CORPORATE GOVERNANCE REFORMS IN BANKS: LESSONS FROM NIGERIA?

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Abstract

In Sub-Saharan Africa, and indeed in most emerging economies, national governments have in one way or the other (in varying degrees) intervened in the running of corporations. These interventions (usually referred to as reforms) have been eliciting discourses on whether Governments should show interest, be involved in the running of corporations, and also on the effectiveness of those interventions. This paper reviews the subject of this discourse with base reference on banking reforms initiated by various administrations in Nigeria over the decades, articulates lessons from the reforms, raises questions for further research and argues that corporations and markets should be self regulated. National governments should provide operational guidelines, enabling framework and put in place a sustainable mechanism for monitoring, and intervene only when the need arises. The paper also calls for the development of new governance architecture for banks and corporations in order to address emerging corporate governance realities.

Keywords: corporate governance, banks, Nigeria

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Introduction

Corporate governance describes the expectations of stakeholders on how corporations are governed (Offor 2009). These expectations may or may not be codified but should indicate guidelines on acceptable best practices. The OECD principles of corporate governance provided a frame work for shareholders, other financial stakeholders, boards of directors, checks and balances, the control environment, audit, transparency and disclosures as well as commitment to and enforcement of good corporate governance(Barger 2006). This creates the impression that everyone has a role to play in ensuring good governance.

Banking is a business of trust and requires that the confidence of the stakeholders on the bank or the system is sustained.

Based on these premises, national governments have been involved directly or indirectly in the running of corporations including banks. In the process, they have in different degrees been championing one reform or the other in an attempt to sustain confidence in the banking system and protect the economy from collapse or crisis. Whether these reforms or interventions have been effective in preventing crisis or not is debatable.

In the last four decades the Nigerian Government has initiated series of reforms in the banking sector. These reforms were in response to the desires of the government to revitalize the economy and resolve crises rocking the industry as well as to correct structural imbalances in the economy (Donli 2004).

Reforms in the Nigerian banking sector started in 1952 when the Federal Government began the process of regulating banks with the promulgation of the 1952 Banking Ordinance. This ordinance, which was enacted after the banking collapse of that era, established a minimum capital requirement intended to minimize bank failures. Prior to then, there was effectively no legal framework for banking in Nigeria. It could be said then, that banks operating in Nigeria were more or less self-regulated.

Several reforms have since then been initiated with varying degrees of success or impact. The bulk of those reforms were promoted by the Federal Government or its agencies and were anchored on ordinances, decrees, and acts of parliament or guidelines aimed at improving the process of banking in the country.

Examples of these reform efforts include (Duncan 2010):

The 1958 CBN ordinance that established the Central Bank of Nigeria (CBN) to regulate/supervise banks in Nigeria

1958 Banking ordinance that prevented foreign control of Nigerian banks

Banking ordinances of 1959, 1961, 1962, 1964 and 1969 were enacted to correct certain defects in the system and close some loopholes in previous legislation

1979 Amendment of the 1958 Bank ordinance to increase minimum capital requirement and differentiated between commercial and merchant banks.

1991: Banks and other financial institutions decree (BOFID) revamps the legal framework for the establishment of banks in Nigeria.

1999 Universal Banking guidelines that amended BOFID and introduced universal banking in Nigeria.

2004-2006 CBN Governor Chukwuma Soludo's reforms of the banking sector aimed at raising the

minimum capital requirement to N25 billion and consolidation of the banking sector leading to the reduction in the number of banks to 24 eventually (Soludo 2004).

2009 CBN Governor Lamido Sanusi introduced reforms in response to the global financial crisis with the aim of raising the quality of banking supervision (Sanusi 2009).

2010: Scrapping of universal banking and diversification of the banking sphere, development of pillars for banking reforms, creation of framework for specialized/regional banks as well as opening of the banking sector to foreign investors.

