# CORPORATE GOVERNANCE COMPLIANCE AND ITS EFFECTIVENESS IN THE NIGERIAN BANKING INDUSTRY

***Achuzia Somuawine Azani*, Mei Yu**, Osita Chukwulobelu*****

## Abstract

This paper examines the extent of compliance to the Central Bank of Nigeria (CBN) 2006 Corporate Governance Code by 24 Nigerian commercial banks and reveals a compliance level of 76.6%. The major non-compliance areas include non-constitution of a board committee consisting of non-executive directors, that regulates the compensation for executive directors, and the non-inclusion of independent directors on the main boards of many banks. Furthermore, the analysis shows that the benefits resulting from the changes for compliance outweigh the additional layers of supervisory checks and bureaucratic overbearing associated with the Code. The Code has brought about more effective corporate governance, accountability and greater transparency despite a low frequency of supervision and examination of the banks by the CBN.

**Keywords:** Corporate Governance, Compliance, Banking, Nigeria

*Birmingham City Business School, Birmingham City University, Birmingham, B42 2SU, UK
Email: somazani@yahoo.com
**Corresponding author. Birmingham City Business School, Birmingham City University, Birmingham, B42 2SU, UK
Tel: +44/01212024620
Email: mei.yu@bcu.ac.uk
***Birmingham City Business School, Birmingham City University, Birmingham, B42 2SU, UK
Email: osita.chukwulobelu@bcu.ac.uk

## 1 Introduction and Rationale

Fundamentally, the origin of corporate governance issues has been attributed to the emergence of modern firms, in which there is a separation of a firm's equity ownership from its management that gives rise to a conflict of interests (e.g. Berle & Means, 1932; Jensen and Meckling, 1976). Consequently, there is a continuing interest among academia and policy makers to strengthen corporate governance mechanisms, hence protect the interest of firms' different stakeholders. For instance, in the UK, the collapse of Polly Peck and Coloroll in 1990, and BCCI and Maxwell Communications Corporation in 1991 led to the first major attempt to reform and improve corporate governance with the publication of the Cadbury Report in 1992.

Additionally, in the USA there were a series of major corporate failures and disasters at the beginning of the new century, notably Enron in 2001 and WorldCom in 2002, which further helped to underscore the importance of effective corporate governance to protect investors and other stakeholders. Further, the current debate that is raging on about banks' bailouts and bonuses, following the collapse of Lehman Brothers in 2008 and the subsequent un-abating global economic recession, has shockingly exposed the huge divergence between the interests of shareholders, other connected stakeholders and the wider society on one hand, and those of corporate managers on the other. Many academic research papers about corporate governance have been spurred by these corporate failures and scandals as well as the banks' failures in Asia and Russia during the 1990s.

However, much of the literature on corporate governance has addressed the issues of confronting companies and firms in the non-financial sectors. These studies have taken the principal-agent problem, in which the principal is the owner/shareholder of the firm and the agent is the manager/employee of the firm, as the starting point of analysis, (e.g. Kern, 2006; Keasey et al., 2005; Stenberg, 2004; Sundaramurthy, 1996). In his study, Kern (2006) argues that the traditional model of the principal-agent problem fails to take account of the important role that financial regulation can play in representing stakeholder interests in the economy. However, he also noted that following the USA savings and loan crisis in the 1980s, and the Asian financial crises in the 1990s, most experts recognised that effective prudential regulatory regimes for the banking sector require strong corporate governance frameworks for banks and financial institutions.

There are now some studies that deal specifically with corporate governance in banks (Belkhir, 2009; Kaymark and Bektas, 2008; Turlea et al., 2010). This paper seeks to contribute to the growing research by

focusing on the compliance level and the effectiveness of the Central Bank of Nigeria's 2006 Code of Corporate Governance for Nigerian Banks. More crucially, this study is important because, as Kern (2006) and Mülbert (2009) argue, the corporate governance of banks and financial institutions is an important area of financial regulation, as a result of the universal risks that banking activities pose for the economy and society at large. Nigeria is no exception to such risks. Moreover, Nigeria has by far, the biggest economy in sub-Saharan Africa, and hence any crash of its banking and financial industry will have a devastating effect on the other economies that make up the Economic Community of West African States (ECOWAS). The continuing crisis in the Euro and the wider European Union (EU) only serves to buttress this point.

Lastly, our study is also important because over the last 5 years there has been a great loss of confidence in Nigerian commercial banks by both customers and investors alike, due to the banking scandals and failures of 2009 and 2011. Although much has been written on corporate governance reforms in Nigeria recently (Adekoya, 2011; Dabor and Adeyemi 2009; Adekoya 2011), we are unaware of any journal paper that took our perspective. By investigating the extent of compliance with the CBN's 2006 Code of Corporate Governance, this study helps to answer whether the continuing low confidence in the banks is justified or whether the Code has succeeded in curbing the worst abuses of the banks and in providing greater protections to all stakeholders.

## 2 Background

According to Central Bank of Nigeria (2011), in 1986 there were only 40 banks in Nigeria, but the number had tripled to 120 by 1992. However, according to the same CBN Report, by 1998 the number of banks in operation had declined to 89 as a result of the liquidation of 31 terminally distressed banks. The rapid growth and the failures that followed have been attributed to a lax regulatory regime by the CBN and weak internal corporate governance structures of the banks (Okorie and Oyewole, 2011).

The CBN response to the banking failures was to increase the minimum capital requirement (capital base) of all commercial banking institutions in Nigeria from its level of ₦10 million in 1989 to ₦500 million with effect from December 1998. This fifty fold increase in the capital base of banks was soon followed by a much more significant increase, and banking consolidations engineered by the CBN. The Central Bank ratcheted up the minimum capital requirement to ₦25 billion and required compliance by the end of 2005. This had the intended consequence of forcing weaker banks to liquidate or seek mergers. The massive banking consolidations that followed resulted in the number of banks in Nigeria shrinking further from 89 in 1998 to only 25 by the end of 2005, and as of 2011, the number has fallen to 24.

