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CORPORATE GOVERNANCE AND RISK MANAGEMENT FRAMEWORKS: AN EMPIRICAL INVESTIGATION OF NIGERIAN DEPOSIT MONEY BANKS IN THE POST-CONSOLIDATION ERA

By

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Abstract

This study examines the impact of board independence, a key corporate governance mechanism, on risk management in Nigerian banks following the post-consolidation reforms. Analyzing panel data from 14 banks (2009-2018) using regression analysis, the findings reveal a mixed outcome. Board independence significantly strengthens capital adequacy but has no significant effect on asset quality (credit risk) or liquidity. This indicates a “governance decoupling,” where formal compliance exists without deep integration into core risk culture. The study concludes that while governance reforms have fortified capital buffers, their effectiveness in curbing credit risk and optimizing liquidity remains limited, calling for a strategic re-evaluation of board oversight.

Keywords: Corporate Governance, Risk Management, Board Independence, Nigerian Banks.

1 Introduction

1.1 Background to the Study

The Nigerian banking sector's journey in the 21st century has been one of radical transformation, precipitated by the landmark consolidation exercise of 2004/2005. Mandated by the Central Bank of Nigeria (CBN) under Governor Charles Soludo, this policy increased the minimum capital base from N2 billion to N25 billion, aiming to create “bigger, stronger, and more resilient” financial institutions (Soludo, 2004). While this successfully reduced the number of banks and increased capital buffers, it soon became apparent that size and capital alone were insufficient guarantors of stability.

The global financial crisis of 2008-2009, coupled with a subsequent domestic banking crisis, exposed critical vulnerabilities within the newly consolidated Nigerian banks. The collapse of several institutions and the CBN's intervention in others revealed a systemic failure in two interconnected areas: corporate governance and risk management. Banks were found to have engaged in massive, often poorly secured lending, particularly to the capital market

and oil and gas sectors, with governance structures too weak to rein in executive excesses (Sanusi, 2010). This period was characterized by questionable asset quality, inadequate liquidity planning, and boards that failed in their fiduciary duties of oversight.

In response, a wave of regulatory reforms was initiated, focusing intensely on strengthening corporate governance. The 2014 Code of Corporate Governance for Banks and Discount Houses in Nigeria and its successor, the 2018 Nigerian Code of Corporate Governance (NCCG), placed significant emphasis on the role of the Board of Directors, particularly the function of Independent Non-Executive Directors (INEDs). These codes were predicated on the theory that an independent board is essential for effective monitoring of management and for ensuring that risk-taking is prudent and aligned with the long-term health of the institution.

Against this backdrop, this study investigates the critical interplay between the corporate governance structure of banks—proxied by board independence—and the effectiveness of their core risk management functions,



specifically the management of capital risk, credit risk, and liquidity risk.

1.2 Statement of the Problem

Despite over a decade of intensive regulatory focus on corporate governance and risk management, the Nigerian banking sector continues to exhibit symptoms of underlying fragility. The ratio of non-performing loans (NPLs) remains volatile and often exceeds the CBN’s prudential threshold, indicating persistent credit risk management challenges. Furthermore, instances of corporate governance failures, such as the recent crisis in Skye Bank (now Polaris Bank), where auditors and executives were indicted for falsifying accounts, suggest that the reforms have not fully permeated the industry’s culture (CBN, 2018).

The core problem is a potential “decoupling” between the formal adoption of governance codes and their substantive integration into the risk management framework of banks. While banks may comply on paper by appointing the required number of INEDs, the tangible impact of this independence on key risk metrics like capital adequacy, asset quality, and liquidity is not well-established empirically in the Nigerian context. This study, therefore, seeks to answer the pivotal question: To what extent has enhanced board independence, as a key governance mechanism, translated into improved risk management outcomes in the post-consolidation Nigerian banking sector?

1.3 Objectives of the Study

The main objective is to assess the relationship between corporate governance and risk management in Nigerian DMBs. The specific objectives are to:

- Evaluate the impact of board independence on the management of capital risk (proxied by capital adequacy)
- Analyze the effect of board independence on the management of credit risk (proxied by asset quality)
- Investigate the influence of board independence on the management of liquidity risk (proxied by the liquidity ratio)
- Examine the consequential impact of these risk management metrics on bank profitability (ROA)

1.4 Research Hypotheses

- H01: Board independence has no significant impact on the capital adequacy of Nigerian deposit money banks
- H02: Board independence has no significant impact on the asset quality of Nigerian deposit money banks
- H03: Board independence has no significant impact on the liquidity levels of Nigerian deposit money banks
- H04: Capital adequacy, asset quality, and liquidity have no significant joint effect on the profitability of Nigerian deposit money banks

