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CORPORATE GOVERNANCE: CAN CREDITORS FIT IN WITH COMPANIES' BOARD OF DIRECTORS?

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Abstract

How do suppliers of finance make sure that firm managers enforce credit contracts, or do not invest in bad projects? This approach is missing in corporate governance research. To bridge the gap, we take steps towards developing a stakeholder perspective with the focus on examining the effects of creditor participation in a firm's top decisions, in relation to board performance. Based on a sample of 154 questionnaire survey responses from Nigerian public firms, after relating all measured items to every construct in the statistical tests of exploratory factor analysis (EFA), we employed the use of confirmatory factor analysis (CFA) in a structural equation modelling (SEM) approach for an in-depth analysis to estimate how well the stakeholder model fits the data. Building upon the construct creditor participation, and based on the proposed theory, we confirmed three dimensions – protect risk projects, protect collateral, and enforce contracts – to be confirmed measures of the latent construct. Significant creditors such as banks interfering in the firm's board, especially in major board decisions, can reduce the potentials of managers to engage in high-risk projects. This has significant positive effects on the board's role performance. However, items in the two dimensions – protect collateral and enforce credit contracts show weak measurements after EFA. The consequences are a new research agenda for boards has been set. The agenda will focus on the suppliers of debt finance, as significant to the firms akin with their equity shareholders' counterparts. This will create knowledge; reduce conflicts of interests, and exploitation; and ensure equitable distribution of firm value. The approach exposes firms to access more inclusive strategic inputs especially on important and less risky projects that will yield better margin and sustainable growth. This may stimulate further debates on other stakeholder researches that are vital to debt financiers and boards, thus becoming actionable for practitioners in decisions on projects.

Keywords: *Corporate governance, board role performance, creditors, risk projects.*

Introduction

In spite of the theoretical backing of the importance of suppliers of finance in the corporate governance structure, empirical evidence on governance discussion by large creditors is scarce. However, researchers find evidence of banks improving companies' performance more so than other block-holders (Gorton & Schmid, 1996; Kaplan & Minton, 1994). In Germany and Japan, the powers of the banks vis-a-vis companies are very significant because banks vote significant blocks of shares, sit on board of directors, play a dominant role in lending, and operate in a legal environment favourable to creditors (Jackson & Moerke, 2005). Even in the United States where equity shareholder is the focus in the governance structure, Gilson (1990) reports that banks play a major governance role

in bankruptcies, when they change managers and directors. In addition, De Long (1991) points to a significant governance role played by J.P. Morgan partners in the companies they invested.

Important questions are: How do the creditors get managers to return some of the profit to them? How do they make sure that the managers do not steal the capital they supply or invest in bad projects? Unlike highly-trained employees and managers, the initial debt investors have no special ability to help the firm once they have parted with their money. Their investment is sunk and nobody – especially the managers needs them (Shleifer & Vishny, 1997). Yet despite all these problems, outside finance occurs in almost all market economies, and on an enormous scale in the developed markets. Some reasons given in the literature are managers deliver on their agreement to pay back because of reputation-building (Diamond, 1991) and investor opportunism (Kaplan & Stein, 1993). Is the situation in emerging markets such as Nigeria the same? Apparently, procedures for turning control over to the banks are neither established based on existing law (e.g. Germany) nor on conventional norms (e.g. Japan), and worst still, the legal protection is not guaranteed (Okike, 2004) as well due to influences of personal interests and slow legal processes (World Bank, 2004). In line with the empirical evidence, which shows that banks improve company performance (Gorton & Schmid, 1996; Kaplan & Minton, 1994); and with the recent Central Bank of Nigeria is proactive stance on regulatory guidelines for Islamic banking, there are emerging Islamic corporate governance issues. Will the recognition of significant creditors at the top investment-decision processes of firms result in effective board performance for Nigerian firms?

Literature Review

Banks and Corporate Governance Structure

It is obvious that the Islamic mode of operations in financing differ significantly from its conventional counterparts, thus a different paradigm in the viewpoint of corporate governance. In the conventional literature, some scholars (Shleifer & Vishny, 1997; Whitley, 1999) inclined to believe that the success of the Japanese economy prompted the question whether the Japanese corporate governance model (stakeholder perspective) deserved to be considered as an alternative to the shareholder-focused model. Firms in Japan were provided with financial support by the government through the network of financial institutions, known as the convoy system, in which the main bank played the key role (Chaithanakij, 2008). The system empowered the main bank to play a critical role in monitoring the firms, which then resort to some risky business transactions, including involvement with the real estates and securities business. The system was in balance and it worked well. Government protection combined with cheap funds encouraged fast and steady industrial development (Freedman, 2007).

However, Aoki (2001) opined that the role of the main bank, which had been the strong pillar of the Japanese corporate governance, has gradually disappeared. The declining role of the central bank, which once used to be an effective control mechanism for firms (Aoki, 2001), has caused an unprecedented risk in the Japanese corporate governance landscape by knocking the high-level corporate power structure out of balance. Each large Japanese firm maintains a long-term relationship with one large bank, known as its main bank that acts as an outside monitoring institution beyond a financial service provider with the capacity to provide soft loans to ailing banks, and bail-out financially distressed banks and other financial trouble-laden firms (Chaithanakij, 2008).

They also punished failed management by replacing it with their own officers or other trusted bankers. This provided a credible discipline on the management of financial and non-financial firms (Aoki, 2001). Perhaps due to the burst of the economic burble in early 1999 that caused widespread bankruptcy in real estate firms and financial institutions, there were failures among the successful firms which sought bail-outs by the government through the convoy system. The strong criticism from the media against alleged

favouritism has brought the convoy system to a halt, along with the declining role of the main bank within the corporate governance landscape (Aoki, 2001; Freedman, 2007).

The participatory role of a financier (bank or any debt investor) to companies largely depends on the prevailing legal framework in the country. For example, Jackson and Moerke (2005) observed that despite broad similarities in Germany and Japan, the legal framework is a key area of difference. The two-tier board system in Germany reflects strong legal intervention into the internal make-up of the enterprise in order to promote effective checks and balances between management and shareholders. These non-contractual rights and obligations based on law contrast sharply with the informal arrangements of employee participation in Japanese firms, as well as the lack of separation between monitoring and management functions within Japanese boards. As a result, Japanese boards are more hierarchically structured, with decision-making focused on a group of senior representative directors under the CEO, and the focus is on longer-term profits to provide steadily growing benefits to its permanent employees (Aoki, 2005). In Germany, the whole managing board has equal responsibilities, in principle, and more influence and more leeway to participate (Jackson & Moerke, 2005).

In addition, corporate governance in Japan has a basic distinctive feature in that the main bank of a firm has had an important role as an efficient provider of funds, monitoring and disciplining the client firm, and assisting corporations to invest in more risky but high profit projects, which is termed the bank-based indirect financial system (Okabe, 2004). Thus the main bank system was an impelling force for the post-War high growth of the Japanese economy that attracted international attention in the 90s. After this, the World Bank initiated a large scale international research project on this type of financial system, publicised the research results, and recommended the suitability of this system to developing countries (Okabe, 2004). In this respect, Aoki (2001) praised the corporate monitoring role of the main bank system in Japan. However, Okabe (2004) observed that an increasing number of researches afterwards have shown, both theoretically and empirically, that the monitoring function of a main bank should, and in fact did, function not at any time but only when a set of conditions were satisfied. Table 1 below is a summary of the two types of financial systems and their properties.

Table 1

Anglo-American and Japanese-German Models

	Anglo-American Model	Japanese-German Model
Main financial transaction	In the open market	Bilateral transaction
Main funding instrument	Securities	Loan
Dependence on bank	Low	High
Nature of bank loan	Short-term	Short-term and long-term
Importance of internal funds	High	Low
Shareholding by banks	Not important	Important
Major shareholders	Households, institutional investors	Banks, intercorporate shareholding
Block share trading	Frequent	Not frequent

(continued)

	Anglo-American Model	Japanese-German Model
Corporate control	Stock market	Main banks
Information processing	Market acquires and distributes diversity of opinion and risk; information cost is low	Banks and client companies jointly own information by keeping long-term relationship; economies of scale in information acquisition
Allocation of risk	Risk is dispersed broadly to various economic agents	Risk is essentially concentrated in banks
Performance characteristics	More responsive to change	Superior at implementing corporate policies that require agreements among various groups
Suitable economic activity	Developing new industries, new technologies and starting up new businesses (product innovation)	Improving the production process and efficiency of existing products (process innovation)
Industry examples	Railways, computer and biotechnology	Automobiles and electronics

Source: Okabe (2004)

Looking at the trend of events, an important question to ask is how has the financing pattern of Japanese corporations, on which stakeholder corporate governance structure is based, evolved recently? To get the answer to this fundamental question, a study conducted in Japan by Okabe (2004) reported statistics for 1990–2001 as shown in Table 2 below. The summarised figures revealed the following: (a) the total amount of funds acquired maintained a clear downward trend throughout this period; (b) internal funds have always had an overwhelming importance; (c) acquisition of external funds declined drastically; and (d) of all the external finance sources, bank borrowing rapidly decreased while equity funding remained rather stable (Okabe, 2004).

