

A brief study on Corporate Governance in the Financial Enterprises of Bangladesh; Specially in Banking sector.

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Executive Summery:

This is an exploratory paper with the aim of determining the nature and practice of corporate governance in the financial sector in Bangladesh. Corporate Governance Philosophy of a company stems from its belief that the Company's business strategy, plans and decisions should be consistent with the welfare of all its stakeholders, including Shareholders, viewers etc. As in many developing countries banks play a vital role in Bangladesh economy, as the dominant financier for the industrial and commercial activities. Despite the expansion, the operational efficiency of the banking institutions has continued to be dismal. Bank in developing countries are faced with high risk of sharking as a result of heavy government ownership, lack of prudential regulation, weak legal protection and presence of special interest group. Bangladesh Bank is working to establish teams of expert s whose primary responsibility will be monitor the performance of the banking sector for good risk management and corporate governance. Performance of corporate governance in bank depends on several factors. Like Reliability of management, Efficiency of the board, Adequacy of the banking system, Commitment towards deposit lender and suppliers, Board member commitment, Quality of corporate reporting, Stake holders participation in management, Credit rating. The cumulative impact of these factors results in a corporate behavior which is followed in Bangladesh. A series of discussions and meetings with key personnel of the organizations such as active board members, board secretaries, and company executives were held to identify the focus of the study within the context of Bangladesh. Based on these preliminary findings, a questionnaire was developed to collect specific information on the state of corporate governance in some selected industries. The questionnaire was made semi-structured to allow for in-depth interviews with key individuals of the companies. In each company, this led to several rounds of discussions and interviews with more than one individual. This has limited ability of the study team to analyze the results using quantitative techniques. Thus Corporate Governance (CG) is the way the firm ought to be run, managed and controlled. It is related with supervision and holding the responsibility of those who direct and control the management.

1. Background of the Study:

This is an exploratory paper with the aim of determining the nature and practice of corporate governance in the financial sector in Bangladesh. Corporate Governance Philosophy of a company stems from its belief that the Company's business strategy, plans and decisions should be consistent with the welfare of all its stakeholders, including Shareholders, viewers etc. Good Corporate Governance practices enable a Company to attract financial and human capital and leverage these resources to maximize long-term shareholders' value, while preserving the interests of multiple stakeholders, including society at large. Corporate governance indicates the policies and procedures applied by firms to attain certain sets of objectives, corporate missions and visions with regard to stockholders, employees, customers, suppliers and different regulatory agencies and the community at large. The role of governance is to maximize shareholder's wealth. Corporate governance depends on managerial performance as well as a consideration of social responsibility, the socio-cultural-environmental dimension of business procedure, legal and ethical practices with a focus on customers and other stakeholders of an organization. Corporate governance is gaining importance among policy makers, entrepreneurs, business personnel, stakeholders and related organizations. From 1990 Bangladesh commenced a move towards a free market economy. A floating exchange rate mechanism was introduced from 2003.

2. My Study Area

As in many developing countries banks play a vital role in Bangladesh economy, as the dominant financier for the industrial and commercial activities. Since the independence in 1971, the government until 1982, when the 'ownership reform' measures started in the financial sector, had carried out the regulation and ownership of all financial institution. During the reform period two out of six National Commercial Banks (NCBs) were denationalized and private commercial banks were allowed to operate in the country's economy. In 2003, out of the 49 banks operating in Bangladesh, 9 belongs to the public sector, 30 are local private and 10 are foreign owned banks (Bangladesh Bank 2003). Despite the expansion, the operational efficiency of the banking institutions has continued to be dismal. The sector witnessed decreasing profitability, increasing non-performing assets and provision and capital shortfalls eroded credit discipline, rampant corruption patronized by political quarters, low recovery rate, inferior asset quality, managerial weaknesses, excessive interference from government and owners, weak regulatory and supervisory role etc.

