博士論文

The Effectiveness of Corporate Governance Mechanism in Private Banking Sector of Bangladesh

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Abstract

Corporate Governance (CG) has captured increasing attention among academics, practitioners and regulators worldwide in recent times. Many academics and scholars indicate that a wide range of accounting and finance studies have contributed to governance literature examining the relation between corporate governance and firm performance. In this study, I would like to mainly focus on corporate governance practices: firstly, the effectiveness of board composition to bank's performance and market valuation of Bangladesh. Secondly, how corporate governance mechanism influence to determine CEOs remuneration of banking sector of Bangladesh. Banks are corporations & their firm value depends on good governance as any other firms. They provide financing for commercial enterprises, basic financial services to a broad segment of the population and access to payment systems. In the context of Bangladesh, the need for corporate governance has been highlighted because of the series of scams in Bangladeshi banking sector that had become almost regular feature in recent times. Most of the corporate governance studies in Bangladesh have indicated poor corporate governance due to lack of accountability, lack of fairness and transparency in practices, and faulty incomplete and ineffective audit and disclosure. These have led to widespread corruption in banking industry of Bangladesh, even though there exist many institutional and legal frameworks to oversee the banking sector of Bangladesh.

For the first time, the country-level initiative to develop corporate governance regulation in Bangladesh began in 2003 by Bangladesh Enterprise Institute (BEI), a non-profit and non-political research center. On 9 January 2006, BSEC issued an order requiring the listed companies to follow a number of CG related conditions. The aim was to improve the CG situation and thereby, better protect the interests of minority shareholders and develop Bangladesh capital market. After the capital market collapse in 2011, BSEC again revised its notification order of 2006 (February 20). It is to be noted that the first notification was issued under a 'comply or explain' basis. It means that although the disclosure of compliance statement

was mandatory, companies had the option to comply with individual provision or explain the reasons for noncompliance with any of the provisions. However, the revised notification of 3 July 2012 requires the companies to 'comply' with all the guideline conditions. The revised guidelines include many new provisions in the areas of board independence, audit committee affairs, board's declaration on the corporate governance issues to ensure good corporate governance practices among companies.

On my first study, in order to see the magnitude of relationship between board composition and banking performance we have formulated regression equations. In this study, data have been collected from year 2006 to year 2015, in total 10 years of 29 sampled private commercial banks of Bangladesh. Total period has been divided into two sub periods: the first period is from 2006 to 2011 and the second period from 2012 to 2015 to see the influence of 2006 and 2012 corporate governance guidelines respectively. The regression result of whole period has shown that there is little statistically significant relationship of board composition in terms of number of directors, audit committee size, independent directors in the audit committee and board, the number of board meeting on the financial performance of banks measured by ROE, ROA and Tobin's Q of Bangladeshi banking sector. This means that the independent variables used in the study have negligible contribution in the financial value of the banks in most cases. When we look into different sub periods the result appears to be mixed. The sub period 2012-2015 shows stronger relation among different variables than those of previous sub period of 2006-2011. This is likely to be due to reform in the corporate governance guidelines introduced in 2012. It is believed that a well-balanced functioning of different variables is likely to result in better corporate performance. It is likely that independent directors may not be able to contribute in checks and balances among different activities implied by the corporate governance guidelines of 2006. However, all of the corporate governance variables are seen as in negative relation with market based performance measured of Tobin's Q in the period of 2012-2015. After

the revision of CG guidelines, board composition variables have a positively significant effect on ROE and ROA but the market does not evaluate that revision.

On my second study, I have examined how corporate governance mechanisms in terms of board of directors influence the determination of CEOs pay increase in banking sector of Bangladesh. From graphical representation, it is observed that CEOs annual remuneration has almost tripled at the year of 2017 even though the banking industry performance in terms of ROA, ROE and NPL shows a downward trend. In this study, data have been collected from year 2006 to 2017 total 12 years data of 29 private banks and analysis have been carried through regression equations under fixed effect model. The result implies that the determination of CEOs compensation package is largely linked to the corporate governance mechanism, specifically board members of the bank. That is due to the fact that all the bank performance variables in terms of ROA, ROE and NPL coefficients exhibit the expected relationship with CEOs pay but insignificantly. This result is different from other previous literatures studied on both developed and developing countries. Subsequently from the risk management point of view, I have hypothesized that increase of the amount of provision for possible loan loss will be negatively related to the rise of CEO pay. But it has been found that provision for classified loan is positively related to CEO pay and is significant at 0.1% level. This implies that board of directors appreciates CEO through the increase of CEO compensation considering the amount of provision maintained for the risk.