Table 2

Sources of Funds of Private Non-financial Firms, Yearly Average in Trillion Yen

	1990-1993	1994-1997	1998-2001
Acquired funds total	86.2	53.0	37.7
Internal funds	52.5	48.1	43.6
External funds	33.7	4.9	– 5.9
New stock issue	2.7	2.4	2.1
Debenture	2.7	– 0.8	– 0.7
Bank borrowing	28.3	3.3	– 7.3

Source: Okabe (2004)

Nevertheless, in the two nations (Japan & Germany), unlike the Anglo-Saxon system that is fragmented among individuals and institutional investors oriented to financial gains from share-price appreciation and dividends, Jackson and Moerke (2005) affirmed that there are striking similarities in terms of their corporate ownership. It is typically concentrated among a stable network of strategically oriented banks and other industrial firms, with interests in promoting inter-firm cooperation, reducing risks, and generating relationship-specific rents; thus non-existent market for corporate control. Therefore, in these two societies, banks play the central external governance role through relational financing, combining debt and equity, providing financial services, and monitoring in times of financial distress – with Japanese main banks acting as delegated monitors through direct equity stakes, credit and dispatched directors (Sheard, 1994), while German universal banks are linked to credit, equity stakes, the exercise of proxy votes, and supervisory board representation (Edwards & Fischer, 1994).

Usually, financiers (Banks and other creditors) are involved in long-term and complex relations with industrial firms based on credit, large equity stakes, financial services and advice, representing shareholders as a delegated monitor or through proxy votes, holding seats on corporate boards, and being active in corporate rescues (Aoki & Patrick, 1994). Japanese main bank relationships were dramatically weakened as a consequence of the financial liberalization, which has eroded some rents from relational banking. Liberalization also eased the corporation's access to external capital markets, greater access to the bond market, rising share prices that led to cheap equity finance and thus increased competition among financial intermediaries, consequently reducing the demand for bank credits (Jackson & Moerke, 2005). In this regard, the lending to smaller and riskier firms by banks resulted in a huge volume of poor-risk assets. As this banking crisis unfolded, and despite Japanese banks' zero interest rate policy, banks reduced outstanding loans to meet capital adequacy ratios and created a credit crunch for smaller firms. This Japanese business model worked quite well in the past for industries of relatively low and moderate technology with stable market demand, but it does not seem to go hand in hand with rapid change in high technology sectors and those with uncertain business conditions (Chaithanakij, 2008).

On the wave of this interest, as Japanese banks were floating in the banking crisis, Germany was able to avoid a similar financial mishap. This attests to the importance of a country's prudence regulations, bank-regulator relationship and risk management. German banks seem more willing to let major firms go bankrupt – in: Holzmann 1999 and Walter Bau 2005, as seen in Jackson (2005), whereas Japanese banks remain more cautious about foreclosing on their clients. As large firms have become increasingly self-financing, usually through international equity markets, banks have sought to diversify from lending activities that generate interest based income to other types of fee-based income. For example in Germany, Deeg (1999) stated that private banks shifted away from industrial loans and deposits towards highly profitable investment banking services. This is a confirmation of an earlier assertion that the Deutsche Bank and the Dresdner Bank acquired British and US investment banks, shifted their equity holdings to subsidiary companies and divested from some large stakes (Jackson & Moerke, 2005). They further reported that banks were also slowly reducing their supervisory board seats: private banks held 20% of the seats in the largest 100 banks in 1974, but only 6% in 1993. The banks also faced growing dilemmas in maintaining traditional relational banking arrangements within a more market-oriented financial environment. Sometimes, board representation led to conflicts of interest with the banks' investment- banking activities (Hopner & Jackson, 2001).

Interesting continuities in the relations of corporate governance and banks were pointed out by Vitols (2004), who observed that despite the attempt to modernise the financial system and promote a new one, Germany still remained a bank-centered financial system. Notwithstanding

the boom of stock market activity during the IT bubble in 1999 and 2000, levels of activity have rapidly declined; hence firms still show a strong demand for bank finance. The continuity is focused by explaining several institutional factors ignored by recent debates, such as households still having a very limited demand for purchasing equity; large group of middle-income households preferring less risky assets such as bank deposits, unlike high-income households. Thus, the distinctive characteristics of Germany's financial system are not merely the product of financial regulation, but are sustained by the complementary institutions that govern household income and investment, as well as industrial organizations.

Turning to Japan, Miyajima and Arikawa, as seen in Jackson and Moerke (2005), investigated the pattern of bank lending to firms in the 90s and its implication to corporate governance. They found that larger and successful firms listed on the Tokyo Stock Exchange (TSE) tend strongly towards capital market finance. The authors do not predict the demise of the Japanese main bank system; rather the future role of the banks depends strongly on the restructuring of the banking sector perhaps through complementary roles in corporate restructuring. All these factors may contribute to revitalising bank monitoring capabilities, which will make the threat of intervention credible for struggling client firms. Taken together, bank–firm relationships thus display both continuity and change (Jackson & Moerke, 2005). Meanwhile, firms with low growth prospects still depend on the banks to finance their investments. Such high concentration of bank loans to poorly performing firms, gives strong incentives for banks not to push the necessary restructuring onto the client, given the constraints placed on the struggling banks to avoid their own capital shortage. The main bank system thus lost its positive function as an effective incorporate monitor in the 90s, and revealed a dark side. The authors do not however predict the demise of the Japanese main bank system. The future role of the banks depends strongly on the restructuring of the banking sector through new bank strategies, recent banking mergers, policy measures to reduce bad loans, and complementary roles in corporate restructuring played by new private equity investors and reformed bankruptcy procedures. All these factors may contribute to revitalizing bank monitoring capabilities, which will make the threat of intervention credible for struggling client firms, they concluded.

In sum, (Jackson & Moerke, 2005) opined that in both Germany and Japan, relationship-banking has not diminished completely, but has shifted towards different groups of firms. Banks are unlikely to regain their past monitoring capacity with regard to very large firms, but may continue to play a unique governance role among smaller credit-oriented firms. In addition, moves to market-based form of governance may have a potentially paradoxical result of weakening corporate accountability to the extent that banks play a weaker role as corporate insiders, but is not compensated for by more active role of outsiders. However, the regional differences of both countries will remain extremely important in mediating global pressures.

Currently, in the Nigerian business environment, no such similar arrangement exists either by law or conventional norms. As mentioned earlier, what is obtainable in the Nigerian context is the Anglo-Saxon model. However, empirical evidence found that both the German and Japanese firms' business models worked quite well in the past for industries of relatively low and moderate technology with stable market demand (Chaithanakij, 2005). In other words, Japanese firms availed the full opportunity by the effective utilization of the stakeholder model when the economy was developing, which transformed Japan and Germany into developed or emerged status. Therefore, it may not be out of place for Nigerian firms to adopt with modifications such a successful system because Nigerian industries are relatively of low and moderate technology with stable market demand; perhaps the emerging economy can as well be transformed to a sustainable economic growth for placing on corporate boards supervisory sits for significant debt investors.

Board Role Performance

'The phrase corporate governance is often applied narrowly to questions about the structure and functioning of the boards of directors' (Blair, 1995). This view was reflected in Donaldson (1990), who defines corporate governance as 'the structure whereby managers at the organizational apex are controlled through the board of directors, its associated structures, executive incentives, and other schemes of monitoring and bonding'. While Tricker (1994) states: 'Corporate governance addresses the issues facing the boards of directors, such as the interaction with top management, and relationships with owners and others interested in the affairs of the company, including creditors, debt financiers, analysts, auditors and corporate regulators'.

