International Journal of Economics, Commerce and Management
United Kingdom ISSN 2348 0386 Vol. VIII, Issue 10, Oct 2020

http://ijecm.co.uk/

IMPORTANCE OF NIGERIAN FINANCIAL INSTITUTIONS COMPLIANCE WITH THE CORPORATE GOVERNANCE

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Abstract

Financial institution as a catalyst in the process of economic development mobilized savings from the surplus units and channels them to the deficit units of the economy for productive investment. The failure of banks and other corporate bodies precipitates negative multiplier effect on stakeholders (shareholders, staff, creditors, suppliers etc.) and hampers national economic growth and development. The main purpose of this study was to evaluate the importance of financial institutions compliance with corporate governance. Specifically, this study aims at evaluating the need for good corporate governance in Nigeria banks, examine the regulatory framework for corporate governance in Nigeria banks, examined the relationship between financial institutions and economic development, evaluate the relationship between corporate financial leaders and banking business and valuate banks compliance with regulations. The main source of data for this study was secondary data that comprised comprehensive literature review. The conclusion/findings revealed that, the banking sector in

Nigeria is adequately regulated, given the crucial role of banks in national economic development. However supervisory and control institutions lack effective monitoring and enforcement capabilities, resulting in weak corporate governance in Nigerian banks. It was recommended among others that, Government regulatory authorities should check the side effect of policies formulated before implementation. Policies such as frequent increase in banks capital base and the abolition of universal banking system should be considered properly before implementation as this policies can hinder the discharge of bank duties to the economy.

Keywords: Financial institutions, corporate governance, regulatory bodies and economic development

INTRODUCTION

The economy of Nigeria moves round the hub of an active financial system. This system comprised financial markets, financial instruments, financial institutions and improved rules and regulations (corporate governance) that facilitate and regulate the flow of funds from surplus units to the deficit units. As a catalyst in the process of economic development, the Nigerian financial institution mobilized savings from the surplus units and channels them to the deficit units of the economy for productive investment. By surplus units we mean those economic units whose income exceeds their expenditures within a specified period of time; thus facilitating lending within this period. Deficit on the other hand refers to those economic units whose financial need or expenditure exceeds their income within any given period; hence they need loans from these surplus units. In addition, it provides medium of exchange, which promotes exchange, and exchange is at the centre of any economic development. These roles enhance the productive capacity and overall output and employment through its transformation of the savings of individuals and businesses into investment by others (Ekeziel 1997). The financial institution as a corporate entity that deals in financial claims is regulated by the government through various regulatory bodies such as the CBN, NDIC and the SEC who supervise their activities. The federal government and governmental units e.g Money Banks (CBN) and Nigeria deposit insurance corporation (NDIC) are able to carry out a wide range of activities on the domestic and international scene only if an efficient means exist for raising funds for making payments and for borrowing (Njoku, 2005)

Ekezie (1997) opined that financial system is a set of rules and regulations and the aggregation of financial arrangements, institutions and agents that interact with each with each other and the rest of the world to foster economic growth and development of a nation. From this management-related definition, the financial system can be defined as the composition of

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various financial institutions as well as their regulatory authorities that are interrelated and interdependent in the performance of those functions that enhance economic growth and development. The above definitions underscore the importance of financial system in any nation's economy. It plays a vital role in the process of economic development as well as providing services that are essential in a modern economy (Enwereuzor, 1997).

There are basically two groups of financial institutions in Nigeria namely, the banks and non-banks financial institutions. To enable a thorough examination of the problem under study a focus will be based on the banking institutions mostly and their level of compliance with regulatory bodies or corporate governance. Corporate governance, a relatively new area of studies, has increasingly attracted the interest of academicians, researchers, government and business moguls both in the developed and developing economies. It is generally accepted that a good number of corporate failures are caused largely by issues related to poor corporate governance (Central Bank of Nigeria, 2003).

