



EFFECT OF REGULATORY PENALTIES ON FINANCIAL PERFORMANCE OF QUOTED INDUSTRIAL FIRMS IN NIGERIA

¹Ude, Anthony Ejiofor, ²Prof. Uche Ugwuanyi and ³Nwabuisi, Anthony Okorie

Department of Accountancy, Enugu State University of Science and Technology, Enugu State, Nigeria¹²³

Abstract

This paper examined the effect of regulatory penalties on financial performance of quoted industrial goods firm in Nigeria. The study specifically examined the effect of litigation infraction charges, corporate Governance infraction charges and operational Non-Compliance charges on the profit for the year of quoted industrial goods firms. Data for the study were sourced through the annual reports and accounts of First Aluminium Nig Plc, Beta Glass and Dangote Cement Plc. The collected data was analysed using multiple regression analysis. Result of the analysis revealed that litigation infraction charges (LIC) have a positive and significant effect on profit for the year (PFTY) of Quoted industrial goods firms. The study further shows that corporate Governance infraction charges has a positive and significant effect on profit for the year (PFTY) of quoted industrial goods firms. The research equally revealed that operational Non-Compliance charges (ONCC) has a negative and non-significant effect on profit for the year (PFTY) of quoted industrial goods firms. Based on the findings, the study recommended among others that quoted firms should sensitize all their employees on the cumulative effect of operational non-Compliance charges (ONC) on the firms' performance (PFTY).

Keywords *Litigation Infraction Charges; Corporate Governance Infraction Charges; Operational Non-Compliance Charges; Financial Performance; Industrial Firm; Regulatory Penalties*

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Introduction

One of the enforcement techniques used by regulatory agencies to ensure compliance by individuals and entities within the purview of their enabling laws, is the imposition of fines. These fines which are imposed in instances of non-compliance, omission, or failure to undertake an act within a stipulated period are often backed by law and have long become an effective deterrence tool deployed by regulatory agencies to induce adherence. In recent times however, there have been debates surrounding the powers of certain Regulators to impose fines. Over the years, a lot has been said and written (Abioye, 2017; Adigun, 2017; Ismaila & Damola, 2018; Zeidan, 2012) on regulatory violations of corporate laws, policies, provisions, and operational guidelines for companies in Nigeria. In spite of the various regulatory laws such as the CBN Act (2007), Financial Reporting Council of Nigeria (FRC) Code of Corporate Governance (2018), CBN Codes of Corporate Governance (2016; 2014 & 2003), Companies and Allied Matters Act (CAMA) 2004, federal inland revenue service (FIRS), IFSR and several other circulars issued to be complied with by firms operating in Nigeria, as charges for corporate governance and operational guideline breaches. Businesses operating in Nigeria are increasingly being regulated as the Government strives to promote good corporate governance and best practices. To ensure your business is on the right side of the law and compliant there are certain regulatory requirements, which must be obtained. Here they include tax clearance certificate, this needs no introduction and is issued by the Federal Inland Revenue Service. In their bid to capture the informal sector into the tax net, the FIRS has ensured that as a compliance requirement, most multinationals and large cap companies must request for Tax Clearance Certificate from Vendors before contracts are consummated and LPO's issued. Tax clearance Certificates are obtained after filing your Audited Accounts on or before the sixth month of any fiscal year and paying the tax liability if any. For example, Audited Accounts for year ended December 31, 2012, must be filed on or before June 30, 2013. Applications filed after the stipulated period attracts penalty. VAT and WHT are indirect taxes collected by companies on behalf of the Government. The Government expects these deductions to be remitted monthly as such any failure to do so can attract very stiff penalties. You must make sure your remittances are up to date. Non-evidence of VAT and WHT remittances can often lead to a non-issuance of Tax Clearance Certificate.