Probing the key warning signs that indicated the need for reforms

The Central Bank of Nigeria in its code of corporate governance for banks operating in Nigeria post consolidation (2006) listed the following as some of the key warning signs that indicated a need for further reforms:

i) "Disagreements between Board and Management giving rise to board squabbles"
ii) "Ineffective board oversight functions."
iii) "Fraudulent and self-serving practices among members of the board, management and staff."
iv) "Ignorance of and non-compliance with rules, laws and regulations guiding banking business."
V) "Passive Shareholders."
Vi) "Poor risk management practices resulting in large quantum of non- performing credits including insider-related credits."
Vii) "Ineffective Management Information System."
Viii) "Inadequate and misleading disclosures."
Ix) "Succumbing to pressure from other stakeholders e.g. shareholder's appetite for high dividend and depositor's quest for high interest on deposits."

These key warnings signs could have been mitigated by appropriate supervision by empowered board of directors and comprehensive regulation and monitoring by the Central Bank.

In the current dispensation, the CBN under Sanusi Lamido identified the issues bordering on disclosures and exposure to margin lending as key warning signs and launched his reforms based on the result of a stress audit test.

Prior to Soludo and Sanusi, the key warning signs had been the perennial distress in the banking sector (despite the series of government interventions and reforms), corporate governance challenges, risk management issues, weak capital base, etc.

Opening up the banking sector to banks from across the globe

The aftermath of Sanusi's reform was an invitation to banks especially in Africa to invest in the Nigerian Banking sector. The banks that were up for plucking were mainly those rescued by the CBN in 2009 in the aftermath of the global financial crises. The CBN conducted road shows to sensitize investors on the need/benefits of investing in the nation's lucrative banking sector. Before this initiative, foreign banks were not allowed to own controlling shares in the leading banks in Nigeria. Such restrictions could have slowed down the pace of development in the nation's banking sector especially in this era of globalization.

Several international banks and other investors have been indicating their interest in acquiring the banks in response to the invitation.

These investors may be contending with such issues as profitability, due-diligence, legal tussles, financial valuation (net worth), analysis of the likely economic benefits.

Some have also identified that the rescued banks' option is not the only vehicle of opening up Nigeria's banking sector, since foreign investors can opt to establish new banks.

Nigeria remains a nation of interest to investors based on the population of the country and its flexible economy.

Diversification and creation of specialized and regional banks

The CBN has issued guidelines for setting up of specialized and regional banks. They have in the process dismantled the existing universal banking model. The new structure recommends the inclusion of a holding structure for banks who meet the criteria.

The scrapping of universal banks may have been in response to calls by insurance companies and other stakeholders for CBN to do so over the past few years. Insurance companies have argued that banks with insurance company subsidiaries have eaten deep into the market shares of insurance companies.

Other stakeholders have posited that universal banking exposed depositors' funds to high level of risk. In the new arrangement, banks are being encouraged to concentrate on their core business within the following options: holding companies, international banks, regional banks, specialized banks, and Islamic banks.

What remains in the aftermath of the cleansing of the banking sector

The CBN reforms targeted among others the reduction of banks high operating cost. Transparency, etc
CBN/Banks need to address the prevailing high operating cost of Nigerian banks and put in place robust cost control mechanism. Banks in Nigeria operate a business model that seems to encourage taking on huge costs. Area of focus to include establishment of required infrastructure, collaboration and cost sharing among banks, outsourcing of non-core functions, cost governance (shared services implementation), procurement, product rationalization etc.

While improving earnings is a strategic push for banks, checking rising cost is vital for profitability.

Genuine competition among banks:

This is becoming evident following the implementation of a common year end for banks in Nigeria. Nigerian banks are becoming more innovative in pricing and more efficient in revenue tracking and income recognition.

Downward review of lending and deposit rates:

Both deposit and lending rates have dropped in the majority of Nigerian Banks. Banks are still skeptical at lending.

Improvement in disclosures

Banks financials since the commencement of the current reforms have been enlarged to include among others, level of provisioning or exceptional items, non-performing loans ratio, profit attributable to equity holders, and exposure to some relevant sectors of the economy. Prior to now, those items were lumped together and the financials show mainly profits, gross earnings, dividends, etc.

Intrinsic Lessons

African countries in particular have faced challenges in implementing appropriate banking reforms as a result of unstable political transitions, promotion of policies or reform efforts that were not well articulated, some affiliations or integrations with certain international financial groups, lack of adequate manpower in the bureaucracy, as well as economic crises including the recent global financial crises.