In the literature, empirical evidences show that there is the need to re-examine some governance arrangements to improve the scenario. In this regard, managers have incentives to expropriate a firm's assets by undertaking projects that benefit themselves personally but adversely impact shareholder wealth (Shleifer & Vishny, 1997). This means that the way of controlling the rights conferred on managers by large investors will have to be reduced. For example, cash flow rights are mechanisms of managerial control that can be mitigated by large investors' concentrated ownership, but they have potential for abuse because large shareholders can expropriate wealth from the smaller shareholders (Shleifer & Vishny, 1997).

In the literature on corporate governance, scholars are unanimous about the main functions of the board of directors that indicate their performance: *board monitoring role, board service role, and board networking role*. Nicholson and Kiel (2004) define effectiveness as three board outputs: organizational outputs, group-level outputs, and individual outputs. They stress that group dynamics have a powerful effect on a team's effectiveness, and so assessing board-focused outputs is vital to understanding how boards add value. By implication, Maharaj (2009) opines that any relationship between the board and corporate performance will be interceded by the effectiveness of the management team and the dynamics of the board of directors (BOD). To buttress the meaning of effectiveness, Sonnenfeld (2002) argues that exemplary boards are robust, effective social systems. This means extending their personal attributes and experience for social networking to be able to attract scarce resources that are beneficial for the organization.

Board Monitoring Role

In the agency theory, the conventional understanding of the boards of directors is that they reduce the costs associated with the separation of ownership and control especially in widely-held firms owned by a large number of small and dispersed shareholders who need to delegate the responsibility of running the firm to professional managers. Since these shareholders find it costly and lack the incentive to monitor management, managers may behave opportunistically to run the firm according to their interests rather than that of the shareholders. Thus, Zuaini and Napier (2006) opine that agency conflict arises when the manager neglects the minority shareholders' interests. Sarkar (2009) reports that managerial opportunism imposes agency costs, manifested in unobservable and often unverifiable actions taken by them such as expanding firm size beyond optimal level, consuming perquisites, or satisfying managerial hubris, all of which increase their private benefits but which reduce the value of the firm and hence the benefits to the shareholders.

As a corporate democracy, directors (legislature) are elected by the shareholders (citizens), to monitor the managers (executives) in view of shareholder interests. This view challenges the shareholders' choice of who should serve on the board to optimally fulfill these functions. To align the interests of managers and shareholders, the BOD defines a firm's purpose, strategizes and draws up plans to achieve that purpose, appoints the CEO, monitors and assesses the performance of the executive team, and assesses their own performance (Cadbury Committee Report, 1992). In other words, the most important function of the BOD is fiduciary duty to the shareholders and other stakeholders.

Board Service Role

As defined by Wan and Ong (2005), board performance refers to the ability of the board to execute its role effectively and be transparent to the public. Monitoring and service are the two main board functions under the agency theory. Strategy planning is the most important board task under the strategic choice model. In addition to dealing with conflicts resulting from divergent preferences of stakeholder coalitions, board service role in the behavioural perspective emphasizes the board members.

In terms of the board processes, a strengthening of the effort norms will make directors more aware and more willing to contribute to the performance of the board. In addition, a higher level of cognitive conflicts, which are task-oriented, are likely to make the directors perform their roles better. With more skills and knowledge within the board, there should be more service and strategic planning outcomes arising from board activities.

Boards of directors participate in the strategic decision-making process and support the top management in defining the strategic context of the firm (Stiles & Taylor, 2001). The board service task includes a set of related activities, such as evaluating and selecting strategic alternatives that have been developed by the top managers, providing advice to improve the quality of strategic decisions, and so on (Stiles & Taylor, 2001). A high level of service task performance is believed to have a positive impact on a firm's long-term competitive advantage (Andrews, 1980).

However, Stiles (2001) used a multi-method approach involving an in-depth examination of 51 directors of UK public companies, a survey of 121 company secretaries and four case studies of UK Plc, where multiple-board members were interviewed. Through the use of a grounded methodology, he examined the impact of the boards on strategy and showed that by establishing the business definition, gate-keeping, selecting directors, and confidence building, the board influences the boundaries of strategic action. Evidence for the managerial domination of the boards was slight, but the results showed support for a number of theoretical frameworks, suggesting that multiple perspectives are required to fully understand the nature of board activity.

Similarly, in a related joint effort, board effectiveness through an examination of the work and relationships of non-executive directors, it was argued that while board structure, composition and independence condition board effectiveness, it is the actual conduct of the non-executive directors vis-à-vis the executive that determines board effectiveness based on the Higgs review assessment (Roberts, McNulty & Stiles, 2005). Interestingly, since empirical studies do not reveal a conclusive relationship between board structure and firm performance, attention has shifted towards board-role performance. In this regard, Johnson, Daily and Ellstrand (1996) examined three conceptual models for the studying of board-role performance: structure, process and mediation models by developing 17 propositions for empirical research. This is in contrast to previous research which largely investigated board-role performance in general or under the dominant-agency perspective which emphasizes the board's monitoring role. Daily et al. (2003) for example, noted that "In addition to the monitoring role, directors fulfill resource, service, and strategy roles". Examining all four roles together in a single study has the potential to provide a richer perspective into board research. They explicitly advocate the role of board process instead of the traditional structure-performance.

Second, the tradition of board members being cronies of the CEO has not disappeared, and boards often are reluctant to challenge a CEO, especially a powerful and successful one. They often feel obligated to the incumbent for recruiting them to the board and they often have strong social ties to the CEO (Johnson et al., 1996; Ong & Wan, 2008).

In this respect, Ong and Wan (2008) conclude that understanding the nature of effective board-role performance is among the most important

areas in management research. When boards of directors are seen as stewards of organizational resources that impact, for better or for worse, the whole of society, the importance of understanding and improving the way they discharge their roles becomes apparent. Hence, by treating boards as decision-making groups and drawing an existing knowledge of board and group dynamics, researchers can focus directly on what boards need to do in order to perform their roles more effectively.

Board Networking Role

Networking refers to a system of trying to meet, talk and woo other business interests who may be critical to the firm's survival and success. Outside directors with high prestige and high status are usually co-opted by managers to increase the acceptance of the firm within its operational environment (Johnson et al., 1996; and Zahra & Pearce, 1989). Furthermore, representatives of external stakeholders, such as financial institutions can be co-opted in order to facilitate the firm's access to scarce financial resources (Johnson et al., 1996).

Stakeholder Theory

In contrast to the agency theory, advocates of the stakeholder theory argue that, a wider objective function of the firm is more equitable and more socially efficient than one confined to shareholder wealth (Freeman, 1984; Jones, 1995; Kay & Silberston, 1995; Donaldson & Preston, 1995; Collier, 2008; Sikka, 2008; and Fassin, 2009). They argue that, the well-being of other groups such as employees, suppliers, customers, and lenders, local community, who have a long-term association with the firm and therefore a stake in its long-term success, is recognized. These stakeholders are able to build trust relations, which support profitable investments and mutually beneficial exchanges (Kay & Silberston, 1995). They cite Japan and Germany as successful industrial societies in which extensive stakeholder involvement with the firm is pervasive, and corporate goals are defined more widely than shareholders' profits.

As a first line of criticism, it can be observed that this exclusive focus on the board's monitoring tasks is at odds with both corporate law and corporate practice. Blair and Stout (1999) analyse US corporate law and argue that although it may be most efficient to have directors elected by shareholders, their fundamental responsibility is with the firm itself. Hence, the principal-agent representation of the corporation is at odds with the legal description of the firm as a separate entity. Similarly, the shareholders cannot be formally taken as principals. On the contrary, the board of directors itself is better conceived of as representing the top of the corporate hierarchy, and the board's fundamental role is to mediate between all corporate stakeholders in situations where stakeholders' interests do not necessarily coincide (Kostant, 1999). A broader view of director responsibilities is likely to lead to the inclusion of strategic tasks as well. Therefore, a study of what boards actually do, and how independence affects these tasks, calls for a broader conceptualization of board tasks as an important element of corporate governance.

A second line of criticism addresses two fundamental assumptions of the principal-agent model. Firstly, interactions between board members and management are essentially seen as discrete events in the agency theory (Willenborg, van Ees & Huse, 2007). Consequently, decision-making in discrete settings is most efficient in case all actors act as if they meet for the first time. In particular, the disutility of monitoring perceived by the board members should be minimal and unaffected by the interests of the managers. Hence, independent boards are required to optimize the quality of board decision-making. So, the emphasis is not on the process of decision-making itself, but on the result-oriented decisions of the board with positive impacts on firms.

