



# Corporate Governance and Ethical Decision Making of Nigerian Commercial Banks: System Generalized Moment Method Approach



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**Abstract:** *The study investigates the impact of corporate governance mechanisms – specifically board composition, audit committee characteristics, and firm size on ethical decision-making among Nigerian commercial banks. The motivation arises from growing concerns about unethical practices in the banking sector despite existing governance codes, and the need to understand how governance structures influence ethical outcomes in an emerging economy. Despite regulatory reforms and the adoption of corporate governance frameworks, Nigerian banks continue to face ethical lapses, including fraudulent practices and weak compliance cultures. Prior studies have provided mixed evidence on how governance variables affect ethical behavior, and limited attention has been given to how firm-level governance mechanisms shape ethical decision-making within the Nigerian context. The study employed a System Generalized Method of Moments (GMM) estimation technique using panel data from selected 22 Nigerian commercial banks. Ethical decision-making served as the dependent variable, while board composition, audit committee, and firm size were the key explanatory variables, with financial leverage as a control variable. Findings revealed that board composition had a negative and statistically significant effect ( $\beta = -0.020$ ,  $p = 0.014$ ) on ethical decision-making, indicating that changes in board structure may reduce ethical focus. Firm size showed a weakly significant negative relationship ( $\beta = 0.000$ ,  $p = 0.022$ ), suggesting that larger banks may be less inclined toward ethical practices unless robust governance systems are in place. In contrast, audit committee and financial leverage displayed negative but statistically insignificant effects, implying limited direct influence on ethical decision-making. The study concludes that board composition is a critical determinant of ethical behavior in Nigerian banks. The findings underscore the need for balanced board structures, strong governance frameworks, and ethical leadership to foster integrity in corporate decisions. Policymakers and regulators should strengthen governance codes to ensure board independence, diversity, and competence, while future research should explore the moderating roles of corporate culture and regulatory enforcement in enhancing ethical outcomes.*

**Keywords:** Firm Size, Board Composition, Agency Theory, Audit Committee

## Introduction

Ethical decision-making is increasingly vital in banking, where strong corporate governance promotes transparency, accountability, and stability. Global scandals and Nigeria's 2009 banking crisis exposed how weak governance fosters fraud and mismanagement. Despite reforms like the CBN Corporate Governance Code and BOFIA 2020, unethical practices persist due to poor enforcement and weak oversight.

Grounded in Agency and Stakeholder theories, this study examines how firm size, board composition, and audit committee effectiveness affect ethical decision-making in Nigerian banks. Prior studies suggest that strong boards and independent audit committees enhance ethics, but little is known about how firm size interacts with these factors.

Using data from the CBN, NDIC, and FRCN, the study aims to provide insights for regulators and policymakers to strengthen governance and reduce unethical behavior. Persistent governance failures—such as board inefficiency, audit weakness, and rising fraud—continue to threaten investor confidence and financial stability. The research therefore seeks to clarify how governance mechanisms can foster ethical accountability and integrity in Nigeria’s banking sector.

### **Research Objective**

The main objective of this study is to analyse the effect of corporate governance on ethical decision making. Specifically:

1. To examine the effect of Firm size on ethical decision making.
2. To analyse the influence of Board Composition and ethical decision making.
3. To investigate the relationship between Audit Committee Effectiveness and ethical decision making.

### **Literature Review**

#### **Ethical Decision Making**

Ethical decision-making involves making choices that reflect moral values, fairness, and integrity (Wittmer, 2019). It requires individuals and organizations to balance ethical principles with real-world consequences. The concept can be viewed from three main perspectives—normative, psychological, and organizational—each offering a different understanding of how ethical choices are formed and applied.

The normative perspective focuses on moral theories such as deontology, utilitarianism, and virtue ethics (Versteegt, Van Dijke & Kaptein, 2025). It provides a clear moral foundation by emphasizing duty, outcomes, or character. However, it is often criticized for being too rigid and impractical in complex situations where values conflict or emotions play a role (Thoma et al., 1999; Van Zyl, 2018).

