Corporate Governance and Stakeholders Interest: A Case of Nigerian Banks

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Abstract

The paper investigates the theory of corporate governance and stakeholders interest. It discusses corporate governance theory that has emerged. The study was strengthened by the principles and pillars of corporate governance stresses by OECD. The methodology was based on stakeholders model and value added approach was used. Annual return of ten selected banks for period of ten years were utilized. Finding revealed that corporate governance has not been effective in most Nigerian banks. Shareholders had not been fairly treated. The corporate insiders had capture the corporate outsiders, shareholders as the principal stakeholders had been sidelined as evidence by huge amount retained devoted for the future. The paper recommended pragimatic approach and political will to implement principles of corporate governance to ensure fair treatment of stakeholders.

Keywords: Corporate governance and Stakeholders interest

1. Introduction

It is incontrovertible that, corporation has become a powerful and dominant institution which has extended to every corner of the globe in various sizes, capabilities and influences. Their Governance has tremendously influenced on the economies as well as various aspect of social landscape. However, shareholders are seen to be losing trust and market value has been affected. More so, with the emergence of globalization, there is greater de-territorialization and less of government control which results is a greater need for transparency and accountability (Abdullah and Valentine 2009) cited (Crane and Matten 2007). Hence, corporate governance has become one of the critical issues in the business world today.

A number of definitions exist for the subject, put simply corporate governance is the system of internal controls and procedures by which individual companies are managed. It provides a framework that specifies the rights, roles and responsibilities of different groups, management, the board and shareholders within an organization (Imala, 2007). The organization of economic cooperation and development (OECD 1999 and 2004) thus defined, corporate governance as a set of relationships between a business's management and its board of directors, its shareholders and lenders, and other stakeholders such as employees, customers, suppliers, and the community of which it is a part. The subject thus concerns the framework through which business objectives are set and the means of attaining them and otherwise monitoring performance are determined. In essence, corporate governance should promote transparency, consistent with the rule of law and articulate the division of responsibilities among regulating and enforcement authorities.

Since the publication of OECD document, issues related to corporate governance attract considerable national and international attention. The Basel Committee on banking supervision made up of supervisory authority which was established by the Central Bank governors of the group of ten countries in 1975, usually meet at the Bank for International Settlement (BIS) endorsed the concept of corporate governance to safe guard depositors funds. To this effect, the Basel Committee on banking supervision published evidence in 1999 to assist banking supervisors in promoting the adoption of sound corporate governance practices. In February 2006, the Basel Committee on banking supervision issue a revised version of the 1999 paper titled enhancing corporate governance for banking organizations which details some considerations for corporate governance related activities of the banking organization that are conducted through structure that lack transparency or injurisdiction that pose impediments to information flows.

In essence, from the above discussion, corporate governance could be conceptualized as the manner in which power is exercised in the management of economic and social resources for sustainable human development. It is predicted on the leadership activities framework. (Oladimeji 2007) cited (McRitchie, 2001) viewed corporate governance as principle that focus on transparency, accountability, boards disclosure, investors involvement and related issues. He added that firms with stronger shareholder rights would have higher firm value, higher profits, higher sale growth, lower capital expenditure and few corporate acquisition. Effectively, corporate governance reduces control right. Shareholders and creditors confer on management who invest on project with positive net present value (shleifer and vishny, 1997).

This topic would not have elicited much attention , but the financial scandals around the world and the crash of major corporate institutions in USA, south Africa, Asia, Europe and Nigeria such as Johnson Matheys Bank (JMB), Bank of Credit and Commerce International (BCC), Adelphia, Enron, World com, and Commerce Bank have shaken investors confidence in the capital market and the efficacy of existing corporate governance practices in promoting transparency and accountability which has generated much reaction to the problems of corporate governance in business and every intellectual gathering (Kajola 2008). The purpose of this research is to examine corporate governance and the stakeholders interest with special reference to the banking sector.

1.1 Principles and Pillars of Corporate Governance

The Organization of Economic Cooperation and Development (OECD) put forward a set of international principles of corporate governance. These principles were developed both in response to growing recognition of the importance of governance to enterprise performance. The OECD principles are organized into five headlines namely: the rights of the shareholders which deal with the protection of the shareholders rights and the ability of the shareholder to influence the behavior of corporation; The right to secure method of ownership registration; convey or transfer shares; obtain relevant information on the corporation on timely and regular basis; participate and vote in general shareholder meetings; elect members of the board; and share in the profits of the corporation.

