



Directors' Conflict of Interest and Its Implication for the Sustainability of a Company

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Research Note

Abstract

Events on the Boards of directors in Nigeria have exposed diverse cases of conflict of interest and non-disclosure. Activities of some directors reveal that they do not know the boundaries of their allegiance to the companies that appointed them. This paper examined the role of directors' viz-a-viz conflict of interest and how it affects the sustainability of the companies. The doctrinal method was used to analyze the principles of corporate governance as it is related to the conflict of interest of those who are involved in the management. With the use of primary and secondary sources, the authors discussed the legal provisions addressing issues on conflict of interest, and the impact and implication of conflict of interest related to the organizations, the economy, and corporate sustainability. The paper found that lack of adherence to the provision of corporate governance framework had led to the pervasive cases of non-disclosure, conflict of interest, criminal liability, and extinction of the companies in extreme cases. This paper also offers recommendations for curbing the menace of conflict of interest in order to ensure corporate sustainability.

Keywords: Conflict of interest, Corporate Sustainability, Director's liability, Disclosure

1. Introduction

The success of a company is determined by the shareholders, the directors, and the overall supervision of the governing board of a company (Ezenwa, 2021). The directors are especially regarded as the brain of the company. As the directors perform their duties and responsibilities, there tend to be situations that breed conflict of interest. This conflict of interest is usually detrimental to the company and many a time threatens the continued existence of a company. Directors, however, do not realize the extent of the liabilities that may arise from these conflicts of interest.

Due to the causes and effects of the collapse of companies on the economy in Nigeria especially resulting from directors' conflict of interest, the Financial Reporting Council in Nigeria established the Nigeria Code of Corporate Governance (NCCG) 2018. The code defines the role and expectations of the Board of directors and key functionaries of companies, addresses the issues of directors' conflict, and states principles that companies should comply with to address conflict of interest. Recently, the Companies and Allied Matters Act of 2020 (CAMA) was amended to bring the statutory framework for corporate vehicles up to speed with global standards and best practices (Adewale, 2013).

The thrust of this paper is that directors and other officers of companies whilst executing the company's business often have personal interests to pursue. Therefore, the paper sheds light on the concept of directors conflicting interests in a company, it explains the various factors that lead to a conflict of interest. It further

considers the liabilities that could arise from a conflict of interest in a company and also its implications on the company including how it affects its sustainability. The solution to curbing directors' conflict of interest has also been provided in this paper, especially how this issue would be prevented if companies comply strictly with the principles stated in the Nigeria Code of corporate governance (NCCG) 2018 as the code aims to establish good governance in every corporate organization.

2. Clarification of Concepts

2.1. Conflict of Interest

It occurs when the director has competing interests that interfere with the discharge of his official duties. ('Conflict of interest – Is disclosure sufficient?' 2020). Conflict of interest is when an entity's action or decision-making becomes undependable due to imbalance or uncontrolled differences between personal desires and positional or leadership responsibilities (Segal, 2019). A company or director has certain interests such as money, reputation, technical expertise, goodwill, or network in an entity which impugns the objectivity with which the company or director tends to serve non-selfish interests. This then puts into question whether their actions, judgment, and/or decision-making can be unbiased.

2.2. Corporate Sustainability

It is the ability to keep in existence or maintain a thing up to a certain level. Sustainability hinges on how corporate entities can meet their corporate objectives without diminishing the ability of future potential (Mitchell 2020). Corporate sustainability is hinged on basic factors such as economic, environmental, and social—also known informally as profits, planet, and people (Michaela & Taušl, 2014). Corporate sustainability borders on how companies can positively navigate current environmental, social, and economic trends and developmental prospects at a sustaining rate through their governance practices (Krechovská & Procházková, 2014). Sustainability captures a leadership approach to long-term objectives through strategic implementations, corporate standards, ethics, and culture aligning with the interests of the company and those of its owners and other diverse stakeholders (Youmatter, 2020). Sustainability propels business decisions to be made because of visionary goals (Youmatter, 2020).

