

Corporate
governance practices
in bangladesh special
highlights on financial
inst...



**ASSIGN
BUSTER**

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.

Of the three cases examined in this study, each of them is old in the financial sector. We observed that the leasing firm, incorporated in 1985, made no disclosures in regards to its corporate social responsibility and, as a consequence, conclude that the corporate governance mechanisms in this firm are likely to be unsophisticated. Keywords: Corporate governance; corporate social responsibility; Disclosure; Ethical Business Procedure; 1. 0

Introduction

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.

<https://assignbuster.com/corporate-governance-practices-in-bangladesh-special-highlights-on-financial-institutions/>

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. Yet the capital market of the country has still not fully developed. Although the country is moving towards a free market economy neither government nor private initiatives have been sufficient to promote good corporate governance leading to an acceptable level of corporate social responsibility.

According to the Bangladesh Enterprise Institute (2004) there are numerous potential benefits and rewards for Bangladesh by improving corporate governance, practices. The primary and most important benefit from implementing mechanisms such as a code of corporate governance is likely to be felt at the national level with an improved global perception of business procedures including improved ethical business practices. In turn, this could lead to a process of revitalization of the Bangladeshi economy.

If a code of corporate governance can be fully implemented, in public corporations, joint stock companies, state owned enterprises, and non-governmental organizations, the reputation of Bangladesh as a destination for investment will be greatly enhanced. The capital market in Bangladesh is underdeveloped. The market lacks appropriate laws, transparency and the corporate disclosure system is faulty. It provides little protection to minority shareholders' rights and often action against listed companies is difficult.

Solaiman (2006) observed that the Bangladesh securities market has failed to achieve any significant growth since its inception in 1954. This stagnation

is attributable to a number of factors that include, inter alia, the existence of weak legal and regulatory frameworks, the absence of active market professionals, the predominance of individual investors, and a serious dearth of foreign and institutional investors. Legal and regulatory weaknesses are considered to have critically hindered the market's potential growth. Some important laws are outdated, and the regulator has introduced some unrealistic reforms over the years.

Most of the reforms accomplished thus far concentrate on incentives to investors and issuers alike, but nothing significant has been done for investor protection. Solaiman (2006) argues that effective legal protection to investors is indispensable for the development of, and the restoration of public confidence in the infant securities market of Bangladesh. Corporate governance initiatives have the potential to redress some of these issues and lead to an improvement in conditions affecting these important market constituents.

In terms of corporate governance, the public sector is still facing a very gloomy situation. The boards of directors of the central bank, nationalized commercial banks, specialized financial institutions etc. , cannot even appoint their auditors. This is done by the concerned ministry. Moreover, the financial liberalization process, which was started in 1990, has exposed financial institutions to many challenges including sometimes-severe credit risks and value fluctuations. According to the Asian Development Bank (2005) during the latter half of 1996, Bangladesh's stock market experienced a major bull run.

Market capitalization rose by 265%, average daily turnover increased by over 1,000%, and the share price index jumped by over 260%.

Subsequently, stock prices started falling sharply. Stock market prices at the end of April 1997 had dropped by close to 70% from their peaks in November 1996. The report of the Asian Development Bank (2005) also stated that due to the inability of the existing stock exchanges to service the requirements of small retail investors, a huge unofficial korb market in shares developed. The report found that small investors at korb market reached well over 25,000.

According to news published in The Independent (2008), Bangladesh Bank through issuance of a circular on 23rd August requested commercial banks to appoint two directors from the depositors by September 30. Bangladesh Bank has undertaken the initiative as per the Bank Company Act 1991 to ensure accountability and transparency of the banking activities through appointing two representatives from the depositors to the Board of Directors. The posts of the depositor directors will be in addition to 13 bank directors none of whom should be from the "family members" of the existing directors.

This study has been undertaken with the following objectives. First, to identify and understand the nature and extent of corporate social responsibility reporting by banks in Bangladesh. Next, to consider the explanations of corporate social responsibility reporting and to assess the need to improve corporate social responsibility of banks in Bangladesh. The remainder of this paper proceeds as follows. In section two a review of relevant literature in the areas of corporate governance is examined. In section three, an explanation of the research design is provided.

<https://assignbuster.com/corporate-governance-practices-in-bangladesh-special-highlights-on-financial-institutions/>

The cases and results are discussed in section four. Lastly, a summary of the findings and potential areas for further research is provided.

2.0 Literature Review

We present a range of perspectives on corporate governance frameworks in a search for corporate governance practices of the financial sector in Bangladesh. 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-a-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.

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. 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:

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. Batra, Kaur and Dangwal (2007) argue that in order to achieve high standards of corporate governance, internal pressures such as peers and market competition should be more effective than enforcement by regulating agencies. It is also imperative that the regulators should expand their role and take effective measures to propagate the concepts of best practices in ushering an era of good corporate governance. Corporate social responsibility disclosures can be an attempt by a firm to legitimize corporate actions. In our study we search for indications that corporate social responsibility disclosures are a result of peer and/or regulatory pressure. Hoffman, Frederick and Schwartz

(2001) tried to address whether a corporation has a conscience and how ethical governance and managed care can coexist.