Statement of Problem

These monetary sanctions on regulatory non-compliance originate from failure to comply with the code of corporate governance and the operational guidelines issued by regulators. These statutory non-compliance charges have affected shareholders' value creation of these firms in terms of profit before tax (PBT). Previous local and international studies (Adrison, 2008; Agbaeze & Ogosi, 2018; Cochrane, 2017; Ikpefan & Ojeka, 2017; Ismaila & Damola, 2018; Koster & Pelster, 2017) conducted in this field concentrated solely on corporate governance and compliance guideline indices, without expanding their scope to capture monetary sanctions incurred and reported by the deposit money banks for non-compliance to regulations. The continuous neglect of in-depth research on the effect of the monetary charges for corporate governance non-compliance and operational guidelines non-compliance by firms operating in Nigeria by previous researchers necessitated this study on the effect of regulatory penalties on Financial Performance of quoted industrial goods firms in Nigeria.

Objectives of the Study

The broad objectives of this seminar paper are to examine the effect of regulatory penalties on Financial Performance of quoted industrial goods firms in Nigeria. The specific objectives of this study include the following.

1. To examine the effect of litigation infraction charges on the profit before tax of quoted industrial goods firms.
2. To ascertain the effect of corporate Governance infraction Charges on the profit before tax of quoted industrial goods firms.
3. To determine the effect of operational Non-Compliance charges on the profit before tax of quoted industrial goods firms.

Review of Related Literature

Conceptual Framework

Regulatory Non-Compliance Charges (RNCC)

RNCC are monetary values attached to breaches/violations of codes of corporate governance policies, banking laws & policies, provisions, guidelines, directives, circulars governing the activities of Firms' operations as prescribed by the regulatory authorities. These non-compliance charges are applied in Statement of Comprehensive Income of firms in the form of corporate governance non-compliance charges and operational non-compliance charges.

Corporate Governance Non-Compliance Charges (CGNC)

CGNCs are monetary values attached to breaches/violations on extant codes of corporate governance guidelines particularly on issues requiring prior approvals & ratifications by the CBN before they are implemented by the DMBs (CBN, 2014). These charges occur specifically due to Senior Management Overrides (SMOs) on CBN guidelines. Asogwa (2016) examined the major causes of corporate governance failures in the Nigerian banking sector and found a lack of a robust corporate governance structure as the primary cause of banks' failures. He concluded that the setback to corporate governance among Nigerian banks is the non-adherence to corporate governance principles, the dearth of understanding of the theories, mechanisms and implications of corporate governance failures on banks' financial performance.

Operational Non-Compliance Charges (ONC)

ONC is monetary values attached to the violations/breaches of Standard Operating Procedures (SOPs) issued by the regulator to guide daily operations and activities of the quoted companies. Becker (1968) investigated the firm's decision to commit an illegal act and concluded that a higher inspection rate and severe monetary penalty improve compliance. Other studies (such as Heyes, 1993; Kamdabe & Segerson, 1998) found that increasing enforcement stringency does not necessarily lead to higher compliance rates. Harrington (1988) opined that firms' compliance behaviour & compliance strategy depends on their compliance cost. According to Harrington (1988), firms with low compliance costs will always comply, while firms with large compliance costs will always violate, and firms with medium compliance costs will alternate compliance decisions based on their previous inspection outcome. Notwithstanding these controversies, monetary sanctions for operational violations are drag-down on the returns accruable to the shareholders.

Profit Before Tax (PBT)

Profit before tax is a measure that looks at a company's profits before the company must pay corporate income tax. It is all a company's profits without the consideration of any taxes. Profit before tax can be found on the income statement as operating profit minus interest. Profit before tax is the value used to calculate a company's tax obligation (Ene & Bello, 2016). Hodgson (2017) opined that profit before tax may also be referred to as earnings before tax (EBT) or pre-tax profit. The measure shows all a company's profits before tax. A run through of the income statement shows the different kinds of expenses a company must pay leading up to the operating profit calculation. Gross profit deducts costs of goods sold (COGS). Operating profit factors in both COGS and all operational expenses. Operating profit is also known as earnings before interest and tax (EBIT). After EBIT only interest and taxes remain for deduction before arriving at net income. Ikpefan, et al. (2016) are of the view that profit before tax is the same as earnings before tax, it is used to identify how much tax a company owes. It can also be a profitability measure that provides for greater comparability among companies that pay a varying amount of taxes. Understanding the income statement can help an analyst to have a better understanding of PBT, its calculation, and its uses. The third section of the income statement focuses in on interest and tax. These deductions are taken from the summation of the second section, which results in operating profit (EBIT). Interest is an important metric that includes both a company's interest from investments as well as interest paid out for leverage.