The psychological perspective examines how people actually make ethical decisions, drawing on models like Kohlberg’s stages of moral development and Rest’s Four-Component Model. It recognizes that emotions, biases, and social influences affect moral reasoning (Miner & Petocz, 2003). While it captures the realities of human behavior, it can undervalue ethical principles and lacks clear standards for judging right and wrong.

#### **Corporate Governance**

Corporate governance refers to the system of rules, practices, and processes that guide how organizations are directed and controlled (Tricker, 2015). It defines the relationships among key stakeholders—shareholders, boards, management, and regulators—to promote accountability, transparency, and ethical decision-making. Corporate governance can be viewed from three major perspectives: shareholder, stakeholder, and regulatory (Letza, Sun & Kirkbride, 2004; Stein, 2008). Each perspective offers unique insights, along with its strengths and limitations.

The shareholder perspective focuses on maximizing shareholder value, rooted in agency theory (Jensen & Meckling, 1976). Governance mechanisms like board oversight and executive compensation aim to align management’s actions with shareholder interests. This approach strengthens efficiency, profitability, and accountability (Lehmann, Warning & Weigand, 2004). However, it has been criticized for prioritizing short-term financial goals and neglecting

broader ethical, social, and environmental responsibilities, which can create reputational and ethical risks.

### **Firm Size**

Firm size refers to the overall scale and scope of a business, commonly measured by total assets, revenue, market share, or number of employees (Shalit & Sankar, 1977). Different schools of thought have offered varying explanations for why firms grow or remain small, with the neoclassical, managerial, and institutional schools providing three major perspectives (Shapiro & Shapiro, 1976; Brenner & Schwalbach, 2003). Each perspective contributes unique insights into the determinants and implications of firm size, along with distinct strengths and weaknesses.

The neoclassical school explains firm size through efficiency and production theory. It argues that firms expand when they achieve economies of scale, enabling them to lower production costs as output increases (Nell, 1980). Rooted in classical economics, this view assumes firms aim to maximize profits through optimal resource allocation (Huang, 2025). Its strength lies in offering a rational, quantitative understanding of firm growth focused on cost efficiency and competition. However, it is criticized for unrealistic assumptions about perfect markets and equal access to resources, overlooking the effects of real-world imperfections and managerial or institutional influences.

### **Board Composition**

Board composition refers to the structure and makeup of a company's board of directors, including the balance between executive and non-executive members, diversity, independence, and expertise (Grace, Ireland & Dunstan, 1995). It is a vital element of corporate governance because it shapes oversight, accountability, and strategic decision-making. Scholars have explained board composition through three main perspectives – agency theory, resource dependence theory, and the stakeholder perspective (Zelege, 2025) – each with unique insights and limitations.

From the agency theory perspective, board composition is seen as a tool for minimizing conflicts of interest between shareholders and managers (Kaur & Kaur, 2025). This view advocates for more independent, non-executive directors to enhance monitoring and ensure managers act in shareholders' best interests. Its main strength lies in promoting transparency, accountability, and control over management decisions. However, it is often criticized for focusing narrowly on shareholder value, neglecting broader stakeholder concerns, and potentially reducing industry expertise when independence is overemphasized.

The resource dependence perspective views board composition as a means of securing access to essential resources, networks, and external legitimacy (Spira, 2022). Directors are valued for their strategic knowledge, professional connections, and influence, which can strengthen organizational competitiveness and adaptability. This approach highlights the board's strategic importance beyond monitoring roles. Yet, it can also encourage overconnected boards, creating conflicts of interest and reducing independence, while too much focus on external relationships may weaken internal governance.

### **Theoretical Review**

Several theories explain the relationship between corporate governance and ethical decision-making. Among them, Agency Theory, Stakeholder Theory, and Stewardship Theory provide a solid foundation for this study.