Thirdly, human nature in the agency theory is at odds with real-world observations (Willenborg, van Ees & Huse, 2007). Human beings are assumed to be fully rational, capable and self-interested agents. Although corporate governance scandals have shown that self-interest exists, it

is not out of place to ponder on the old-adage that 'it is human to err'. Consequently, the assumption that all deviations from the goals are due to intentional misappropriation requires qualification (Hendry, 2005). This also implies that boards can be called upon to provide their expert advice to the management instead of the saint-devil impression.

Therefore, the assumption of the arm's length bargain underlying the classical principal-agent model does not capture the social dynamics inside the boardroom. In addition, dispersed corporate ownership cannot be regarded as a sufficient condition for the conclusion that the interaction between the board and the managers is best conceived of as discrete events between anonymous actors. At best, the emphasis on board independence as a precondition of optimal control can be regarded as only one element of a more comprehensive picture of social interaction (Willenborg, van Ees & Huse, 2007). Boards can be considered as special working groups, of executives and non-executives, characterized by a cognitive output, complex decision-making and restrictive communication and operating procedures. The individual expertise and knowledge as well as the relational capital of the board members serve as inputs for the decisions of the board.

In addition, using the stakeholder theory, Collier (2008) focuses on regulators, lenders and tenants as other dimensions of corporate governance. Focussed entirely on employees, Sikka (2008) uses the stakeholder theory to assess the role and importance of workers within the system of corporate governance in the UK. In spite of the theoretical backing of the importance of the suppliers of finance in the governance structure, empirical evidence on governance discussed by large creditors is scarce. However, researchers find evidence of banks improving companies' performance more than other block-holders (Gorton & Schmid, 1996; Kaplan & Minton, 1994). In Germany and Japan, the powers of the banks vis-a-vis companies are very significant because banks vote significant block of shares, sit on board of directors, play dominant roles in lending, and operate in legal environments favourable to creditors. In the United States, Gilson (1990) reports that banks play a major governance role in bankruptcies, when they change managers and directors. In addition, DeLong (1991) points to a significant governance role played by J.P. Morgan partners in the companies they invested.

In Nigeria, where procedures for turning control over to the banks are not established based on existing law, and where legal protection is not guaranteed (Okike, 2004) as well as due to influences of personal interests or slow legal process (World Bank, 2004), the need to include large creditors in the investment-decision processes of firms cannot be over-emphasised, especially that empirical evidence show banks improve company performance (Gorton & Schmid, 1996; Kaplan & Minton, 1994). It is therefore reasonable to suggest that:

H - *Creditor participation on board is significantly related to Board Role Performance*

Methodology

There is widespread recognition that a strong board aids adequate investor protection, and other relevant stakeholders that can substantially not only affect public firms, in their ability to commit to stakeholders, improve firm value, effective board performance, but also the development of capital markets and the growth of the economy in general (Jones, 1995; Sikka, 2008; Bhagat et al., 2008; and Fassin, 2009). These developments sparked nations, academics and rating agencies develop many dimensions of corporate governance and indices for evaluating the quality of corporate governance practices in public firms.

However, Figure 1 shows a theoretical framework model where the exogenous latent constructs (creditor participation) are represented by three reflective dimensions – protect risky contracts, protect collateral and enforce credit contracts, with 11 measurement items, while the endogenous latent construct (board role performance) is measured by 9 items. These

developments sparked nations, academics and rating agencies develop many dimensions of corporate governance and indices for evaluating the quality of corporate governance practices in public firms. As mentioned earlier, this study employs the use of confirmatory factor analysis (CFA) in a structural equation modelling (SEM) as the statistical technique to test how the overall model tests the data. In other words, indicators are associated with each latent construct and are specified by the researcher from an established theoretical framework (Hair et al., 2010).

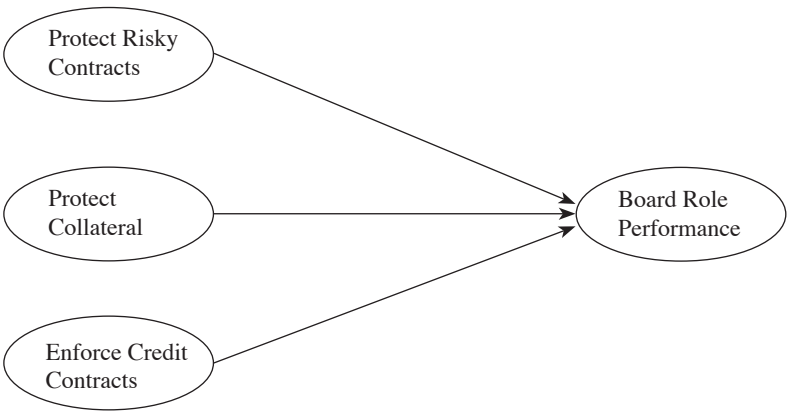


Figure 1. Stakeholder theoretical framework of creditors.

Sample

The empirical study was carried out using public listed companies in Nigeria as the sample frame. Listed companies are chosen because they are regulated, easier to obtain data and are also more accurate since they are certified. The population of 318 Nigerian listed companies was targeted for the study, but a sample of 154 was achieved, of which 30% was considered adequate for further statistical analysis (Rea & Parker, 2005). As a first step, an informal chat with a few middle and high level managers and an overview of the study background in the literature confirmed that the questionnaire approach was appropriate and logical. All the data for the employee participation variables were obtained from responses to a 5-points Likert Scale questionnaire. Great care was taken in adapting the questionnaire.

Instrumentation and Measurements

As a first step, a series of discussions with experts who possess relevant research experience in corporate governance were held. Thus, based on the research findings in the literature, the survey questionnaire items (refer to Table 1) for the construct were adapted and in some instances developed. In addition, the UK Innovation questionnaire largely influenced the adoption of some questionnaire items. Though we have not seen any previous efforts to test similar constructs, based on the proactive efforts embarked upon, the content validity was deemed adequate.

As a pre-test process, the research instrument was submitted to four senior academics with extensive combined experience in survey research. They were able to provide critical assessment of the content (face) validity of each item, as suggested by Rea and Parker (2005). These expert suggestions during the questionnaire design and revision process helped ensure a close match between the pre-test and the final version of the instrument. Piloting of the survey instrument was accomplished

by administering the questionnaire to a small sample (30) of respondents in Nigeria whose responses and general reactions were sought and examined. Luckily, all those that participated in the questionnaire pre-test were sufficiently knowledgeable about the issues of relevance to the field of inquiry. Among them were nine high-level managers, one company secretary, and one CEO.

The questionnaire contained a total of 26 sets of statements including 4 demographic questions. Each of these sets of questions required a single response (tick as appropriate in the answer options 1-5) for each of a range of items. Each statement was rated by the respondents on a range of measures scaled from 1 "strongly disagree" to 5 "strongly agree". Greater scores mean a higher level of constructs. Items specific to a given construct were separated from each other in the questionnaire to minimize consistency bias and reduce any sense of repetitiveness. Additionally, each measure included at least one reverse-coded item. The questionnaire cover motivated participation by suggesting the usefulness of the questionnaire as an evaluation tool for reflection on the participants' own corporate experience, indicating the amount of time required to complete the survey, and assuring participants of anonymity and confidentiality. The field operation of these variables is discussed below.

Results: Data Analysis

All internal consistency reliabilities based on Cronbach's alphas for the 5-point interval scale measurement items are better than the results in the pilot survey. In the main study, the three manifest

Table 1

Reliability of Measurement Items

Board Role Performance (Endogenous Variable): Measurement Items	*Cronbach's alpha*
Monitoring (3 items)	*0.777*
The board engages in succession planning for CEO	
The board evaluates the performance of top executives	
The board controls plans and budget.	
Service (4 items)	*0.842*
The board contributes to the implementation of strategic decisions	
The board takes long-term strategic decisions	
Board's suggestions frequently improve strategic decisions	
Board benchmark strategic plan with industry data.	
Networking (2 items)	*0.780*
The board contributes to the acceptance of the firm in the environment	
The board provides contacts with relevant stakeholders.	
Creditor Participation (Exogenous Variable):	
Risk (4 items)	*0.814*
Bank on firm's board reduces potentials to squander credit funds on projects	
Bank on firm's board assures other financiers safety on their investments	
Bank participation in project decisions assures effective credit utilization	
Debt investor rights to legal protection are disincentive to management misdemeanor.	