Firms and Regulatory Compliance

All licensed firms in Nigeria are strictly required by regulations to comply with codes of corporate governance policies, banking laws and policies, provisions, guidelines, directives, circulars governing the activities of Firms' operations as prescribed by the regulatory authorities to avert noncompliance charges. However, the quantum of regulatory non-compliance charges reported by DMBs in Nigeria and the international banks respectively show that the level of compliance is deficient amongst banks. However, most scholars (such as Adrison, 2008; Agbaeze & Ogosi, 2018; Cochrane, 2017; Ikpefan & Ojeka, 2017; Ismaila & Damola, 2018; Koster & Pelster, 2017) concentrated their studies solely on corporate governance and compliance indices without expanding their scope to capture monetary sanctions incurred by firms for non-compliance to regulations. However, to research on the correlation between socially irresponsible or illegal acts committed by firms and the decreases in their shareholders' wealth, Frooman (1997) conducted a study using a meta-analysis approach on twenty-seven event studies covering the period from 1992-1996. The study concluded that compliance to regulations is a necessary condition for firms to increase their shareholders' wealth and to be socially responsible and law-abiding is in the self-interest of the firms. Therefore, regulatory non-compliance charges would negatively affect firms' performance and by extension, impact adversely on the value creation maximization of shareholders' investments.

Theoretical Framework

Shareholders' Value Maximization Theory

The theory driving this study is the Friedman (1970) Shareholders' Value Maximization theory which deals on social responsibility of businesses to both the owners and their social environment by ensuring that the operations of the businesses are carried out in such a manner to increase business profits lawfully and competitively without deception or fraud, with the primary motive to maximise shareholders' value creation and shareholders' overall interest. From shareholders' standpoint, value maximisation can be created by managers (agents) through competitive profit before tax (PFY), driven by avoidance of revenue wastages and recklessness by managers. According to Brigham & Daves (2004), every company's objective is to maximise shareholders' wealth. This implies that every business exists for value maximisation to shareholders and the society where it operates; therefore, charges incurred by firms on violation of banking regulation drags down firms' earnings that would boost profitability and value creation for the benefit of better returns to shareholders. It would be difficult for managers to fulfil their responsibilities of improving shareholders' value maximisation if earning that would boost financial performance (PFY) are utilized for settlement of regulatory infraction committed by companies on corporate governance & operational violations.

Empirical Review

Ismaila and Damola (2018) conducted a study on Regulatory non-compliance and performance of 15 firms in Nigeria. The study examined regulatory sanctions from an emerging economy perspective and the impact of regulators imposed monetary sanctions on banks' performance. Data were analysed using multiple regressions. The result of the study showed that penalties imposed by regulators on foreign exchange and international trade-related infraction in the Nigerian banking industry have no significant impact on the bottom line of the defaulters as the cost of penalties is below the benefits enjoyed from such infringements by the DMBs. This result of no significant impact on the bottom line (profitability) is because foreign exchange and international trade-related non-compliance is a single violation among the offences under regulatory operational non-compliance. Agbaeze and Ogosi (2018) examined the impact of corporate governance on the profitability of Nigerian banks (2005 - 2015). The study made use of Ex-post facto research design on secondary data from annual financial statements and accounts of five selected banks in Nigeria. Profitability was measured by profit after tax while several members on the board were used as a measure of corporate governance. Regression test statistic was used to test the hypotheses. The correlation result revealed that there is a positive relationship between the profitability of Nigerian banks and corporate governance (number of members on the board). The researcher concluded that complying with corporate governance has a positive impact on the profitability of Nigerian banks.

Gap in Empirical Literature

The review of literatures indicates that many related studies have been conducted in this area. However, most of the existing studies were done outside Nigeria. Despite the gaps in the reviewed literatures, this study sought to contribute by using a new methodology and extend the study period to 2021 (ie update the study period) and also to examine the effect of regulatory penalties on Financial Performance of quoted industrial goods firms in Nigeria.