Problem of the study

In Nigeria, thirty-three banks failed between 1995 and 2000, and recently the Central Bank of Nigeria declared nine banks failed for reasons ranging from inadequate capitalization to poor corporate governance (Central Bank of Nigeria, 2006). The failure of banks and other corporate bodies precipitates negative multiplier effect on stakeholders (shareholders, staff, creditors, suppliers etc.) and hampers national economic growth and development. This makes banking business in Nigeria quite risky and a lot of fear is being exercised in establishing bank branches in both the rural and urban areas of the country, so as to exercise their ultimate purpose of existence; which is their ability to lend confidently and sufficiently and to undertake risky but economically beneficial development oriented investments which rather depends crucially on profits being earned by depositor. Justifiably about 65-70% of banks total revenue is derived from investment being loans granted by banks to their customers. It has to be noted that those profitable business of the banks are associated with enormous risks which may either be as a result of exogenous or endogenous factors which include: Lack of adequate capital in banks, increasing rate of bad debts, inherent and sprawling fraud rate in the economy, meeting the security requirements by financial institutions (banks) and fluctuation of interest rates due to unstable level of inflation. This explains why governments of various nations strive to put in place necessary legal and regulatory framework for good corporate governance, in order to forestall or reduce the incidence of corporate failure. It is against this background, the current study seek to evaluate the importance of Nigerian financial institutions compliance with the corporate governance.

Purpose of the study

The main thrust of this study is to evaluate the importance of Nigerian Financial institutions compliance with the corporate governance. Specifically, this study seeks to:

i. Evaluate the need for good corporate governance in Nigeria banks
ii. Examine the regulatory framework for corporate governance in Nigeria banks
iii. Examine the relationship between financial institutions and economic development
iv. Evaluate the relationship between corporate financial leaders and banking business
v. Evaluate banks compliance with regulations

LITERATURE REVIEW

The need for good corporate governance in Nigeria Banks

Banks, the world over, play critical role as catalyst of national economic growth and development. Services provided by banks, which, among others, include financial intermediation, payment and fund transfer services, financial and investment advisory services, are very crucial both at the micro and macro-economic levels. Adequate funding of small, medium and large scale industrial establishments is a sine-qua-non for full capacity utilization and consequent contribution to the national gross domestic product. Banks not only provide the required financial services to the private sector of the economy, they also constitute important source of government funding for economic development projects. Above all, banks serve as important medium through which government economic policies are implemented. It is in realization of the critical role of banks in the healthy growth and development of the economy that various Nigerian governments have shown keen interest in the banking sector by establishing regulatory framework and institutions to monitor and control banking operations. Over the years, the Nigerian banking sector has witnessed varying degrees of banking crises, beginning with the colossal collapse of indigenous banks during the unregulated banking era in the first half of the 20th century (Uzoaga, 1985; Orji, 2000). Between 1995 and year 2000, the banking sector recorded thirty-three cases of bank failures (Central Bank of Nigeria, 2001). The failure of nine banks in the recent past was attributed partly to inadequate capitalization and partly to problems related to corporate governance. Bank distress leads to loss of confidence of the banking public, which precipitates bank run and its negative effects on the economy. In a bid to address the problem of bank failure in Nigeria, the Central Bank of Nigeria in July 2004 introduced a major banking reform, which saw upward review of bank capital base from 2 billion naira to 25 billion naira with effect from 1st of January, 2006 (Central Bank of Nigeria, 2006). The consolidation exercise, which involved mergers and acquisitions, produced twenty five mega banks out of eighty nine banks operating before the consolidation (Ogowewo and Uche,

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2006). Although the bank consolidation exercise in Nigeria addressed the problem of weak capital base, it has raised additional corporate governance challenges, arising from integration of processes, information technology and cultures. Above all, the emergence of mega banks following the consolidation exercise has tasked the skills and competencies of boards and managements in improving shareholders' wealth in a competitive environment (Wilson, 2006). It is therefore important that problems associated with corporate governance in Nigerian banks must be addressed, in order to actualize the envisaged gains of consolidation (Chizea, 2006).

The regulatory framework for corporate governance in Nigeria banks

Banking in Nigeria is highly regulated. In recognition of the crucial role of banks, government provides legal framework to ensure healthy growth and development of the banking sector. The first attempt at bank regulation in Nigeria was the passage of the Banking Ordinance in 1952 by the British Colonial Administration, on the recommendation of Mr G. D. Paton, an official of the Bank of England, appointed to investigate the high rate of bank failure in Nigeria (Uzoaga, 1985; Orji, 1987). Three key institutions are currently established through legislation to address problems associated with corporate governance, to ensure that expected standards are attained and obligations to all stakeholders and the society at large are met. The institutions are the Corporate Affairs Commission, The Securities and Exchange Commission and the Central Bank of Nigeria.