Agency Theory (Jensen & Meckling, 1976) explains that conflicts often arise between shareholders and managers when managers act in their own interests rather than for the organization's benefit. In Nigerian banks, weak governance—such as poor board oversight and ineffective audit committees—can enable unethical practices like insider trading and misreporting. Larger banks, with more complex operations, require stronger controls to prevent such issues. The theory highlights the importance of robust governance systems to align management behavior with shareholders' interests and promote ethical decision-making.

Stakeholder Theory (Freeman, 1984) emphasizes that corporate governance should protect the interests of all stakeholders—employees, customers, regulators, and society—not just shareholders. In Nigerian banks, unethical actions like fraud and fund mismanagement harm these groups and erode trust. Effective board composition and strong audit committees are therefore essential for balancing stakeholder interests and promoting ethical governance.

Stewardship Theory (Donaldson & Davis, 1991) argues that managers act as trustworthy stewards who prioritize the organization's long-term success. Well-structured and independent boards and audit committees promote ethical leadership and integrity. In Nigerian banks, strong governance mechanisms encourage ethical decision-making and help prevent financial misconduct.

### **Empirical Review**

Recent studies emphasize the vital role of audit committee composition, diligence, and effectiveness in improving financial integrity and sustainability. Yahaya (2025) found that gender-diverse audit committees in Nigerian firms enhance earnings quality by strengthening ethical oversight. Aigienohuwa and Irowa-Omoregie (2025) showed that diligent audit committees improve asset efficiency, though gender diversity's impact depends on active participation. Jamil and Wahyuni (2025) reported that effective audit committees—defined by size, independence, expertise, and meeting frequency—significantly boost ESG performance, linking strong oversight to broader sustainability outcomes.

Research on firm size and ethical decision-making is limited, but related studies show that larger firms often benefit from stronger governance, innovation, and strategic capabilities. Chatterjee et al. (2024) found that big firms with data-driven cultures and strong leadership achieve higher innovation and performance. Farooq et al. (2022) showed that firm size strengthens the positive impact of good governance on performance, as large firms have more capacity to enforce accountability. Similarly, Ma et al. (2021) revealed that large firms make quicker, more strategic innovation decisions due to greater resources and credibility. Overall, firm size enhances governance effectiveness and strategic decision-making.

Research shows that board composition strongly influences governance quality, decision-making, and firm performance. Vianney et al. (2020) and Kim (2020) found that legal frameworks and active board participation improve governance outcomes. Studies on board diversity, such as Hartmann et al. (2020), Abou-El-Sood (2021), Nicolò et al. (2021), and Datta et al. (2021), revealed that gender-diverse boards enhance CSR, reduce risk-taking, and promote transparency. Other findings, including Barros et al. (2021), Simiyu et al. (2021), and Kirsch et al. (2021), show that effective and diverse board structures improve firm value, service delivery, and decision quality.

## **Methodology**

This section outlines the study’s methodology, including the research design, population, sampling, data collection, model specification, variable measurement, and data analysis methods. The research adopted an ex-post facto design, which examines cause-and-effect relationships without manipulating the independent variables.

The population comprised all 22 commercial banks in Nigeria with national licenses as of December 31, 2024, as listed on the Central Bank of Nigeria’s website. The study covered a five-year period (2019–2024), selected based on data availability.

## **Model Specification**

In order to achieve the objective of the study, the mathematical equation has been developed. The following model was used to examine the relationship between the corporate governance variables on ethical decision making of commercial Banks in Nigeria with national license is in line with the work of Gwaison and Maimako (2021) as follows;

$$EDM = \dots\dots\dots (1)$$

$$EDM = f(FSIZE, BCOMP, ACE, FL) \dots\dots\dots (2)$$

$$EDM_{it} = \beta_0 + \beta_1 FSIZE_{it} + \beta_2 BCOMP_{it} + \beta_3 ACE_{it} + \beta_4 FL_{it} + \mu_{it} \dots\dots\dots (3)$$

Where:

EDM= Ethical Decision-Making disclosure index, BSIZE= Firm Size, BCOMP=Board composition, ACE= Audit Committee,  $\mu$ = Stochastic error term/ random error term,  $i$ = Cross section dimension and ranges from 1 to  $n$  number of period,  $t$ = Time series dimension and ranges from 1 to  $t$  number of banks,  $\beta_1, \beta_2, \beta_3, \beta_4$  and  $\beta_5$  are the parameters to be estimated.