Methodology

Research Design

The study adopted *ex post facto* research design which provides an empirical solution to research problems by using data which are already in existence. The study was therefore based on published financial statements of the selected industrial goods firms in Nigeria.

Sources of Data

The data used in this study were secondary data which were generated from the annual reports and accounts of the sampled industrial goods firms operating in Nigeria as of 31 December 2021.

Area of Study

This study was carried out in Nigeria, with specific reference to industrial goods firms operating in Nigeria.

Population

The population of the study is made-up of the 12 quoted industrial goods manufacturing companies in Nigerian during the period of study. The reason for the choice of this market is primarily due to the reliability of data. Audited financial statements are reliable as auditors certify them.

Sample Size Determination

Sample size of 3 industrial goods firms which include: First Aluminium Nigeria Plc, Beta Glass Nigeria plc and Dangote Cement Plc was collected. The study selected the sample based on the following criteria:

1. Companies must remain listed on the Nigerian Stock Exchange (NSE) during the 2012-2021 periods.
2. Companies must have complete financial statements for the period under review.
3. Companies must be operational within the period under investigation.

Model Specification

The Multiple Regression Model is represented as.

$$PBT = a + \beta_1 LIC + \beta_2 CGIC + \beta_3 ONCC + \epsilon_t$$

Where:

PBT	=	Dependent Variable (Profit before tax)
LIC	=	Litigation infraction charges
CGIC	=	Corporate Governance infraction Charges
ONCC	=	Operational Non-Compliance charges
A	=	Constant
$\beta_1 \beta_2 \beta_3$	=	Coefficients
ϵ_t	=	Error Term

Description of Variables in the Model

In line with the objective of this analysis, the research variables were divided into dependent and independent variables. The dependent Variable of the study is Profit before tax (PBT) while the independent variables are, Litigation infraction charges (LIC), Corporate Governance infraction Charges (CGIC) and Operational Non-Compliance charges (ONCC).

Method of Data Analysis

The statistical tools for analysis in this study includes;

- I. The descriptive statistics analysis.
- II. Multiple regression analysis.

Descriptive Statistics explains the characteristics of research variables. It reveals the mean, median, standard deviation and other frequency distribution indices including maximum and minimum values of the time series data. We have multiple regression analysis when there are more than one independent variable affecting the dependent variable. Regression analysis, in essence provides a procedure for determining the regression line which is defined as the best straight line or linear approximation of the effect of independent variable on dependent variable.

Data Presentation

Raw Data Obtained from the sampled firms

<i>Company</i>	<i>Years</i>	<i>PBT 000</i>	<i>CGIC 000</i>	<i>ONCC 000</i>	<i>LIC 000</i>
<i>First Aluminium Nig Plc</i>	2012	75,897	15,189,428	7,707,450	105,779,701
	2013	80,528	16,908,244	881,588	121,593,623
	2014	79,106	18,227,442	17,303,645	126,606,022
	2015	82,112	20,947,782	1,558,284	122,975,993
	2016	88,622	31,638,842	14,788,514	130,360,660
	2017	87,355	36,862,557	518189	128655328
	2018	85,569	31,524,701	482347	138229559
	2019	66,991	34,199,119	456148	130617133
	2020	78,056	40,283,492	713848	130971984
	2021	47,309	40,352,504	566363	107585263
<i>Beta Glass</i>	2012	14,897115	20,091,935	1,829,583	16,875,084
	2013	23,209984	10,816,368	3,982,299	60,828,397
	2014	34,185560	15,342,204	2,394,634	21,252,320
	2015	40,594801	43,953,731	3,001,440	29,150,552
	2016	35,939643	48714686	18,123,660	110,502,840
	2017	38,007074	97736155	4,114,153	119215053
	2018	30,878075	72504953	1,829,583	169585932
	2019	44,878177	82734317	3,982,299	146804128
	2020	75,056	107037484	2,394,634	162334422
	2021	47,309	20,091,935	3,001,440	193374314
<i>Dangote Cement Plc</i>	2012	8,336,227	105,779,701	6,017	41,167
	2013	9,634,650	121,593,623	10,099	47,512
	2014	9,854,229	126,606,022	10,543	46,166
	2015	9,347,922	122,975,993	21,092	43,754
	2016	7,478,808	130,360,660	15,111	45,736
	2017	8,003,283	128655328	22542842	501724
	2018	11,689,943	138229559	32476502	724919