Despite the increase in the capital base to ₦25 billion, the global financial crisis that started in 2008 exposed the fragility of a number of Nigerian banks. Some had to be bailed out in 2009, and again more recently in 2011, by the CBN through the Assets Management Company of Nigeria (AMCON). These banks were found not only to have liquidity and inadequate capitalization to absorb their huge losses, but also had very weak internal corporate governance structures that manifested themselves in all kinds of management abuses and excesses. The worst of the abuses and excesses led to the sacking of eight CEOs and some of their senior management team by the CBN, and their arrest and prosecution by the Economic and Financial Crimes Commission (EFCC), and their subsequent convictions by the courts.

Previously in 2004/5, a regulatory investigation by the CBN looked into the conduct and the internal corporate structures of various banks and revealed shocking weaknesses and abuses in the way Nigerian banks are managed and controlled, which left many of them in a perilous state of financial distress. The major corporate governance weaknesses uncovered by the investigation included boardroom rifts arising from conflicts between the boards of the banks and the management, lack of board oversight functions, self-centred conduct of some board members, and concentration of powers on chairman or managing director/CEO. The major abuses were manifested in the form of poor compliance with prescribed internal controls and operation processes, poor risk management procedures, resulting in substantial levels of non-performing loans including insider-related credits, and gross flouting of banks' own lending guidelines. The CBN investigation also found that the fragile states of some banks were further compounded by shareholders' demands for ever-increasingly huge dividend payouts, and big depositors threatening to switch their deposits to other banks unless they received higher rates of interest. From this investigation, the CBN concluded that there was an urgent need to review some of the existing regulatory provisions of internal corporate governance for Nigerian banks. The review gave rise to the 2006 Corporate Governance Code guidelines, which was reviewed in 2012.

Despite the massive publicity generated by the Code, and the uncompromising measures taken by the CBN against erring banks and their boards, we are unaware of any journal paper that examined the level of compliance and the effectiveness of the Code. This study attempts to bridge this gap. The compliance with the Code is examined using the whole population of 24 commercial banks currently operating in Nigeria, while the effectiveness of the Code is examined based on Guaranty Trust Bank PLC.

## 3 Literature Review

### *3.1 Agency Theory and Corporate Governance*

Agency theory suggests that a corporation's framework consists of a relationship of agreements between the owners of the business, known as the principals, and managers of that business, referred to as the agents (Jensen and Meckling, 1976). Sundaramurthy (1996) argues that agency problems emanate because contracts cannot wholly stipulate the duties and commitments of parties to the contract, which provides the opportunity for agents to make choices and decisions, concerning the use of corporate resources, that profit them personally at a cost to the firm. Similarly, Roberts (2005) suggests that it is the combination of assumed autonomy and self-interested motivation that creates the problems within agency relationships.

In the main, agency problems arise because managers possess superior and more information than the owners of the firm. This 'information asymmetry' unfavourably affects the owners' ability to determine whether or not their benefits are being properly pursued by managers (Sarens and Abdolmohammadi, 2011). Furthermore, the structure of dispersed ownership that the agency theory brings about means that the shareholders' ability to exercise absolute control on how the business is run is greatly impaired (Jensen and Meckling, 1976; Ntim, 2009). Thus, both the origins and potential consequences of agency problems, in turn, raise the issue of corporate governance and board accountability.

There have been various definitions of the term 'corporate governance' as it emerged as a distinct area of study over the last two decades (Ntim, 2009). The Cadbury Report (1992) in the UK defined corporate governance "as the system by which companies are directed and controlled" (para.2.5). This definition provides only a narrow characterisation of corporate governance. A much broader definition is provided by Gospel and Pendleton (2005, p.3) who defined "corporate governance as a relationship between three sets of actors or stakeholders (capital, management and labour), which is concerned with who owns and controls the firm, in whose interest the firm is governed and the various ways (direct and indirect) whereby control is exercised". A similar broader definition is also favoured by the OECD (2004, p.11), which sees corporate governance as involving "a set of relationships between a company's management, its board, its shareholders and other stakeholders' as well as providing the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined".

Although the broader definition is now favoured by most countries, differences exist among them about how best to implement and achieve effective corporate governance. In the next section, we briefly examine the various models of corporate governance that have been suggested in the theoretical literature.

### *3.2 Models of Corporate Governance*

#### *3.2.1 Shareholding Model of Corporate Governance*

Fundamentally, the 'Shareholding Model' of corporate governance assumes the parochial interest of the owners of the business where the underlying focus is maximising the shareholders wealth (Rossouw,2005; Macey and O'Hara,2003; Jensen and Meckling, 1976).The model is also known as the Anglo-American model and tends to derive from the narrow definition of corporate governance. It neglects the interests of other wider parties associated with the firm such as customers and the local communities.

Moreover, the inevitable conflict of objectives remains in this model. Since shareholders (principals) have to give the control of their business to a few executives (agents) to manage the corporation on their behalf, there is a potential threat that these agents will seek personal benefits to the disadvantage of the owners –principals (Keasey et al., 2005; Jensen and Meckling, 1976). The Cadbury Report (1992) suggests a resolution of this agency problem by recommending the introduction of a corporate governance code of ethics and conduct that is underpinned by the universal corporate values of accountability, discipline, fairness, independence, responsibility, and transparency to regulate director and managerial behaviour.

Again, the shareholding model posits that many of the agency problems can be resolved by the introduction of efficient contracts to govern the relationship between owners of capital and labour (Jensen and Meckling, 1976). It opposes the intervention of central authorities and government as such interventions usually distort free-market operations. Taking the rational economic model as its cornerstone, it assumes that factor markets (e.g., capital, managerial labour and corporate control) are efficient, and therefore argues that self-regulation, backed by additional voluntary mechanisms that includes a voluntary corporate governance code, are more effective in reducing differing activities of managers (Keasey et al., 2005).

However, a major and undermining weakness of the shareholding model lies in its near total exclusion of the social, ethical and moral responsibilities of the firm as an important societal institution, and the narrowness of the model's concept of stakeholders (Rossouw, 2005; Keasey et al., 2005). Furthermore, Stenberg (2004) criticises the inherent weaknesses of this model because shareholders' lack sufficient power to control management and prevent misuse of corporate resources. Theoretically, the maxim of shareholders primacy connotes that firms exist to maximize shareholders wealth and that residual

powers lie with the shareholders to appoint and dismiss managers who run their corporation during annual general meetings (AGM). However, Stenberg (2004) argues that, in reality the exercise of such powers is constrained by procedures that govern corporate processes.