## **Measurement of Variables**

The study measured ethical decision-making using a disclosure index, where a score of 1 was assigned for ethics disclosure and 0 otherwise, following the approach of Othman, Ishak, Arif, and Aris (2014). Firm size was measured as the logarithm of total assets, in line with the method used by Shalit and Sankar (1977). Board composition was determined by the percentage of membership held by outside independent directors to total directors, as applied by Rashid, De Zoysa, Lodh, and Rudkin (2010). The audit committee variable was measured by the number of audit committee members, consistent with Ghafran and O’Sullivan (2013). For the control variable, financial leverage was measured as the proportion of total debt to total shareholders’ fund or equity, following Zain (2014).

## **Results and Discussion**

The descriptive results indicate that 73.6% of banks exhibit ethical behavior, though inconsistencies remain across institutions. Bank sizes vary greatly, with larger banks generally having stronger governance systems. Board composition shows limited independence on average, while audit committees average 8.5 members, meeting regulatory standards. Financial leverage averages 9.8%, suggesting low debt reliance but varying risk levels across banks.

Correlation results reveal weak negative relationships between ethical decision-making and all governance variables—firm size, board composition, audit committee, and financial leverage—indicating that increases in these factors slightly reduce ethical behavior. Governance variables themselves show mostly weak interrelations, with stronger boards and audit committees associated with lower leverage and more prudent financial management.

**System Generalized Method of Moments (System GMM) regression model**

**Table 1: System GMM Regression results**

EDM	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
BFSIZE	.02	.006	-2.74	.002	0	0	*
BCOMP	-.02	.008	-2.46	.014	-.036	-.004	**
ACE	-.029	.02	-1.46	.143	-.068	.01	
FL	-.38	.27	-1.41	.159	-.91	.149	
Constant	1.074	.185	5.81	0	.711	1.436	***
Mean dependent var	0.736		SD dependent var		0.443		
Overall r-squared	0.205		Number of obs		110		
Chi-square	11.867		Prob > chi2		0.018		
R-squared within	0.003		R-squared between		0.501		

\*\*\*  $p < .01$ , \*\*  $p < .05$ , \*  $p < .1$

Table 1 above shows the System Generalized Method of Moments (System GMM) regression model which was estimated to examine the impact of corporate governance mechanisms – firm size (BFSIZE), board composition (BCOMP), audit committee (ACE), and financial leverage (FL) – on ethical decision-making (EDM) among Nigerian commercial banks. The System GMM estimator was chosen because it effectively addresses key econometric challenges such as endogeneity, unobserved heterogeneity, and dynamic relationships, making it more reliable than Pooled OLS, Random Effects, or Fixed Effects models in panel data analysis.

The results show that firm size (BFSIZE) has a negative but weakly significant coefficient ( $\beta = 0.000$ ,  $p = 0.022$ ), suggesting that larger banks may be slightly less inclined toward ethical decision-making, although this relationship is only marginally significant at the 10% level. This could indicate that as banks expand, their focus on profit maximization might outweigh ethical considerations, unless strong governance structures are in place.

Board composition (BCOMP) shows a coefficient ( $\beta$ ) of -0.020, a standard error of 0.008, a t-value of -2.46, and a p-value of 0.014.

This means that board composition has a negative and statistically significant effect on ethical decision-making (EDM) among Nigerian commercial banks. Specifically, the negative coefficient implies that as the composition of the board changes – which may reflect factors like increased size, different mix of executive and non-executive directors, or changes in diversity – there is a decline in ethical decision-making. In other words, boards with certain compositions might be less effective at promoting ethical standards and oversight, possibly due to conflicting interests, lack of cohesion, or weak governance practices.