Internal control system along with accounting and audit qualities are believed to have been a sub standard. Many of the problems have been attributed to lack of sound corporate governance into the banks. The report by Banking Reforms Commission (1999) and BEI (2003) raises serious concerns on the banking sector and criticize the quality of governance and

prevails in the banking sector in Bangladesh, which provides an impetus to explore the governance issues in detail in this proposal.

3. Objective of my study

The Global Financial Crisis has brought into focus the need for better supervision and governance in banks internationally. Banks are corporations and their firm value depends on good governance as any other firms. Corporate governance in banks is also of interest to businesses that are dependent on bank finance. The cost of funds in efficiently governed banks is found to be lower. From policy perspective bank regulators (reserve bank or central bank) would have interest in sound corporate governance mechanism in banks from financial system stability perspective.

Bank corporate governance is particularly important in less developed countries like Bangladesh because economic development and growth is dependent to a large extent on well functioning, stable and soundly managed banking system. For this reason, in 2004, Bangladesh Enterprise Institute (BEI) published the Code of Corporate Governance (CCG) for Bangladesh that is suited for, among others, financial institutions. The obvious function of a CCG for Bangladesh is to improve the general quality of corporate governance practices in Bangladesh. The Code does this by defining best practices of corporate governance and specific steps that organizations can take to improve corporate governance. In addition, the Code provides a standard that can be used to measure firms' progress towards the goal of best practices. However, a problem, which is how the CCG can be fully implemented, needs to be considered. Full implementation of the Code in all banks of Bangladesh would undoubtedly take a number of years and would require the cooperation of a vast number of relevant stakeholders (BEI, 2004).

Bank in developing countries are faced with high risk of sharking as a result of heavy government ownership, lack of prudential regulation, weak legal protection and presence of special interest group. The independent regulatory agencies are important in developing countries to act against the frequent collusion among government, businesses and bankers to serve special interest group. Recently the financial markets of developing economies have experienced rapid changes due to growth of wider range of financial products. As a result of this, banks have been involved with high risk activities such as trading in financial markets and different off-balance sheet activities more than ever before.

Corporate Governance is the term given to the management practices followed by the business organization. I believe that good business practices, transparency in corporate financial reporting and the highest levels of corporate governance must be maintained. This section includes documents regarding banks' corporate governance practices that keep banks

accountable to its shareholders. These channels in turn are activated through several structural and institutional factors pertaining to the corporation.

They are as follows:

1. The ownership structure of the organization.
2. The financial structure of the corporation.
3. The structure and functioning of the company boards and the associated internal control systems
4. The legal, political and regulatory environment within which the corporate functions.

4. Banks of Bangladesh:

Central Bank: Bangladesh Bank : Pursuant to Bangladesh Bank Order, 1972 the Government of Bangladesh reorganized the Dhaka branch of the State Bank of Pakistan as the central bank of the country, and named it Bangladesh Bank.

Banks: After the independence, banking industry in Bangladesh started its journey with 6 nationalized commercialized banks, 2 State owned Specialized banks and 3 Foreign Banks. In the 1980s banking industry achieved significant expansion with the entrance of private banks. Now, banks in Bangladesh are primarily of two types:

Scheduled Banks: The banks which get license to operate under Bank Company Act, 1991 (Amended in 2003) are termed as Scheduled Banks. **Non-Scheduled Banks:** The banks which are established for special and definite objective and operate under the acts that are enacted for meeting up those objectives, are termed as Non-Scheduled Banks. These banks cannot perform all functions of scheduled banks.

Private Commercial Banks: Private Banks are the highest growth sector due to dismal performances of government banks (above). They tend to provide better services. There are about 29 Commercial banks are performing their financial activities in the economy of Bangladesh. There also some specialised bank and some financial institution have made their own space in the field of finance

Specialized development banks

Specialized Banks (SDBs): 4 specialized banks are now operating which were established for specific objectives like agricultural or industrial development. These banks are also fully or majorly owned by the Government of Bangladesh.