#### *3.2.2 Stakeholding Model of Corporate Governance*

According to Keasey et al. (2005), Rossouw (2005), and Stenberg (2004), the 'Stakeholding Model' is an all-inclusive model in which the board of directors of a firm are not only answerable to the shareholders (owners), but also to the other participants that include contractual stakeholders (customers, employees, suppliers, creditors and bankers amongst others) as well as non-contractual stakeholders (media, special interest groups, local communities, professional bodies, the state, government of the day and the society at large). Similarly, for Fama (1980), the Stakeholding Model explicitly suggests that the agency relationship cannot be limited to the shareholders (principals) and managers (agents) as the major participants, but includes other stakeholders who also influence the corporation. Still in the vein, Jensen (2002) and Ntim (2009) see the firm as consisting of different social groups, with each group making its own contributions by way of resources, and in turn, expecting their interests to be enhanced.

Therefore, unlike the shareholding model, the Stakeholding Model strongly advocates the inclusiveness of identifiable stakeholders rather than advancing the parochial interest of the shareholders. The model suggests that the way a corporation treats its stakeholders reflects its ethical standard and this should be done through the identification of its stakeholders and the stakeholder engagement. The content of the stakeholder engagement is generally described as an obligation to inform stakeholders about the company's performance (Rossouw, 2005). Equally, the framework of the Stakeholding Model promotes closer contact between all stakeholders (shareholders, creditors, managers, employees and suppliers) as well as the integration of business ethics as a solution to achieving a balance among the various stakeholder interests (Ntim, 2009).

However, the Stakeholding Model's strong stance on balancing the differing interests of the various stakeholders may reduce its appeal to equity investors and skew sourcing of capital towards more debt than equity capital (Ntim, 2009; Stenberg, 2004). It has also been argued that the model runs contrary to the principal concept of business. In other words, its insistence on firms finding an ideal balance of distribution of benefits to all stakeholders may conflict with the idea of business, which involves the investment of shareholders' capital in a modern firm to primarily maximise its long-term value (Sternberg, 2004; Jensen, 2002). Also, the definition of who 'all stakeholders' are is seen as rather ambiguous since the concept of stakeholders encompasses the generality of those whose conduct influence or are influenced by the business (Sternberg, 2004).

### *3.3 Empirical Studies on Corporate Governance Compliance*

There have been quite a few empirical studies of compliance with corporate governance codes by listed companies and the effectiveness of the codes in various countries (e.g. Aguilera and Cuervo-Cazurra, 2009; Arcot et al., 2010; Werder et al., 2005; Ntim, 2009; Price et al., 2011). Since the Cadbury Code became public in 1992, McKnight et al. (2009) examined 221 non-financial UK PLCs and the findings showed improved corporate performance by companies which adopted the Code. Arcot et al. (2010) examined the effectiveness of the 'Comply or Explain' approach to corporate governance in the UK. They found an increasing trend of compliance with the Combined Code and a frequent use of standard explanations in case of non-compliance for 245 non-financial companies for the period of 1998-2004. Werder et al. (2005) studied compliance level of 408 firms listed at the Frankfurt Stock Exchange and found that the German Corporate Governance Code truly stimulates changes in corporate governance practices because corporations absorb adaptations to stipulated principles that were not adopted in the past.

For studies in emerging markets, Price et al. (2011) document a significant increase in compliance over 2000–2004 for Mexican PLCs. However, they found no association between the governance index and firm performance, nor is there a relation with transparency. On the contrary, Ntim (2009) reveal that compliance with the affirmative action and stakeholder corporate governance provisions impacts positively on the performance of South African listed firms. Similar evidence was documented in Wahab et al. (2007) and Kouwenberg (2006) for Malaysian and Thai listed companies respectively, as the compliance of the corporate governance codes lead to increased firm valuation. Chen and Nowland (2011) examined the effectiveness of corporate governance codes in four East Asian markets over the period 1999-2009 and found significant improvements in code compliance, but not all can be attributed to the introduction of code recommendations. Aguilera and Cuervo-Cazurra (2009) reviewed the literature on codes of good governance covering 64 countries and conclude that despite the criticism that the codes' voluntary nature limits their ability to improve governance practices, codes of good governance appear to have generally improved the governance of countries that adopt them, although there is need for additional reforms.

According to Wanyama et al. (2009) and Okike (2007), weak corporate governance has been the bane of many organizations in both developed and developing countries, including Nigeria where

corruption is endemic. This has led to a situation where companies continuously flout regulations because enforcement apparatuses are unstructured and ineffectual. Thus, the institution of a regulatory code geared towards corporate governance is not enough, but more importantly, is the drive to implement compliance alongside the corporation laws.

### 3.4 Corporate Governance Frameworks in Africa and Nigeria

According to Rossouw (2005), the introduction and pursuit of effective corporate governance has been bedevilled by many obstacles in Africa, most prominent of which are the lack of effective regulatory and institutional frameworks that can ensure the enforcement of the standards of good corporate governance. Nevertheless, there have been some exceptions among Africa's 53 countries, notably South Africa's (1994 'King I' South African Corporate Governance Report; 2002 'King II' South African Corporate Governance Report; 2009 'King III' South African Corporate Governance Report), Ghana's (Manual on Corporate Governance 2000), Kenya's (Private Sector Corporate Governance Trust 1999), Malawi's (Corporate Governance Task Force,2001), Mauritius' (Report on Corporate Governance 2003), and Uganda's (Manual on Corporate Governance and Codes of Conduct), and of course, Nigeria's (Code of Corporate Governance 2003, and Code of Corporate Governance for Banks 2006).