(continued)

Board Role Performance (Endogenous Variable): Measurement Items	*Cronbach's alpha*
Collateral (4 items)	*0.852*
The use of high powered contracts is limited by fear of management self-dealing	
Equity financing covered by sufficient collateral reduces debt-risk exposure	
The use of high-powered contract is limited by optimal design of incentives	
Dominant bank ownership influences management to pay back debts.	
Enforcing Credit Contracts (3 items)	*0.758*
Bankruptcy law does not assure quick recovery to pay back debts of firms	
Widely held equity investments facilitate debt financing	
Large financiers are tough enough on managers despite inefficient legal system.	

variables measuring board-role performance and creditor participation are internally consistent with 0.777, 0.842, 0.780 & 0.815, 0.852, and .0.758 respectively. In this paper, the data analysis was conducted in two stages. First, as stated above, the scale reliability coefficient was calculated for each of the scales used in creditor participation and board-role performance. Cronbach's reliability coefficients ranged from 0.777 to 0.852. Since all the figures were above the 0.70 accepted threshold suggested by Hair et al (2010), it shows that the items achieved the accepted correlation level to retain them under each scale for further statistical analysis. In this respect, the exploratory factor analysis (EFA) using the principal component method with varimax rotation was conducted on both the board performance and creditor participation variables to examine their dimensionalties not based on any theoretical underpinning. Five items were removed because of low communality figures (< 0.5). The remaining measured items were confirmed using the CFA based on the proposed theoretical framework, and the relationships between creditor participation and board-role performance constructs were empirically tested using the structural equation modelling.

Exploratory Factor Analysis (EFA)

In contrast to CFA, EFA does not require a priori hypotheses about how indicators are related to underlying factors or even the number of factors, hence the term "exploratory" (Kline, 2005). In other words, there is little direct influence on the correspondence between the indicators and the constructs. In this regard, Kline (2005) affirmed that EFA is not generally considered a member of the SEM family, though it is a statistical technique used for evaluating a measurement model. In this study, as a first step, EFA was performed to evaluate the questionnaire items that measure each of the latent constructs through an iterative process.

The exploratory factor analyses were carried out using the principal component analysis and the varimax rotational methods in order to extract the dominant factors and indicators within each factor that share common variance. The direct oblimin rotational method was not selected for this study because of its assumptions that the factors are correlated with one another. It is the correlation of factors that the study intends to confirm for the measurement model (CFA) after exploring for the study measures.

In this respect, three factors with an eigenvalue greater than five explained 67% of the variance for the construct creditor participation using the principal factor analysis. Two items were removed from the scale. The varimax-rotated factor pattern implies that all the three factors concerned – risk; collateral; and enforce

contracts with the 11-item scale (α = 0.693; KMO = 0.760; and < .001 Sig) measuring the construct present acceptable figures to build the latent construct creditor participation for further statistical analysis. The result of the EFA for creditor participation is shown in Table 2 below.

Table 2

EFA: Creditor Participation (Exogenous Variable)

Measurement Items	Factor Loadings	% of Variance
Bank sit on firm's board reduces the risk to squander credit funds	0.740	67%
Bank sit on board assures other financiers' safety on investment	0.805	
Board involving bank in project decisions assure credit utilization	0.846	
Debt investor legal right is disincentive to CEO misdemeanor	0.796	
Use of high powered contract is limited by fear of CEO self-deal	0.715	
Financing backed with large collateral reduces debt-risk exposure	0.846	
Use of powerful contract is limited by optimal design of incentive	0.892	
Bank's dominant debt ownership influences CEOs to settle debts	0.861	
Powerful interest in banks preserve inefficient governance system	0.836	
Bankruptcy law does not assure quick recovery of debts from firm	0.838	
Widely held investments facilitate quicker financing approval	0.763	
Kaiser-Meyer-Olkin Sampling Adequacy	.760	
Bartlett's Test of Sphericity: Appr. Chi-Square	657.631	
df	55	
Sig.	.000	
Eigenvalue	2.9	
Cronbach's Alpha (α)	.693	

Table 3

Board-role Performance

Measurement Items	Factor Loading	% of Variance
Board controls plans and budget	0.788	66%
Board evaluates performance of top executives	0.850	
Board engages in succession planning for CEO	0.696	
Board takes long-time strategic decisions	0.680	

(continued)

Measurement Items	Factor Loading	% of Variance
Board's suggestions frequently improve strategic decisions	0.860	
Board contributes to the implementation of strategic decisions	0.686	
Benchmark strategic plan with industry data	0.789	
Board contributes to the acceptance of the firm in the environment	0.600	
Board provides contacts with relevant stakeholders	0.762	
Kaiser-Meyer-Olkin Measure of Sampling	.893	
Bartlett's Test of Sphericity: Approx. Chi-Sq	680.081	
	36	
Sig.	.000	
Cronbach's Alpha (α)	.893	

Similarly, three factors with an eigenvalue greater than five explained 66% of the variance for the endogenous construct board-role performance using the principal factor analysis. Two items were removed from the scale. The varimax-rotated factor pattern implies that all the three factors concerned – monitoring; service; and networking with the 11-item scale (α = 0.893; KMO = 0.893; and < .001 Sig) measuring the construct present acceptable figures to build the latent construct board-role performance for further statistical analysis. The result of the EFA is shown in Table 3.

In the structural equation modelling (SEM), the measurement model is evaluated first to confirm the measurement adequacy of the items for the construct. The second stage involves the evaluation of the structural model, which shows a regression-like relationship between the constructs. This two-stage approach will overcome the problem of localizing the source of poor model fit associated with other single-step approaches (Kline, 1998). However, before proceeding to the SEM data analysis, it is necessary to test the validity of the two constructs. Having ascertained both the internal consistency of the items (see Table 4), and the EFA test, the next section will discuss construct validity.

Measurement Error in SEM

An important question is how do we represent theoretical concepts and then quantify the amount of measurement error? In this paper, the measurement model enabled us to use all the 20 measured items to adequately define the two latent constructs, and then the model was used to assess the extent of measurement-error known as *reliability*. From the stakeholder's perspective, creditor participation is complex, and can have many dimensions. Hence the design of the 11 best items to measure the construct. However, in its most basic form, measurement-error is due to inaccurate responses, data entry errors, interpreting questions differently from what the researcher intended, or the natural degree of the respondents' inconsistency when multiple items are used to measure same construct (Hair et al., 2010). With the application of CFA, it becomes easier to assess the contribution of each indicator and measure how well the combined set of indicators represents the latent constructs (reliability and validity). In this study, we were able to incorporate the extent of the measurement-error into the statistical estimation; thus we improved the structural model (see Figure 2).

Composite Reliability

Reliability is an assessment of the degree of consistency between multiple measurements of a variable. The first measures we considered in this paper was the reliability coefficient, which assessed the entire scale, with Cronbach's alpha (see Table 1) being the most widely used measure (Hair et al., 2010). Generally, reliability is inversely related to measurement-error. In other words, as reliability goes up, the relationships between a latent construct and the indicators are greater, meaning that the construct explains more of the variance in each indicator. If reliability is 1, i.e. 100%, then measurement-error is 0. But in statistical reality, no indicator items can perfectly define a latent construct. SEM offers the advantage of automatically accounting for measurement-errors. Also available are reliability measures derived from confirmatory factor analysis, such as the composite reliability. In Table 4, the range of the factor loadings for the construct creditor participation is 0.715 to 0.892. This is the correlation between the original construct and the indicator factors, with higher loadings making the construct representative of the factor. Squared-factor loadings indicate what percentage of the variance in an original construct is explained by a factor. For example, the 0.740 loading on item risk1 explains 54.8% of the variance of the construct creditor participation. In sum, for all practical and statistical significance, factor loadings for the two latent constructs (20 items) - creditor participation and board-role performance exceeded the 0.50 threshold set by Hair et al. (2010). Similar with the standard deviation of any set of data values, the standard error is the expected variation of an estimated regression coefficient, but instead denotes the expected range of the coefficient across multiple samples of the data. It is usually useful in statistical tests of significance that test to see whether the coefficient is significantly different from zero. It has been affirmed by Hair et al. (2010) that reliability is also an indicator of convergent validity, and that different reliability coefficients do not produce dramatically different reliability estimates, but a slightly different *composite reliability* value. It is computed from the squared sum of factor loadings for each construct and the sum of the error variance terms for a construct as represented by A/A+B. The high composite reliability value of 0.907 confirms the assertion that sometimes Cronbach's alpha coefficient understates reliability (Hair et al., 2010).