The Corporate Affairs Commission

Section I of the Companies and Allied Matters Act 1990 established the Corporate Affairs Commission (CAC) to replace the Company Registry, which existed under the repealed Companies Act, 1968. By the Companies Act, 1968, all banks operating in Nigeria must be locally incorporated and subject to unrestricted control by Nigerian monetary authorities. The Companies and Other Matters Act, 1990 covers provisions on corporate governance in banks and other corporate bodies in Nigeria and charges the Corporate Affairs Commission with the responsibility of enforcing the provisions and monitoring operations of the corporate bodies. Thus the Commission has the responsibility for incorporation, registration, management and wining up of companies in Nigeria. The CAC maintains register of companies in Nigeria and carries out investigations into the affairs of companies to ensure transparency and the protection of the interest of stakeholders and the general public. The Companies and Allied Matters Act, 1990, requires that annual returns of companies be submitted to CAC for the purpose of monitoring and surveillance. The Companies and Other Matters Act, 1990 obviously made adequate provisions to ensure transparency, equity, accountability and balance of powers between directors and members of the company. Wilson (2006) asserts that the ability of Corporate Affairs Commission to effectively monitor and enforce the provisions of the enabling law is seriously in doubt. The power to investigate corporate dealings that are inimical to corporate survival is hardly invoked and cases of default in submission of annual returns by corporate bodies abound.

Securities and Exchange Commission

The Securities and Exchange Commission (SEC) is the apex regulatory organ of the Nigerian capital market, established by Securities and Exchange Commission Act No. 71 of 1979, and further strengthened by SEC Decree of 1989. The Investment and Securities Act No. 45 of 1999, which repealed SEC Decree of 1989, conferred on the Securities and Exchange Commission, as apex regulatory and supervisory body, extensive powers over institutions operating in the capital market. Nwankwo (1982) asserts that the need to regulate the capital market arises from information asymmetry and other imperfections that lead to sub-optimal functioning of the capital market. The Securities and Exchange Commission, under the enabling law, has responsibility for the regulation and surveillance over capital market dealers and operations in order to maintain good standards and professionalism. Its other functions include registration and supervision of all securities and security exchanges, issuing houses, stockbrokers and other market operators. It regulates company mergers and acquisition and other forms of combinations and promotes orderly growth and development of the capital market through purposeful restructuring. In exercise of its regulatory powers, the Securities and Exchange Commission in 2003 published a Code of Best Practices on Corporate Governance, as recommended by the Peterside Committee, and reviewed same in 2008 (Securities and Exchange Commission, 2008). The Code aims at ensuring that managers and investors of companies, including banks, show high level of accountability and transparency in the interest of stakeholders and the society at large. Major areas covered in the code include the board of directors, audit committee and the role of shareholders. The board of directors, with a recommended board size of between 5 and 15, has oversight functions over the affairs of the corporate body, through proper selection, appointment, performance appraisal and compensation of management staff. The board has responsibility for strategic planning, effective and efficient risk management framework, ensuring the integrity of accounting procedure and financial reports. It equally ensures the maintenance of high ethical standards and compliance with enabling laws of the land. The Code provides specifically for audit committee, charged with the responsibility of ensuring that accounting and reporting policies of the company satisfy the legal and ethical requirements. The audit committee has other functions specified in the Code,

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including review of the scope and planning of audit requirements, recommendation to the board on appointment, remuneration and removal of external auditors and review of reports of internal and external auditors with recommendation made to the board. The SEC Code of Corporate Governance seeks to enhance shareholder participation at general meetings, making recommendation for suitable venue, notice of meeting and provision of financial statements and other relevant information to ensure effective shareholder participation in the corporate governance. The regulatory framework, as provided by the enabling law, however has continued to manifest significant weakness, resulting in inability of the Commission to effectively monitor public companies that are listed in the Nigerian Stock Exchange. The powers of the Securities and Exchange Commission not only to regulate through its registration requirements, but also to discipline public companies through suspension and revocation of company registration is hardly invoked. Under Section 224 of the Investment and Securities Act, 1999, the Investment and Securities Tribunal (IST) was established and under Section 259 of the Act, the Administrative Proceeding Committee (APC) of SEC was established. The setting up of IST and APC is aimed at speedy resolution of disputes involving quoted banks and other corporate bodies. However decisions of IST and APC are subject to appeal in the High Court and the effectiveness of the two organs of SEC is consequently constrained by the slow process of appeal in the High Court. Above all, the regulatory powers conferred on the Securities and Exchange Commission by the extant law and penalties that may be imposed on quoted companies are not applicable to private companies. This is a serious constraining factor when overall impact of regulation on corporate performance is considered.