2019	75,908,943	130617133	13426	60285
2020	82,789,543	130971984	14457	60,541,412
2021	66,528,350	107585263	34719709	74,073,380

Data Analysis

Table 2: Descriptive Result

	PBT	CGIC	ONCC	CGIC
Mean	17862573	68953752	6197006.	68953752
Median	8169755.	46334209	1693934.	46334209
Maximum	82789543	1.38E+08	34719709	1.38E+08
Minimum	47309.00	10816368	6017.000	10816368
Std. Dev.	24590174	47188288	9941245.	47188288
Skewness	1.410871	0.235238	1.778849	0.235238
Kurtosis	3.885222	1.347776	4.989272	1.347776
Jarque-Bera	10.20349	3.443057	19.38348	3.443057
Probability	0.006086	0.178793	0.000062	0.178793
Sum	5.00E+08	1.93E+09	1.74E+08	1.93E+09
Sum Sq. Dev.	1.63E+16	6.01E+16	2.67E+15	6.01E+16
Observations	30	30	30	30

The summarized descriptive statistics of the explained and explanatory variables as presented in Table 2 below for the period 2012 to 2021, revealed the following observations. First, the Profit before tax is reported to have a mean (median) value of 17862573 (8169755) and standard deviation of 24590174. Equally, the mean of profit before tax is about 17862573 or below 100% and the mean of Corporate Governance infraction Charges is 68953752 or above 100% and the mean of Operational Non-Compliance charges is 6197006 or below 100%, which is also below 100%. The result indicates that in the average of every N46.334209K of CGIC, ₦61.97006K of ONCC and ₦16.93934K of Litigation infraction charges was earned as profit before tax. The maximum values of these series are 1.38E+08, 34719709, 1.38E+08, 82789543 and 74073380 for Profit before tax, Corporate Governance infraction Charges, Operational Non-Compliance charges and Litigation infraction charges, respectively. The minimum values are 47309, 10816368, 6017.000 and 20997.00 for Profit before tax, Corporate Governance infraction Charges, Operational Non-Compliance charges and Litigation infraction charges, respectively. The value of skewness and Kurtosis reveals the extent normality is achieved in the distribution. Table 1 reveals that the observed distribution for Profit before tax, Corporate Governance infraction Charges, Operational Non-Compliance charges and Litigation infraction charges respectively have skewness co-efficient of 1.410871, 0.235238, 1.778849 and 1.090305 respectively, which are not more than unity. The table further indicates that Kurtosis coefficient for Profit before tax, Corporate Governance infraction Charges, Operational Non-Compliance charges and Litigation infraction charges respectively are 3.885222, 1.347776, 4.989272 and 3.941521, respectively.

Test of Hypotheses

Test of Hypothesis One (See Appendix I)

Result of hypothesis one shows a t-statistics of Profit before tax (PBT) is 7.461258 which is greater than 2 and the p-value is 0.0000 which is less than 0.05. We therefore conclude that Litigation infraction charges (LIC) has a positive and significant effect on Profit before tax (PBT) of quoted industrial goods firms.

Test of Hypothesis Two (See Appendix I)

Result of hypothesis two shows a t-statistics of Corporate Governance infraction Charges (CGIC) is 7.461258 which is greater than 2 and the p-value is 0.0011 which is less than 0.05. We therefore conclude that Corporate Governance infraction Charges (CGIC) has a positive and significant effect on Profit before tax (PBT) of Quoted industrial goods firms.