- Bangladesh Krishi Bank
- Rajshahi Krishi Unnayan Bank
- Bangladesh Development Bank Ltd
- BASIC Bank Limited (Bangladesh Small Industries and Commerce Bank Limited)

5. Understanding Corporate Governance

The word 'corporate governance' has become a buzzword due to the Asian financial crises in 1997-98, the activities of the corporate sector affected entire economies, and deficiencies in CG endangered the stability of the global financial system. In general, CG deals with laws, procedures, practices and implicit rules that determine company's ability to take managerial decisions *vis-à-vis* its claimants—in particular, its shareholders, creditors, customers, the State and employees. However, a somewhat broader definition would be to define CG as a set of mechanisms through which a single country or firms within a country operates when ownership is separated from management. Therefore, corporate governance is the system by which companies are directed and controlled.

There is a global consensus about the objective of 'good' corporate governance: *maximizing long term shareholder value*.⁸ Since shareholders are residual claimants, this objective follows from a premise that, in well performing capital and financial markets, whatever maximizes shareholder value must necessarily maximize corporate prosperity, and best satisfy the claims of creditors, employees, shareholders, and the State. Since the concept of government controlling the economy is gradually eroding, it has made the market a decisive factor in settling economic issues. This has also coincided with the thrust given to globalization because of the setting up of the WTO and every member of the WTO trying to bring down the tariff barriers. Globalization involves the movement of four economic parameters namely, physical capital in terms of plant and machinery, financial capital in terms of money invested in capital markets or in FDI, technology, and labor moving across national borders. The pace of movement of financial capital has become greater because of the pervasive impact of information technology and the world having become a global village. ⁹ When investments take place in emerging markets, the investors want to be sure that not only are the capital markets or enterprises with which they are investing, run competently but they also have good corporate governance. CG represents the value framework, the ethical framework and the moral framework under which business decisions are taken. In other words, when investments take place across national borders, the investors want to be sure that not only is their capital handled effectively and adds to the creation of wealth, but the business decisions are also taken in a manner which is not illegal or involving moral hazard.

Corporate governance therefore calls for three factors:

1. Transparency in decision-making;
2. Accountability which follows from transparency because responsibilities could be fixed easily for actions taken or not taken, and;
3. The accountability is for the safeguarding the interests of the stakeholders and the investors in the organization. Over the last few years different country groups have been establishing their own common set of benchmarks for corporate governances, for instance, the OECD Council called upon the OECD to develop a set of CG standards and guidelines and published in May 1999 a common set of guiding principles on corporate governance for all OECD member countries. To institutionalize CG practice, OECD has introduced following principles are:

Rights of shareholders

1. Recognition of basic shareholder rights
2. Shareholders have the right to participate in decisions concerning fundamental corporate changes
3. Voting rights of shareholders
4. Disclosure of disproportionate voting rights of certain shareholders to obtain a degree of control
5. Markets for corporate control should be allowed to function
6. Shareholders should consider the costs and benefits of exercising their voting rights

Equitable treatment of shareholders

1. All shareholders of the same class should be treated equally
2. Insider trading and abusive self-dealing should be prohibited
3. Board members and managers should disclose material interests

Role of stakeholders

1. Assure that rights of stakeholders are protected by law
2. Stakeholders should have the opportunity to obtain effectiveness redress for violation of their rights
3. Permit performance-enhancing mechanisms for stakeholder participation
4. Stakeholders should have access to relevant information in the corporate governance process

Disclosure and transparency

1. Scope of material information to be disclosed
2. Information should be prepared in accordance with high accounting standards
3. Annual audit should be conducted by an independent auditor
4. Fair, timely and cost-effective means of disseminating information

Responsibilities of the board

1. Board members should act on the best interest of the company with due diligence and care
2. The board should treat all shareholders fairly
3. The board should ensure compliance with the law and take account the interest of stakeholders
4. Definition of key functions of the board
5. The board should exercise objective judgment independent from management
6. Board members should have access to accurate, relevant and timely information

Source: OECD Principles of Corporate Governance (1999).