In Nigeria, prior to the return of the country to a democratic form of government in 1999, corporate governance reforms were usually exercised through military decrees. The most notable of such decrees was the Corporate and Allied Matters Decree in 1990, which was renamed Corporate and Allied Matters Act (CAMA), when the country returned to civilian rule. This law governs and regulates all corporate matters relating to profit and non-profit organisations in Nigeria. It also set up the Corporate Affairs Commission (CAC) which has wider powers and more authority than the now defunct Company Registrar it replaced. It supervises, regulates and resolves all 'corporate' related matters in Nigeria. The CAMA has been criticised, for instance by Adekoya (2011), for lacking sufficient stakeholders' input and parliamentary scrutiny when it was promulgated. Nonetheless, the Act addressed some of the lapses and loopholes that were noted in the 1968 Company's Act. The Securities and Exchange Commission 2003 Corporate Governance Code was introduced to supplement the effectiveness of the CAMA (Amaeshi and Amao, 2008; Wilson, 2006; Amao, 2002).

The Banks and Other Financial Institutions (BOFI) Act of 1992 conferred the exercise of statutory regulatory powers over all banking and non-bank financial institutions on the Central Bank of Nigeria (CBN). The CBN 2006 Code of Corporate Governance for Banks supplements the effectiveness of the BOFI Act of 1992; it arose out of a number of considerations, including the weaknesses that were identified in the 25 mega banks that emerged from the banking industry consolidation exercise 'engineered' by the CBN in 2005.

Page 2 of the Code provides the rationale for the introduction of the new corporate governance as follows:

"In Nigeria, a survey by the Securities and Exchange Commission (SEC) reported in a publication in April 2003, showed that corporate governance was at a rudimentary stage, as only about 40% of quoted companies, including banks had recognized codes of corporate governance in place. Specifically for the financial sector, poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution's distress in the country."

"Yet, the on-going industry consolidation is likely to pose additional corporate governance challenges arising from integration of processes, IT and culture. Research had shown that two-thirds of mergers, world-wide, fail due to inability to integrate personnel and systems as well as due to irreconcilable differences in corporate culture and management, resulting in board and management squabbles. In addition, the emergence of mega-banks in the post consolidation era is bound to task the skills and competencies of boards and managements in improving shareholder values and balance same against other stakeholder interests in a competitive environment. A well-defined code of corporate governance practices should help organizations overcome such difficulties."

Page 10 of the 2006 Code of Corporate Governance describes the key areas of critical importance and enhanced supervision that require strict compliance by the banks. Furthermore, the Code suggests that the agency problems of banks in Nigeria stem from lapses in the structure of board of directors. Consequently, it stipulates that:

"The board should have full and effective oversight functions over the bank, constitute a board that has numbers of non-executive directors exceeding that of executive directors with all directors being knowledgeable in business and financial matters with requisite experience as well as an effective and efficient sub-committees of the board that will include audit, credit, remuneration and risk management."

However, despite the provisions of the CBN 2006 Corporate Governance Code, the Code acknowledges that there are still challenges facing the prudential regulation of the Nigerian banking industry. These include 'technical incompetence of board and management, relationships among directors, inadequate management capacity, insider-related lending, and ineffective board/statutory audit committee', amongst others. Similarly, Adekoya (2011) and Okorie and Oyewole (2011) argue that a

combination of intractable institutional and cultural problems, in general, continue to impede the effective implementation of corporate governance in Nigeria, including a weak regulatory framework, institutionalised corruption, collapse of moral values, falling standard of education and wide spread poverty caused by high unemployment. Even setting these intuitional/cultural challenges aside, Rossouw (2005) argues that corporate governance codes in Nigeria tend to follow the Anglo-Saxon non-inclusive Shareholding Model, and therefore do not explicitly commit the board of directors to be accountable other stakeholders as well, which for the banks would include the wider Nigerian economy. He notes that this contrasts with the Stakeholding Model (Agle et al., 2008) which is the dominant model of corporate governance codes adopted by South Africa (e.g. 1994 King I Report on Corporate Governance and 2002 King II Report on Corporate Governance).

## 4 Research Methodology

As mentioned earlier in Section 2, this study took a two-pronged approach. First we investigated the extent of compliance to 22 provisions of the CBN 2006 Code. We used the entire population of the 24 commercial banks that emerged after the 2005 banking consolidation and bank bailouts of 2009 and 2011. A questionnaire survey is one approach that could have been used to gather data on the compliance levels of the banks to the Code, but this was not adopted on the grounds of low response rate and low level of reliability on the responses (Gillham, 2000). Instead, the data for this analysis came from the 2010 annual reports of the banks exclusively. Secondly we used telephone interview and examined the effectiveness of the Code using Guarantee Trust Bank PLC. The interview is suited as it leaves significant room for interviewees to volunteer information and describe their own experiences to the subject (Jankowicz, 2005).

**Table 1.** Nigerian Banks Corporate Governance Code Compliance

| Provision | Corporate Governance Code Requirements | No. of Compliance Banks | Compliance Level % |
|---|---|---|---|
| 1 | Chief Executive Officer (CEO) 10 year tenure | 22 | 92% |
| 2 | CEO and Chairman separation | 24 | 100% |
| 3 | Non-relation of CEO and Chairman | 24 | 100% |
| 4 | Board committee composition | 24 | 100% |
| 5 | Board directors qualifications and knowledge | 23 | 96% |
| 6 | Non-involvement of Chairman in board committees | 18 | 75% |
| 7 | Biography of directors | 24 | 100% |
| 8 | Percentage of non-executive directors | 24 | 100% |
| 9 | Quota of non-executive members as independent directors | 9 | 38% |
| 10 | Frequency of board meetings | 20 | 83% |
| 11 | Training and education of directors on oversight functions | 14 | 42% |
| 12 | Determination of remuneration of executive directors by non-executive directors | 7 | 29% |
| 13 | Non-executive directors limitation to sitting allowances, directors fees, travel and hotel expenses | 11 | 46% |
| 14 | Statutory returns by banks to CBN shall be certified by CEO and Chief Finance Officer(CFO) | 23 | 96% |
| 15 | Details on activities of board committees | 24 | 100% |
| 16 | Full disclosure of all directors and their companies/entities/persons related to them shall be made in CBN returns | 17 | 71% |
| 17 | Members of audit committee shall be non-executive directors and ordinary shareholders appointed at AGM | 24 | 100% |
| 18 | Appointment of external auditors shall be approved by the CBN | 24 | 100% |
| 19 | External auditors shall render risk management and internal control compliance returns to CBN | 20 | 83% |
| 20 | Tenure of external auditors shall be for a maximum of 10 years | 24 | 100% |
| 21 | 5 year financial reporting summary standard | 24 | 100% |
| 22 | Details of shareholding structure | 21 | 88% |
| Total | | | 76.6% |

## 5 Data Analysis

### 5.1 Findings on Corporate Governance Compliance

Essentially, the CBN 2006 Corporate Governance Code sets out explicit principles under which its guidelines are underpinned, namely: Leadership, Organizational Effectiveness, Remuneration, Industry Transparency and Accountability, and Shareholders Relationship.