Equitable treatment of shareholders emphasized that all shareholders including foreign shareholders should be treated fairly by controlling shareholders. In essence, this principles call for transparency with respect to the distribution of voting rights and the ways in which the voting rights are exercised. The high point of the principle include: shareholders of the same class should be treated equally; insider trading and abusive self-trading are prohibited; board members and management are required to disclose any material interest in any transaction affecting the corporation.

The principle also recognized the rights of the stakeholders as established by law which encourage active cooperation between the corporation and the stakeholders in creating wealth and sustainability of such enterprise. There rights includes: opportunity to redress any violation of their right; provide stakeholders with relevant information to enable them participate actively and permit performance enhancing mechanism for stakeholder participation. Other principles of OECD include disclosure and transparency of information. It stipulated that all the material matter regarding the governance and performance of the corporation should be disclosed. It also underscore the importance of applying high quality standards of accounting disclosure and auditing: disclosure should include the financial and operating results; company objectives; major share ownership and voting rights; members of the board and key executives and their remuneration; governance structure and policies information should be prepared, audited and disclosed in accordance with quality standards, while the channels for disseminating information should be fair timely and cost-effective.

The principle also recognize the responsibilities of the board, thus the board has a definite function to perform to ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the corporation and shareholders. In doing this, board member should direct and control the affairs of the company; ensure the independence of the board; act on a fully informed basis and in good-faith with due diligence and care, and in the best interest of all stakeholders; treat all shareholders fairly, particularly in decision that affect different shareholders groups; and ensure compliance with applicable laws between management, shareholders and stakeholders.

1.2 Rational For Bank Corporate Governance

Given the important nature of financial intermediaries particularly the banking sector in the economy and the high degree of sensitivity to potential difficulties arising from ineffective corporate governance couple with the need to safeguard depositors funds. Corporate governance become a critical issue for sound financial system. Effective corporate governance practices are essential to achieve and maintain public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and economy as a whole particularly, at a time when banks are now global in term of size of shareholders funds, foreign investment inflow and lending activities. Poor corporate governance may contribute to bank failures and lose of confidence in the ability of a bank to properly manage its assets and liabilities, including deposits, which could in turn trigger a bank run or liquidity crisis.

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how they: Set corporate objectives; Operate the bank's business on a day-to-day basis; Meet the obligation of accountability to their shareholders and take into account the interests of other stakeholders; Align corporate activities and behaviour with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and Protect the interests of depositors. In view of the important attached to the institution of effective corporate governance. The Federal Government of Nigeria through her various agencies have come up with various institutional arrangement to protect the investor of their hard earned investment from unscrupulous management/director of listed firms in Nigeria. These institutional arrangement, provide in the "code of corporate governance best practices" issued in November 2003, and assigned roles for the board and the management, specified Shareholders right and privileges and ensured that various stakeholders are fairly treated.

1.3 Theory of Corporate Governance

Corporate governance is dovetailed with the body of knowledge and theories as posited by several authors like Alchian and Demstez (1972), Jensen and Meckling (1976), Donaldson and Davis (1991), Agyris (1973), Freeman (1984), Clarkson (1995), Hillman Canella and Paczold (2000), Cyert and March (1963), Williamson (1996), Pound (1963), Hawley and Williams (1996), Crane and Matten (2007). These theories range from the agency theory and expanded into stewardship theory, stakeholder theory, resource dependency theory, transaction cost theory, political theory and ethics related theories.

1.4 Agency Theory

Agency theory is base on the principle of contract which exists between the principal and the agent. The theory was exposited by Alchian and Demaetz and further refined by Jensen and MecKling as postulated by (Abdullah and Valentine 2009). The agency theory is define as the relationship under which one or more person (the principal) and another person the agent to perform some service on their behalf and delegate some decision making authority to the agent. Within the framework of a corporation, agency relationship exists between the share holders (principal) and the company executives and managers (agents). The agent is expected to act in the best interest of the principal, but on the contrary the agent may not make decision on the principal interest (Padilla 2000). This problem was highlighted by (Ross 1973) and further presented by (Jensen and Meckling 1976). In essence, the problem of agency theory arise from the separation of ownership and management and employee and managers in a corporation could be self-interested. The agency theory can be explored to explain the relationship between the ownership and management structure and where there are separation the agency model can be refined to include the goals of the management with that of the owners.

The model in figure (1) shows that principal employed the agent who are expected to act in the principal self interest on the contrary, the agent in performing the principal interest could end up to be self interested.