2.3. Director's Liability

This is the responsibility or culpability borne by a director for wrongful dealings in the company or with the resources of the company either directly where the director is engaged in an illegal transaction or indirectly where the director authorizes an unlawful transaction although carried out by someone else. CAMA is replete with provisions that spell out actions for which directors are culpable (Section 290). This is alongside several other governance structures or sectoral regulations stating the responsibilities and liability of Directors.

2.4. Disclosure

This simply means the act of making new or hidden information known. In finance, disclosure entails the timely revelation of all material information that can influence the mind of the public or investors about a company's state and viability. Such information contains news and operational data which impact the business. Disclosure is paramount in corporate governance because it includes information related to a company's financial status, management activities and decisions, and operational efficiency. The "requirement of disclosure ensures that a company's Board ensures the authenticity of its operations and processes. Disclosure is seen as a mechanism for transparency and accountability (Dembo & Rasaratnam, 2014). When disclosure is improved, transparency is guaranteed, in effect, this breeds a healthy corporate governance structure (Church & Kuang, 2009).

3. Causes of Conflict of Interest

Some of the major factors that trigger the existence of the director's conflict of interest are as follows.

3.1. Lack of properly documented agreement between parties

According to Prophet Amos, two people cannot work together except if they agree (Amos 3:3). For Directors to work in a company with full commitment, the terms of the relationship, either director's service contract or shareholders' agreements have to be spelled out. In many situations, family members and friends when sitting together in a relaxation spot, come up with a business idea and immediately make plans to register and start up a company without taking the time to count the cost and even agree on what should or should not be allowed in the business relationship. In a few circumstances where there are agreements to bind the relationship, (shareholders' agreement or Director's contract) the terms detailing restrictions i.e. what a director can or cannot do are not stated.

3.2. Greed

Often few directors enter into business relationships, with a feeling of greed and entitlement. Without waiting to put in the effort to grow the business and get paid their properly agreed remuneration, they begin to plot how they can make more money from parallel business opportunities within the set-up of the employer. In many cases, this attitude jeopardizes the business of the company.

3.3. Multiple Directorships

CAMA and the NCCG allow a director, especially a non-executive director to be an executive director or non-executive director on the board of other companies. However, over the years, this has presented a platform for conflict of interest. Directors on a Board are seen to award contracts to other companies in which they are also a director and can inflate the contract sum or boycott tender processes or qualification scrutiny. This undermines the corporate ethics, values, and creative prospects of a company. Directors serving on multiple boards of companies in the same industry tend to leak trade secrets or price-sensitive information which leads to a loss of competitive edge of a company (Muhrtala, 2015).

Although multiple directorships are allowed by law in section 278 CAMA, a director who holds multiple directorships does so with the wrong motive (usually for financial gains) and is most times not able to perform his duties properly in all the companies. This thereby leads to a performance conflict between the director and the companies. CAMA expressly prohibits a director holding multiple directorships from using resources obtained in one company for the benefit of the other or for personal advantage (section 281 of CAMA). However, in practice, most directors find it difficult to comply with this provision. Rather than lead the company along with long-term value creation, selfish directors fail in actualizing the company's vision, they divert resources for their agenda.

3.4. Secret transactions by directors

Directors are to disclose to the board or the chairman where they have an interest in a contract or transaction the company is or is about to engage in. Because of the awareness of the financial status of a company, selfish directors collaborate with other companies or give a tip to other companies to bid and win such contracts. When a director exposes his interest in a transaction before the same is consummated, such a director is excused from voting on the transaction or award of the contract.

In section 296 of CAMA, directors are prohibited from taking loans from the company. A company is prohibited from advancing security or guarantees to its directors as this places the board in a precarious position when making decisions concerning the indebtedness of the director. The director may also develop a sense of entitlement for financial gratifications from the company and may not readily want to settle the outstanding debt. The company in many cases because of sentiment is usually reluctant to pursue debts for

successful recovery, this usually leads companies to lose a huge amount of money and in some cases, such debt could lead to the liquidation of the companies concerned.

3.5 Related Party Transaction

This is a transaction involving a company and any related company or director. This means the transactions are carried out by the company and an affiliate company. Although related party transaction is not itself illegal, it can tend toward illegal conduct such as conflict of interest situations whereby due processes may be boycotted or company standard procedures compromised. An example is where a company sells and transfers an asset at a much lower rate than it would have if it were to sell to an unrelated party.

