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Corporate Governance Enhances the Performance of Financial Institutions: A Comparative Study on Banking Industry of Bangladesh

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ABSTRACT

Corporate Governance refers to the manner by which organizations are administered and to what reason. It distinguishes who has power and responsibility, and who simply decides. Corporate Governance has become visible noticeably over the world particularly in business regions like banks, NBFIs, insurances, administrative bodies, and autonomous bodies. This study intends to critically notice the exhibition of financial institutions improved by ensuring great corporate governance and what are the deterrents holding behind to accomplish it. From this examination we can gather that, various sorts of financial scams and advance defaulting hampering the business enormous. We had compared information gathered from 20 banks including both conventional and Islamic bank contrasting year 2020 with year 2022 recorded and controlled under Bangladesh Bank's administration. The corporate governance practices in Bangladesh have been largely limited to financial Sector and the Banking sector can serve as a motivation for better corporate governance through its requirements and procedures for approving and monitoring loans. These results suggest that better corporate governance mechanisms are imperative for every banking company and should be encouraged for the interest of the investors and other stakeholders as well as company's both financial & operational activities.

Keywords: Corporate Governance, Financial Performance, ROA, ROE, Banking Sector, Financial Institution, Board of Directors.

INTRODUCTION

Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and

monitoring performance. Corporate governance in financial institutions is the set of standards and principals used to create a system of checks and balances over the management of banks and financial intermediaries. It establishes the way financial institutions are directed and controlled, ordinarily through standards set for the conduct of the board of directors and senior management. Corporate Governance has become known noticeably over the world particularly in business areas like banks, NBFIs, insurances, regulatory bodies, and autonomous bodies. The terms of corporate governance and its everyday usage is a phenomenon of the last fifteen years and so on. However, the development of corporate governance and its areas encompasses a variety of discipline including finance, banking accounting, management, and economics, law and organizational behavior.

Corporate Governance practice in Bangladesh: The corporate administration practice in Bangladesh analyzes the major inside and outside factors like lawful system, financial sector scenario, accounting standards and disclosures with regulatory requirements, the role of independent regulators and Judiciary and finally the role of a pressure group.

Companies and Corporate Laws: Companies of Bangladesh is incorporated and governed by the Company Act 1994, Bank Company Act 1991, Financial Institution Act 1993, Bangladesh Securities and Exchange Commission Act 1993 (2012 amended) and Bankruptcy Act 1997 which defines the rights and responsibilities of both majority and minority shareholders. But because of appropriate execution of Corporate Governance financial scams and fraudulent exercises are expanding step by step. Recent financial scams and increasing default loan size have brought the banking sector of Bangladesh under criticism. Undoubtedly, the industry is increasing day-by-day with new banks and their branches. The current situation of large financial frauds and high non-performing loans (NPL) of banks call for a close scrutiny of this sector and necessitates taking required measures. Bangladesh Bank instructed all commercial banks to have strong and healthy corporate governance so that such fraudulent activities can strictly be monitored. So, the main purpose of this study was to critically observe the current Corporate Governance status and practices in the banking sector of Bangladesh as well as their financial strengths.

LITERATURE REVIEW

The corporate governance of banks in developing economies is important for several reasons. First, banks have an overwhelmingly dominant position in developing economy financial systems, and are extremely important engines of economic growth **(King and Levine & Levine)**. Second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for the majority of firms **(Levine)**.

Firms' ability to generate profit can be maintained and measured by the magnitude of CG. "When making investment decisions, investors want to ensure the ability and strength of the company to generate profit. **Hossain et al. (2021).**

Bezawada (2020) concluded that good CG enables to ensure good financial performance and ensure a fair return for all stockholders of the firms.

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Rashid, Zobair, Chowdhury, and Islam (2020) researched Bangladesh using CG factors as BS, BI, Accounting and Legal experts on the board. They found an affirmative connection of legal experts in the board, an insignificant relationship.

According to Rahman and Islam (2018) "The main and crucial reason behind the financial crisis of the banking sectors in Bangladesh is an inadequate practice of CG.**"**

Rahman and Islam (2018) researched in Bangladesh using CG factors such as BS, board composition, CEO duality, and performance measures as ROE and ROA. They established BS is significantly affirmatively related to ROE and ROA. Board composition is also significantly positively related to ROE, and CEO duality is also significantly positively related to ROA. On the contrary, some argue that large BS is fewer efficient due to less harmonization, control, and supervision.