1.5 Stewardship Theory

Stewardship theory emerged from psychology and sociology field of study. The theory argues against managerial opportunity and emphasizes on trust and achievement on the part of managers as both managers and owners have similar objectives. The Board is expected to take an active part in the strategy formulation process, Senior management and Board members work as a team not merely to ensure compliance but also to enhance organisational performance through collaborative efforts (Donaldson and Davis, 1991). Thus the governance process is seen to promote trust as a means of motivating employees to achieve organisation objectives. From the above discussion, steward comprises the top management particularly the company executive and managers which protects and maximizes shareholders wealth through firm's performance so that steward utility functions are maximized (Davis, Schoorman and Donaldson 1997). Unlike agency theory, stewardship theory stressed not on the perspective of self interest and individualism but rather on the role of top management team being as stewards and integrating their goal as part of the organization (Donaldson and Davis 1991). (Agyris, 1973) posited that agency theory consider individuals as economic being but suppresses its own aspirations while stewardship theory recognizes the importance of structures that empower the stewards and officers to maximum autonomy built on trust. (Davis, Schoorman and Donaldson 1997) further stressed on the need of employee or executive to be independent so that shareholder returns are maximized and monitoring and controlling behaviours cost is minimized. (Daily, Dalton and Cancella, 2003) added that for the top management to protect their reputation, executive and directors are inclined to operate the firm profitably. (Fama, 1980) contended that executives and directors are also managing their careers in order to seen as effective steward of their orgnisation.

The model in figure (2) shows that stewards are empowered by the shareholders to protect and maximize the shareholders wealth through enhancement of the profitability and return of the firm. The shareholders also provide some intrinsic and extrinsic motivation in form of managerial perks to avoid the steward from succumb to self interest opportunity behaviours which could fall short of congruence between the aspirations of the shareholders.

1.6 Stakeholder Theory

The stakeholder theory focus on variety of different group or individual whose interest are directly affected by the activities of a firm. These groups or individuals are referred to as stakeholders in the organization. Some of the stakeholders are the shareholders who provides the risk capital of the firm and their goal is to maximize their wealth; trade creditors supplied goods or services to the firm and have the objective of being paid the full amount for the goods and services supplied. The financial institutions provided both the short term and long term credit facilities and have the objective of receiving payment of the principal as well as interest. Employees, provided their skills in form of labour to the firm and expect a reward inform of salaries and other benefits; the government provides the enable environment for business to operate but expect reward inform of taxation; the customers interest is to get quality products of the firm at avoidable price and must be available at the right time and place; the communities are also interested in the positive contribution of the firm to the environment in which it is located. The important of the stakeholder theory is that managers in a corporation have net work of relationship which is critical other than owners, managers and employees relationship as in the case of agency theory (Freeman, 1999). In essence the stakeholders deserved and required management attention since all groups or individuals participate in a business to obtain benefits (Donaldson and Preston 1995).

The model in figure (3) shows that business firm is a holistic compendium of relationship emanating from the environment which it evolves, such relationship is a form of give and take approach between the organization and various concern parties to instill the going concern of a firm.

2. Literature Review

Most of the empirical literature on corporate governance has attempted to understand corporate governance in terms of agency theory and explored links between different corporate governance practices and firm performance. This literature is motivated by the assumption that, by managing the principal-agency problem between shareholders and managers, firms will operate more efficiently and perform better. This 'closed system' approach found within agency theory posits a universal set of linkages between corporate governance practices and performance and devotes little attention to the distinct contexts in which firms are embedded. Despite considerable research effort, the empirical findings on this causal link have been mixed and inconclusive. Critiques of agency theory have pointed out its 'under-contextualized' nature and hence its inability to accurately compare and explain the diversity of corporate governance arrangements across different institutional contexts. Similarly, much of the resulting policy prescriptions enshrined in codes of 'good' corporate governance rely on universal notions of 'best practice, which often need to be adapted to the local contexts of firms or 'translated' across diverse national institutional settings.

Emmon and Schmid (1999) cited Shleifer and Vishny (1997) they postulated that corporate governance ensured investors in corporation received adequate return on their investment otherwise, outside investors would not lend to the firm or purchase their equity securities. Consequently, firm would be forced to rely on internally generated funds. They added that legal and political environment are critical influence on the nature of corporate governance and there by improve corporate performance in every country. Hence investor protection and stronger rule of law are related to corporate governance and organization performance.

Mehar (2003) examine corporate governance and dividend policy .He noted that payment of dividend is extremely important and in some economies firms are even forced to pay dividend through external finance. In Pakistan he observed that payment of dividend correlate with the type of governance. The study utilized a pooled data of annual audited accounts of 180 listed firms of the Karachi Stock Exchange. A model was formulated using variables such as dividend, net current assets, profit after taxes, number of shares held by the management, corporate taxes and bonus shares issued. The estimated results reveal that corporate governance has significant relationship with dividend policy but negatively related with liquidity position of the firm.