4. Implications of Directors' Conflict of Interest on the Company

Directors' conflict of interest as mentioned earlier arises when directors have an agenda different from the common goal and vision of the company. This conflict of interest comes to light through several circumstances in a company. An example of conflict of interest that led to the displacement of a company is seen in the banking sector where the governor of the central bank sacked the CEO and board of the then Oceanic bank Plc, Intercontinental bank, Finbank Plc. and some other banks as a result of a corrupt governing structure. The banks under the administration of these management teams accumulated a debt margin which eroded the values of shareholders' funds. There was a fallout from the policy of full disclosure and transparency which led to reckless risk management in the bank. The directors and members in question did not act in the best interest of the company as they got into other contracts of the award, incurred debts in the name of the company, and misappropriated funds by living an ostentatious lifestyle with the company's money.

They compromised the standard of good governance and the board no longer contributed to the sustainability of the company. In response to the investigation and compliance with the law, the governor replaced the management team and the bank failed to exist as the name was changed and the company was taken over. From this case, we see a clear example of the implication of conflict of interest in an organization. Several acts constitute a conflict of interest and all have implications on both the company and the directors themselves having to bear the cost too.

4.1. Implications for the company

Directors' conflict of interest affects the cycle of succession planning created by the company. In circumstances where the company has prepared to employ a director for 5 years or 10 years, then the director is expected to train other members suitable for the role after his retirement, especially in a family business. Where that director is caught in the web of conflict of interest, the company would be left with no choice but to call for the removal of such a director. With this type of situation, a setback has occurred in the succession plans or strategy the company had in view.

Another implication of directors' conflict of interest is that it affects the financial stability and growth of the company. In most circumstances, directors guilty of such acts are the major brain behind the operations of the company. They are the ones who bring more profit and productivity to the company. Therefore, where they have to be removed as a result of the conflict of interest it would affect the productivity and growth of the company and sometimes, the company goes bankrupt which eventually leads to its winding up, taking over, or liquidation.

Also, conflict of interest affects the reputation of companies. The circumstance surrounding incidents arising from conflict of interest may leave the company in a bad shape, especially in the eyes of the stakeholders and the public. It would affect the trust of the public in the company and further discourage any investments in the company.

4.2. Implication on the Directors involved

A company, though a separate legal entity from its founders is an artificial entity that acts through human agents such as its directors, managers, and officers whose actions can be arrogated as that of the company it represents (*Kurubo vs. Zach-Motiso (Nig) Ltd 3PLR/1992/28 CA*). A company is consequently responsible for the actions of directors carrying on business on behalf of the company. However, in some cases, the corporate veil will be lifted to impute directors with liability and penalty where the corporate visage is unlawfully used to perpetrate fraud or illegality (*Chaitanya & Kaushalya, 2015*). Under s314 CAMA, the liability of directors may be unlimited, provided that notice in writing shall be given to the director to that effect. For example, directors or officers will be personally liable for a refund where the company receives a loan for a specific purpose; or money or other property by way of advance payment for the execution of a contract or project and with intent to defraud, fails to apply the money or other property as purposed. Directors can be personally liable (e.g. actions of a de facto director) or jointly liable (e.g. fraudulent use of loan facility). A director who fetters his discretion to vote in the wrong way is personally liable for a breach of his fiduciary duty of care, and also where he acts negligently or fails to act in the best interest of the company (Section 305 CAMA). Under the contract, a company can sue the director where there is a failure of duty contractually imposed on the director either in the service contract or in the articles of association of the company. Shareholders or third parties can sue a director for dereliction or breach of duty severally or jointly (s17, National Office for Technology Acquisition and Promotion Act). Conflict of interest among directors implies that they would be held liable. This liability may be civil or criminal.

Civil Liability is where a director breaches contractual obligations that result in damages to the company or a third party, civil liability is usually inevitable. The damages may be as a result of the breach of promotional contracts, breach of warranty, or a breach in the provisions of CAMA leading to conflict of interest. A director whose acts of conflict of interest are discovered may be disqualified from the company (*Kiladejo et al., 2021*). As a result of this disqualification, the director may lose all or part of his terminal benefits or entitlements from the company because his appointment is deemed terminated. Also, there is a loss of personal goodwill and the director's reputation or integrity. If the situation is such that it becomes a public matter, the director loses respect and his brand is affected negatively.

