INTERNATIONAL JOUNAL OF: FINANCIAL RES. AND MANAGEMENT SCIENCE

TIMBOU-AFRICA ACADEMIC PUBLICATIONS
INTERNATIONAL JOURNAL, AUGUST, 2023 EDITIONS
VOL. 14 NO. 7 ISSN: 2773-1040

STAKEHOLDER THEORY AND ITS IMPERATIVES IN BANKS' CORPORATE GOVERNANCE

EZEOCHA, CHUKWUEMEKA MAURICE.

Department of Banking and Finance, Federal Polytechnic, PMB 1012, Kaura Namoda, Zamfara State, Nigeria

ABSTRACT

Corporate governance is a crucial issue for the management of banks, and has recently been given a great deal of attention in various national and international fora. This paper therefore undertakes a critical review of the stakeholder theory of corporate governance and the imperatives of its application in the banking sector, especially in developing economies like Nigeria. The paper adopts an explanatory research method with content analysis drawn from scholarly articles and various library materials. It is observed that the unique feature of the banking sector demands extensive attention on the quality of corporate

Introduction

One of the main drivers in the evolution of corporate governance over the centuries remains corporate failures and systematic crises, the first of which is the South Sea Bubble financial crises reported in the 1700s that led to the legislation of new business laws and practices in England (Kurfi, 2021). Financial scandals around the world and the collapse of major corporate institutions in the USA, Europe such as Lehman Brothers, Merrill Lynch, American International Group (AIG), once again, brought to the fore, the need for the practice of good corporate governance. Major corporate governance codes were developed in 2002 and 2003 in the US and the UK after an increase in corporate collapses such as Enron, worldCom, among others, due to fraud in accounting practice and poor internal controls (Afolabi & Dare, 2015; Gupta & Shallu, 2014).

In the wake of Enron and other similar cases, countries around the world have reacted quickly by pre-empting similar events domestically. For instance, as a speedy response to these corporate failures, the United States of America (USA) issued the Sarbanes–Oxley Act in July 2002, whereas in January 2003 the Higgs Report and the Smith Report were published in the United Kingdom (UK), again in response to their corporate governance failures. Similarly, in a country like Nigeria, Securities and Exchange Commission (SEC) in 2003, released the Code of Best Practices for Public Companies. Like in other developing economies, the banking sector of Nigeria has reported a number of cases of collapse in the past, so the issue of corporate governance here gained the status of high importance like in the other sectors of the Nigerian economy (Ranti, 2011). The Central Bank of Nigeria (CBN) also issued the Code of Corporate Governance for banks in Nigeria, effective from April 3, 2006, to deal with issues of transparency, equity ownership, criteria for the appointment of directors, board structure and composition, accounting and auditing, risk management and financial reporting.

governance systems that promotes the interest of the stakeholders and as such, the stakeholders or various constituencies of a bank cannot be ignored in the management of a bank due to the various roles they play, as well as their impact on the activities of the bank. To this effect, the stakeholder theory ranks prominently in banks' corporate governance practice because it considers the interest of various banks' stakeholders, thereby promoting the overall corporate efficiency of banks. The paper therefore recommends that banks should be acquainted with the various expectations of stakeholders and their rights as established by law. Banks should also engage in active co-operation with their stakeholders in creation of wealth, jobs and a financially sound enterprise, as this helps to provide answers to the important issue of priorities in relationships among stakeholders as well as how to manage these relationships.

Key Words: *Banks, Corporate Governance, Stakeholder Theory.*

Banks usually account for the lion share of a financial system in most economies and this dominance is overwhelming in case of a developing country in greater need of a sound financial system. The development of good corporate governance framework is necessary for boosting the confidence of stakeholders in the banking system, and to ensure its efficient and effective working to the public. The unique feature of the banking sector therefore, demands extensive attention on the quality of governance systems in practice. Macey and O'hara (2003) suggested that banks should be treated specially and differently than other firms when considering their risk and governance mechanisms. In banking, any theory of corporate governance which ignores the interests and varying expectations of different stakeholders that constitute the constituencies of a bank, leaves much to be desired (Ezeocha, 2021). The stakeholders, though external to an organization, cannot be ignored as insignificant due to the various roles they play, as well as their impact on the activities of the organization. Effective corporate governance reflects a company's values, culture, and policies that seek the maximization of benefits for stakeholders in a legal, ethical, and sustainable way (Adegbite, 2015)
This paper therefore explores the imperatives of the application of the stakeholder theory of corporate governance in banks. In trying to achieve this objective, the paper adopts the descriptive research method, with content analysis of qualitative data drawn from the review of relevant scholarly articles and library materials on the internet.