However, members of APEC considered that the OECD guidelines have the problem of 'one size cannot fit all' and some may be applicable to some, but not all. APEC countries therefore called upon the Pacific Economic Cooperation Council (PECC) to develop a set of guidelines which were in line with the OECD principles. The APEC guidelines can be considered as a middle step for emerging markets to achieve a better practice of good corporate governance. This set of guidelines forms the standard for individual Governments, regulatory bodies and professional bodies to develop their agendas and with a view to setting up acceptable codes of practice.

6. Scenario in of Corporate Government practice in Banking Sector:

Banking companies pose unique corporate governance attention as they differ greatly with other types of firms in terms of broader extent of claimants on the banks assets and funds. A group of entrepreneurs and/or executives could set up a banking business by putting very little equity from own pocket as the nature of business itself guarantees flow of enormous amount of funds in the form of deposits. The general approaches of corporate governance argue in favor of shareholders right only, as the managers and executives may not always work in the best interest of shareholders. But the shareholders actually account for a very tiny portion of the bank's asset and funds. Rather almost every bit of bank's investment are financed by the depositor's fund. In case of losses or failure it will be a depositors' savings that the banks would lose. Such risk demand priority in protection of depositors that ushers in a broader view of corporate governance that suggests the interest and benefits of the supplier of funds for a firm should be upheld (Shliefer and Vinshny, 1997, Oman,2001). In many countries deposit insurance is used as a mechanism to safeguard the banking system as well as the depositors.

7. Scope of the study:

There are 48 commercial banks in Bangladesh including commercial and foreign banks. The prospect of corporate government practice is bright in banking industry in the country. Bangladesh Bank is working to establish teams of experts whose primary responsibility will be monitor the performance of the banking sector for good risk management and corporate governance. It has been found that performance of bank is good at credit rating. The study has been conducted on 25 banks; both foreign and nationalized commercial bank. Maximum bank credit rating was 'A', that means high efficiency in management.

Merchant banks are new concept in financial system of Bangladesh, which significantly differs with traditional banking. There are a lot of scopes to explore and develop the industry. At the same time for financing larger investment, investors need to know the functions and usefulness of merchant banking. General investors can also be benefited by investing through merchant banking service like portfolio management. Although merchant banks are not providing all range of service that they can do, but day by day they are enlarging their service area in the capital market of Bangladesh and opening a new prospects in Corporate Governance.

The purpose of this study is to assess whether corporate governance practices in Bangladesh banks have undergone significant improvement after introduction of the Code. To achieve the objectives of the study, we do content analysis of the annual reports of banks in Bangladesh before and after the introduction of the Code in 2004 and score the various elements of corporate governance. Thereafter use a non-parametric difference test to answer the research question whether the introduction of the Code has led to significant improvement in corporate governance practices of banks in Bangladesh. The study is important for several reasons. First, we contribute to the existing literature on corporate governance in banks by providing evidence from a hitherto unexplored country like Bangladesh. As already indicated above, some existing literature supports that improved corporate governance practice in banks leads to better allocation of resources within an economy and contributes to growth. Second, the findings from the assessment of the compliance with the Code of corporate governance would help the Securities and Investment Commission in Bangladesh as well as the Bank of Bangladesh to take suitable policy measures to further strengthen the corporate governance of banks in Bangladesh. These positive findings are also expected to help the banking industry in Bangladesh to further strengthen the corporate governance practices so as to achieve world's best practice. This paper is organized as follows. Section 2 presents a brief of overview of the banking industry in Bangladesh. Section describes previous literature. Section 4 presents data

and method used in this study. Finally the results are then shown in Section 5 and conclusions are addressed in final Section.

8. Methodology:

Performance of corporate governance in bank depends on several factors. Like

- Reliability of management
- Efficiency of the board
- Adequacy of the banking system
- Commitment towards deposit lender and suppliers.
- Board member commitment
- Quality of corporate reporting
- Stake holders participation in management
- Credit rating

The cumulative impact of these factors results in a corporate behavior which is followed in Bangladesh.