Pillai and Al-Malkawi (2018) argued in their research that BS, audit type and CSR in GCC countries have a negative influence on financial performance.

Hossain (2017) "Bangladesh is also being pressurized by the international communities to follow an international, comparable CG framework**".**

Duru, Iyengar, and Zampelli (2016) found that CEO duality significant negatively shocks the firm operating profitability.

Haider, Khan, and Iqbal (2015) found that Board size, number of meetings, and AC size are also positively associated with performance.

It is essential to establish good corporate governance practices at the national level in developing countries due to the implicit relationship between private interests and the larger government **(Nicolas Meisel 2014).**

A firm's behavior is shaped by its corporate governance practices. Therefore, it is reasonable to expect that they will also influence a firm's stock prices **(Gompers et al. 2013)**.

Denis and McConnell (2012) define corporate governance as a- An institution of corporate governance is a set of institutional and market-based mechanisms that encourage managers and controlling shareholders to make decisions that maximize the value of the company for its shareholders.

Kutubi (2011) has examined board of director's size, independence and performance: an analysis of private commercial banks in Bangladesh. This study has examined the impact of board size and the independent directors on the performance of the local private commercial banks in Bangladesh. The study has found that statistically significance positive relationship existed between the proportions of the independent directors and the performance of the banks.

Hossain (2011) highlighted the corporate governance practices in Bangladesh. The study has pointed out that good corporate governance has implication for company behavior towards employees, shareholders, customers & banks. He has suggested that improving corporate governance can provide significant rewards to both individual companies and countries.

Rashid et al (2010) have examined board composition and firm performance from Bangladesh perspective. The study has also examined the influence of corporate board composition in the form of representation of outside independent directors on firms‟ economic performance in Bangladesh. The finding of the study has provided an insight to the regulators in this quest for harmonization of internal corporate governance practices.

Objective & Methodology of the Study

Objectives of the Study:

The financial institutions such as scheduled banks listed under Bangladesh bank is chosen in this review for the relationship estimation between corporate governance and financial performance of the firm. The particular targets of the proposed study are:

- To quantify the degree of operations of the firm (business performance) made by recorded scheduled banks (both govt. & private) in Bangladesh.
- To analyze the relationship between corporate governance and worth of the firm (financial performance) of recorded organizations in Bangladesh.

METHODOLOGY

Population of the Study

The quantity of population in this study depends on the financial institutions in Bangladesh which is constrained by Bangladesh Bank (BB). As of now, there are roughly 63 scheduled banks recorded simultaneously by the public authority and private banks under full control and oversight of Bangladesh Bank.[1]

Sampling Design

This study relies upon the “Random Sampling Method ". This area is included 63 enrolled banks under Bangladesh Bank’s policy, 20 banks of them have been taken as a test. Selected tests are as follows:

A. State Owned Commercial Banks- ***4*** Banks
B. Private Commercial Banks- ***16*** Banks
    a. Conventional PCB- 11 Banks
    b. Islami Shariah based PCB- 5 Banks

Period of Study

As per the Yearly Reports of selected scheduled banks in Bangladesh, we analyze the fiscal summaries of the most recent three years **(2019-20 to 2021-22)** of related concerns.

[1] https://www.bb.org.bd/en/index.php/financialactivity/bankfi#:~:text=These%20banks%20are%20also%20fully,by%20individuals%2Fthe%20private%20entities

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Sources of Data

The exceptions have been changed in accordance with enhance stable final results with a duration canvassed from **year 2020 to year 2022** and the exploration work executed primarily based on secondary information.

ANALYSIS & DISCUSSION

Variables Used in the Study

Table 1 ensures the performance of Corporate Governance in the banking industry; we have gathered information from 20 traditional banks containing both public and private banks in Bangladesh. Beneath table contains information of banks foundations, board size and independent director, number of male & female directors in board size/members.