Conceptualizing Corporate Governance in Banking

Corporate governance is not a concept that could be subjected to a water-tight definition. It generally refers to the system of governance, rules, ethical standard, mechanism, processes in which a corporation is being directed and controlled. The Sir Adrian Cadbury Report on the Financial Aspects of Corporate Governance (2012) defined corporate governance as "The system by which companies are directed and controlled". The pursuance of corporate governance mechanisms ensures the financial viability of corporate business, as through it, all the affairs of the firm are managed effectively and directed towards the creation of value for the shareholders.
According to Owojori (2010), corporate governance is the system of internal controls and procedures by which individual companies are managed. In the views of Sayogo (2006), corporate governance is a

process where rules and ethical standards govern the relationships in organizations. Bhasin (2012) stated that corporate governance is made up of principled processes, which set the relationship between the firm's management, corporate board, minority and majority shareholders. Corporate governance refers to the process and structures by which the business and affairs of an institution are directed and managed, in order to improve long-term shareholders value by enhancing corporate performance and accountability, while considering the interest of other stakeholders (Ezeocha, 2021)

Oboh (2005) opined that corporate governance encompasses the legal and regulatory framework governing the actions of firms, organizations, institutions, their internal policies and controls established by the institutions themselves. Corporate governance is the term that describes the role of a corporation's executive staff and board of directors in ensuring that the firm's activities meet the goals of the firm's stakeholders (Bateman and Snell, 2013). It provides a framework that defines the rights, roles and responsibilities of different groups - the management, board, controlling share-owners and minority or non-controlling share-owners within an organization.

Corporate governance mechanism helps in setting corporate objectives and defines the means for the attainment of those objectives.

Corporate governance refers to the rules, processes, or laws by which institutions are operated, regulated and governed, and it is developed with the primary purpose of promoting a transparent and efficient banking system that will engender the rule of law and encourage division of responsibilities in a professional and objective manner (CBN 2014). A good corporate governance practices provide a structure that works for the benefit of stakeholders by ensuring that the enterprise adheres to accepted ethical standards and best practices as well as formal laws. Good corporate Governance therefore embodies both enterprise (performance) and accountability (compliance concerns), (Alaribe, 2014). The primary goal of corporate governance is to enhance the value of a company through ethical behavior, espousing a policy of openness and fairness and ensuring informed decision making throughout the company.

However, in banks, corporate governance includes all those methods, which the shareholders of the bank use for inducing managers for maximization of their wealth (Crespi et al, 2002). Akinsulire (2011) supports the view that the concept of good corporate governance in banking industry implies total quality management which includes six (6) performance areas. These performance areas include Capital Adequacy, Assets Quality, Management, Earnings, Liquidity and Sensitivity risk (CAMELS)

According to Awotunde e tal, (2011), corporate governance, from a banking industry perspective, 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

Similarly, in the views of kurfi (2021), corporate governance, from the banking industry perspective, entails the manner through which the board of directors and senior management govern the business and affairs of individual banks. This includes how banks set their corporate objectives; run day-to-day operations; consider the interest of various stakeholders; align corporate activities with the expectation that banks would operate in a safe, sound manner, and in compliance with the applicable laws and regulations; and protect the interest of depositors. Banks corporate governance radiates the corporate values, codes of conduct and other standards of appropriate behaviour and the system used to ensure

compliance with them. Basically, corporate governance in the banking sector requires judicious and prudent management of resources and the preservation of resources (assets) of the corporate firm; ensuring ethical and professional standards and the pursuit of corporate objectives; it seeks to ensure customer satisfaction, high employee morale and the maintenance of market discipline, which strengthens and stabilizes the bank (Okoi, Stephen and Sani, 2014).