Each of the above guidelines is then divided into 22 provisions for which compliance is required by the CBN. Table 1 provides the detailed list of the provisions and the results on the compliance levels with each provision by 24 banks.

Firstly, the result shows that the overall compliance level with 22 provisions of the Code is 76.6%. This compares favourably with the 40% compliance level by Nigerian listed companies, including banks, to the Code of Corporate Governance in Nigeria, according to a 2003 study by the Nigerian Securities and Exchange Commission. The difference suggests that the extent of compliance with corporate governance for Nigerian banks has improved significantly over 7 years between the SEC study and this study. However, it could also be due to survivorship bias in that SEC's study included a number of financially distressed banks which have since ceased to operate in the wake of CBN's sweeping banking reforms of 2005 and 2009, whereas this study does not.

We will now proceed to discuss our results by the five categories of the Code as outlined above in Section 5.1.1. The results for Leadership and Organizational Effectiveness are summarized graphically in Figure 1, but are discussed separately.

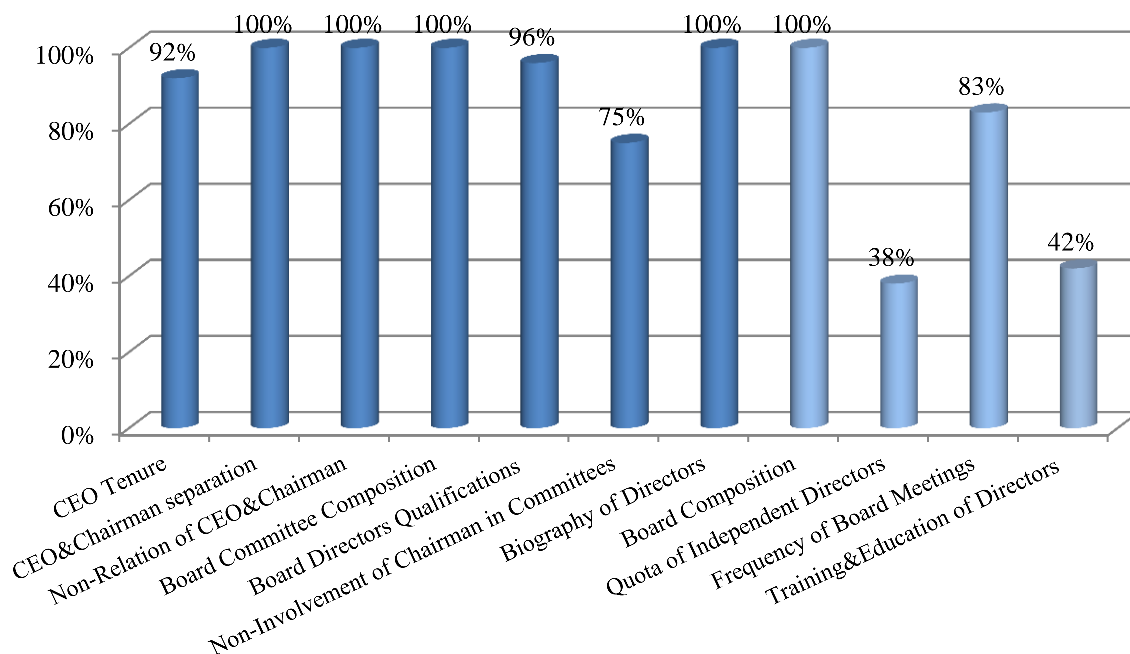
#### *5.1.1 Leadership and Organizational Effectiveness*

*Leadership.* This aspect of the CBN Code (provisions 1–7 in Table 1 above) stipulate that a bank shall be constituted by a knowledgeable and efficient board of directors which is collectively responsible for the long-term success of the company. The board's responsibilities are geared towards providing a financial and strategic focus for the bank. The directors shall act in the general concern of all stakeholders of the bank.

The Leadership provisions aim to reduce the possibility of power being concentrated on one person or connected persons by: (i) separating the positions of Chairman and CEO, (ii) prohibiting members of the same extended family from occupying the positions of Chairman and CEO or an executive director of a bank at the same time, (iii) limiting the tenure of the CEOs to a maximum of 10 years, and (iv) barring the Chairman from serving simultaneously as chairman and a member of any of the board committees.

The compliance levels of some of the Leadership provisions are shown graphically in Figure 1 below, but more comprehensively, as can again be seen from Table 1, all 24 banks (100%) complied with four out of the seven Leadership provisions, 21–23 banks (92–96%) with another two provisions, and only 18 banks (75%) have complied with the requirement that bars the chairman of the board from sitting on board committees. This means that 6 banks have been unable to curb the overbearing influence of their board chairmen on the various committees as stipulated by the CBN Code, which is a concern.

**Figure 1.** Leadership and Organizational Effectiveness Compliance



*Organizational Effectiveness.* This aspect of the CBN Code emphasizes the relevant structure necessary for the board to operate in an effective way to ensure a high efficiency in their functions. The provisions on Organizational Effectiveness also aim to reinforce independence of the boards by stipulating that the number of executive directors (EDs) should not exceed that of non-executive directors (NED) out of a maximum board membership of 20, with at least 2 of the NEDs representing no special interest groups, and hence independent. Furthermore, while the Code insists on adherence to corporate governance principles as a necessary tool for successful performance of boards, it is often not a sufficient condition. Hence, the need for boards to adopt various measures and structures in adhering to these corporate governance principles to ensure the banks' successful performance becomes mandatory.