They stressed the need for corporate morality. In our study we examine disclosures with a view to understanding whether the firm is attempting to convey a sense of corporate conscience and ethical behaviour. Shah and Haq (2007) undertook an empirical study and found that in the cement sector of Pakistan, corporate governance structure variables such as percentage block holding by individual and family members, board size and firm size have a positive impact on firm performance.

They concluded that the firms' performance is adversely affected if the CEO also acts as chairperson of the board of directors; the percentage of block holdings by financial institutions has a negative relationship with performance; the size of the firm has a positive impact on firm performance and the expected leverage is an adverse signal for firm performance. In this study, we also examine the board of directors with a view to understanding typical composition.

We are searching for the inclusion of women as directors as this may provide a useful indicator of a firm's attitude towards corporate social responsibility towards women. Imam and Malik (2007) find in Bangladesh that foreign holdings are increasing in those firms that have good governance. They observe a positive relationship between institutional ownership and firm performance suggesting that institutional shareholders have the incentive as well as the power to monitor and control the behavior of firms, and have played a significant role in corporate governance.

<https://assignbuster.com/corporate-governance-practices-in-bangladesh-special-highlights-on-financial-institutions/>

The role of large institutions in corporate governance is particularly important in countries where legal protection of shareholders' interest is weak for historical and institutional reasons. This is a situation that exists in many transition economies. Jongsureyapart and Wise (2007) found that the roles and effectiveness of the board of directors of Thai listed companies have to be driven by the regulators to develop more independent boards. They commented that corporate governance in Thailand is generally regarded as having improved since financial crisis and outside directors are identified as playing leading role. Talukdar(2007) pointed out that Bangladesh Bank through issuance of its circular the chairman of the board of directors (or chairman of any committee formed by the board or any director) does not personally possess the jurisdiction to apply policymaking or executive authority, he shall not participate in or interfere into the administrative or operational and routine affairs of the bank. Whereas the CEO will be responsible to implement the policies taken by the board and look after administrative works.

Bangladesh bank has directed the bank to establish an audit committee comprised by the board of directors. Ahmed, Alam, Jafar, Zaman (2008) argued that the weakest link among all corporate governance mechanisms adopted in Bangladesh is concentrated on ownership structure. The listed firms need to take greater efforts to streamline their ownership. Floating all shares and selling off government ownership stakes is the right way to go. The level of corporate governance is strictly subject to the level of public governance and the constraints of existing institutional infrastructure.

Bangladesh should take concrete measures to reform the government and continue to build a solid institutional infrastructure. ? 3. 0 Research design

The study is exploratory in nature. Three examples (cases) of corporate governance practices in the financial institutions in Bangladesh are provided and critiqued. For our reports we made a questioner which is made by the each of the groups selected questions and then we went to three financial institution two banks and one leasing company and then interviewed three key persons and then made our reports.

As our study is exploratory in nature and is limited to identify the instances of corporate governance practices and attempted to achieve a corporate practices in the financial sectors in Bangladesh. 4. 0 Cases & Findings: Case-01: Uttara Bank: Uttara Bank is one of the largest and oldest private-sector commercial bank in Bangladesh with years of experience. It has 211 branches at home and 600 affiliates worldwide which create efficient networking and reach capability. For our report we contact with Mr. Md. Saud Bin Manna, and find these corporate practices in Uttara Bank- . The bank believes “ corporate governance” is the relationship between the participators and the firm’s performance to the common goal of business and so the shareholders have the right to participate in fundamental corporate changes. 2. The shareholders have the right to participate in fundamental corporate changes and the BOD do not perform their duties in an even handed manner and they are informed in time and the minority shareholders also participate in more or less manner but they do not make any agenda in the AGM. . The bank allows few of their in houses stakeholders to participate in major decision making process and they have the right

policies for the relationship between company and stakeholders. 4. The bank is efficient enough to assure they are very much correct and for ensuring this they have remuneration committee, appointment committee and audit committee and they also publish the circular of organization's AGM both in Bengali and English newspaper. 5.

The BOD is neither efficient nor inefficient about ensuring the corporation's accounting and financial reporting system but they do not have sufficient number of non-executive board members and the organization have the "codes of conduct" for the BOD and the key executives. Case-02: IDLC: IDLC Finance Limited is a multiproduct financial institution, established in 1985 with the collaboration of reputed international development agencies such as:

- Korean Development Leasing Corporation (KDLC), South Korea
- Kookmin Bank, South Korea
- International Finance Corporation (IFC) of the World Bank Group
- Aga Khan Fund for Economic Development (AKFED)
- German Investment and Development Company (DEG)

For our report we interviewed with Mr. Avijith Barua, Probationer Officer, Credit Risk Management, IDLC and found these corporate governance practices in IDLC-

1. IDLC considers that its corporate governance practices comply with almost all the aspects of the SEC Notification No. SEC/CMMRRCD/2006-158/Admin/02-08 dated February 20, 2006 and almost all aspects of Bangladesh Bank's DFIM Circular No. 7 dated September 25, 2007. In addition, to establishing high standards of corporate governance, IDLC also considers best governance practices in its activities.