Corporate governance in banks therefore is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that would foster good corporate performance. With good corporate governance, banks will be able to utilize their funds by giving out loans appropriately, which will increase their efficiency, thereby promoting bank growth dynamics. Corporate governance is a crucial issue for the management of banks, which can be viewed from two dimensions. One is the transparency in the corporate function, thus protecting the investors' interest, while the other is concerned with having a sound risk management system in place (Uwuigbe, 2011). Moreover, the truth about bank regulation is that governance in banks must be concerned with not only the interests of owners and shareholders but with the public interest as well.

Omankhalen, e tal (2013), noted that the chances of success improve substantially when the banks practice good corporate governance. Equally when the principles of good governance are not observed, the chances of failure become very significant and inevitable. The level of success which a bank may claim with justification is directly related to the effectiveness of the Board in corporate governance.

Review of Some Theories of Corporate Governance

Akintoye (2010) identified three theories of corporate governance: The Stewardship Theory, the Agency Theory and the Market Theory. However, Kurfi (2021) opined that four theories can be employed to explain corporate governance: Agency theory, Stakeholder theory, Stewardship theory, and Theory of the firm.

The Stewardship Theory of Corporate Governance considers that managers are good stewards of the business organization and work diligently to attain high level of corporate profit and shareholders' returns. So since people can be trusted to act in the public good in general and in the interests of their shareholders in particular, it makes sense to create management and authority structures because they provide unified command and facilitate autonomous decision making as well as enable companies to act (and react) quickly and decisively to market opportunities.

The Agency Theory sees Shareholders as the 'Principals' and Management as their 'Agents'. This theory is the most dorminant and is rooted in the separation of business ownership (investors) and control (management) and conflict of interest between shareholders and managers, which may result in an 'agency problem', The agency problem arises out of the possibility of opportunistic behaviour on the part of the agent, which works against the welfare of the principal. Agents will, however, act with rational self-interest: as employee Directors of a company, they will tend to maximize their monetary compensation, job stability and other perks, and do no more than seek to appease shareholders. They cannot, in other words, be expected to act in the interests of the shareholders. They need, instead, to be monitored and controlled to ensure that the principals' best interests are served.

The Market Theory holds that it doesn't really matter whether managers see themselves as Stewards or Agents, because shareholders will simply sell in the market, the stocks and shares of those companies whose directors are not generating adequate return for their investment.

The Stakeholder Theory of corporate governance focuses on the effect of corporate activity on all identifiable stakeholders of the corporation. The theory sees the organization as a system of

stakeholders operating under a wider societal system, which provides the input, market, legal and other operational infrastructure for the organization. With the stakeholder theory, there is the expectation that corporations will make efforts to mitigate or reduce conflicts between stakeholders.
The Theory of the firm, which recognizes the inevitability of the four factors of production (land, labour, capital and entrepreneur) in creating utility, places the greatest premium on the entrepreneur (the Board of Directors in this case), on whose shoulders, corporate governance responsibilities rest.

Critiquing Stakeholder Theory of Corporate Governance

The stakeholder theory was first presented in 1984 by Dr. R. E. Freeman, a professor of business administration at the University of Virginia, in his milestone book, "Strategic Management: A Stakeholder Approach". As per his theory, the shareholders of a company are just one of the many stakeholders involved in the business. Freeman (1984), in this his book, defined stakeholders as any group or individual whose support to an organization is essential for the survival of the organization. Stakeholders are all of the individuals or groups that have contributed dedicated assets to an enterprise and who are already in venture capital status as a *fait accompli* (Razums and Laguna, 2018).
Generally, Stakeholder Theory is a view of capitalism that stresses the interconnected relationships between a business and its customers, suppliers, employees, investors, communities and others who have a stake in the organization (Freeman, 1984)). In supporting this view, Nwonyuku (2016) emphasized that a company should operate and be accountable to all groups and individuals, and that the organizational purpose should go beyond maximization of shareholders' wealth.
It is important to note that the Stakeholder theory emphasizes the need to have a broad-minded approach to business because all constituent parts contribute to the generation of an outstanding result. The theory suggests that shareholders are not the only group, but one of many groups a corporation or organization must serve. It argues that a firm should create value for all stakeholders, not just shareholders, and is therefore diametrically opposed to shareholder theory, which argues that a company's sole motivation should be to advance its shareholders' interests which are primarily concerned with monetary growth. Under the stakeholder theory, anyone that is affected by the organization or its workings in any way is considered a stakeholder, including employees, customers, suppliers, local communities, environmental groups, governmental groups, and more.

