Direct RESEARCH JOURNALS

Vol.4 (1), pp. 8-14, June 2017
ISSN 2449-0806
International Standard Journal Number (ISJN)
e-ISJN: A4372-2600
Article Number: DRJA289640127

Direct Research Journal of Social Science and Educational Studies (DRJSSES)
directresearchpublisher.org/journal/drjsses/

Review

Corporate governance failure: Lesson from on-going financial crisis in Nigeria (2015 - 2017)

***AHMODU, O. L., AREO, A. B. and ADENIYI, A. B**

Department of Management Sciences, College of Social and Management Sciences, Wesley University Ondo. Nigeria.
Corresponding Author Email: lateef.ahmodu@wesleyuni.edu.ng or ahmoduolamidelateef10@gmail.com

Received 1 April 2017; Accepted 13 June, 2017

Corporate governance's failure is the failure of the regulatory market, stakeholder and board of governance. This has largely contributed to the on-going financial crisis in Nigeria. The objectives of this paper are: to examine corporate governance failure using the on-going financial crisis in Nigerian economy as a case study and to investigate the factor causes and extract lessons from the current financial crisis in Nigerian. The research design method used for this study was content analysis through a theoretical and conceptual approach. Thus, making it principally a phenomenological method of qualitative research. The study revealed that the Nigerian economy is plagued by a high level of corporate governance failure as well as weak corporate governance components; Such as the board of governance, regulatory market and shareholders. Based on these findings, the study therefore recommends that corporate governance stakeholders should lay more emphasis on implementing strategies that will ensure the strengthening of corporate governance component. It also recommends that proper and thorough screening measure should be employed and strictly adhered to in the appointment of corporate governance members.

Key words: Corporate governance, financial crisis, regulatory and stakeholders

INTRODUCTION

Corporations have become a powerful and dominant institution in today's Nigerian economy. They have advanced to every nooks and crannies of the globe in various sizes, capabilities and influences. Cooperation governance has tremendous influence on the economies and various aspects of Nigerian financial sectors (Adewakun, 2010). Shareholders seem to be losing trust and market value tremendously. Moreover, with the emergence of globalization, there is greater deterritorialization and less of governmental control, resulting in greater need for accountability (Crane and Matten, 2007). Hence, corporate governance has become an important factor in managing organizations in this current financial crisis in Nigeria. In order to understand corporate governance failure, it is important to define its concept. Even though, there is no single accepted definition of corporate governance failure, it can be defined as a failure of the whole set of regulatory, market, stakeholder and board of governance, which has largely contributed to the on-going financial crisis in Nigeria. Corporate governance could also be seen as a set of processes and structures for controlling and directing an organization. It constitutes a set of rules, which governs the relationships between management, shareholders and stakeholders (Ching et al., 2006).

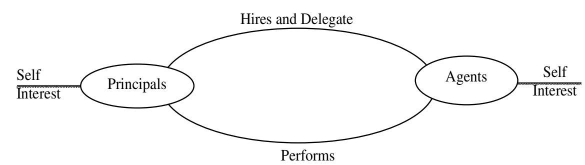
Corporate governance system does not just fail to prevent the on-going financial crisis and corporate collapses, but has actually incentivized corporations to manipulate share price, abuse corporate accounting principles and practices, in order to create and take excessive financial and business risks for short-term profit maximization (Clark, 2004). The underlying challenges with corporate governance are not just some technical or implementation problems, but more often about the problem of paradigms, governing approaches and the orientation of corporate governance systems, which are deeply ingrained in on-going financial crisis in Nigeria. The failure of corporate governance was an apparition haunting the world; the specter of total collapse of the Nigerian financial crisis as a result of the greed of a few decision-makers and the failure of economy regulators in Nigeria (Adewakun, 2010). The anxiety over the current financial crisis in Nigeria is understandable going by the lesson learnt from the past financial crisis in Nigeria. Corporate governance includes all types of firms and its definitions could extend to cover all the financial and non-financial activities. As a result, this paper reviewed two fundamental theories underlining corporate governance (Bhimani 2008). Among the corporate governance theories are agency theory and stakeholder theory which are briefly discussed as follows:

Agency Theory

Agency theory suggests that the firm can be viewed as a nexus of contracts between resource holders. An agency relationship arises wherever one or more individuals, called principals, hire one or more other individuals called agents, to perform some duties and then delegate decision- making authority to agents (Bamberg and Klaus, 1987). The scholars opine that, the primary agency relationships in business are those between stockholders and managers and those between debt holders and stockholders. These relationships are not necessarily harmonious; indeed, agency theory is concerned with so-called agency conflict, or conflicts of interest between or among corporate governance and business ethics (Padilla,2002). Agency theory which in the formal sense originated in the early 1970s actually emerged as a dominant model in the financial economics literature and is widely discussed in business ethic texts. From the Ethicists point of view, it is pointed out that the classical version of agency theory assumes that agents (that is, managers) should always act in principals (owners') interests (ACCA, 2015).

However, if taken, it is either the principal's interest is always morally acceptable ones or managers should act unethically in order to fulfill their "contract" in the agency relationship. According to Bowie and Freeman, (1992) these stances do not conform to any practicable model of business ethics. In view of the above vis-à-vis the practice of corporate governance, it apparently shows that huge responsibility is placed on the neck of the agents by the principals. To fulfill the ultimate goal of the agency theory by the so-called agents, the need to apply corporate governance is such that it is inevitable to the whole process and operations of the corporate organizations. The recent Nigerian experience of failed governance is a reflection of poor understanding and application of agency theory which led to bad practice of corporate governance (Padilla, 2002).

Jensen and Meckling, (1976) were of the opinion that the model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority. This theory prescribes that people or employees are held accountable in their tasks and responsibilities. Employees must constitute a good governance structure rather than just providing the need of shareholders, which maybe challenging the governance structure (Figure 1).

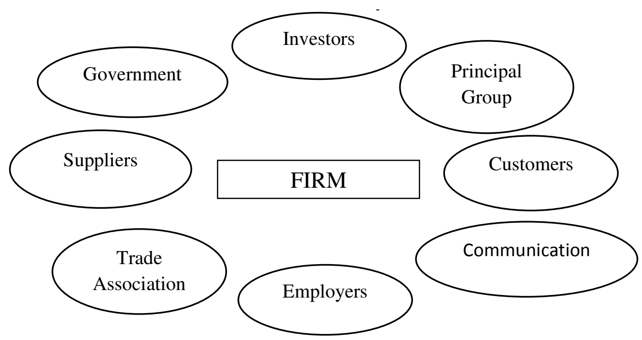


Adapted from Bamberg and Klaus, (1987).

Figure 1. The agency model.

Stakeholder theory

A theory by Freeman (1984) in the book of strategic management; revealed that stakeholder theory was embedded in the management discipline in 1970 and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders. Wheeler et al. (2003) argued that stakeholder theory derives from a combination of the sociological and organizational disciplines. Indeed, stakeholder theory is less of a formal unified theory and more of a broad research tradition, incorporating philosophy, ethics, political, economics, law and organizational theory. This theory proposes corporate accountability to a broad range of stakeholders. It is based on companies being so large, and their impact on society being so significant, that they cannot just be responsible to their shareholders. There is a moral case for a business knowing how its decisions affect people both inside and outside the organization. Stakeholders should also be seen not as just existing, but as making legitimate demands on an organization. The relationship should be seen as a two-way relationship. What stakeholder wants from an organization will vary. Some will actively seek to influence what the organization does and others may be concerned with limiting the effects of the organization's activities on themselves. Relations with stakeholders can also vary; possible relationship can include conflicts, support, regular dialogue or joint enterprise (Figure 2).



Adapted from: Freeman, (1984).

Figure 2. Stakeholder theory model.

CONCEPT OF CORPORATE GOVERNANCE FAILURE

Corporate governance failure in Nigeria began with Judiciary system that is divided into; the Supreme Court, the Court of Appeal, the High Court, the Commercial Court and the Magistrate Court. The corporation and statutory entities are regulated and supervised by various institutional bodies. For instance, the registration of private companies is done by Corporate Affairs Commission under the Companies and Allied Matter Act. (CAMA, 1990); the listed firms are regulated and supervised by Securities and Exchange Commission. The financial sector and other institutions are regulated and supervised by Central Bank of Nigeria (CBN), Financial Reporting Council (FRC) and the Economic and Financial Crime Commission (EFCC) which are in charge of prosecution of fraudulent and corrupt practices. All of the above institutions are established to improve the legal and corporate governance system in the country (SEC, 2011).