Criminal Liability includes the liabilities where the directors may be liable for criminal actions for diverting funds or businesses of the company or for falsifying records or accounts or performing fraudulent misrepresentation and deceit. They may pay fines or serve a term of imprisonment. They may be liable for compensation.

5. Implementing a Corporate Governance Structure to Curb Directors' Conflict of Interest

Owing to the sensitive nature of the office of the Director, there are statutory and regulatory expectations and standards expected of the director, requiring him to act in a prescribed manner. It is a conflict of interest when directors, who are the alter ego of the company, fail to act in the best interest of the company or fetter their discretion to vote in a particular way, their fiduciary position is compromised and the company leadership is undermined, this leads to digression for the company and may eventually lead to its extinction. The Corporate Governance Code and CAMA are replete with various provisions for the successful operations of companies, however, to ensure the sustainability of companies, company owners and boards must ensure that they not only incorporate corporate governance structures and policies but also need to implement them for them to get the desired results. Examples of a good corporate governance structure as provided by NCCG principles are; the inauguration and operations of functional boards, ensuring that there is a proper management structure and team, governance/compliance unit, creating relevant policies such as board charter, company handbook, anti-corruption, bribery and ethics policy, transparency policy, etcetera. From the combination of the provisions in CAMA and the NCCG, the following are the principles and

policies companies are expected to comply with to achieve good governance, curb directors' conflict of interest, and ensure the sustainability of companies.

5.1. Board Structure, Composition, and Responsibilities

The Board of directors is the highest governing body in the operation of the company. There must be a proper balance of skills and diversity in the board's composition. To achieve this, competence, independence and integrity must not be compromised. The board and its structure must comprise persons who are committed to acting in the interest of the company and are ready to make decisions that are in line with the tenets of good governance so that the company can be sustainable. For small businesses, managing directors/chief executive officers may appoint a board of advisors who would play the same duties as a proper board does.

5.2. Conflict-of-Interest Policy

The Board is to implement a conflict-of-interest policy that sets the company's culture regarding situations that may lead to a conflict of interest, procedures for checks, and penalties for contravention. This policy is to be part of the induction package of each director. (Murray, 2009). The actions of the board following disclosures should be based on the conflict-of-interest policy of the company. Directors should be made to expressly declare any conflict of interest at the point of appointment; annually and at subsequent times when he becomes aware of any possible conflicting interest at the first opportunity. The NCCG recommends the adoption of policies to check conflict of interest through preclusion of insiders from dealing in the shares of the company; unlawful appropriation of the company's asset profit; disclosure of related party transactions. This policy is implemented through prompt and continuous implementation of the requirement for disclosure where the director discloses issues affecting his membership in the board; whilst the company's minutes of the meeting should capture the resolution of the board regarding conflict-of-interest issues.

5.3. Internal Audit

Internal audit assures effective governance, risk management, and internal control systems and ensures the operations of a company measure up to the regulatory and corporate standards (Principle 18, NCCG). The function or absence is to be explained in the company's annual report. This is an accountability measure upon the board to shareholders. The Audit Committee should periodically appoint a qualified independent reviewer to assess the efficiency of the internal audit. The external auditor provides an independent opinion on the reliability of the Company's financial statements and processes (Principle 20, NCCG). To accentuate internal audits, a whistle-blowing structure should be established to encourage stakeholders to report misconduct and violations of laws by company officials (Thapar, 2012).

5.4. Ethical Culture

Companies must establish policies and practices that promote high standard behavior and an acceptable approach to conducting business in a company. Principle 25 is the principle of ethical culture which checkmates abusive tendencies, and other corrupt practices that may arise in a company thereby promoting investors' confidence. The Board is to formulate and periodically review a Business Conduct and Ethics code, and model commitment to same through compliance. Typically, the code provides that directors abide by professional and ethical standards; keep privileged information; not compete with the interest of the company and uphold and implement a whistle-blowing culture, preclusion of insider trading.