Stakeholders of a business can be categorized into:

- Internal stakeholders: those who have a direct relationship with the business, such as owners, managers, and workers. They often have interests in the performance, growth, and reputation of the business.
- External stakeholders: those who do not have a direct relationship with the business, but are influenced by its actions and outcomes, such as the community, the environment, and the society. They may have interests in the social, ethical, and environmental impacts of the business.

Who are the Bank Stakeholders and What are their Interests and Expectations?

Banks stakeholders are the groups or individuals that have an interest or influence in the bank's activities and performance. They include:

i. **Shareholders**: These are the owners of the bank whose primary concern is that their investments in the bank yield maximum returns. They provide the capitalization needs of the bank and in return, require maximum and adequate return on their investments. They therefore, expect the bank to be profitable.

ii. **Board of Directors**: The Board is responsible for overseeing the conduct of the bank's business. They provide oversight and restraint to stop management excesses. They monitor and advise management on the formulation and implementation of strategies in the corporate governance of banks. In fact, the Board of Directors is the focal point of corporate governance system in any institution, including banks. Directors receive compensation in form of fees, sitting allowances for meetings, salaries, and other forms of benefits, as agreed and approved. They therefore expect the bank to be liquid and profitable.

iii. **Bank Employees**: These are individuals that make up the workforce of a bank. They are the manpower resources that the bank engages in its effort to achieve its goals and objectives. They are the human faces of the banking organization and constitute the manpower system. They provide their skills in form of labour to the bank and expect good working conditions and adequate remunerations for their services. For this to happen, the bank must be liquid and profitable.

iv. **Customers/Depositors of Funds**: Customers use the bank's products or services and demand security, convenience, and value. In other words, the customers' interest is to get quality products of the bank at affordable charges and such products or services must be available at the right time and place They are net savers who keep idle cash with the bank and they expect maximum liquidity to enable them have their funds back when they need them as agreed.

i. **Financial market/ Creditors**: Financial markets provide funding and liquidity to the bank and affect its reputation and stability. Bank creditors make available debt finances which the bank utilizes for growth and expansion. They require prompt payment of interest on their invested funds and full repayment of principal amount as at when due. They expect the bank to be profitable.

ii. **Borrowers of Funds**: This comprises those people who borrow money from the bank. They want the bank to grant them credit whenever they need it and also at the lowest interest rate. They provide investment outlet for the bank through lending, which is a major source of bank profitability. They expect the bank to be liquid.

iii. **Government/Regulatory Authorities**: The government provides the enabling environment for the banking business to operate, but expect reward in the form of taxation. They regulate and supervise the banks and protect the public interest. With delegated authority from government, regulatory authorities formulate laws and codes and also monitor and control activities of banking business. They ensure that banks do not take excessive risks, operate prudently within regulatory requirements and pay their taxes as good corporate citizens. In order to meet these expectations, they expect the bank to be both liquid and profitable.

iv. **Host community**: This refers to the people and area where the bank is situated, that is, the geographical location of the bank. The host community provides the bank with a good operational environment. It expects the bank to be a good socially-responsible corporate citizen, capable of maximizing and exploiting the opportunities available and minimizing the threats to the environment. The host communities are interested in the positive contributions of banks to the environments in which they are located.

The Need to Apply Stakeholder Theory in Banks' Corporate Governance

It is worthy to note that the differences in the expectations of the bank stakeholders results in a conflict between the bank's dual objectives of **liquidity** and **profitability**. The task of keeping the various interest groups satisfied can be daunting. This task continually faces the banks' board of directors and senior management, on whose shoulders, rest the responsibility of good corporate governance. The application of the stakeholder theory of corporate governance in this direction, becomes very imperative since it takes into cognizance the interests of all these stakeholders.