Furthermore, Nigeria has operated a culture of political patronage where the ruling political elite do not pay attention to public accountability. Thus, the military and civilian regimes institutionalized corruption by creating an atmosphere that they are above the law (Bakare, 2011). The military and civilian rulers appointed their cronies as board of members' government agencies and private business organizations. This lead to government failures of corporations where there is lack of proper accountability and as a result of institutionalized corruption in the country. Fagbadebo, (2007) explains that diverse views on failure maintain that it is a bad behaviour. Also, failure is not easy to define and it is generally not difficult to recognize when observed. As a result, the author argues that the simplest and popular definition for failure is the state or condition of not meeting a desirable or intended objective. This may be viewed as opposite of success, as Nigerian government is trying to meet up with the citizen desired.

One of the notable events in the recent history of corporate bodies is the failure of the Chief Executive Officer (CEO) and other management of financial institutions. This has led to the collapse of most Nigerian banks in the mid- 1990s and even recently. Also, there is corrupt corporate behaviour in non-financial firms in Nigeria such that the scandal of oil sector, aviation industry, educational sector and the national assembly births budget padding. Business Codes of Ethics and Corporate Governance Code of Best Practice play an important role in driving transparency and accountability reforms, which can remedy failure. In addition, the type and quality of laws and regulations (including level of enforcement) of the countries in which the companies operate has a direct bearing on the level of failure in a particular country (Bowie and Freeman, 1992).

FEDERAL GOVERNMENT'S INITIAL REMEDIAL ACTIONS

There are legal enforcement mechanisms established by the Federal Government to mitigate or eradicate corruption in Nigeria. This include the Banks and other Financial Institutions Act (BOFIA), the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act 1994. Others are the Money Laundering Act 1995 and the Money Laundering Act (Prohibition) 2004. In 1999, government set up two anti-graft bodies such as Independent Corrupt Practices and Other Related Offences Commission (ICPC) and the Economic and Financial Crime Commission (EFCC) Act 2004 in order to eradicate corruption. However, as of today, corruption has not been eradicated in the country. It is still extant and persistent in every sector of the economy (SEC, 2011).

COMPONENTS OF CORPORATE GOVERNANCE FAILURE

Regulatory governance failure

A regulatory failure in governing financial companies before the financial crisis was manifested in substantial deregulation and lack of regulation in the finance industry. In 2007, the CBN governor declared that 'There must be a strict supervision of all financial institutions, credits and investments; there must be an end to speculation with other people's money' (Soludo, 2007). However, the strict supervisory rules over the finance industry in response to the great depression had been gradually abandoned after 2008 financial crisis onwards.

Market governance failure

This claim that the market is the most efficient and rational way of allocating resources, monitoring corporations and disciplining corporate underperformance and misbehavior has been advocated and promoted by neoclassical economists and modern finance theorists (Obinatu, 2006). Yet, the optimal market governance as currently hypothesized does not work well in practice. In capital market, for instance, the share prices of many corporations did not reflect the managerial inefficiencies. The market for corporate control movement in the 2008 brought about more negative than positive effects. Information failure is inherently embedded in a 'complex system' of financial markets where price volatility and liquidity were nonlinear functions of patterns arising from the interactive behaviour of many independent and constantly adapting market participants. A Nobel laureate in economics, points out that 'when information is imperfect, markets do not often work well and information imperfections are central in finance. Overall, the fundamental prerequisites for the operation of market disciplinary force were not in place prior to the financial crisis (Clark, 2004). Neoclassical economists claim that the market is the most efficient way of allocating resources, monitoring corporations and disciplining underperformance. Yet, it does not currently work in practice.

Stakeholder governance failure

Stakeholder governance is typically seen in German and Japanese corporations where financial institutions employees, suppliers and major customers exert significant influence on corporate decision-making through specific institutional arrangements. However, there is no formal stakeholder governance system and structure established in Nigeria financial model. Arising from stakeholder theorists, it could be informed that the reason why Nigeria corporate governance system failed is due to the absence of stakeholder involvement in corporate governance.