6. Monitoring and compliance

Monitoring is born by the fact that a corporation is not usually run by the owner(s) on one hand, and the fact that agents hired to represent the owners do not always have congruent interests with those of the company or its owner(s)/investors. There is therefore the need to put in place structures, systems, and procedures by which the owners monitor and ensure that the vision of the company is not tampered with and that possibility of its sustainability does not become adversely impossible. Monitoring covers all strata of the company's operation. Monitoring should be embedded in the internal control structures and procedures of a company such that its operations are self-authenticating and inconsistencies detected and controlled by internal procedures. This includes instituting a mandate requiring board approval or shareholders' approval where a transaction exceeds a certain threshold.

Compliance on the other hand relates to the requirements of conformity on a company to pre-set standards and qualifications for its continued existence and relevance. Corporations are an offshoot of multifarious factors within the environment it operates; therefore, their continued existence is naturally hinged on the level of their compliance to these multifarious factors including laws, regulations, policies, economic trends, systemic and non-systemic risks, national and international socio-political interactions.

The Board monitors the company's performance, providing oversight of structural and tactical decisions such as approval of the budget, policies, implementation of strategies, business plans and objectives, risks and conflicts of interest, internal control systems etcetera. The Board is in turn monitored by the shareholders through governance provisions. For effectiveness, monitoring and compliance should be consistent, timeous, proactive, qualitative, and encompassing, embedded in the company's standard operations. Monitoring and compliance should also ensure an adequate flow of information and feedback channels.

7. Implementing Liability for Secret Profit policy

Section 306 CAMA expressly provides that a director is to ensure that his interest does not conflict with his duties in the company. He is to stay clear of making secret profits whilst using the company's property or resources, else he will be liable to render an account and refund every secret profit made from utilizing the company's resources. The company's resources include corporate information such as trade secrets, price-sensitive information about the company's shares, and the company's investments. This corporate resource serves as the company's competitive edge in the market. The director is to keep such price-sensitive information confidential and not just that, refrain from using it to benefit himself or his affiliates. This duty of confidentiality persists even after the director's appointment with the company expires. Directors may only escape this liability where the disclosures of interests in the company's transactions are made before the general meeting of shareholders before the profit is made.

7.1. Board Committees (Principle 11)

The company is required to set up a nomination and governance Committee that oversees the appointment of qualified and competent board members and top management officials whilst ensuring that appointments do not compromise the independence and effectiveness of the Board. This process ensures that potential conflict of interest issues in multiple directorships are nipped in the bud or tackled headlong.

There is also a need for an audit committee and a risk management team. The audit committee sees that internal processes and procedures of the company are effective safeguards and compliant while the risk management committee ensures that transactions, the operation, and human resources of the company are adequately managed. Risk management assesses the risk tolerance and capacity profile. They determine if the intended action or decision of the board is risk-adjusted e.g. acquisition of loans, monitoring the execution of contracts to standards, insurance cover, etc. All these corporate governance measures ensure that the policies and actions of the company are in the best interest of the company. This is what guarantees corporate sustainability.

Lastly, there should be a Board evaluation committee that ensures the board's capacity and fitness. They must ensure that directors are effectively and efficiently discharging the duties and responsibilities of their office. Where these principles are entrenched and implemented by corporate organizations, corporate sustainability is guaranteed.

8. Impact of Directors' Conflict on Corporate Sustainability

Corporate sustainability can only be achieved if there is a proper corporate governance structure set up in a company. Corporate Governance is the way a corporate entity is administered toward achieving its goals and objectives. Corporate sustainability is the holistic approach and attitude of a corporate entity to ensure that it achieves and continues to exist enabling the achievement of its overall objective for a long time. Corporate governance, therefore, is the measure for achieving corporate sustainability. The policy against conflict of interest is a major corporate governance principle that must be strictly complied with. Where there exists a company that has not imbibed the tenets of good governance and still battles with issues such as a director's conflict of interest, such a company is far from achieving corporate sustainability.

Directors' conflict of interest in a company affects the sustainability of the company (promoters, stakeholders), the economy of the country, and society. For example, it may lead to a lack of Foreign Direct Investment (FDI) owing to a poor investment climate arising from a bad reputation, youth restiveness, and criminal tendencies may increase where there are widespread poor corporate cultures and unemployment.

