line with global best practices and international standard. Where a person

[4] The first contribution of this thesis which is summarised in (a), (b) and (c) of this chapter argues that owing to the deficits on corporate governance theories and its mechanisms, the future of Nigerian banking sector should be risked-based that is premised on risk management. The reason is because corporate governance mechanisms remain inadequate to protect other stakeholders especially the depositors. Risk management as a regulatory governance framework has been suggested to complement and reform the governance theories and its mechanisms in order to protect the depositors and the public given the potential for systemic risk in banking. For detail analysis on why risk management as a regulatory governance framework complements and reforms corporate governance mechanisms see chapters 5 and 6 of this thesis.

[5] The second contribution of the thesis that is summarised in (d) of this chapter argues that accountability in banking sector should go beyond the board and management to include the banking regulatory institutions (such as CBN, CAC, SEC, NDIC) so as to deepen the governance standard in the sector. As highlighted in chapter 6 of this thesis, this liability model propounded here should be grounded on negligence or bad faith against the banking regulators. In furtherance of that, the stakeholders especially the depositors should be able to initiate individual or class actions against the regulators in the sector where the claimants can connect or prove that the regulators' inactions or deliberate omissions to carry out their regulatory oversight as provided in the Nigerian laws contributed largely to banking failures. In this way, accountability mechanisms and investors' confidence will further be deepened in industry.

appointed lacks the requisite knowledge, skills, and competence, he shall be held liable and be made to refund all entitlements and benefits taken when acting as a director. The onus of requisite knowledge and competence should be on the would-be director to disclose qualification and competence and not on the company.

(f) Independent non-executive directors should be on the majority of the board of banks to effectively challenge the management major decisions that would affect shareholders and bank generally.

(g) Shareholder activism and their participations must be encouraged as provided in the CAMA.[6] For instance, the law makes some provisions for access to the court for redress for minority shareholders.[7] This includes actions brought by an aggrieved shareholder for wrongs done to him personally or to take a derivative action in the name of the company.[8] Furthermore, CAMA permits a shareholder to institute an action on the ground of unfairly prejudicial and oppressive conduct with the court having a wide range of relief to choose

(h) On qualifications of auditors, a standard should be provided by CAMA and strict penalties applied to promote compliance with ethics of banking and international standard. There should be a review of all necessary laws that regulate all aspects of accounting practices and audit in Nigeria to unify the

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[6] CAMA 1990 300-320
[7] ibid
[8] See generally Olufemi Amao and Kenneth Amaeshi. 'Galvanising shareholder activism: A prerequisite for effective corporate governance and accountability in Nigeria' (2008) (82(1) Journal of Business Ethics 119-130; Emmanuel Adegbite, Kenneth Amaeshi, and Olufemi Amao. 'The politics of shareholder activism in Nigeria' (2012) 105(3) Journal of business ethics 389-402.

various accounting bodies in the country so as to provide for a common disciplinary body and punishment of offenders.

(I) There should be a co-operation and collaboration of all regulatory agencies (CBN, SEC, CAC, and NDIC) in the banking sector for effective compliance and management.

(j) Penalty provisions dealing with the directors, management and other banking officers in BOFIA should be reviewed to serve as a deterrent to would-be corporate offenders.

(k) In reviewing the banking and financial laws, serious sanctions should be prescribed and enforced in cases involving insider abuses, mismanagement of the shareholders and stakeholders funds and breach of professional duties, especially, auditors of companies.

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