Board of governance failure

In Nigeria corporate governance financial model, the triple relationship between shareholders, the boardroom and management has been broken since the separation of ownership from control. Shareholders are largely reluctant to monitor corporations and passive in attending shareholder general meetings. Both institutional and individual shareholders do not behave like owners. Institutional investors even encouraged adoption of high-risk business strategies before the financial crisis. The issues of board incompetence and lack of independence as well as Chief Executive Officer dominance and abuse of power have long been concerned, but unsolved.

FACTORS CAUSING CORPORATE GOVERNANCE FAILURE IN NIGERIA

Economic factors

This currently arises from negative economic conditions in the macro-economy perspective. Such adverse economic conditions include; high and rising inflation rate; high and increasing foreign exchange rate; subsisting huge foreign debts; huge and expanding fiscal deficits; inadequacy of foreign exchange; monetary policy changes; inconsistent or unstable economic policies; unguided economic reform programmes e.g deregulation, low capacity utilization in the industries; low per capital income; high domestic debts; dwindling national income and corruptions. For example, the combination of high inflation and exchange rates reduce the capacity of bank customers to save. Thus, deposit mobilization becomes a subject of intense competition with consequences for higher operational and financial costs. On the other hand, low capacity utilization and low income per capital reduce the ability of borrowers to repay their financial obligations. Thus, bad debts developed with serious consequences for increased provisions, which lead to reduced profits or increased losses.

Political factors

These are the factors politically induced, which turn out to have adverse consequences on the effective management of financial sectors. For instance, political instability and indeed uncertainty associated with the suspension of formal CBN governor in 2014 and power of incumbency 2015 presidential election, engendered fear in the populace. Also, after 2015 general election, the government created fear with its unguided statements about how corruption has destroyed the country in the past and how everyone found guilty is going to go to jail. This led to unanticipated massive withdrawal of funds from the financial sectors. More so, many debtors either neglected or refused to repay their borrowings while corruption, fraud and forgeries became the order of the day. Again, the political interference on the management of financial sector is such that most government owned finance sectors were politically influenced to grant loans and overdrafts, which soon after became hardcore and remained unpaid. Furthermore, appointments of board and management members of such sectors were mainly politically influenced, many times resulting to using unqualified and / or inexperienced person to manage the economy.

Institutional factors

There are numerous internal causative factors of finance sectors failure. These include; boardroom squabbles arising from ownership structure, insider abuse, frauds and forgers, weak / ineffective internal control systems, poor asset quality, lack of adherence to CBN prudential guidelines, inadequate capital, poor management and other internal factors. For this reason, consolidation and increase in finance capital base with the view to strengthening Nigerian economy, and also making them more reliable was the idea of former CBN governor (Soludo, 2007).

LESSON LEARN FROM ON-GOING FINANCIAL CRISIS IN NIGERIA

No doubt, the Nigerian financial sector is the key driver of the Nigerian economy and definitely, has evolved over the years since 1894. For example, First Bank of Nigeria Plc. (then Bank of British West Africa), the first commercial bank was established originally to serve the British shipping and trading agencies in Nigeria. It has thrived from a government regulated environment to the era of the Structural Adjustment Program (SAP) embarked upon by government in 1986 it was aimed at deregulating the economy in the direction of market determined pricing (Cowry Asset Management Limited, 2009).

Based on the lack of consensus about the causes of the financial crisis in Nigeria, it was learnt that, for the next several decades, scholars and policy-makers will be debating on many factors of this specific crisis. This will determine whether the right lessons have been learned. Some argued that the lack of comprehensive supervision of public and private finance with operations around the country caused the problems faced by the global economy today. In this view, no single national financial supervisor or regulator could possibly understand the full scope of the operations of these institutions. Some financial institutions have failed, or the authorities have decided to rescue them, which is tantamount to failure from a market perspective. However, they did not fail because they had multiple national supervisors and thus escaped appropriate supervision. Size has been a problem, and complexity has led to some decisions to rescue particular institutions in whole or in part, but the global scope of the operations of these institutions was not a major contributing factor to the crisis per se.

Thus, it is being viewed that these causes of the on-going financial crisis are failures in macroeconomic policies and in financial supervision and regulation. The study therefore assigned principal blame to failures in macroeconomic policies by a small margin. We do not see this as inconsistent of policy with the view that there are structural flaws in national, global financial regulatory and supervisory systems, which had been building for years and should be addressed in the wake of the crisis. It may well be that a crisis of this magnitude was necessary to uncover those flaws. Whether they would have been revealed without the macroeconomic failures is at least a debatable question.