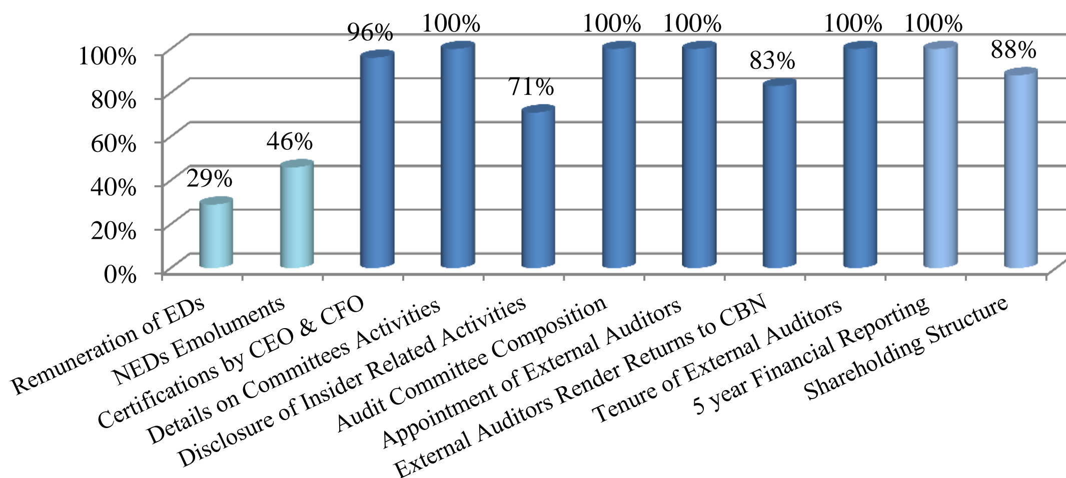
The Code on Organizational Effectiveness is underpinned by the four remaining provisions in Figure 1. 100% of banks have complied with the requirement that the number of EDs should not exceed that of NEDs. The compliance levels regarding frequency of board meetings and training and education of directors are 83% and 42% respectively. It means that 20 out of 24 Nigerian banks complied with the requirement to hold no less than four unvarying board meetings over the course of a financial year, and also gave sufficient advance notification for all board meetings as stipulated by the Code. On the other hand, only 10 banks complied with the provision to budget and train their directors annually on developments regarding their oversight functions, thereby raising questions on how effective the directors have been in discharging their responsibilities. Only 9 banks out of the 24 (38%) have complied with the provision on the quota of non-executive members as independent directors, which is quite concerning. It is very important that the board should have a sufficient number of independent NEDs so that no individual or small group of individuals can dominate the board's decision making.

#### *5.1.2 Remuneration, Industry Transparency and Accountability, and Shareholders Relationship*

*Remuneration.* There are two requirements (provisions 12 and 13 in Table 1) to the CBN Code relating to directors' Remuneration. Firstly, the Code emphasizes "a strict independence in the determination of the remuneration packages for EDs by recommending the constitution of a committee of NEDs only that shall determine the remuneration of executive directors, and that the remuneration must not be overly bogus but must be made attractive such that it entices, retains and stimulates the directors in driving the strategic focus of the banks. However, this remuneration shall be aligned with the current strength and profitability of the banks". Secondly, the Code stipulates that the remuneration of NEDs themselves in any financial year shall be limited to a sitting allowance, directors' fees, and reimbursement of travel and hotel expenses.

As can be seen in Table 1, our analysis shows that only 7 banks (29%) complied with the first requirement on directors' remuneration, and 11 (46%) with the second requirement. These results are also shown graphically in Figure 2 below. Respectively, they represent the first and third lowest levels of compliance with the CBN 2006 Corporate Governance Code, and suggest that the problem of excessive executive pay and 'gravy train' for NEDs, which led to this aspect of the Code, might still be prevalent in the Nigerian Banking industry.

**Figure 2.** Remuneration, Industry Transparency and Accountability, and Shareholders Relationship Compliance




*Industry Transparency and Accountability.* The aspect of Industry Transparency and Accountability of the CBN Code covers seven different requirements (see provisions 14–20 in Table 1), and stresses that shareholders and potential investors will build confidence if due process and internal control

mechanisms are built into all the procedures of the bank. Therefore, it recommends that core attributes of sound corporate governance practices such as industry transparency, due process, data integrity and disclosure requirements that are essential to instilling stakeholder confidence must be injected into the corporate structure of the banks.

As can be seen from both Table 1 and Figure 2 above, our results show 100% compliance levels with four out of the seven requirements relating to the CBN Code on Transparency and Accountability**,** namely provisions 15, 17, 18 and 20. These results are quite important; the first implies that all 24 banks provided full disclosure to their stakeholders on the detailed activities of the various board committees, which ought to help build greater confidence on the boards of the banks; the second that all the banks have constituted Audit Committees whose members are drawn from the NEDs and ordinary shareholders appointed at AGM, thereby ensuring unfettered independence of this important committee of the banks' boards from their management teams, while the third and fourth suggest that arms-length relationships exist between all 24 banks operating in Nigeria and their external auditors, and hence on the various reports produced by the auditors on the banks.

Of the remaining three provisions 14, 16 and 19, as can be seen from Table 1 or Figure 2, the compliance levels were 96%, 71% and 83% respectively. Given the importance or significance of each of these requirements, perhaps 100% compliance levels should also be demanded not just expected. For instance, 96% compliance level with provision 14 means that the statutory returns and other financial information submitted by one bank to the CBN were not signed off or certified by the Chief Executive Officer and Chief Finance Officer of the bank as stipulated by the Code. The implication is that the stakeholders of the bank could not be certain whether or not the reports contained any untrue statements of material fact, as of, and for the periods presented in the reports.

Similarly, it is very concerning that only 17 banks (71%) complied with the provision on full disclosure of all directors' activities, their companies, entities or persons related to them. In other words, 7 banks did not comply with this requirement. It is of utmost importance that stakeholders are informed of such insider-related information in the returns made to CBN such that it reveals transparency in the banks' activities. This can undermine confidence in the share prices of the banks.