The stakeholder theory, among other things, seeks to ensure customer satisfaction, high employee morale and the maintenance of market discipline, which strengthens and stabilizes the bank. Good Corporate Governance in banks should involve a set of relationship between bank's management, its Board, its shareholders and other stakeholders. Lipunga, (2014) advanced the need for involvement of all stakeholders, as the promotion of good corporate governance is a collective effort and cooperation of all the stakeholders.

The stakeholder approach identifies and models the groups which are stakeholders of the bank, and therefore describes and recommends methods by which management can give due regard to the interests of those groups. The cooperation of all stakeholders including regulators is critical to maintaining public trust and confidence in the banking system and the economy as a whole because of the significant role that the banking sector plays in daily activities in the economy.

The applications of the stakeholder theory in governing the banks provides proper incentives for the Board and Senior Management to pursue objectives of the bank viz-a-viz the expectations of shareholders and other stakeholders. It ensures a well-articulated corporate strategy against which the overall success of the bank and the contributions of individual groups can be measured.

Stakeholder theory encourages bank managers to articulate the shared sense of value they created and identify a binding force that brings the core stakeholders together. According to Gitundu e tal. (2016), stakeholder theory encourages managers to develop relationships that inspire stakeholders to enhance a firm's performance. In this regard, it facilitates effective monitoring and encourages banks to use resources more efficiently.

Stakeholder theory proposes the inclusion of stakeholders in the constituent Board to attract the best resources around that will manage the organization in the best interest of all stakeholders (Nwonyuku, 2016). In effect, it helps the bank to increase productivity, improve employee satisfaction, and lower employee turnover rates, making talent retention and acquisition easier. The bank also benefits by using the positive feedback received from the customers, as happy customers act as unpaid marketers who help in increasing overall customer patronage.

The stakeholder theory provides the structure through which the objectives of banks and the means of attaining those objectives are set, and performance, monitored. It ensures strong internal and external audit functions, risk management functions and other checks and balances, and also ensures special monitoring of risk exposures where, conflicts of interest are likely and appropriate information flows internally and to the public.

Challenges of Applying Stakeholder Theory

The challenge to users of stakeholder theory, according to Tricker (2015), is how to identify the genuine groups that have the interest of a company. Many believe that the stakeholder theory intends to fulfill everyone's interests, which is practically impossible. Another challenge in the application of stakeholder theory is that a manager is accountable to a large and indefinite number of stakeholders without specific

guidelines on how to manage different conflicting interests. The complexity in operationalizing stakeholder theory is the difficulties in deciding what weight to attach to the competing interest of shareholders and other stakeholders (Nwonyuku, 2016). Many experts also criticize this theory because it lowers the management's focus on shareholder value, which may destroy the organization's overall value proposition.

Conclusion and Recommendations

Corporate Governance is necessary for the proper functioning of banks. Given the important financial intermediation role of banks in an economy, their high degree of sensitivity to potential difficulties arising from ineffective corporate governance and the need to safeguard depositors' funds, corporate governance for banking organizations is of great importance to the financial system. The unique feature of the banking sector demands extensive attention on the quality of corporate governance systems that promotes the interest of the stakeholders.

The stakeholders or various constituencies of a bank cannot be ignored in the management of a bank due to the various roles they play as well as their impact on the activities of the bank. However, key to the effective application of the stakeholder theory in banking is the realization that all stakeholders engage in some manner with the bank, with the expectation that the bank will deliver the type of value desired or expected. Thus, in corporate governance practice in the banking sector, the stakeholder theory ranks prominently because it considers the interest of various banks' stakeholders, thereby promoting the overall corporate efficiency of banks.

It is therefore recommended that banks should be acquainted with the various expectations of stakeholders and their rights as established by law. Banks should also engage in active co-operation with their stakeholders in creation of wealth, jobs and a financially sound enterprise as this helps to provide answers to the important issue of priorities in relationships among stakeholders as well as how to manage these relationships. Lastly, more stringent sanctions should be imposed on Board members and bank management who engage in acts inimical to the interest of corporate stakeholders.

REFERENCES

Adegbite, E. (2015). Good Corporate Governance in Nigeria: Antecedents, Propositions and Peculiarities. *International Business Review, 24,* 319-330.

Afolabi, A., & Dare, A. M. (2015). Corporate Governance in the Nigerian Banking Sector: Issues and Challenges. *European Journal of Accounting Auditing and Financial Research, 3*(5), 64-89.