The truth about this on-going financial crisis in Nigeria is that it was caused by past and present government due to unguided rhetoric policy and uncultured body language. There is nothing Nigeria consumes today that we were not consumed in the past, therefore it's not our consumption pattern that put pressure on Naira but withdrawal of funds by foreign investors caused by this present government. After 2015 general election, the government created instability with its sketchy statements about how corruption has awful the country in the past and how everyone is going to jail if found guilty. The inconsistence in government policies made foreign investors to liquidate their investment and change their money to dollars. In the process of trying to flee, they were willing to buy dollars at any price, which led to high exchange dollar rate and reduce the volume of Naira in circulations. Even though some of them were not ready to run away, but want their money in dollars to save their investments from devaluation. Furthermore, government gave a bad signal by banning deposit of foreign currency into domiciliary accounts. That was enough for free market believers to see the draconian handwriting on the wall. This was the beginning of dollar rush. To make matters worse, the government came up with another outrageous policy of rationing dollar to certain sectors and blocking many sectors out. That was the nail in the coffin which facilitated the emergence of corporate governance failure (Soludo, 2016).

Also, foreign investors took over $80 Billion out of the economy within a short period of time and everything went down on a free fall. Policy continuity and political stability will not have let billions of dollars leave our shores within such tiny time frame. Even though the government might have income famine due to militancy and terrorism challenges in Nigeria. The fear of unknown created by present government is responsible for the financial crisis not only the low oil price. Interest rate in America is currently at 0.50% while it is 11.4% as at January 2017 in Nigeria. This is being forecasted as it’s expected to be 14% by the end of first quarter this year according to Trading Economics Global Macro Models and analysts’ expectations. Chase Morgan gave President Buhari warning about the repercussions of his fixing policy before they pulled out, but his economics cyber warriors said JP Morgan can go to hell, they no longer believe in economic metrics since their messiah is in charge. Funny enough the country is suffering because of the lunkheaded policy, but they find relief by blaming the past governance and Gucci appetite of average Nigerians. If this government continues with this untraced loftiness policy, Naira will go down to N1000/ $ 1 (Okonjo-Iweala, 2016).

We also learned that deleveraging is a process that does not discriminate even among economies and financial systems that are less leveraged than others. Similarly, at the start of the crisis, trade links were stronger than they had been for a century. The US economy drove much of the recent expansion in trade with its external deficits, and that process has reversed. According to IMF projections, world trade in goods will decline by 11.5 percent in volume and by 25 percent in value. Therefore, we should not be surprised that only 17 of the 182 economies that the IMF follows are expected to grow faster this year than they did last year, or that 71 of them are projected to shrink, including 30 of the 34 advanced countries. In this crisis, the citizens and authorities of a country can run, but they cannot hide.

CONCLUSION

This paper reviewed that corporate governance from theoretical perspectives. The emergence of agency theory and stakeholder theory addresses the cause and effect of variables, such as the configuration of board members, regulatory markets and stakeholders. In addition, these theories focused on the view that the shareholders' aimed to get a return on their investments. In today's business environment, business process should also focus on other critical factors such as legislation, culture and institutional contexts. Corporate governance is constantly changing and evolving changes are driven by both internal and external environmental dynamics. However, it should be emphasized that the cyclic booms and depressions are essential ingredients of the capitalist system, thereby rendering the so-called global financial crisis not totally unexpected to those who govern finance in the global market-place. The interdependence and inter-connectedness of the countries finance within the global capitalist economy are such that when the biggest players sneeze, the marginal ones catch cold in what is proving to be a financial swine flu, those without the wherewithal for survival in Nigeria today would be left with no other fate but perdition and doom. The beggar-thy-neighbor or dog-eat-dog mentality that characterizes the contemporary global finance in Nigeria ensures that only bones are left for late-comers. In the scenario painted above, it would seem that everybody is for himself while the devil takes the hindermost. This paper expounds the extent of failure caused by this on-going financial crisis in Nigerian. Hence, it is crucial that a holistic realization be driven across the corporate world that would bring about a different perspective towards corporate governance. The days of cane and bridle are becoming a mere shadow and the need to get to the root of a corporation is essential. Therefore, it is important to re-visit corporate governance in the light of the convergence of these theories and with a fresh angle, which has a holistic view and incorporating subjectivity from the perspective of management sciences.