A study of corporate governance in the banking industry revealed that given the critical nature of bank in the path of economic progress, the governance of bank should assume a central role. The assertion is that banking crises dramatically advertise the enormous effect of corporate governance since there are various stakeholders whose interest are to be met. Specifically, bank are generally more opaque than non-financial industries and banks can alter the risk composition of their assets more quickly than non-financial firms, as such, they can easily hide problems by extending loan to clients that cannot service previous debt obligations.

(Abdullah and Valentine 2009) postulated that the fundamental theories of corporate governance started with the discussion of agency theory expended to stewardship theory, stakeholder theory and evolved to resource dependency, transaction cost, political and ethical related theories like business and virtue ethics. However, these theories address the cause and effect of variable such as the configuration of board members, audit committee, independent director and top management and their social relationships rather than it regulatory framework. They concluded that combination of various theories would be the best approach to described good governance practice rather than focusing on single theory. Similarly, (Kajola,2008) examined the nexus between corporate governance mechanisms and firm performance using panel method and ordinary least square as a method of estimation, his findings revealed evidence of positive significant relationship between corporate governance mechanism and measure of organization performance.

(Odaki and Kodama 2010) argued that the theories of economic institutions predict that complimentary exists between the natures of corporate governance of its human capital investment. They postulated that the way a firm is owned and controlled is interrelated with human capital investment and the way employees are trained and paid. The study use employer employee matched data from large Japanese firm and discovered that stakeholders oriented corporate governance invest in firm specific human capital more heavily than those with shareholder oriented corporate governance.

3. Methodology

The study was anchored under the principles and pillars of corporate governance which recognized equitable treatment of shareholders and satisfaction of the interest of other stakeholders. The study adopted stakeholders approach within the framework of the corporate governance theory to check the soundness of the applicability of principle of the corporate governance in the banking sector with respect to equitable treatment of shareholders and fair treatment of the other stakeholders in the banking sector. Secondary data were collected from ten (10) sound banks, data collected span from period of (1998-2008). The data collection focuses on value added statement of the commercial banks. Discreptive approach was used, means and percentage were used to show the return accrued to various stake holders in the banking sector

4. Discussion of the Result

Table (1) shows the gross earning of selected firms in the banking sector and how their earnings were distributed among the stakeholders as detailed in the value added reports. The result shows that corporate governance has not been effective in the Nigeria banking system. The trust of corporate governance in any institution is to ensure equitable distribution of returns among the stakeholders and protection of shareholders rights through adequate share in the profit of the corporation. The result shown that the amount provided for the provider of funds (shareholders) is insignificant if compare to the gross earning over the years. It range from 1% in 2007 to maximum of 17% in1999 with an average of 10% and ranked lowest among other stakeholders. The shareholders (principal) which objective is to get satisfactory return had been ignored.

The table also revealed that the employees who are the corporate insiders received substantial share of the organization earning. Their earnings range from 35% in 2006 to 54% in 1998 with average of 43% over the years. The large percentage of the earnings distributed to the employees reflected in the huge amount paid to staff in term of salaries and various managerial perks. The employees who are the agents of the corporation had ignored the principal interest but considered their own interest above the shareholder objectives.

More so, substantial portion of the earnings were retained for future growth and development. The minimum was 25% in 1998 and the highest was 48% in 2007 with an overall average of 37% over the period investigated and rank second in the shared of banks earnings. This shows that the corporation is retaining huge amount of earning without adequately consider the interest of the shareholders which is a fundamental breach of the cardinal principles of corporate governance.

The government interest is represented by various forms of taxes collected to create the enabling environment for the banking sector to thrive. The table revealed minimum of 8% in 1998 but grow to 12% in 2006 with an average of 10% over the years. This shows that government also participated in the share of the earning of the banking system.

Conclusion of the finding revealed that shareholders had not been adequately treated. The corporate insiders which are the employees had captured the corporate outsiders by enhancement of their own interest at the expense of the shareholders. Again it was observed that the stakeholders were not equitably treated as required by the pillar of corporate governance.

5. Summary and Conclusion

The paper discussed principle of corporate governance with particular reference to the Nigerian banking system. Several principles of corporate governance developed by organization of Economic Corporation and Development (OECD) made up of the right of the shareholders, equitable treatment of shareholders, the right of the stakeholders, disclosure and transparency of information and the responsibilities of the board were recognized. The rational for bank corporate governance and theory of corporate governance such as agency theory, stewardship theory and stakeholder theory were discussed. Several literatures on corporate governance, organization performance and fair treatment of stakeholders were reviewed. The study also utilized secondary data particularly, the value added statement of ten selected banks spanning from 1998 to 2008. Descriptive analytical approach was used. The finding revealed that shareholder`s objective which is to get satisfactory returns on their investment had been ignored, the employees who are the corporate insiders received substantial share of the organization earnings while huge portion of the earnings were retained without due consideration of the shareholders which represent the fundamental breach of the cardinal principles of corporate governance and government also participated in the share of the earnings of the banking system.