The independent role of Board of Directors, separate and independent role of Chairman and Chief Executive Officer, distinct role of Company Secretary, <https://assignbuster.com/corporate-governance-practices-in-bangladesh-special-highlights-on-financial-institutions/>

Chief Financial Officer and Chief Compliance Officer, different Board committees allows IDLC to achieve excellence in best corporate governance practices. 2. The Directors are appointed by the shareholders in the Annual General Meeting (AGM). Casual vacancies, if any, are filled up by the Board in accordance with the stipulations of the Companies Act, 1994 and Articles of the Company.

In addition, one third of the Directors retires from the Board every year in the AGM, but remains eligible for re-election. The Board of Directors is in full control of the Company's affairs and is also fully accountable to the shareholders. They firmly believe that the success of the Company largely depends on the credible corporate governance practices adopted by the Company. 3. The shareholders have the right to participate in fundamental corporate changes and they are informed in time and the minority shareholders cannot participate in decision making so they cannot make any agenda in the AGM. . The company is efficient enough to assure they are very much correct and for ensuring this they have remuneration committee, appointment committee and audit committee and they also publish the circular of organization's AGM in the most popular newspaper. 5. The company does not always allow their in houses stakeholders to participate in major decision making process it totally depends on the issue and they have the right policies for the relationship between company and stakeholders.

Case-03: City Bank:

City Bank is one of the oldest private Commercial Banks operating in Bangladesh. It is a top bank among the oldest five Commercial Banks in the country which started their operations in 1983. The bank currently has 87
<https://assignbuster.com/corporate-governance-practices-in-bangladesh-special-highlights-on-financial-institutions/>

online branches and 10 SME service centers spread across the length & breadth of the country that include a fully fledged Islami Banking branch. We contact with Mr. Qazi Salman Ghyas, Management Trainee Officer, The City Bank Ltd and came to know some information about their bank. These are-

- 1.

The Directors are appointed by the shareholders in the Annual General Meeting (AGM). In addition, one fourth of the Directors retires from the Board every year in the AGM, but remains eligible for re-election. The Board of Directors is in full control of the Company's affairs and is also fully accountable to the shareholders. They firmly believe that the success of the Company largely depends on the credible corporate governance practices adopted by the Company. 2. The shareholders are informed in time and have the right to participate in the AGM.

Above all BOD ensure that they at all times will fulfill their fiduciary responsibility to their stakeholders, especially to their depositors and customers, while maintaining the highest level of ethics and values, through conscience driven decision making within accepted corporate core values. 3. Everyone at City Bank contributed to fostering the present transforming culture of accountability, openness and integrity, beginning with the Board of Directors. 4. The Board's guidance, supervision and commitment to sound corporate governance ensure that their bank is managed for the benefit of all its many stakeholders. 5.

City Bank's policies and procedures meet or exceed the standards and requirements in all the locations where they operate. ? 5. 0 Conclusions &

<https://assignbuster.com/corporate-governance-practices-in-bangladesh-special-highlights-on-financial-institutions/>

Recommendations: The need for a competent financial sector is important to stimulate and support economic growth through efficient resource allocation. Good CG practices are essential to the effectiveness, competitiveness and safety and soundness of financial institutions. These are recommended for these three financial institutions- Streamlining the Guidelines with the Code of Corporate Governance: A Code of CG has been published by BEI can be streamlined to reduce duplication and resources to comply with CG requirements for the FIs. Protection of depositors: Given the special nature of banking institutions, a broad view of CG where regulation of banking activities is required to protect depositors. In developed economies, protection of depositors in a deregulated environment is typically provided by a system of prudential regulation, but in developing economies such protection is undermined by the lack of well-trained supervisors, inadequate disclosure requirements, the cost of raising bank capital and the presence of distributional cartels.

Improvements in prudential regulation: Liberalization policies need to be gradual, and should be dependent upon improvements in prudential regulation. Bangladesh needs to expend resources enhancing the quality of their financial reporting systems, as well as the quantity and quality of bank supervisors. Given that bank capital plays such an important role in prudential regulatory systems, it is necessary to improve investor protection laws, increase financial disclosure and impose fiduciary duties upon bank directors so that banks can raise the equity capital required for regulatory purposes.

A further reason as to why this policy needs implemented is the growing recognition that the CG of banks has an important role to play in assisting supervisory institutions to perform their tasks, allowing supervisors to have a working relationship with bank management, rather than adversarial one.

Political determinants of Corporate Governance: CG of financial institutions, particularly banking sector, in Bangladesh is severely affected by political considerations.

Given the trend towards privatization of government-owned banks in Bangladesh, there is a need for the managers of such banks to be granted autonomy and be gradually introduced to the CG practices of the private sector prior to divestment. Role of the shareholders: Where there has only been partial divestment and governments have not relinquished any control to other shareholders, it may prove very difficult to divest further ownership stakes unless CG is strengthened.