The statistical significance of this relationship suggests that the effect is not due to random chance, and board composition is an important determinant of ethical decision-making outcomes. This finding indicates that the structure and makeup of the board – including factors such as independence, expertise, and diversity – play a crucial role in shaping ethical behavior within organizations.

The audit committee (ACE) variable has a negative but statistically insignificant coefficient ( $\beta = -0.029$ ,  $p = 0.143$ ), implying that while there is a tendency for audit committee characteristics to negatively relate to ethical decision-making, the effect is not strong enough to be conclusive. This might indicate that the effectiveness of audit committees varies across banks or that other factors mediate their impact on ethical outcomes.

Financial leverage (FL), which is included as a control variable, also shows a negative but statistically insignificant effect, with a coefficient of -0.38 and a p-value of 0.159. This indicates that higher levels of debt relative to equity do not have a significant impact on ethical decision-making in Nigerian commercial banks. However, the negative sign suggests that increased financial pressure from leverage could potentially reduce the priority given to ethical considerations.

The Sargan test checks whether the instruments used in the System GMM model are valid and uncorrelated with the error term. With a chi-square value of 11.012 (df = 8) and a p-value of 0.201, which is above 0.05, the null hypothesis of valid instruments is accepted. This means the instruments are appropriate and the model estimates are reliable.

### **Discussion of Findings**

Both Ma, Zhu, and Liu (2021) and Farooq, Noor, and Ali (2022) highlight the crucial role of firm size in shaping how organizational structures and strategies affect performance and decision-making. Ma et al. found that larger firms, with greater innovation capacity, are more proactive in technology licensing, especially before patent disclosure, while smaller firms face constraints that delay such strategic actions. This shows that firm size influences not only innovation outcomes but also strategic timing and value realization.

Similarly, Farooq et al (2022) discovered that firm size significantly moderates the relationship between corporate governance and firm performance. Larger firms benefit more from strong governance practices, translating them into higher profitability and market value, while smaller firms often lack the capacity to fully leverage governance mechanisms.

The study found that board composition has a negative and significant effect on ethical decision-making, meaning that changes or imbalances in board structure can reduce ethical oversight. This aligns with Vianney et al. (2020) and Kim (2020), who noted that weak regulation and inactive boards hinder ethical governance. However, studies like Hartmann et al. (2020), Abou-El-Sood (2021), Nicolò et al. (2021), and Datta et al. (2021) show that board diversity – especially gender diversity – enhances ethics and transparency. Thus, the negative effect may reflect limited diversity and weak structures in Nigerian banks, highlighting the need for stronger, more inclusive governance reforms.

The study found that the audit committee has a weak negative but insignificant effect on ethical decision-making, meaning its presence or composition alone does not strongly influence ethical behavior in banks. This suggests that factors like governance culture, leadership, and ethical enforcement play a larger role. The result aligns with Aigienohuwa and Irowa-Omoregie (2025), who also found no significant link between audit committee diversity and efficiency. Overall, the finding indicates that structural features of audit committees are not enough to ensure ethical outcomes without strong institutional support and an effective governance environment.

### **Conclusion and Implication of the Study**

This study contributes to corporate governance research by showing how firm size, board composition, and audit committee features affect ethical decision-making in Nigerian banks. It finds that weak or poorly structured boards significantly reduce ethical behavior, supporting agency theory, while larger firm size slightly weakens ethical focus, consistent with stakeholder theory. Audit committee and financial leverage effects were insignificant, suggesting ethics depend more on culture and regulation than structure alone.

The study concludes that board composition is a critical determinant of ethical behavior in Nigerian banks. The findings underscore the need for balanced board structures, strong governance frameworks, and ethical leadership to foster integrity in corporate decisions. Policymakers and regulators should strengthen governance codes to ensure board independence, diversity, and competence. The study recommends stronger governance codes, ethics training, diverse and independent boards, and improved audit committee effectiveness. Future research should explore the moderating roles of corporate culture and regulatory enforcement in enhancing ethical outcomes.

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