Test of Hypothesis Three (See Appendix I)

Result of hypothesis three shows a t-statistics of Profit before tax (PBT) is -1.551156 which is greater than 2 and the p-value is 0.1321 which greater than 0.05. We therefore conclude that Operational Non-Compliance charges (ONCC) has a negative and non-significant effect on Profit before tax (PBT) of Quoted industrial goods firms.

Discussion of Findings

Finding from the test of hypotheses shows that litigation infraction charges (LIC) have a positive and significant effect on profit before tax (PBT) of Quoted industrial goods firms. This result is in line with the studies of Ismaila and Damola (2018) conducted a study on regulatory non-compliance and performance of 15 firms in Nigeria. The result of the study showed that penalties imposed by regulators on foreign exchange and international trade-related infraction in the Nigerian banking industry have no significant impact on the bottom line of the defaulters as the cost of penalties is below the benefits enjoyed from such infringements by the DMBs. Finding from the test of hypotheses two shows that Corporate Governance infraction Charges has a positive and significant effect on profit before tax (PBT) of quoted industrial goods firms. This finding corroborates the findings of Agbaeze & Ogosi (2018) on examined the impact of corporate governance on the profitability of Nigerian banks (2005 - 2015). The correlation result revealed that there is a positive relationship between the profitability of Nigerian banks and corporate governance (number of members on the board). It is also in agreement with the study of Ikpefan & Ojeka (2017) on the relationship between corporate governance and distress in Nigeria firms 2000-2005. The result shows that corporate governance has no significant improvement in the prevention of bank distress but has significantly improved the performance of the Nigerian banking sector. The result of hypothesis three shows that Operational Non-Compliance charges (ONCC) has a negative and non-significant effect on Profit before tax (PBT) of Quoted industrial goods firms, this is in line with the study of Adrison (2008) on the effect of Penalties on Regulatory Compliance. Data was collected from four sources: Environmental Protection Agency (EPA), Census Bureau, Bureau of Labour Statistics (BLS), and Bureau of Economic Analysis (BEA) from 1990-2000 in the United States of America. It was found that the way regulators enforce the regulations is responsible for the small effect of penalties in reducing non-compliance. The researcher recommended that if regulators want to see a substantial increase in the probability of compliance, it should consider imposing more frequent and severe penalties.

Summary of Findings

- I. At the end of this study on the effect of regulatory penalties on Financial Performance of quoted industrial goods firms in Nigeria.
- II. It was observed that litigation infraction charges (LIC) have a positive and significant effect on profit before tax (PBT) of Quoted industrial goods firms.

- III. The study further shows that Corporate Governance infraction Charges has a positive and significant effect on profit before tax (PBT) of quoted industrial goods firms.
- IV. The research equally revealed that operational Non-Compliance charges (ONCC) has a negative and non-significant effect on Profit before tax (PBT) of Quoted industrial goods firms.

Conclusion

Penalties imposed by regulators are aimed at impacting on the bottom line of defaulting firms. However, results from our study showed that penalties imposed by regulators in the Nigerian manufacturing industry have not shown significant impact on the bottom line of the defaulters. This implies that companies have considered penalties imposed by regulators as operational expenses and transferred such to customers. Penalties imposed on foreign exchange and international trade related infraction showed that the cost of penalties is below the benefits enjoyed from such infractions. This is evidenced by the positive impact of penalties imposed on foreign exchange and international trade infraction on profitability of firms.

Recommendations

Based on the findings of this study, the following recommendations have been outlined:

- I. Quoted firms should sensitize all their employees on the cumulative effect of operational non-compliance charges (ONC) on the firms' performance (PBT).
- II. Senior management of quoted firms should minimise incidences of Senior Management Overrides on codes of Corporate Governance guidelines as those overrides are the root-cause of heavy corporate governance noncompliance charges reported by the firms.
- III. Regulatory Non-compliance Charges Score (RNCS) should be introduced as a Key Performance Indicator (KPI) and also Scorecards Measurement Index (SMI) in the yearly appraisal of the Head of Compliance Department and the Managing Directors of Quoted firms in Nigeria to enable them take responsibility and champion the philosophy of zero-tolerance for regulatory non-compliance in their firms, thereby minimise its effect on firms' financial performance

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