Table 4

Composite Reliability (Creditor Participation)

Latent Variable	Item Code	Factor Loading	(Factor Loading)^2	Std. Error	(FL)^2 + Std. Error	Composite Reliability
Creditor Advisory	RS1	0.74	0.548	0.066		A/A+B
	RS2	0.805	0.648	0.058		
	RS3	0.846	0.716	0.065		
	RS4	0.796	0.634	0.073		
	CL1	0.715	0.511	0.087		
	CL2	0.846	0.716	0.091		
	CL3	0.892	0.796	0.083		
	CL4	0.861	0.741	0.083		

(continued)

Latent Variable	Item Code	Factor Loading	(Factor Loading)^2	Std. Error	(FL)^2 + Std. Error	Composite Reliability
	CC1	0.836	0.699	0.053		
	CC2	0.838	0.702	0.047		
	CC3	0.763	0.582	0.044		
			A Σ 7.292	B Σ 0.75	8.0422	0.907

Table 5

Composite Reliability (Board-role Performance)

Latent Variable	Item Code	Factor Loading	(Factor loading)^2	Std. Error B	Σ (FL)^2 + Σ Std. Err	Composite Reliability
Board Performance	MN1	0.788	0.621	0.054		A/A+B
	MN2	0.85	0.722	0.067		
	MN3	0.696	0.484	0.057		
	SV1	0.68	0.462	0.063		
	SV2	0.86	0.739	0.063		
	SV3	0.686	0.471	0.065		
	SV4	0.789	0.623	0.056		
	NT1	0.6	0.360	0.065		
	NT2	0.762	0.581	0.064		
			A Σ 5.064	Σ 0.554	5.618	0.901

Convergent Validity

A measure may be internally consistent (reliable) but not accurate enough to measure a particular construct (valid). Construct validity is the extent to which a set of measured items actually reflects the theoretical latent construct those items are designed to measure (Hair et al., 2010). A fundamental assessment of construct validity involves the measurement of the relationships between items and constructs (i.e., the path estimates linking construct to indicator variables). In CFA application, larger standardized loading estimates confirm that the indicators are strongly related to their associated constructs and are a indication of construct validity. A rule of thumb suggests that standardized loading estimates should be at least .5 and ideally .7 or higher. Low loadings suggest that a measured variable is a candidate for deletion from the model (Hair et al., 2010). A more appropriate idea to discuss construct validity for CFA/SEM is the convergent validity. The items that are indicators of a specific construct should converge or share a high proportion of variance in common, known as convergent validity (Hair et al., 2010). One of the important ways available to estimate the relative amount of convergent validity is: high loadings

on a factor would indicate that they converge on a latent construct. Since the standardized parameter estimates are constrained to range between – 1.0 and + 1.0, Hair et al. (2010) stated that, a good rule of thumb is that standardized loading estimates (R) should have a regression weight of 0.5 or higher, and ideally 0.7 or higher. Looking at Tables 4 & 5 below, all the items have R value < 0.5. Also, with the exception of MN1, MN2, and RS1, with R values 0.600, 0.607, and 0.613 respectively, all the other items have R ≤ 0.7. The rationale behind this can be understood in each item's communality, which represents the amount of variance accounted for by the factor solution for each item. In this paper, all the items have been assessed to meet acceptable levels of explanation, i.e. < 0.5. The square of a standardized factor loading represents how much variation in an item is explained by the latent construct and is termed the variance extracted, sometimes referred to as *squared multiple correlation* (SMC). The result in the Table below indicate acceptable construct validity because the figure of 0.992 for construct reliability are > that of variance extracted, 0.931 for the construct board-role performance, and 0.978 for construct reliability are > that of variance extracted, 0.917.

Table 6

CR & VE: Board Performance

Item Code	Std. Loading	(Std. Loading)^2	(Σ Std. Loading)^2	Σ (Std. Loading)^2	Std. Error	Σ Std. Error	Constr Relibty: A/A+B	Variance Extractd C/ C+B
MN 1	0.600	0.360			0.034			
MN 2	0.607	0.368			0.053			
MN 3	0.709	0.503			0.003			
SV 1	0.700	0.489			0.038			
SV 2	0.725	0.526			0.036			
SV 3	0.727	0.529			0.038			
SV 4	0.740	0.548			0.027			
NT 1	0.757	0.573			0.036			
NT 2	0.730	0.533			0.037			
	Σ 6.294		39.614 (A)	4.427 (C)		0.329 (B)	0.992	0.931

The Creditor Measurement Model (CFA)

In a CFA model, the Squared Multiple Correlation (SMC) values represent the extent to which a measured variable's variance is explained by a latent construct. The rules provided for the factor standardized loading estimates tend to produce the same diagnostics because the SMC is a function of the loading estimates regardless of whether the researcher is estimating in a congeneric measurement model, CFA or path model with latent constructs (Holmes-Smith et al., 2005). In addition, a major component of construct validity is convergent validity – items that are indicators of a specific construct

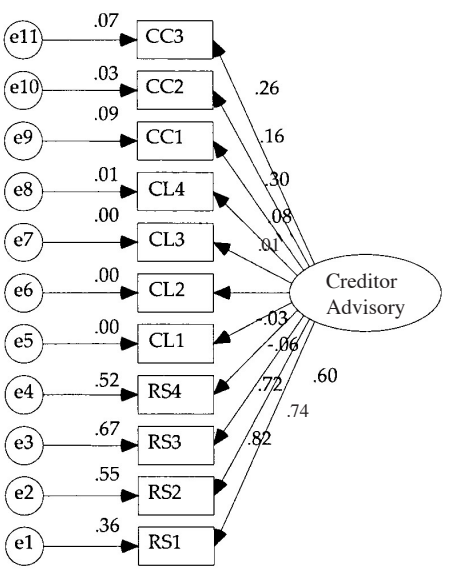
Table 7

Creditor Participation

Variable & Item Code	Std. Loading	(Std. Loading)^2	(Σ Std. Loading)^2	Σ (Std. Loading)^2	Std. Error	Σ Std. Error	Constrc RelibltyA/ A+B	Varianc Extrctd: C/C+B
Creditor								
RS 1	0.613	0.376			0.055			
RS 2	0.754	0.569			0.036			
RS 3	0.804	0.646			0.043			
RS 4	0.729	0.531	8.41 (A)	2.122 (C)	0.058	0.192 (B)	0.978	0.917
	Σ 2.900							

should converge or share a high proportion of variance in common. Factor loadings, variance extracted (or SMC), average variance extracted (AVE) and construct reliability are some of the available ways to estimate the relative amount of convergent validity. In general, researches report at least one of the three model-based estimates of reliability: construct reliability, SMC or VE (Bollen, 1989).

In this paper, we estimated the relative amount of convergent validity because both construct reliability and variance extracted were shown (see Table 6), and also the SMC loadings were used to measure the construct validity (see Figure 3). As mentioned earlier, the SMC for a measured variable is the square of the indicator's standardized loadings. In other words, from the default outputs in the SEM figures below, it is



Chisquare: 452.120
df: 44
Normed Chisquare: 10.275
CFI: .344
NFI: .333
TLI: .181
GFI: .623
AGFI: .435
RMSEA: .246

Figure 2. Initial creditor participation measurement (CFA) model.

estimated that the predictors of RS3 (indicator) explain 63% of its variance (i.e., the error variance of RS3 is approximately 37% of the variance of RS3 itself). Thus, the SMC value threshold of a good observed variable should be .5 and above (Hair et al. 2010). Nevertheless, 0.3 indicates an acceptable item variable (Holmes-Smith et al., 2005) especially when the indicators for a construct are not more than 3 provided other constructs have higher indicators. A standardized factor loading of 0.7 for an observed variable is roughly the equivalent of 0.5 SMC. From the CFA analysis of the creditor measurement model, seven items present offending estimates. The remaining items of R1, R2, R3, and R4 are retained based on the AMOS modification indices output, as shown below.

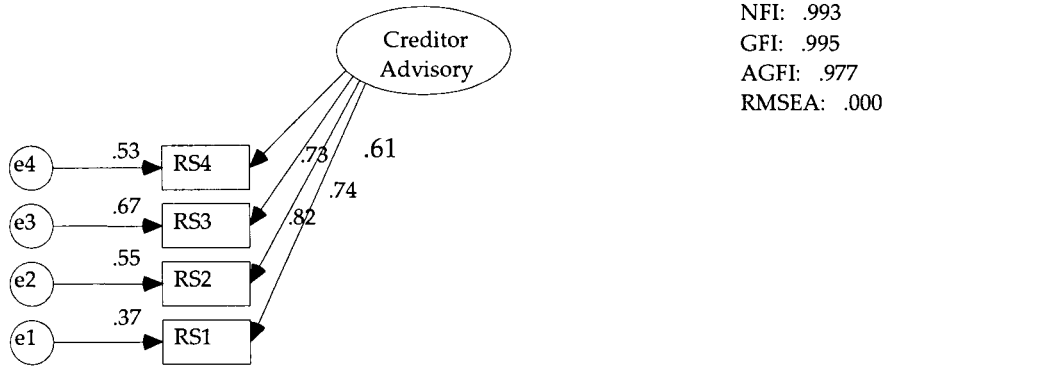


Figure 3. Creditor participation measurement (CFA) model after modification.