Table- 1: Variables used in the study

Name of the Bank	Estd.	MD & CEO	No of Board of Directors	No of Independent Directors	No of Male Directors	No of Female Directors	Total Board Size / Members
Agrani Bank	1972	1	10	0	9	1	25
Janata Bank Limited	1972	1	9	0	8	1	23
Sonali Bank	1972	1	10	0	9	1	6
Basic Bank Limited	1988	1	7	0	7	0	12
AB Bank Ltd	1982	1	7	2	7	0	16
Bank Asia Ltd	1999	1	14	5	11	3	25
BRAC Bank Ltd.	2001	1	10	6	8	2	17
Dutch Bangla Bank Ltd.	1995	1	7	2	6	1	45
Eastern Bank Ltd.	1992	1	14	3	11	3	16
IFIC Bank Ltd.	1976	1	10	2	8	2	11
NCC Bank Ltd.	1985	1	14	1	12	2	11
Premier Bank Ltd	1999	1	13	2	12	1	15
Pubali Bank Ltd.	1959	1	14	2	12	2	32
The City Bank Ltd	1983	1	11	2	7	4	27
Trust Bank Ltd.	1999	1	12	2	10	2	14
Al-Arafah Islami Bank Ltd	1995	1	21	2	21	0	10
Islami Bank Bangladesh Ltd.	1983	1	20	4	20	0	31
Shahjalal Islami Bank Ltd	2001	1	21	3	19	2	27
Social Islami Bank Ltd.	1995	1	12	2	11	1	6
First Security Islami Bank Ltd	1999	1	13	3	9	4	14

Descriptive Statistics

Table 2 provides descriptive statistics of the gathered factors. All out number of tests gathered from 20 recorded Conventional and Islamic banks. The vast majority of the banking industry includes single Managing Director **(MD)** and Chief Executive Officer **(CEO)**. Mean number of top managerial staff is equivalent to somewhere around 12 members, greatest tracked down 21 individuals and least 7 individuals. Participation of female directors compared less than male directors. Greatest complete board size is found involving 45 individuals. Return on Resource (ROA) and Return on Value (ROE) are viewed as on normal 3.65 and 64.73 individually. All out count of examination variable found 20 banks of Bangladesh.

Table- 2: Descriptive Statistics

Particulars	MD & CEO	No of Board of Directors	No of Independent Directors	No of Male Directors	No of Female Directors	Total Board Size / Members	ROA (2020-2022)	ROE (2020-2022)
Mean	1	12.450	2.150	10.850	1.600	19.368	3.649	64.727
Standard Error	0	0.947	0.357	0.974	0.275	2.339	1.781	31.236
Median	1	12.000	2.000	9.500	1.500	16.000	2.330	33.605
Mode	1	10.000	2.000	9.000	1.000	25.000		45.690
Standard Deviation	0	4.236	1.599	4.356	1.231	10.194	7.967	139.693
Kurtosis	0	0.252	0.733	1.172	-0.358	0.528	17.463	18.974
Skewness	1	0.852	0.674	1.403	0.496	0.829	4.022	4.315
Range	0	14.000	6.000	15.000	4.000	39.000	41.150	64.590
Minimum	1	7.000	0.000	6.000	0.000	6.000	-4.640	7.010
Maximum	1	21.000	6.000	21.000	4.000	45.000	36.510	65.600
Sum	20	249.000	43.000	217.000	32.000	368.000	72.970	124.540
Count	20	20.000	20.000	20.000	20.000	19.000	20.000	20.000

Pearson Correlation Analysis

Table 3 represents the Pearson correlation analysis for the variables which are used in the regression model. Pearson's correlation analysis is used for data to find the relationship between Corporation Governance and firm's financial performance. There is a positive relationship between no. of board of directors with total board size. Also, positive connection among independent directors with total board but no impact found on ROA & ROE. Male and Female directors are positively correlated to each other. Female directors have found no impact on firm's financial performance at all. Total board size is responsible in increasing firm's total assets and net income which interpreted positive relationship with Return on Assets (ROA).