However this may not be the best practice in the world of good corporate governance. Some of the best practices and guidelines of corporate governance are coded in the company law and regulations and are expected to be practiced in Bangladesh. In this regard, it is possible that companies follow them because it is mandatory and yet may not fully comply with the essence of the rules and regulations. Considering all these, the multiple methods were used to study about '**Corporate Governance in Financial Enterprises in Bangladesh; specially in Banking sector**'.

Data Collection Methods: The study is the outcome of both the primary & secondary data. The primary data relates to problems faced by the selected banks and suggestions to remove the same in order to examine the prospects of Corporate Governance. The opinions on the prospect of Corporate Governance have been collected from the respondents on the basis of a prepared questionnaire. The requisite primary data were collected from 24 randomly selected bank personnel out of 66 in number from six selected banks. Therefore, a questionnaire method of data collection was extensively used in collecting primary data. The problems of corporate governance and the measures to overcome the same were gathered from the

selected bank personnel. The question was an open ended one. The respondents were asked to identify the problems of corporate governances well as measures for the removal of the same. The secondary data used for the study have been organogram of the selected groups of banks namely Islamic & conventional. These were collected from annual reports of the selected banks.

Data Analysis and Interpretation: The collected data were analyzed and interpreted critically by the authors in order to make the study more effective, valuable & useful to the readers. On the basis of the analysis and the interpretation, the authors have developed the present report.

At first I have to collect this information through a series of discussions and meetings with key personnel of the organizations such as active board members, board secretaries, and company executives, to identify the focus of the study within the context of Bangladesh. Similarly, consultation with academics and researchers were also conducted to further broaden the study questionnaire survey.

Based on these preliminary findings, a questionnaire was developed to collect specific information on the 'Corporate Governance in Financial Enterprises in Bangladesh in some selected industries. The questionnaire was divided into several sections:

- a. Company Profile
- b. Shareholder's rights and disclosure
- c. Public disclosure and transparency
- d. Effectiveness of the board
- e. Function of the board and
- f. Effectiveness of the independent directors.

Preliminary discussion with key stakeholders also revealed that the corporate sector is yet not ready to reveal information beyond their statutory requirements. At this point, the questionnaire was made semi-structured to allow for in-depth interviews with key individuals of the companies. In each company, this led to several rounds of discussions and interviews with more than one individual.

However, because of the political changes in Bangladesh, and because if the actions taken by the government on several key companies (due to allegation of tax evasion and other malpractices), it will be extremely difficult to collect information.

9. Previous findings of implementing corporate governance in Banking Sector:

Problems faced in Practicing Corporate Governance in Banking Industry in Bangladesh:

The respondents were requested to mention the main problems faced by them in practicing the Corporate Governance in Banking Industry in Bangladesh. The respondents' responses as to the problems faced in practicing Corporate Governance in Banking Industry in Bangladesh has been tabulated below:

Sl#	Specific Problems	% Respondents
1	Corporate ownership structures are dominated by family members	100%
2	Accounting standards and disclosure and its impacts on CG and management practices in Bangladesh are mixed	100%
3	Inadequate Bankruptcy Laws	60%
4	Inconsistency between Companies Act, Bangladesh Accounting Standard and Security Exchange Commission requirements	80%
	Weak Regulatory System	100%
	Weak Capital Market Role	100%
5	No Market for Corporate Control	75%
	Most companies in Bangladesh are closely held and a negative correlation exists between good Corporate Governance and defaulting in holding annual general meetings in due time	60%
6	Independent directors do not act as an advocate for minority shareholders or as a source of innovative ideas	65%
7	Lack of Shareholder's Activism	50%
8	Weak Pressure Groups	75%
9	Lack of Auditor Independence	80%
10	Poor Audit Report	60%

Prospect of Corporate Governance practice in Banking Industry in Bangladesh:

The prospect of Corporate Governance practice in banking industries in Bangladesh is very bright if the problems involved in Corporate Governance practice as pointed out earlier by the respondents can be removed. But, it is true that 100% removal of the problems is not always possible. However, the respondents were requested to mention the major suggestions as to the removal of the problems. The responses of the respondents were tabulated above.