Akinsulire, O. (2011). Financial Management, Seventh Edition. Lagos, Ceemol Nigeria Limited.

Akintoye, I.R. (2010). Corporate Governance and Reporting. A Paper Presented at ICAN Interactive Session for Accountants in Education. Lagos, 8th March.

Alaribe, D.C.S. (2014). Internal Audit and Corporate Governance-Benchmarking for Best Practices.

Awotunde, D.A; Kehinde, J.S; and Somoye, R.O.C. (2011). Corporate Governance and Stakeholders Interest: A Case of Nigerian Banks. *International Journal of Business and Management, Vol.6, No, 10, pp 102-109.*

Bateman, S.T. and Snell, A.S. (2013). Management: Leading and Collaborating in a Competitive World, 10th ed, New York, McGraw-Hill Irwin,

Bhasin, M.L. (2012). Voluntary Corporate Governance Disclosure: Evidence from a Developing Country. *Far East Journal of Psychology and Business Vol. 9 No. 2, pp 10- 31*

Cadbury Committee (2012). Financial Reporting Council on UK Corporate Governance Code.

Central Bank of Nigeria (2014). Code of Corporate Governance for Banks and Discount Houses in Nigeria.

Crespi, R., Garcia-Cestona, M. A. and Salas, V. (2002). Governance Mechanisms in Spanish Financial Intermediaries. Universitat Autònoma de Barcelona– 28-02.

Ezeocha, C.M. (2021). A Critical Review of Corporate Governance in Nigerian Banking Industry. *Bakolori Journal of General Studies, Vol. 11 No. 1, pp 2987-2998.*

Freeman, R. E. (1984). Strategic Management: A Stakeholder Approach. New York, Cambridge University Press.

Gupta, P. K., & Shallu, S. (2014). Evolving legal framework of corporate governance in India- Issues and challenges. *Juridical Tribune, 4*, 240-253.

Kurfi, A. K. (2021). Financial Management, Kano: Benchmark Publishers Limited.

Lipunga, A. M. (2014). Corporate Governance Practices in Commercial Banking Sector of Malawi: Evidence from annual reports. *Journal of Applied Finance and Business. 4*(5), 115-133.

Macey, J.and O'Hara, M. (2003), 'The Corporate Governance of Banks'. FRBNY Economic Policy Review. April

Nwonyuku, K. N. (2016). Corporate Governance and Profitability of Listed Food and Beverages Firms in Nigeria. *Industrial Engineering Letters, 6*(3), 47-105.

Oboh G.A.T., (2005). Challenges of Corporate Governance in Nigerian Banking Industry. Selected Essay on Contemporary Issues in The Nigeria Financial System. Ibadan, University Press Plc.

Okoi, I.O., Stephen, O., and Sani, J. (2014). The Effects of Corporate Governance on the Performance of Commercial Banks in Nigeria. International *Journal of Public Administration and Management Research*, Vol. 2, No. 2.

Omankhanlen, A. E; Taiwo, N. J.; and Okorie U. (2013). The Role of Corporate Governance in the Growth of Nigerian Banks. *Journal of Business Law and Ethics, Vol. 1 No. 1,*

Owojori, A.D. (2010). Corporate Governance and Disclosure: The impact of Corruption and Unaccountability on National Development. A paper presented at ICAN Interactive Session for Accountants in Education. Lagos, 8th March.

Ranti, U.O., (2011). Corporate Governance and Financial Performance of Banks: A study of listed banks in Nigeria. PhD thesis, Covenant University, OTA, Ogun State

Razums, W., and Laguna, M. (2018). Dimensions of Entrepreneurial Success: a Multilevel Study on Stakeholders of Micro-enterprises. *Front. Psychol.* 9, 791.

Sayogo, D.S. (2006). The Determinants of Corporate Governance Disclosure through the Internet for companies listed in Jakarta Stock Exchange.

Tricker, R. I. (2015). Corporate Governance: Principles, Policies, and Practices. Oxford, UK: Oxford University Press

Uwuigbe, O.R. (2011). Corporate Governance and Financial Performance of Banks: A Study of Listed Banks in Nigeria. Covenant University, Ota.