In relation to society, where corporate sustainability is entrenched in companies, society stands to benefit from corporate social responsibility initiatives of thriving businesses. However, where directors' conflict of interest discourages corporate sustainability, there is a dearth of economic activities which discourages enterprise and further erases lasting legacies that can be passed on to future generations. The promoter is also affected as he may become psychologically and emotionally destabilized seeing his efforts run down the drain. He lives regretting the untoward decisions he made personally or by other directors. He may become vengeful and distraught and then lose his self-confidence and entrepreneurial spirit. Health side effects – the promoter gets nervous, heartbroken, or edgy. Many disappointed directors have come down with diseases or ailments such as high blood pressure which sometimes leads to loss of life.

The stakeholders also, lose their trust and confidence in the company and begin to transfer out their shares and investments made in the company. This leaves the company with a bad public image and its revival, in the long run, may be impossible.

From the impacts above, conflict of interest among directors in a company has a deep and long-lasting negative effect which is a major reason why if not addressed, the sustainability of companies remains impossible.

9. Conclusion

This paper set out to show that the failures of companies are often related to a lack of proper implementation of corporate governance on company boards which often breeds incidences of insider dealing, director's conflict of interest, lack of disclosure, and lack of risk management. The authors show the challenges of directors' conflict of interest viz a viz their role. The paper sets out governance structures that can be implemented to ensure corporate sustainability, setting out the interconnectivity of corporate governance and corporate sustainability by observing that entrenchment and adherence to corporate governance codes are vital for corporate sustainability. The responsibility for adherence to corporate governance best practices is vested in the board, and by extension, the shareholders/owners/investors. There are supervisory structures in corporate governance that try to ensure that conflict of interests is nipped in the bud. Shareholders monitor the performance of the Board through the exercise of their voting rights. There are also case scenarios of

public and regulatory controls to ensure that key officers of the company align their interests, and work towards the sustainability of the company.

10. Recommendations

The authors recommend that shareholders' agreements and directors' service contracts should be properly considered, executed, and implemented in the company before commencing operations. The company should also design a disclosure and conflict of interest policy and profile, which should be considered during employment/ appointment. Issues that may lead to a conflict of interest should be properly discussed and articulated before the engagement of directors. The policy should enumerate the procedures to follow to detect, correct, and penalize directors' conflicts of interest.

In addition to the shareholders' agreement and conflict of interest policies, companies should ensure there is a disclosure policy structure. Complete disclosure should be required for persons with significant shareholding, disclosure of age, insolvency status, multiple directorship, secret profit, interested contract or related party transaction, and insider dealing.

The authors further recommend that companies should ensure that directors sign indemnity agreement forms for the confidentiality of price-sensitive information. There should be an effective utilization of independent reviewers and external auditors who can disclose the discovery of the acts committed and recognized as criminal offenses. In addition, companies should resist the urge to appoint life directors or shadow/ de facto directors. All directors should be duly appointed and subject to removal without the compulsion for compensation. There should be a rotation of directors objectively and transparently. Directors' remuneration should be taxable and designed to ally their interest to the prosperity of the company e.g. long-term share options. Long-term remuneration packages should not be implemented except ratified by the general meeting.

Also, directors should undergo an intensive induction training program that will expose them to their roles, duties, and liabilities. Companies and Directors should be made to understand the importance of board evaluation as where directors undergo annual evaluation and training; it helps to improve their capacity, skills, and effectiveness.

Finally, companies should implement a whistleblowing policy. The internal and external audit department and their function and independence should be enhanced and accentuated by a whistle-blowing policy. This policy would also encourage stakeholders' participation in ensuring disclosure of conflict of interest.

11. Suggestions for further research

It would be interesting to see the impact of directors' conflict of interest on Nigerian companies using empirical research. Such a study would present case studies of companies that have been impacted by activities from the director's conflict of interest. The findings may serve as a guide to the existing companies and prospective promoters of companies to avoid the pitfalls encountered by the companies. It may then be easier for stakeholders of companies to appreciate the gravity and relevancy of applying corporate governance principles in their companies to ensure corporate sustainability.

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