The Central Bank of Nigeria

The Central Bank of Nigeria (CBN) was established by the Central Bank Ordinance of 1958 as the apex regulatory body in the financial sector. The CBN also carries out this responsibility in line with the provisions of the Companies Act (1968), the Banks and Other Financial Institutions Act of 1991 and the Central Bank of Nigeria Act (1991) as variously amended. By the Companies Act (1968), all banks operating in Nigeria must be locally incorporated and, as Nigerian companies, are subject to unrestricted control by Nigerian monetary authorities. The CBN Act of 1991, as amended, specifies conditions governing the establishment and operation of banking business in Nigeria and the controlling powers of the Central bank of Nigeria. Both the Banks and Other Financial Institutions Act (1991) and the Central Bank of Nigeria Act (1991) aim at ensuring high standard of banking practice and financial stability through efficient and effective surveillance of the CBN. The CBN has, as its core functions, the provision of banking and financial advisory services to government and, as banker of last resort, offers banking services to other banks. Above all, the Central Bank of Nigeria performs its supervisory and control functions by regulating the entry and expansion of banks through issue and withdrawal of licences. It has the responsibility for implementation of monetary policies of government, using specific instruments to influence monetary variables in the economy. The appointment of chairmen and members of board of directors, as well as management staff of banks in Nigeria must be confirmed by the Central Bank of Nigeria. This is to ensure that guidelines are complied with and standards maintained. In August 2003, the Bankers Committee of the CBN released a Code of Corporate Governance for Banks and Other Financial Institutions in Nigeria. The Code was published in realization of the need to amplify the code put together by the Securities and Exchange Commission, which was applicable to all corporate bodies, in order to address the peculiarities of the financial sector. As outlined in the introductory part of the Code, the objective of corporate governance is to improve long-term shareholder value by enhancing corporate performance, while taking into account the interest of other stakeholders. It aims at building credibility, ensuring transparency and accountability, as well as maintaining effective channel of information disclosure that foster good corporate performance. In April 2006, the Central Bank of Nigeria published the Code of Conduct for Directors of Licensed Banks and Financial Institutions. The provisions of CBN Code of Corporate Governance are similar to those published by Securities and Exchange Commission. Much emphasis is placed in the CBN Code on board of directors as ultimate organ of good corporate governance. The Code contains explicit recommendations on the best practice, including constituting effective board of directors, major responsibilities of the board, remuneration of directors, board performance assessment and audit committee. The Code also articulates factors that are relevant to depositors' and investors' confidence, given the importance of these stakeholders to the growth and stability of the financial sector. Although the CBN Code of Corporate Governance (2006) was published to address post banking consolidation challenges in corporate governance, not much appears to have been achieved. The ability of Central Bank of Nigeria to monitor and verify the integrity of returns and financial statements submitted by banks is highly questionable. The CBN appears to be overburdened with its functions as apex regulatory financial institution. There is much reliance on periodic returns, as CBN is unable to carry out regular inspection visits to the banks, as specified by the enabling laws. Such on-site inspection visits are important for verification of integrity and accuracy of returns submitted by banks.

Financial Institutions and Economic Development

In the developed economies, financial institutions mobilize savings in form of deposits, premium, weekly or monthly contributions from their customers. Banks mobilize savings from their

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customers by way of opening various accounts such as savings, current and fixed deposits. Various rules guide the operation of these accounts. The insurance companies collect premiums from their customers in exchange for undertaking to bear their risks, while the credit and thrift cooperative societies collect contributions from their members in like manner; workers contribute part of their salaries to pension funds in order to be paid a bulk sum on retirement. These institutions provide the public with opportunity to save, thereby helping them to accumulate wealth.