Sl#	Specific suggestions	% Respondents
1	Code of Corporate Governance and Best Practice Recommendations	80%
2	Implement Competition Policy	70%
3	Improve the capacity of the Board of directors	100%
4	Ensure the legal and regulatory framework	100%
5	Strengthening the Capacity of the Government	90%
6	Strengthening the Capacity of Public and private sector institutions	80%
7	Institutional Capacity Building	75%
8	Introduction of Good Governance Practices in State Owned Enterprise (SOEs)	70%
9	Improving the quality of Financial Reporting	80%
10	Role of Dhaka Chamber of Commerce and Industry	90%

10. Conclusion:

Like other developing economies, the banking sector becomes the dominant financial intermediary in the financial system of Bangladesh due to underdeveloped capital markets, limited availability of financial instruments and lack of confidence on financial system. Given the bank's intermediary role in providing stability to the financial system, Bangladesh as well as many emerging economies has implemented policies to develop and restructure the banking sector. The unique feature of banking industry which deals with the money of the depositors conveys the inevitability to implement corporate governance in this sector. This is the major concern of my research on banking sector of this region.

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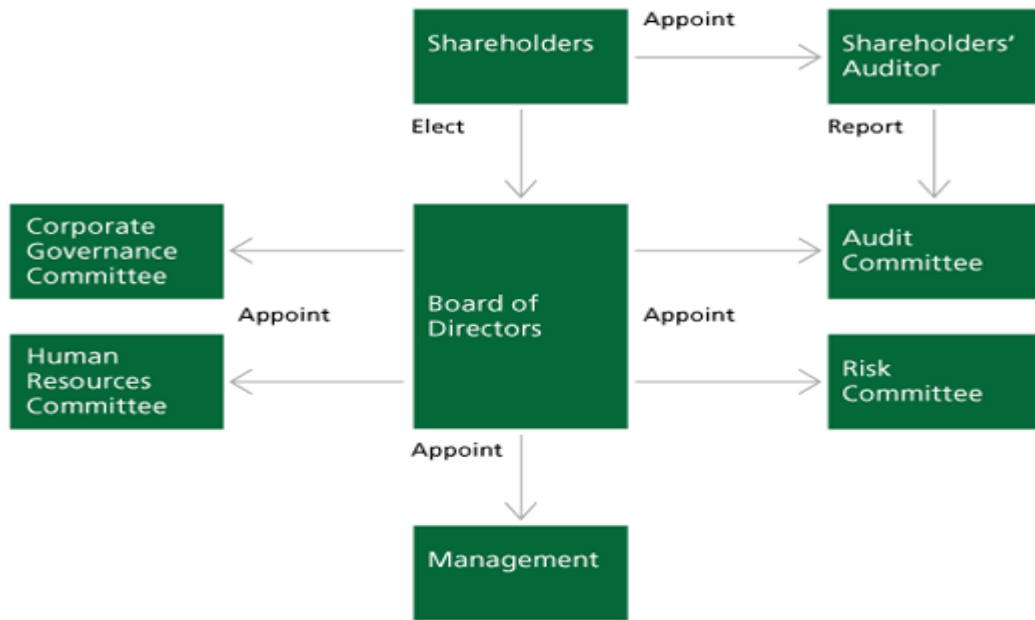
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Appendix:

The Board of Directors and the management of TD are committed to leadership in corporate governance. We have designed our corporate governance policies and practices to be sure we are focused on our responsibilities to our shareholders and on creating long term shareholder value. We can assure you that TD's policies and practices meet or exceed applicable legal requirements. We continuously monitor all proposed new rules and modify our policies and practices to meet any additional requirements. An overview of our corporate governance structure is set out below.

This diagram is a simple overview of the corporate governance structure at TD.



The Statement of Corporate Governance Practices in Annual Report explains the roles and responsibilities of each important part of this structure, as well as other key facts about corporate governance at TD.

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