1.5 Significance of the Study

This study is significant for:

- Bank Regulators (CBN, NDIC): Provides evidence on the effectiveness of governance codes in driving sound risk management, informing future regulatory refinements
- Bank Boards and Management: Offers insights into how board composition and independence can be leveraged to strengthen the three pillars of banking risk, thereby enhancing stability and performance
- Investors and Depositors: Enhances understanding of the link between a bank’s governance structure and its risk profile, aiding in more informed decision-making
- Academic Research: Contributes to the literature on the governance-risk nexus in an emerging market context, moving beyond a direct governance-performance link

1.6 Scope and Limitations

The study focuses on 14 DMBs listed on the Nigerian Stock Exchange from 2009 to 2018, a period that captures the immediate post-consolidation and post-crisis regulatory environment. The primary limitation is the use of quantitative metrics, which may not fully capture the qualitative aspects of board effectiveness or risk culture.

2 Literature Review

2.1 Conceptual Framework

This study is built on a conceptual framework that positions corporate governance (specifically, board independence) as an antecedent to effective risk management, which in turn influences financial performance.

Figure 2.1: Conceptual Framework Model



Corporate Governance (Independent Variable)

- Board Independence (BRDIND)

→ Influences →

Risk Management Framework(Intervening Construct)

- Capital Risk (proxied by CADQ)
- Credit Risk (proxied by ASQLT)
- Liquidity Risk (proxied by LQDT)

→ Which determines →

Financial Performance(Dependent Variable)

- Return on Assets (ROA)

2.1.1 The Triad of Banking Risk

- Capital Risk (Capital Adequacy): The risk that a bank has insufficient capital to absorb unexpected losses. It is the foundation of a bank’s stability and is directly regulated through Capital Adequacy

Ratios (CARs). It serves as a buffer against other risks (BIS, 2010)

- Credit Risk (Asset Quality): The potential that a bank borrower or counterparty will fail to meet its obligations. It is the most significant risk for most banks and is primarily reflected in the quality of the loan portfolio. High NPLs are a direct indicator of credit risk management failure (Kadioglu, Telceken & Ocal, 2017)
- Liquidity Risk: The risk that a bank will be unable to meet its financial obligations as they fall due without incurring unacceptable losses. It involves managing the mismatch between asset maturities and liability maturities (GARP, 2013)

2.1.2 Corporate Governance as a Risk Mitigant

Corporate governance, defined as the system by which companies are directed and controlled, provides the structure for setting objectives and monitoring performance and risk. The board of directors is at the apex of this system. Agency Theory (Jensen & Meckling, 1976) posits that managers (agents) may take on excessive risk for personal gain at the expense of shareholders (principals). A robust board, particularly one with strong independent representation, is tasked with mitigating this by ensuring that management’s risk appetite is aligned with the strategic objectives and safety of the institution (Andres & Vallelado, 2008)

2.2 Theoretical Underpinning

This study is anchored in Stakeholder Theory (Freeman, 1984), which provides a broader and more fitting lens than the narrower Shareholder Theory. A bank’s failure has catastrophic consequences not just for shareholders, but for depositors, employees, the financial system, and the entire economy. Therefore, the board’s role in risk management is a quintessential stakeholder-oriented duty, aimed at preserving the bank as a going concern for all its constituents. The effective oversight of capital, credit, and liquidity risk is fundamental to fulfilling this duty.

2.3 Empirical Review

2.3.1 Governance and Capital Risk

Empirical evidence generally supports a positive link between strong governance and higher capital buffers. Udom and Eze (2018) found that capital adequacy positively impacts bank performance in Nigeria, suggesting that well-governed banks prioritize capital strength. Conversely, Popoola and Mlanga (2019) found an insignificant relationship, indicating that the link may be context-dependent.

2.3.2 Governance and Credit Risk

The evidence on governance and asset quality is mixed. Abdul-Gafoor et al. (2018) found that board independence improves bank performance in India, which could be mediated by better risk control. However, studies focusing directly on NPLs, such as Nzoka (2015) in Kenya, often find that asset quality factors have a significant negative impact on performance, implying governance has not been fully effective in curbing credit risk.

2.3.3 Governance and Liquidity Risk

The relationship is complex. Dietrich and Wanzenried (2014) note that achieving high returns while holding large liquid assets is difficult. An independent board might enforce prudent liquidity policies, but this could result in lower profitability in the short term, creating a tension between safety and returns (Obilikwu, 2018)

2.3.4 Gap in Literature

While numerous studies examine the direct link between governance and performance, few in the Nigerian context explicitly model risk management metrics (capital, credit, liquidity) as the outcome of governance and the driver of performance. This study fills this gap by proposing and testing this nuanced pathway.