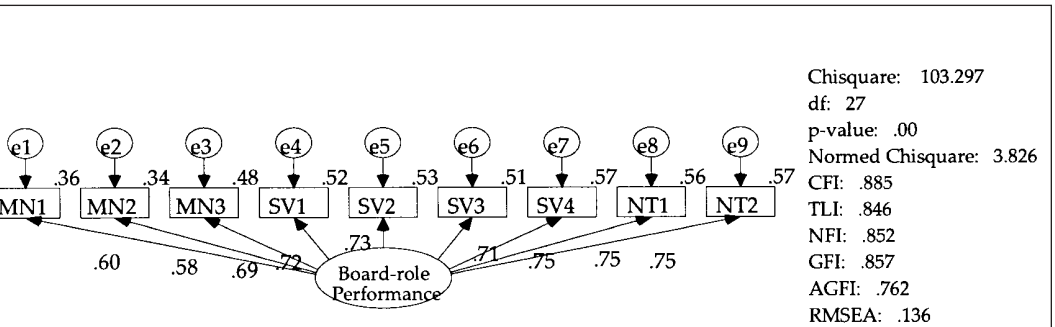


Figure 4. Initial board performance measurement (CFA) model.

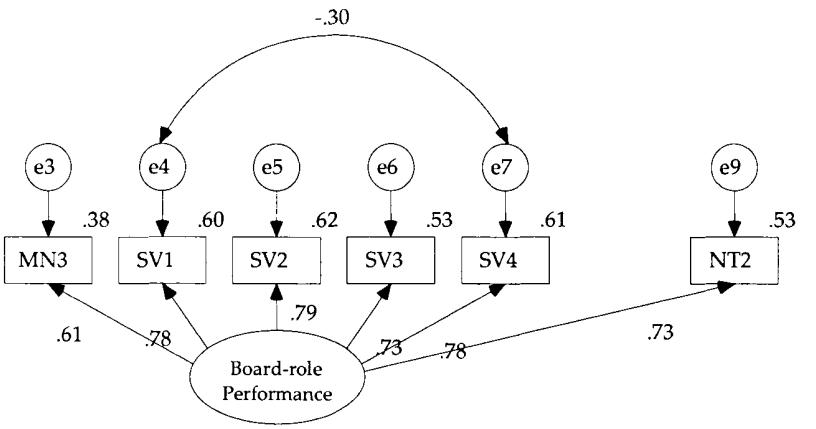


Figure 5. Board performance measurement (CFA) model after modification.

Measures of Fit

Before analysing the structural model, it is necessary to understand how to evaluate the models. Fit measures are grouped into various types and each has its specific capability in model evaluation: (a) measures of parsimony, for example degree of freedom (df) is one of the fit measures used for simplicity and goodness of fit; (b) minimum sample discrepancy function, for example, the Chi-Square statistic is an overall measure of how many of the implied moments and sample moments differ. The Chi-Square statistic (χ^2) is the minimum value of the discrepancy divided by its degree of freedom. The ratio should be close to 1 for correct models (Arbuckle, 2005), or should not exceed 3 before it can be accepted (Byrne, 2010). Since the Chi-Square is sensitive to sample size, it is necessary to look at other measures that also support goodness of fit. The Chi-Square statistic is an overall measure of how many of the implied moments and sample moments differ. Another example is the p-value, which is the probability of getting as large a discrepancy as that which occurred with the present sample under appropriate distributional assumptions and assuming a correctly specified model. So, a ρ-*value* is a method to select the model by testing the hypothesis to eliminate any model that is inconsistent with the available data or that which does not fit perfectly in the population; (c) measures based on the population discrepancy, for example, the root mean square error of approximation (RMSEA) is most commonly used, and the figure should be < 0.05 to achieve model fit; (d) comparison to a baseline model. Three significant indices are Normed fit index (NFI), Tucker-Lewis Index (TLI), CFI, AGFI, and (e) goodness of fit index (GFI) and related measures (Arbuckle, 2005; Byrne 2010; & Holmes-Smith, 2005). However, Arbuckle (2005) affirmed that model evaluation is one of the most difficult and unsettled issues in structural equation modelling. In this paper, all the fit measures have been tested and some of the indicators (especially the offending estimates) had to be removed for both the CFA and the structural models before achieving the criteria for model fit (see summary in Table 8 below).

The fit indices of the board performance measurement model in Figure 5 are summarized. The measurement model after modification indicates that χ^2 is 12.102 with 8 degrees of freedom (d.f.) and p-value = .147, which is an improvement compared to the initial hypothesized

model (Figure 6) with p-value = 0.000 since to be statistically significant, the threshold for the p-value has to be > 0.05. However, in practice, the χ^2 is very sensitive to sample size and frequently results in the rejection of a well-fitting model. Hence, the ratio of χ^2 over d.f. has been recommended as a better goodness of fit than χ^2 (Hair et al ., 2010). A common level of χ^2/d.f. ratio is below 5 (though below 3 is better). The χ^2/d.f. is 1.302 (i.e. 12.102/8), indicating very good fit. Furthermore, other indicators of goodness of fit are CFI = .990, TLI = .981, GFI = .959, NFI = .971, AGFI = .933 and RMSEA = .058. A comparison of this result with the critical values in the output estimates, suggests that the model fits the empirical data well, thus indicating very reliable and valid measures of the two latent constructs.

Table 6

Model Goodness of Fit Indices

	Criteria	Indicators: CFA Model	Indicators: Structural Model
χ^2	/ρ > 0.05	12.102/0.147	33.845/0.139
χ^2/df	< 5	1.513	1.302
Fit Indices: GFI	> 0.9	0.959	0.959
AGFI	> 0.9	0.933	0.928
NFI	> 0.9	0.971	0.937
TLI	> 0.9	0.981	0.978
Alternative Indices: CFI	> 0.95	0.990	0.984
RMSEA	< 0.05	0.058	0.044
RMR	< 0.05	0.017	0.031

The proposed theoretical model in Figure 1 was tested based on the theoretical argument relating the two latent constructs: creditor participation and board-role performance. Factors of protect risky contracts, protect collateral, and enforce credit contracts were used in the 11 indicators measuring creditor participation, while board monitoring role, board service role and board networking role were the indicators of board-role performance. Employing the use of AMOS version 16 among the 20 measurement items as input, the SEM analysis was conducted to examine the relationship between each of the constructs as hypothesised. The final hypothesised results of the SEM analysis are depicted in Figure 7. The fit indices of the overall hypothesized model in Figure 7 are summarized. The measurement model after modification indicates that χ^2 is 33.845 with 26 degrees of freedom (d.f.) and p-value = .139, which is an improvement compared to the initial hypothesized model (Figure 6) with p-value = 0.000 since to be statistically significant, the threshold for the p-value has to be > 0.05. However, in practice, the χ^2 is very sensitive to sample size and frequently results in the rejection of a well-fitting model. Hence, the ratio of χ^2 over d.f. has

been recommended as a better goodness of fit than χ^2 (Hair et al ., 2010). A common level of χ^2/d.f. ratio is below 5 (though below 3 is better). The χ^2/d.f. is 1.302 (i.e. 33.845/26), indicating very good fit. Furthermore, other indicators of goodness of fit are CFI = .984, TLI = .978, GFI = .959, NFI = .937, AGFI = .928 and RMSEA = .044. A comparison of this result with the critical values in the output estimates, suggests that the model fits the empirical data well, thus indicating very reliable and valid measures of the two latent constructs.