Yet national governments have continued to play a role in the governance of banks due to some of the factors listed below:

A) A resolve to achieve national stability
B) An attempt to combat corruption in the sector
C) In order to manage employment and related issues
D) Protection of stakeholders and sustain depositors' confidence in the banking system
E) Political considerations
F) Maintenance of the legal system
G) Stability of the economy

National governments may intervene in order to avoid hiccups and unsavory experiences for the economy. They therefore manage political risk in such a way as to assure investor confidence, shore up ratings and attract investments.

The process of generating and developing a policy framework requires a review. Developing countries need to put appropriate structures in place in order to deal with the pressures for banking reforms. This will enable them enhance banks' capacity to increase the efficiency of transforming financial resources into productive investments locally and even internationally.

The need to review the lessons inherent in past reform efforts is relevant for policy. Government and other state actors have instituted several reforms over the four decades. But why is it that the problems continued to persist and possibly increase in magnitude and sophistication? Have governments been concentrating on the technicalities of the reforms? Or have they been playing to the gallery? Or have they been playing a catching up game with the system? Or did they intentionally create the problems in the first instance in order to create the motion of activities in terms of reforms? Or should they begin to look elsewhere for solutions to the challenges that necessitated the need for reforms? Or does political economy have any role to play in ensuring the success of reforms?

What drives the choice of reforms? Why do actors in the financial industry behave the way they do? Were researches conducted before initiating the reforms? Were the reform policies tested? Were the codes governing corporate behavior tested and subjected to public or expert review? Were the stakeholders carried along? Whose interests will the reform policy protect?

Reforms are needed when there are structural imbalances in the economy. Donli (2006) observed that these structural imbalances were mainly caused by inappropriate policies created by the government in the past and inappropriate implementation. Other factors include frequent changes in policies. This author would like to submit that appropriate responses to the system would have removed the need for further reforms in the first instance. Shouldn't a responsible national government or regulating agency pre-assess the cost and impact of reforms before introducing them?

A review of the Nigerian case indicated that the leading banks which survived CBN Governor Sanusi's "tsunami" (a term used to describe the sacking of the CEO and Executive Directors of banks rescued by the CBN) were mainly those who were pro-active in initiating governance best practices and implementing reforms. Shouldn't banks and corporations be proactive in developing their own reforms instead of waiting for regulators to force or compel them? This could be a lesson in self renewal and rejuvenation.

The prevention of foreign control of leading Nigerian banks may have had a negative impact on foreign investments in the country and slowed down the pace of development in that sector in terms of deepening the level of expertise. The import of this lesson may have been the basis for the reversal of this policy. The current CBN administration has opened up the banking industry to investors from across the globe.

The reversal of the policy on universal banking presents another learning point. The withdrawal of universal banking licenses was to encourage Nigerian banks to concentrate on their core functions. Those who opt to continue to retain subsidiaries in other financial sectors were encouraged to form holding companies. This policy is not without its challenges. There have been issues for stakeholders, the reduction of banks' overwhelming domination of the financial sector, profitability, strengthening of core banking competencies,

further delineation of roles for directors and management. In the past, some executive directors of banks have been assigned key roles in universal banking subsidiaries; a practice which may encourage insider- abuse.

A review of the consolidation of the banking sector has shown that huge capital outlay may have helped Nigerian banks cushion the negative effects of the global financial crises. The inverse is also true in the sense that excess liquidity may have encouraged some recklessness on the part of some banks, as reflected on their exposure to oil and gas transactions and margin lending. There is therefore a need to achieve balance and ensure that appropriate credit risk management processes are put in place.

The intervention of national governments and their agencies on the governance of banks may pose either too much risk or too little risk on the industry (Barger 2006). The impact and effectiveness of the interventions have been debatable and may likely remain so. Should banks or corporations regulate themselves? Or should national governments take the lead?

National governments should provide operational guidelines, enabling framework and put in place a sustainable mechanism for monitoring, and intervene only when the need arises.

Walker (2009) in his review of corporate governance in UK banks and other financial industry entities reported that better governance will not guarantee that there will be no financial crisis but will make a rerun less likely. Should we then not search for new governance architecture for banks and corporations?

Drawing from the failures of the past reform efforts, their limited successes and the uncertainties of the future, this author calls for the development of new governance architecture for banks and corporations in order to address emerging corporate governance realities.

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