3 Methodology

3.1 Research Design

The study employs an ex-post facto design, utilizing historical panel data.

3.2 Population and Sample

The population is all 21 DMBs in Nigeria (2009-2018). The sample is the 14 DMBs listed on the NSE, selected via a filtering technique to ensure data accessibility.

3.3 Data Source

Secondary data was extracted from the annual reports and financial statements of the sampled banks.

3.4 Method of Data Analysis

Data was analyzed using Stata 12. The analysis involved:

1. Diagnostic tests (Correlation, Descriptive Statistics, Normality)
2. Pooled OLS regression analysis

3.5 Variable Measurement and Model Specification

Table 3.5: Variable Measurement and Operationalization

| Constru ct | Variabl e | Acro nym | Type | Measur ement | Theore tical Justific ation |
|------------------------|---------------------|----------|----------------------------|---------------------------|------------------------------|
| Corpor ate Govern ance | Board Indepen dence | BRD IND | Indepe ndent | % of INEDs on board | Agenc y Theory ; NCCG (2018) |
| Risk Manage ment | Capital Adequa cy | CAD Q | Interve ning/ Indepe ndent | Equity / Total Assets | Accord s; BIS (2010) |
| Risk Manage ment | Asset Quality | ASQ LT | Interve ning/ Indepe ndent | Total loans/ Total Assets | Proxy for credit risk exposu |



| | | | | | |
|-----------------|--|------|-------------------------------------|-------------------------------------|-------------------------------------|
| | | | | | re |
| Risk Management | Liquidity | LQDT | Interve ning/ Indepe ndent | Liquid Asset/ Total Assets | GARP (2013) standar ds |
| Performance | Return on Assets Deende nt | LOA | Depen dent | Net Profit Total Assets | Rivard & Thoma s (1997) |
| Control | Firm size | FSZ | Contro l | Log of Total Assets | Standa rd in literatu re |

To test the hypotheses, two regression models are specified:
Model 1 (Testing H01, H02, H03): Assessing the impact of governance on risk metrics

$$CADQ/ASQLT/LQDT_{it} = \beta_0 + \beta_1 BRDIND_{it} + \beta_2 FSZ_{it} + \mu_{it}$$

Model 2 (Testing H04): Assessing the impact of risk metrics on performance

$$ROA_{it} = \beta_0 + \beta_1 CADQ_{it} + \beta_2 ASQLT_{it} + \beta_3 LQDT_{it} + \beta_4 FSZ_{it} + \mu_{it}$$

4 Data Analysis, Results and Discussion

4.1 Diagnostic Tests

4.1.1 Descriptive Statistics

Table 4.1.1: Descriptive Statistics

| Variable | Obs | Mean | Std Dev. | Min | Max |
|----------|-----|--------|----------|---------|---------|
| ROA | 108 | 0.0127 | 0.0212 | -0.0953 | 0.0562 |
| CADQ | 108 | 0.0929 | 0.2008 | -1.5475 | 0.2375 |
| ASQLT | 108 | 0.5579 | 0.1942 | 0.0600 | 1.0400 |
| BRDIND | 111 | 1.2555 | 6.9053 | 0.0600 | 73.3300 |
| LQDT | 107 | 0.2794 | 0.2118 | 0.0764 | 1.9953 |
| L_FSZ | 111 | 9.1370 | 0.3532 | 8.1945 | 9.7758 |

The negative minimum for CADQ is alarming and indicates that at least one bank was technically insolvent during the period, a stark reminder of the latent risks in the system.

4.2 Regression Results and Hypothesis Testing

4.2.1 Model 1: Governance -> Risk Management

Table 4.2: Impact of Board Independence on Risk Metrics

| Dependent Variable | BRDIND Coefficient | p-value | Result for H0 |
|--------------------|--------------------|---------|---------------|
|--------------------|--------------------|---------|---------------|

| | | | |
|-----------------------|---------|---------|----------|
| CADQ (Capital Risk) | 0.0051 | 0.028** | Rejected |
| ASQLT (Credit Risk) | -0.0009 | 0.810 | Accepted |
| LQDT (Liquidity Risk) | 0.0011 | 0.745 | Accepted |

Findings:

- H01 is Rejected: Board independence has a significant positive impact on capital adequacy. This suggests that independent boards are effective in ensuring that banks maintain stronger capital buffers, aligning with regulatory expectations and stakeholder theory
- H02 is Accepted: Board independence has no significant impact on asset quality. This is a critical finding, indicating that INEDs have been ineffective in curbing excessive credit risk or improving loan underwriting standards
- H03 is Accepted: Board independence has no significant impact on liquidity levels. This suggests that liquidity management is either highly technical and delegated to management or that boards are not prioritizing it strategically