The paper recommended that shareholders who provided the required capital for the operation of the banks should be given satisfactory returns to avoid arbitrages among the shareholders. The amount retained for future growth should be judiciously used for banks expansion, mordenation and development to bring additional returns to boost the earnings of the stakeholders.The part of the earnings given to the employees as corporate insiders should be brought to focus to check the huge operating cost in the banking sector and there should be fair treatment among various stakeholders that have direct or indirect interest in the banking system.

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Table 1. Distribution of Banks Earnings among the Stakeholders

Year	Employee %	Govt. %	Provider of funds %	Future growth %
2008	41	10	6	43
2007	42	9	1	48
2006	35	12	10	43
2005	42	9	10	39
2004	45	10	10	35
2003	41	11	14	34
2002	44	11	10	35
2001	41	9	10	40
2000	44	10	16	30
1999	40	11	17	32
1998	54	8	13	25

Source: Computed by the authors using annual report of 10 selected banks from 1998 – 2008

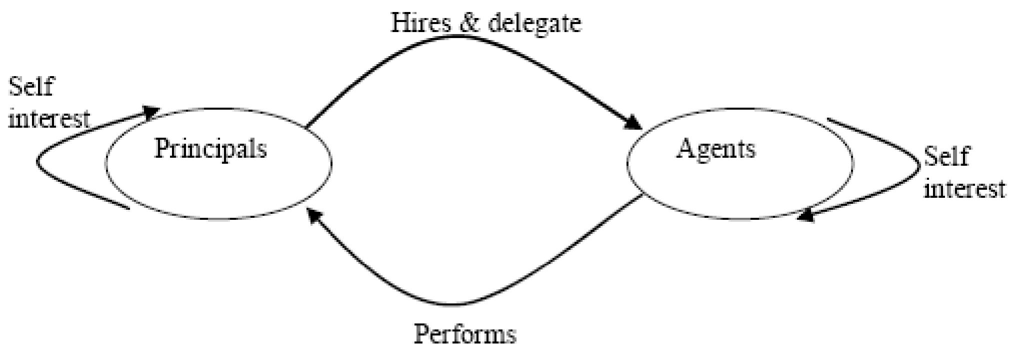

Figure 1. The Agency Theory model

Source: Abdullah and Vadentine(2009)

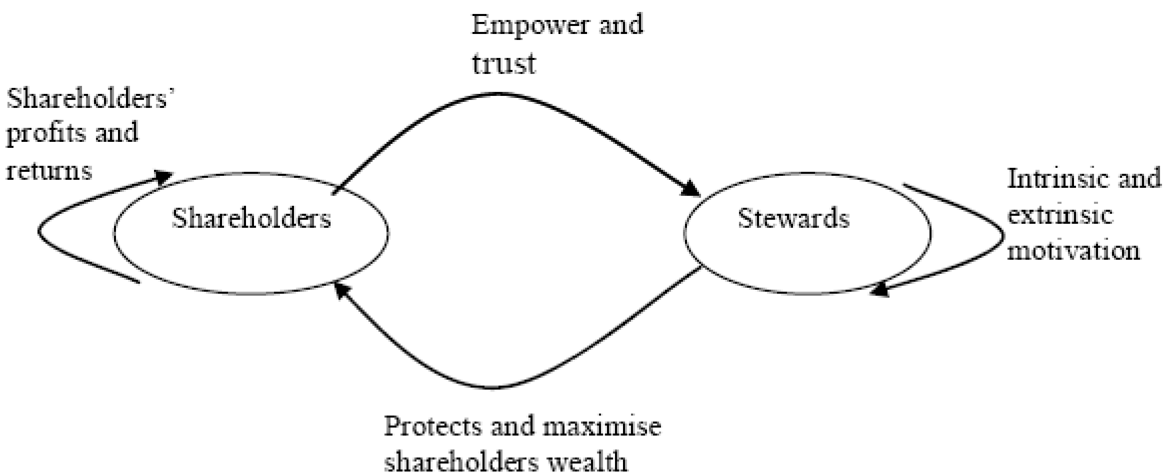

Figure 2. The Stewardship Theory Model

Source: Abdullah and Vadentine (2009)