Lastly, 83% compliance level with provision 19 means that, for 17% of the banks (4 banks), the external auditors did not or could not report on the risk management and internal control practices of the banks, which were mandated to do by the CBN. This is a serious breach of the CBN 2006 Corporate Governance Code that needs to be investigated further but we were unable to do so due to data limitations. It also challenges the 100% compliance levels that were reported with regards to provisions 15 and 17.

*Shareholders' Relationship.* The aspect of Shareholders' Relationship of the Code emphasizes the need for an on-going interaction of the board members and the shareholders with a view of keeping the shareholders abreast of developments and progress as well as understanding the current issues and concerns that the shareholders might have. The key requirements here are: provision 21 which mandates the banks to adopt a 5-year financial reporting summary standard to enable shareholders and other potential investors undertake a trend analysis of the health of the bank, and provision 22 which requires detailed disclosure of the shareholding structures of the banks, with equity holding of 10% or more by any single investor subject to CBN's prior approval.

Table 1 shows that the compliance level with provision 21 was 100%, but only 88% with provision 22. Since the ownership structures of Nigerian banks have become a matter of general public interest in the country since the banking consolidation of 2005, it is curious why 3 banks did not disclose their ownership structures and why the CBN did not force the disclosure.

### *5.1.3 Summary of Findings on Compliance*

Table 1 shows 22 different provisions to the CBN Code which Nigerian banks are expected to comply with and report on. Our analyses show that only 10 (less than half) of these were complied with by all 24 banks operating in the country. In other words, none of the banks was found to have complied with all the requirements of the Code. The worst areas of non-compliance (those with less than 50% compliance), which give reasons for concern, are on the determination of directors remunerations by NEDs (29% compliance rate), the appointment on independent NEDs to the Board (38%), training and education of directors on oversight function (42%), and limiting the attendance allowance of NEDs to actual expenses incurred (46%). Other areas with less than 100% compliance, which also raise concerns, are directors' disclosure on connected companies/persons (71%) and non-inference of the chairman on board committees' activities (75%).

In effect, some of these compliance findings from the 24 Nigerian banks as well as extant empirical studies threw up some key areas of interest and importance that formed the framework for the interview questions put to some high ranking key officers of Guaranty Trust Bank PLC and their responses and analysis are presented in the following section.

### 5.2 Analysis of the Effectiveness of the Code

Our analysis of the compliance levels with CBN 2006 Corporate Governance Code by Nigerian banks presented above has thrown up some key areas of interest and importance which need further investigation. In this section, we present the views of senior officers from Guaranty Trust Bank PLC on the reasons for the low compliance levels with some of the key requirements of the Code, and on the overall effectiveness of the Code.

The choice of Guaranty Trust Bank PLC is based on three important factors. Firstly, it is one of the few new generation banks in Nigeria which survived the 2005 banking consolidation as an independent bank by embarking on a rights issue of over ₦11 billion to satisfy the new CBN minimum capital requirement of ₦25 billion. It was incorporated in 1991 to provide commercial and other banking services.

Secondly, Guaranty Trust Bank PLC has stock market listing outside the country. In 2007, the Bank entered the history books as the first and only Nigerian financial institution so far to undertake a US$350 million regulation S Eurobond issue and a US$750 million Global Depositary Receipts (GDR) Offer on the London Stock Exchange. The bank presently has an asset base of over 1 trillion naira, shareholders' funds of over 190 billion naira and employs over 5,000 people in Nigeria, Gambia, Ghana, Liberia, Sierra Leone and the United Kingdom (Guaranty Trust Bank, 2011).

So the Guaranty Trust Bank PLC is relatively young compared to some other banks, such as First Bank of Nigeria PLC, which has been in existence for more than a century. We interviewed four key officers from Guaranty Trust Bank PLC, using semi-structured interview questions. In order to ensure strict anonymity, the names of the officers interviewed have not been given but their ranks have:

1. Respondent I (Financial Control 'FINCON'& Strategy Group)
2. Respondent II (Systems & Internal 'SYSCON' Control Group)
3. Respondent III (Deputy Managing Director, Subsidiary)
4. Respondent IV (Managing Director, Subsidiary)

All four interviewees were interviewed separately but were asked the same questions. The questions were divided into themes for the purpose of clarity, with the relevant areas of the Corporate Governance Code making up the themes.

Theme I probed the reasons for low compliance in some areas of the Code;

Theme II analysed the weaknesses of the Code and their effects;

Theme III focused on the general effectiveness of the Code;

Theme IV sought the officers' view on the likely improvements to the Code.

*Theme I: Compliance issues with the Code*

Question 1: The compliance level of banks in Nigeria has been very low on the aspect of training and education for board directors; what are the possible reasons for the non-compliance?

The responses to this question identified four main possible reasons, namely, "*the cost implications ....for the erring banks*" (respondent 1), "*we know it all attitude, and no monetary incentive attached to the training*" (respondent 3), and "*lack of time by board members to attend the trainings even when they are organised*" (respondents 2 and 4).

Question 2: The appointment of independent directors into the board is one that has revealed very low compliance by Nigerian Banks; what would you attribute this low compliance to?

The interviewees independently suggest that there is a fundamental flaw in the business ethics of the Nigerian businesses, including banks, which make them flout the laws of the land that they are not happy with. Hence, the unanimous reason given for low compliance on this aspect of the Code is that the unwillingness of board directors of banks to appoint persons to the board who do not have direct or indirect pecuniary interests in the businesses. Yet this is actually the essence of this particular requirement.

Question 3: Has the guideline on splitting the roles of CEO and Chairman been a bane or boost to the smooth operations of the banks' business?

The general consensus from the respondents is that splitting of roles of the CEO and Chairman has been a great boost to the banking industry in Nigeria. To quote respondent 3, "*without a shadow of a doubt, the duality of roles between the CEO and Chairman has been very beneficial compared to the perceived erroneous bane expressed by some sections owing to the bureaucratic and conflicting tendencies this split may bring about*".

Question 4: It has been asserted that most of the banks in Nigeria disclose full compliance in their reports, but that this is not really the case in practice. What's your opinion about it?