Table- 3: Pearson Correlation Analysis

	No of Board of Directors	No of Independent Directors	No of Male Directors	No of Female Directors	Total Board Size / Members	ROA (2020-2022)	ROE (2020-2022)
No of Board of Directors	1						
No of Independent Directors	0.363	1					
No of Male Directors	0.959	0.253	1				
No of Female Directors	0.046	0.353	-0.237	1			
Total Board Size / Members	0.036	0.202	0.016	0.068	1		
ROA (2020-2022)	-0.088	-0.231	-0.088	0.011	0.164	1	
ROE (2020-2022)	-0.297	-0.290	-0.219	-0.247	-0.178	-0.266	1

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Obstructions Confronted Directing Appropriate Corporate Governance

- **Criteria for selecting borrowers:** In some cases, banks struggle to choose the right individuals or organizations to lend to. A faulty selection of borrowers will result in a failed lending transaction. Borrowers should be selected who are financially and mentally capable of repaying the loan. The banks will face higher classified loans if they choose fraud people, whose intention is not to repay the loans. In order to select the right borrower, the bank should have knowledge of the borrower's information, which is a proper KYC (Know Your Customer).
- **An overview of political influence:** The officials stated that no political influence is involved in the loan decision making process, however, there is a suspicion that there is acute political pressure in this matter. As a result of political bias, loans become defaulted and the banking sector becomes vulnerable. There are many fraud borrowers who are very cunning and they build a web of deception for those involved in loan approval, auditing, and reporting. A person who is politically exposed puts pressure on the banking sector for their own benefit as well as for their small fry.
- **Impact of management:** Similar to political influence, the management of banks has an influence on the lending process. Generally, the management plays a significant role in the credit decision making process, which results in higher classified and defaulted loans. Higher management, including the Chairman, the Board of Directors, the Managing Director, and other high officials, have a significant impact on the lending process. Some of them display nepotism toward their friends and family. They sometimes instruct branch managers to prepare lucrative proposals on behalf of their selected customers, even if their loan availing capability is not particularly lucrative for the bank. When there is a lack of documents or collateral as security, the management may approve loans at a special rate.
- **Lack of knowledge of Bangladesh Bank Circulars:** Time to time, Bangladesh Bank provides circulars to commercial banks to ensure smooth operation and safety. These circulars must be followed by all commercial banks. Circulars are sometimes unaware of by officials. As a result, the bank may face operational and reputational risks.
- **Additional benefits are provided to the client:** A second example of bad practices was found in the branches, which was the provision of additional benefits to clients. The term "extra benefit" can be defined in a variety of ways here. For instance, sometimes a client's collateral is not sufficient to obtain a certain amount of credit, but the client is able to acquire more credit than that. In the case of foreign exchange transactions, a minimum cash margin is required, however, clients are provided with an additional facility to avoid depositing cash before the transaction. As a result of having a good relationship with bank officials, clients sometimes request a deferral of the submission of required documents for the completion of a certain transaction, which is also an additional benefit. It becomes problematic when some crucial documents may be missing that were necessary for the transaction. The banks remain unable to demonstrate proper documents when the fraud was committed. According to a Bangladesh Bank official, a certain branch of Prime Bank Ltd had a classified loan of only 2% to 3% last year, but when the client collapsed, the classified loan increased to 82% to 83%.
- **Errors in information provided by the head office:** In Bangladesh, the Bangladesh Bank serves as the central bank and guardian of all commercial banks. As a result,

commercial banks must submit different information to Bangladesh Bank through different statements. In response to the information provided by different banks, the central bank makes different decisions and formulates different policies. The branch offices of each bank send statements to the bank's head office. After that, Bangladesh Bank receives the statements. Branch offices or even Head Offices sometimes temper the truth.