These funds mobilized by the financial institutions as explained above are used to extend loans to deserving customer. These institutions have good methods of arriving at a decision as to who is credit worthy and deserving of their loans. The bank provide credit to the economy to finance consumption and investment spending, the bank through its intermediary function gather funds from millions of small savers to form a pool of investable funds which they lend to firms and other individuals with viable projects or investment ideas to finance production and consumer's spending. By borrowing on short term and lending on long term to customers, meaningful productive investment take place and viable economic growth is enabled. This system of borrowing short and lending long is met by applying several business tactics such as diversification of depositors fund in such a manner that will encourage a fair liquidity in the banks. Also they may put arrangements in place with other banks that they could easily draw on in case of unexpected large withdrawal.

Banks Compliance with Regulations

In analyzing the role of conformity in the banking system, Ugunleye (2005) verified the system's efficiency regarding protecting and stabilizing the financial institutions. Compliance with the banking system is essential as it ensures the protection of customers' funds and privacy (Ugunleye, 2005). The effect of banking regulations, monitoring, and examination on the efficiency levels of banks globally emanated from controls and oversight of business operation as well as higher supervision, through compliance officers improve effectiveness in the banking system. Banking regulations refer to the central apparatus that contains determinants employed during the creation, monitoring, sanctioning, and possible foreclosure of banks in an economy (Alam, 2013). A country's Central Bank, Ministry of Finance, and other relevant financial regulatory agencies promulgate banking regulations (Birindelli & Ferretti, 2013). Compliance levels by banks with the anti-money laundry Act (AML) determine money laundering reduction levels, especially when banks comply with the internal control systems the banks' top leaders set.

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CONCLUSION

From the findings of this study, there was a concrete conclusion that corporate governance/regulatory bodies has been a major contribution of financial institution and this has led to a significant increase in investment and production which has further affected the total output of the country significantly despite some lags or loopholes. The failure of banks and other corporate bodies in the global economy including Nigeria has led to increasing interest in corporate governance and regulations of financial institutions. The banking sector in Nigeria is adequately regulated, given the crucial role of banks in national economic development. However supervisory and control institutions lack effective monitoring and enforcement capabilities, resulting in weak corporate governance in Nigerian banks. Considering the significant contribution of this study to future researchers, more research work should be conducted in this area to appraise the efficacy of the present finding and other financial regulatory bodies should be reviewed.

RECOMMENDATIONS

For improved corporate governance in Nigerian banks, the following recommendations need to be implemented.

i. The Central bank of Nigeria should be restructured to strengthen its supervisory machinery, with greater emphasis on on-site bank supervision and less reliance on periodic returns. More strict sanctions should be imposed on board members and bank management who engage in acts unfriendly to the interest of corporate stakeholders.

ii. Confirmatory clause should be provided in bank annual returns certifying that provisions of the Code of Corporate governance were not breached. The audit committee should have increased number of shareholders representatives. Members should be professionally qualified in accounting and/or financial management and should have the competence to discharge their functions independently.

iii. Extension of branches of financial institutions to the rural areas and other parts of the country as this will increase stimulation of savings and development of the rural areas.

iv. The monitoring and enforcement capabilities of Corporate Affairs Commission (CAC) and Securities and Exchange Commission (SEC) should be strengthened to ensure adequate sanctions for breach of corporate governance provisions in the enabling laws.

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v. The investigative powers of CAC should be strengthened by amendment of relevant sections of Companies and Allied Matters Act, 1990, while SEC should readily apply it deregistration powers on erring banks and other listed corporate bodies. Finally shareholder activism should be encouraged through legislative empowerment of shareholders associations, while special court of appeal should be established to speedily handle commercial cases from Investment and Securities Tribunal and Administrative Proceeding Committee of SEC.

vi. Government regulatory authorities should check the side effect of policies formulated before implementation. Policies such as frequent increase in banks capital base and the abrogation of universal banking system should be considered properly before implementation as this policies can hinder the discharge of bank duties to the economy.

vii. Borrowers should be monitored consistently to ensure compliance and adherence to their proposal and feasibility study in order to reduce the risk of non- payment to the barest minimum.

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