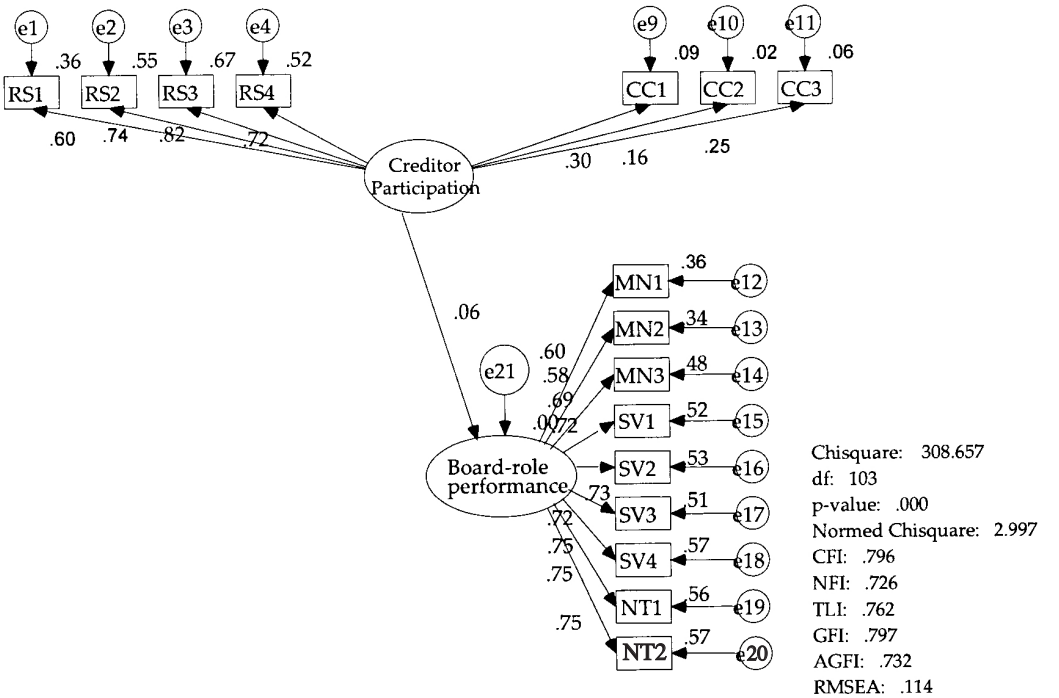


Figure 6. Initial hypothesised structural model.

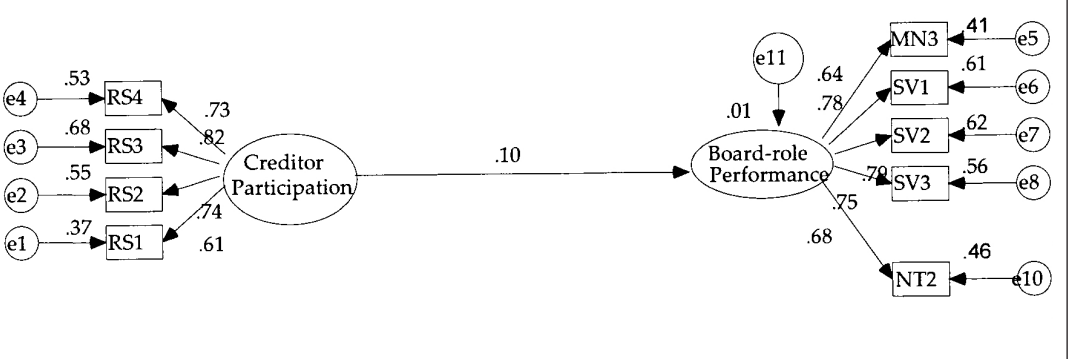


Figure 7. Hypothesized creditor participation structural model.

The default model table below shows the regression weights for the two latent constructs in relation to the statistical significance of their measured items. The *** sign under column 'P' indicates that the probability for getting a critical ratio as large as 6.851 in absolute value is less than 0.001. In other words, the regression weight for creditor participation in the prediction of risk2 is significantly different from zero at the 0.001 level (two-tailed). Similarly for the construct board-role performance, the critical ratio as large as 7.698 in absolute value is less than 0.001. In other words, the regression weight for board-role performance in the prediction of serv1 is significantly different from zero at the 0.001 level (two-tailed). The only exception is encc1, which is significantly different from zero at the 0.005 (two-tailed).

Regression Weights: (Group number 1 - Default model)

			Estimate	S.E.	C.R.	P	Label
risk1	<---	Creditor_Participation	1.000				
risk2	<---	Creditor_Participation	1.065	.155	6.851	***	par_1
risk3	<---	Creditor_Participation	1.335	.186	7.185	***	par_2
risk4	<---	Creditor_Participation	1.322	.195	6.778	***	par_3
encc1	<---	Creditor_Participation	.341	.120	2.845	.004	par_4
mntrg3	<---	Board-role_Performance	1.000				
serv1	<---	Board-role_Performance	1.340	.174	7.698	***	par_5
serv2	<---	Board-role_Performance	1.365	.176	7.762	***	par_6
serv3	<---	Board-role_Performance	1.343	.179	7.501	***	par_7
ntwrk2	<---	Board-role_Performance	1.200	.172	6.980	***	par_8

*** **P** value is statistically significant at **0.01** level

Discussion and Conclusion

This paper began by arguing that significant creditors are major stakeholders in business organizations. Like other contractual stakeholders, they help in generating wealth by providing the short-term and long-term financial loans the corporations require, which can be termed as the nucleus of the organizations. Though a number of scholars have used other factors to raise the importance of suppliers of finance in the corporate governance structure; a typical example is the well-known survey in the US shareholder's viewpoint by Shleifer and Vishny (1997), and the stakeholder's viewpoint in studies of Japanese corporations (Okabe, 2004), or in comparative studies as in Aoki (2001). A central claim of this paper is that board- role performance is a key mechanism of corporate governance that is shaped by the structural forces of sharing a firm's decision processes at the top. In that context, the country's legal provisions (as in Germany), or the firms' conventional norms (as in Japan) are the major sites of considerations. Though it is difficult to say which of the approaches is superior to the other, it can be rightly affirmed that financing of firms through the main banks provide a basis for bringing on board the lenders' strategic advice especially on important issues such as the need to protect the borrowing firm from entering high risk contracts, protect collateral, and ensure that credit contracts are enforced.

An important finding in this study is that the proposed manifest variables of the latent

construct creditor participation (exogenous variable) – protect high risk contracts, protect collateral, and enforce credit contracts have been confirmed to be acceptable measures of creditor participation. Similarly, for the construct board-role performance (endogenous variable), the proposed indicator variables – board monitoring role, board service role, and board networking role have been confirmed to be good measures of the construct. However, board service role items are stronger because three items are retained after all the modification processes to achieve model fit. In addition, after performing the CFA, only four items in the dimension protect high risk contracts were retained.

Within the overall model, the estimates of the structural coefficients provide the basis for testing the proposed hypotheses. As expected, creditor-participation factors are significantly related to board-role performance, thus supporting the proposed hypotheses. In other words, the regression weights for creditor participation in the prediction of board-role performance is significantly different from zero at the 10% level. This study findings confirm the works of Shleifer and Vishny (1997); Aoki (2005); Aoki and Patrick (1994); Jackson and Moerke (2005); Jackson (2005); and Chaithanakiji (2008). Hence, the research objective of determining whether creditor participataion is significantly related to board-role performance has been achieved, hence answering the research question in the affirmative, consistent with the literature.

In Nigeria however, section 19 (2) of Banks and Other Financial Institutions Act (BOFIA), provides that, no person who is a director of any other or any company that holds more than 10% of the total voting rights of the bank can be a director of the bank except with the approval of the bank. In addition, "no bank shall be managed by a person who is – a director of any other company not being a subsidiary of the bank, or engaged in any other business or vocation." With the limitation of the law in perspective, it is time for Nigerian firms to come up with realistic legislation or develop empirical researches on the way forward in respect of the most suitable financial system and governance structure as an alternative arrangement for the emerging society. This is in recognition of the literature backing that, the participatory role of a financier (bank or any debt investor) to companies largely depends on the prevailing legal framework in the country. For example, Jackson and Moerke (2005) observed that despite broad similarities in Germany and Japan, the legal framework is a key area of difference. The two-tier board system in Germany reflects strong legal intervention into the internal make-up of the enterprise in order to promote effective checks and balances between management and shareholders.

In this regard, the monetary policy committee of the Central Bank of Nigeria recently unveiled new measures to stabilize the banking sector to ensure stable and sound banking with minimal risk. This step is strategic because it will enforce desired predictable behaviour by the banks. Secondly, CBN's action may not be unconnected with the recent measures to bear risks at their barest minimum, after last year's failures in the system. Such memories make special precautions economically and politically appealing, because public confidence is crucial for the banks to succeed. In this regard, incentives and controls are necessary. They allow the banks to create credit in order to allocate it to socially desirable ends.

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