RECOMMENDATION

It is obvious that a basic legal and regulatory framework is needed for maintaining the order of free market competition and for good governance. The financial crisis indicates that stricter regulations are particularly needed in the finance industry. But we also need to be aware of the limits of regulations, as regulations are often reactive rather than proactive to corporate activities, and inappropriate regulations may also lead to corporate governance failure or business failure. Hence, a balance between regulatory governance and other governance modes and mechanisms needs to be carefully considered. The study therefore recommends that corporate governance stakeholders should lay more emphasis on implementing strategies that will ensure the strengthening of corporate governance component. It also recommends that proper and thorough screening measure should be employed and strictly adhered to in the appointment of corporate governance members. Good corporate governance provides stability and desirable growth to the sectors. Effective corporate governance reduces perceived risks, consequently reducing cost of capital.

REFERENCES

ACCA (2015). Governance, Risk and Ethics; A study Text for exams from 1st September 2015 to 31st August 2016. BPP leaving media Ltd, BPP House, Aldine Place, London, WIZ 8AA.

Adewakun A (2010). Poor Corporate Governance, Bane of Nigerian Banks. Nigeria Tribune, September 29, 2010, P. 15.

Bakare MO (2011). The Impact of Capital Formation on the Growth of Nigerian Economy: *Research Journal of Finance and Accounting:* Vol. 4. No. 9, 2013.

Bamberg G, Klaus S (1987). Agency Theory, Information and Incentives. Berlin: Springer-V erlag.

Bowie NE, Freeman RE (1992). Ethics and agency theory: an introduction. New York: Oxford Press.

Bhimani A (2008). "Making Corporate Governance Count: The Fusion of Ethics and Economic Rationality". *Journal of Management and Governance,* Vol. 12, No. 2, pp. 135-147

CAMA (2007). A review of CAMA 1990: Issues in Corporate Governance Audit committee and Auditor Independence. Punuka attorney and solicitors.

Cowry Asset Management Limited (2009). Nigerian banking report: A concise look at the milestones, challenges, successes and outlook of the Nigerian banking system. Nigeria: Cowry Asset Management Limited

Ching KW, Tan JS, Chi Ching RG (2006). "Corporate Governance in East Asia, The Road Ahead". Prentice Hall Publication.

Clark T (2004). "Theories of Corporate Governance: The Philosophical

Foundations of Corporate Governance" London and New York: Routledge,

Crane A, Matten D (2007). "Business Ethics" (2nd Ed). Oxford University Press.

Fagbadebo OM (2007). Corruption, Governance and Political Instability in Nigeria. *African Journal of Political Science and International Relations.* 1(2): 28-37.

Freeman RE (1984). "Strategic Management: A Stakeholder Approach". Pitman, London

Jensen MC, Meckling W (1976). "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure". *Journal of Financial Economics*, Vol. 3, pp.305-360.

Obinatu F (2006). Business Ethics and Corporate Governance: A Paper Presented at Mandatory Continuing Professional Induction of the Institute of Certified Public Accountant of Nigeria on July 2006 at Port-Harcourt, River State. Nigeria.

Okonjo-Iweala N (2016). Economic Recession: Ngozi Okonjo-Iweala No Needs Rethink. TNV Nigerian Voice.

Padilla A (2002). "Can Agency Theory Justify The Regulation Of Insider Trading". *The Quarterly Journal of Austrian Economics,* Vol. 5, No. 1, pp. 3-38

SEC (2011). Code of Best Practices on Corporate Governance. Issues by Security and Exchange Commission in 2011

Soludo CC (2007). Macroeconomic, Monetary and Financial Sectors Developments in Nigeria. Central Bank of Nigeria Report, 2007.

Soludo CC (2016). A presentation to the Commonwealth Central Bank Governors at the IMF/World Bank annual meetings in Washington D. C. October 10, 2016. *Thisday Newspapers.*

Wheeler D, Colbert B, Freeman RE(2003). "Focusing On Value: Reconciling Corporate Social Responsibility, Sustainability And A Stakeholder Approach In A Network World". *Journal of General Management*, Vol. 28, pp. 1-28.