4.2.2 Model 2: Risk Management -> Performance

Table 4.3: Impact of Risk Metrics on Profitability (ROA)

| Variable | Coefficient | Std. Error | p-value |
|-------------|-------------------|------------|----------|
| CADQ | 0.0404 | 0.0098 | 0.000*** |
| ASQLT | -0.0008 | 0.0099 | 0.932 |
| LQDT | -0.0024 | 0.0085 | 0.775 |
| L_FSZ | 0.0119 | 0.0053 | 0.027** |
| Constant | -0.0970 | 0.0487 | 0.049 |
| R-squared | 0.26 | | |
| F-Statistic | 8.38 (p=0.000) | | |

H04 is Rejected. The model is significant, and the risk metrics jointly influence profitability.

- Capital Adequacy (CADQ) has a strong, significant positive relationship with ROA. This underscores the dual benefit of strong capital: it enhances stability and profitability, likely by reducing funding costs and enabling strategic lending
- Asset Quality (ASQLT) has an insignificant relationship. This implies that a high loan-to-asset ratio does not automatically translate to higher profitability, especially if the loans are of poor quality—a finding consistent with the credit risk management failure suggested in Model 1
- Liquidity (LQDT) has a negative, though insignificant, relationship. This aligns with theory

that holding excess liquid assets, which yield low returns, can be a drag on earnings

4.3 Discussion of Findings

The results paint a picture of selective governance effectiveness in the Nigerian banking sector.

1. **The Capital Success Story:** The positive link between board independence and capital adequacy is the standout success of the post-consolidation reforms. It appears that boards have internalized the importance of capital preservation, likely due to its quantifiable nature and intense regulatory scrutiny
2. **The Credit Risk Conundrum:** The inability of board independence to significantly improve asset quality is the most concerning finding. It suggests a “governance deficit” in the core banking function of lending. This could be due to several factors: INEDs may lack the technical expertise to challenge complex credit decisions; credit risk may be intentionally obscured by management; or board oversight may be too high-level and infrequent to catch deteriorating asset quality in time
3. **The Liquidity Management Blind Spot:** The lack of a significant relationship suggests that liquidity is not a primary focus of board-level strategic risk discussion. It may be treated as an operational issue, leading to sub-optimal trade-offs between safety and profitability
4. **The Profitability Link:** The strong performance of capital adequacy confirms that sound risk management (in this area) is compatible with profitability. The negative coefficient for liquidity, while insignificant, serves as a warning against the cost of over-liquidity

5. Conclusion and Recommendations

5.1 Conclusion

This study concludes that the post-consolidation corporate governance reforms in Nigeria have had a mixed and nuanced impact on risk management. While they have been successful in strengthening the capital base of banks—a crucial first line of defense—their influence has been weak in the critical areas of credit and liquidity risk management. This indicates a partial “decoupling” where governance structures are in place but have not yet been fully leveraged to instill a robust, enterprise-wide risk culture. The boardroom, it seems, has mastered the arithmetic of capital but not yet the art of controlling credit and optimizing liquidity.

5.2 Recommendations

Based on the findings, the following strategic recommendations are offered:

1. **For Bank Boards (Strengthening Oversight):**
 - Move beyond capital oversight to implement more granular monitoring of credit risk through specialized board committees with credit expertise

- Elevate liquidity risk to a strategic board-level discussion, reviewing liquidity coverage ratios and stress testing results quarterly rather than annually
 - Implement mandatory technical training for INEDs on complex banking risks, particularly credit assessment methodologies and liquidity management frameworks
2. **For Regulators (Enhancing Frameworks):**
 - Strengthen the fit-and-proper requirements for INEDs to include demonstrated understanding of banking risks beyond general corporate governance
 - Mandate disclosure of board expertise matrices in annual reports to increase transparency about the technical competencies available at the board level
 - Consider introducing specific guidelines for board oversight of credit risk, similar to the existing requirements for audit committees
 3. **For Future Research:**
 - Conduct qualitative studies to explore the contextual factors that enable or hinder effective board oversight of credit and liquidity risks
 - Expand the temporal scope beyond 2018 to assess whether more recent regulatory interventions have altered the governance-risk management relationship
 - Investigate the role of board leadership structures (particularly risk and credit committees) as potential mediators between board independence and risk outcomes

The journey toward robust governance in Nigerian banks remains unfinished. Closing the gap between structural form and substantive oversight in credit and liquidity risk management represents the next frontier in strengthening the sector’s stability and sustaining its contribution to economic development.

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