- **Lack of personal guarantee:** Banks often use personal guarantees. It is a must to have a guarantee, whether it is personal or collateral. As a form of security for a smaller loan, a personal guarantee can be taken. When the amount is higher, however, the personal guarantee is not sufficient, and the borrower will need to provide additional collateral. Personal guarantees are becoming riskier when it comes to recovering defaulted loans.
- **Risky Project Investment:** It is the responsibility of the branches to fill up their business targets every year, and today, there is so much competition. In order to survive in the competitive market, banks try to identify various projects in which they can invest and obtain a healthy return on investment. Whenever there is an opportunity for good returns, there is also an opportunity for high risk. In some cases, banks may be able to generate profits by investing in high-risk projects, while in other cases they may lose money by doing so. An additional bad practice of competition is the pursuit of clients at any cost. Banks are forced to find clients desperately as a result of this practice.
- **Monitoring and supervising the borrower:** The main source of income for a bank is loans and advances. As a result, the bank should be more careful when selecting clients. If the client's business is profitable, the bank will be able to make a profit on the loan as well. As a result, the bank bears responsibility not only for disbursing loans to its clients, but also for monitoring and overseeing their use of the funds. Additionally, this will prevent the diversion of funds.
- **Diversification of funds:** One of the major problems in the Bangladeshi banking sector is the diversion of funds. The main difference between Islamic and conventional banking systems is the method of disbursement of funds. A conventional bank disburses the funds directly to the client's account and the client is free to do whatever he or she wishes with the funds. When they take out a loan from the bank, they use it to conduct business, but if they invest in the stock market, buy cars, purchase land, or spend without a clear goal, the funds are diverted. Ultimately, clients are unable to repay their loans due to fund diversion, which leads to their loan default. To prevent fund diversion, strong monitoring and supervision are essential. Conversely, Islamic banks purchase goods on behalf of their clients rather than disburse funds directly to them. So, a little chance of fund diversion exists here. But monitoring and supervising is also needed there.
- **Corrupted Bank Officials:** It is clear that corrupted bankers are responsible for financial fraud and scams. They establish a relationship with the clients and are involved in these fraudulent activities. In their knowledge of the banking rules and regulations, they find a way to commit fraud by showing their thumbs to the bank.
- **Insufficient documentation:** In order to complete a transaction with the client, proper documentation is required. During the time of recovery, any shortage of

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documentation may result in a problem. Default loans will not be legally recoverable if the bank is unable to present the required documents.

- **Deficiencies in the audit:** All frauds and scams in banks can be eradicated through proper auditing. However, there are several reasons why the audit process cannot be conducted properly. An auditing team may be under management pressure or corrupted. There are some banks that conduct only one audit in a year, while the rules require a minimum of two audits to be conducted each year.

RECOMMENDATIONS & CONCLUSION

In view of the analysis and obstructions referenced above, we can finish up certain suggestions following which are incorporated such as:

Some hypothesis proposes, duality of MD and CEO improve financial execution and guarantee great corporate governance. The suggestions through this study infer that, standing firm on two positions at a time will be better not. On the off chance that two positions are independently situated, there will be a superior decision cycle and great control over guaranteeing corporate governance.

Besides, we record those female directors do not have any significant impact on performance as most of them are appointed based on family ownership. Board ought to choose female board members on the grounds that these females will make a critical commitment to company's performance. In any case, administrative shareholdings adversely affect execution. Family dominance and poor administrative oversight in Bangladesh suggests the need of independent directors to safeguard the interest of minority investors. The agency theory suggests that higher portion of independent directors will increase the monitoring and reduce any self-interested actions by managers and therefore, will be connected with better firm execution.

There is generally political distress circumstance in an emerging nation like Bangladesh. So, to give great corporate governance, the public authority needs to guarantee some approach in regards. Govt. requirements to step in advance and credit finance endorsement, where political impact and higher authorities are involved. The greater part of the issues hampering the good governance is connected with credit issues. For this purpose, banks generally contend each other in a hazardous manner that they contribute to those corporations which have no legitimate documentations or personal guarantees and once in a while to keep up with great connection with the client. A lot of branches opening in a solitary region likewise answerable for this present circumstance. Bangladesh Bank ought to control the banks so that the approaches ought to be executed to guarantee better corporate administration and screen them an opportunity to time to meet the measures of arrangements. Inside each financial company they need to give restricted offices to its client addressing every one of their necessities and assist their workers with guaranteeing their authoritative objectives. Not just the Govt. or on the other hand Bangladesh Bank and other monetary industry controlling units alone can tackle this issue, however the entire financial industry alongside their representatives need to stride ahead and make their commitment to guarantee great corporate governance.

In conclusion, the study's overall findings indicate that the practice of corporate governance in Bangladesh is vulnerable and still in its initial stages as the corporate legal environment has not been widely recognized by the companies in Bangladesh for its numerous weaknesses. As a matter of fact, Bangladesh has fallen behind its neighbors and the worldwide economy in corporate governance. One justification behind this shortfall of Corporate Governance is that most organizations are family arranged. In addition, inspiration to disclose data and further develop governance rehearses by organizations is felt adversely. Removing these weaknesses requires appropriate reform, and implementation is highly necessary for Bangladesh. So, if the policymakers adopt and then properly implement the recommendations mentioned above, undoubtedly, a better Corporate Governance environment will prevail in Bangladesh.

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