The interviewees are of the opinion that cases of false accounting do exist in the Nigerian banking industry as in other countries. Respondent 1 also expressed fears about the integrity of the external auditors in their responsibilities, observing that "*over the years, CBN examinations have revealed as much that false reporting does exist, which again raises questions about the external auditors' integrity*". However, all four respondents believe that the trend is getting better as CBN continues to intensify the implementation of the code.

*Theme II: The weaknesses of the Code and their effects*

Question 5: Do you think the CBN 2006 Corporate Governance Code is strong enough to supervise and monitor the banks' activities?

The respondents expressed support to the general strength of the Code but also noted weakness in the CBN's approach to its supervision and monitory. For instance, while respondent 3's answer to this question is *"Yes",* he however, observed that "*the frequency of supervision and examination must be quicker and more aggressive as the CBN cannot afford to wait a long time for examination as has been the case".* Similarly, Respondent 4's answer to the question was *"Yes with code, but No with the frequency of the implementation of the Code and the examination and monitoring of the banks".*

Question 6: Do you feel the CBN Code has done enough to protect the interests of all stakeholders especially the minority shareholders in its current framework?

Three interviewees were of the view that the Code has done enough to protect all stakeholders on the wider scale, but not conscious and explicit enough for the minority shareholders. This is articulated in the response of the Respondent 1, which is quoted below:

*"Yes it does for stakeholders, but I think the current CBN code does not specifically protect the interest of the minority shareholders. However, the insistence on independent directors and the full disclosure of the banks activities as required by the Code ultimately protects all stakeholders including the minority shareholders."*

However, just one interviewee disagreed that the Code protects the stakeholders adequately.

*Theme III: The general effectiveness of the CBN 2006 Corporate Governance Code*

Question 7: What is your general assessment of the CBN 2006 Corporate Governance Code as a guideline for the operation the Nigeria Banking system?

All four respondents agreed that the Code has been very effective in bringing sanity to the banking industry in Nigeria. However, while noting that the Code has been effective, respondent 2 also added that the "*CBN needs to emphasize on more stringent punishment against erring banks"*, while respondent 3 also observed that "*there are still cases of unethical procedures which should come with a severe punishment"*. None agreed to elaborate on the non-compliances that should merit such severe punishments or what the stiffer punishment should be.

*Theme IV: The improvements to the Corporate Governance Code in Nigeria*

Question 8: Lastly, what, if anything, could be done to improve the Corporate Governance Code on banks activities?

The unanimous view of the respondents is that having a Corporate Governance Code is not enough. Their two principal recommendations for improving the Code centre on the need for stiffer penalties for non-compliance, and more robust and frequent examination and monitoring of the banks by the CBN, in order to forestall a crisis such as has already been experienced severely. Respondent 4 also suggests giving the Code the 'Force of Law' as in the USA.

*Summary of Findings on Effectiveness of the Code*

Essentially, the responses of the interviewees to the three questions under Theme I show that while the duality requirement has generally been a force for good in the Nigerian banking industry, contrary to the initial scepticism in the industry, on the other hand, there remains a culture of low ethical standard and poor professional attitude to business which have resulted in some banks flagrantly flouting some requirements of the CBN 2006 Corporate Governance Code. This finding is consistent with Wanyama et al. (2009) and Okike (2007), who reported that pervasive corruption and weaknesses in the underlying frameworks in developing countries have hampered attempts to improve corporate governance practices. It also indicates that the mere introduction of detailed governance codes does not necessarily mean that de facto practices will improve.

Two major weaknesses of the Code were identified by the interviewees, namely, lack of regular policing of the Code by the CBN, and absence of proportionate punishment for non-compliance as the USA Sarbanes-Oxley Act, both of which tend to encourage non-compliance. As the respondents recommended, the CBN must be prepared to sanction erring banks more severely to compel compliance. The interviewees therefore recommended "*the frequent, quicker and more aggressive policing of the Code by the CBN to ensure sustained transparency and accountability in the industry*, and the introduction of *stiffer penalties for erring banks*". It is quite revealing that similar recommendations were made by Okike (2007), who among other things, suggested the removal of the "*current institutional weakness in regulation, compliance and enforcement of standards and rules by revising the antiquated penalties stipulated in the CAMA 1990, making them more realistic; strengthening the enforcement mechanism by enhancing the capacity of the relevant regulatory and professional bodies as well as establishing an independent regulator for corporate reporting and governance in Nigeria*". It seems that, few years later, the same issues remain.

On the theme of the overall effectiveness of the Code, overwhelming responses of the interviewees believe that the CBN 2006 Corporate Governance Code in the Nigerian banking industry has brought about improved accountability and transparency in the operations of the banks. However, there was also concern that the Code lacked explicit protection for minority shareholders and other stakeholders. This appears to be the consequence of the Anglo-American Shareholding Model of corporate governance adopted by the Code. Nonetheless, one respondent observed, "*the insistence on independent directors and the full disclosure of the banks activities required by the Code*

*ultimately protects all stakeholders including minority shareholders."*

## 6 Conclusion

The paper investigated the compliance levels and the effectiveness of CBN 2006 Corporate Governance Code for the Nigerian banking industry. The results found that compliance levels of the 22 provisions of the Code ranged from 29% to 100%, with an overall compliance level of 76.6%. This compares with 40% compliance rate obtained in a 2003 survey by SEC for all listed companies in Nigeria, which included banks. The major non-compliance issues (in which less than 50% of the banks reported compliance) relate to the determination of directors remunerations by NEDs (29% compliance rate), the appointment of independent NEDs to the Board (38%), training and education of directors on oversight function (42%), and limiting the attendance allowance of NEDs to actual expenses incurred (46%). In addition, fear has been expressed by the respondents about the integrity of some external auditors. However, the respondents believe that the trend is getting better as CBN continues to intensify the implementation of the Code.

Notwithstanding the above, this paper concludes that there seem to have been great improvements on the corporate governance practices of Nigerian banks since the implementation of the CBN 2006 Corporate Governance Code. However, there is still much room for improvement especially in the areas of the enforcement of the Code by the CBN as well as in taking appropriate sanctions against defaulting banks and their external auditors, without which compliance may deteriorate and hence undermine confidence which is gradually returning to the Nigerian banking industry after the various bailouts in 2009 and 2011.

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