Finally, I have made some concluding remarks to improve corporate governance for our banking sector. Emergence of private banks in Bangladesh has nearly 40 years of history. Most of the private banks of Bangladesh are either family controlled or controlled by one or a few substantial shareholders, paving the way for the interests of minority shareholders to be expropriated by corporate insiders. Weak investor protection has resulted in a less developed capital market and weak insider trading legislation and enforcement would have been associated with a higher cost of capital. There are areas to be reformed such as the introduction of

guidelines and laws to strengthen internal governance, protect and empower minority shareholders, enhance disclosure requirements and monitor corporate behavior and enforce the law.

Acknowledgement

First of all, I thank the Almighty, who has provided me the brilliant opportunity to build and complete this thesis successfully with good health and sound mind.

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Last but not least, I am grateful to my parents, my younger brother, to my wife Anika Tasnim and my only son Imad Ahmed Arshan for their encouragement and endless support to me.

List of Tables and Figures

Abbreviations:

Abbrev.	Definition
AC	Audit Committee
BCBS	Basel Committee on Banking Supervision
BDT	Bangladeshi Taka (Currency)
BEI	Bangladesh Enterprise Institute
BOD	Board of Directors
BSEC	Bangladesh Securities and Exchange Commission
CEO	Chief Executive Officer
CG	Corporate Governance
COSO	Committee of Sponsoring Organizations
CPD	Center for Policy Dialog
CSE	Chittagong Stock Exchange
DSE	Dhaka Stock Exchange
EEC	European Economic Community
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
GRI	Global Reporting Initiative
ID	Independent Directors
MIC	Middle Income Country
NPL	Non Performing Loan
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
RJSC	Registrar of Joint Stock and Companies
ROA	Return on Assets
ROE	Return on Equity
SEBI	Securities and Exchange Board of India

Synopsis:

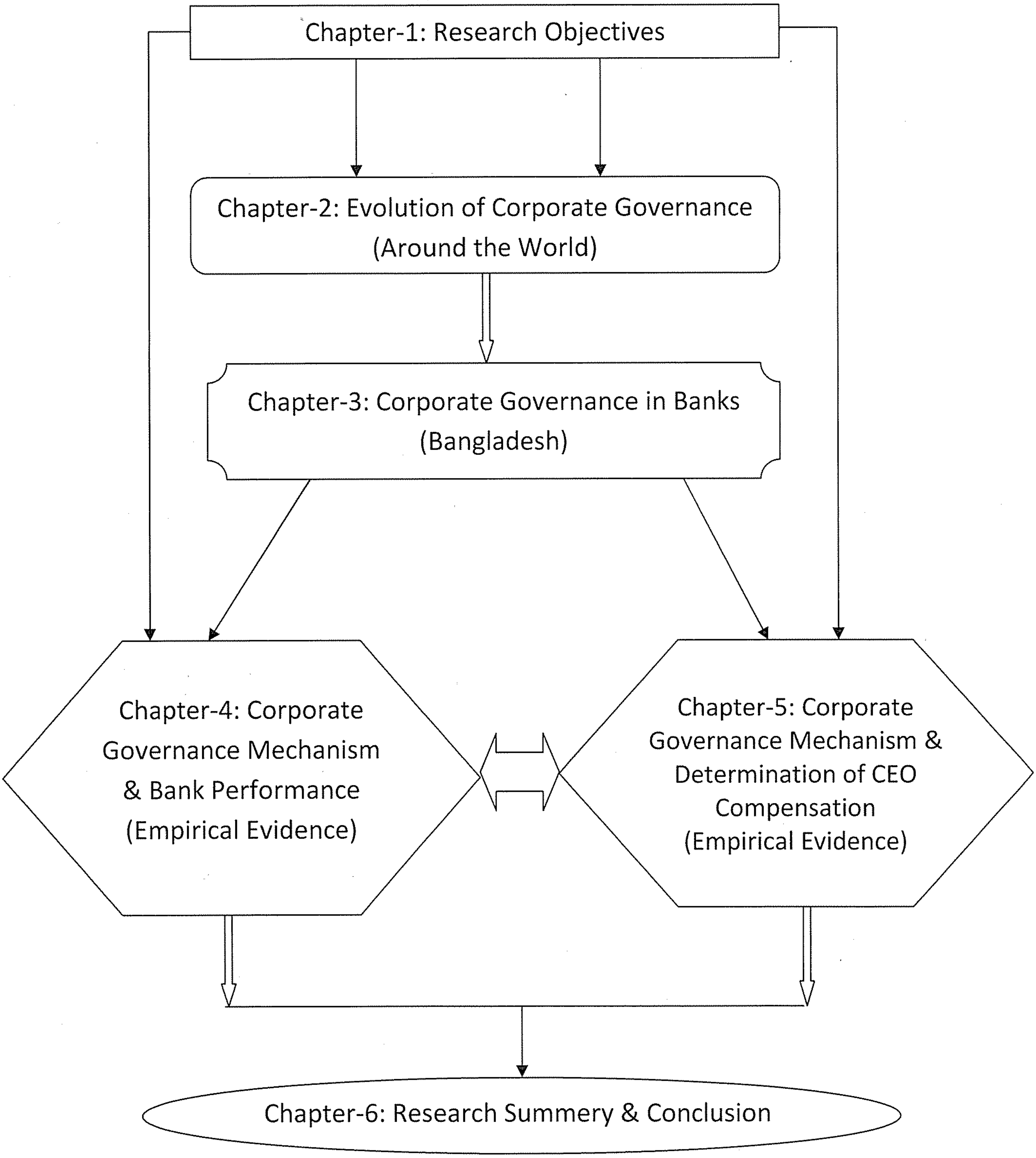

Figure-I: Research Outline Flow Chart

Chapter-1
Introduction

1.1 Background of the Study

Business organizations around the world need to be able to attract funding from investors in order to expand and grow their business activities. Before investing in a business organization, investors will want to be sure that the business is financially sound and will continue to be so in the future. Investor therefore need to have confidence that the business being well managed and will continue to be profitable. In order to have this assurance, investors go through the published annual and accounts of the business and to other information releases that the company might make. They expect that the annual report and accounts will represent a true and authentic picture of company's position. The annual report and accounts are subject to an annual audit whereby an independent external auditor examines the business records and transaction and certifies that the annual report and accounts have been prepared in accordance with accepted accounting standards. However, there are many facts of the business activities that are not effectively reflected in the annual reports and accounts.

There have been a number of high profile corporate collapses that have arisen despite the fact that the annual report and accounts seemed fine. These corporate collapse have had an adverse effect on many people such as shareholders who have seen their financial investment value reduced to nothing, employees who have lost their jobs, suppliers have collapsed for the failed companies and economic loss for local and international communities in which the failed companies operated. People may arise a question like why have such collapses occurred? What might be done to prevent such collapses happening again? How can investor confidence be restored? The answers to these questions are all linked to corporate governance. That's why corporate governance has received increasing attention among academics, practitioners and regulators worldwide in recent times. Many scholars indicate that a wide range of accounting and finance studies have contributed to governance literature examining the relation between corporate governance and firm performance.

Bangladesh has been recognized as one of the most potential emerging economy of the world. For instance, over the last two and half decades, the economy of Bangladesh has made commendable progress. GDP growth rate in Bangladesh averaged 6.04 percent from 1995 until 2018, reaching an all time high of 7.90 percent in 2018. The government of Bangladesh has made strong commitment for meeting the economic target of reaching Middle Income Country (MIC) status in 2021 by ensuring an annual 8% GDP growth. However, the reality of the country does not speak the same. Despite this robust growth rate the country has still remained as one of the poorest countries in the world (Sobhan 2016, Hasan et al., 2014, Azmat & Coghill, 2010; Salman 2009; Sarkar 2011). While attaining MIC goal requires good governance in all spheres of the economy of the country. Unfortunately, the number of corporate scandal is increasing over the years especially in financial sector.

In this study, I would like to mainly focus on corporate governance practice: Firstly, the effectiveness of board composition to bank's performance and market valuation of Bangladesh. Secondly, the determinants of CEO compensation of banking sector of Bangladesh. The subject of Corporate Governance (CG) has attained enormous practical importance for at least three reasons (John et al., 1998).

First, the efficiency of the existing governance mechanisms in developed countries has been subject to debate. Jensen (1989, 1993) argued that internal mechanism of CG did not perform their job. On the other hand, Easterbrook and Fischel (1991) and Romano (1993) viewed the US mechanism and legal system in a positive way.

Second, there is an ongoing controversy on the relative efficacy of the CG of Anglo-American system and that of Japanese and German system. With the new and emerging market economies, this has called for special attention.

Third, the basic principle of CG is that the shareholders elect the board of directors who in turn select top management. The common practice, however, is for the board to be selected by shareholders from the slate approved by the top management. However, the effectiveness of the board in its monitoring function is determined by its independence, size, and composition (John et al. (1997).

Recent trend toward adoption of the Anglo-Saxon CG and the debate over whether one CG system can fit all institutional environments has called for research on examining the quality of governance that do not follow the Anglo-Saxon governance model (e.g., Carcello et al., 2011). The Anglo-Saxon or the Anglo-American model is also known as unitary board model, in which all directors participate in a single board consisting with both executive and non-executive directors in varying proportions. The Anglo-Saxon approach of corporate governance is the basis of corporate governance in USA, UK, Canada, Australia and other Commonwealth countries like India and Bangladesh. Financial scandals at high profile companies even in developed countries like Enron, Tyco, WorldCom etc. have drawn the attention of professionals, experts and academics to corporate governance structure and its effectiveness. The need for corporate governance arises from the potential conflicts of interest among stakeholders in the corporate structure. Ineffective corporate governance is considered for the loss of investor confidence and the stock market slum that usually followed these scandals (Browning and Weil, 2002). In applying agency theory to corporations it is argued that separation of ownership and control creates conflicts of interest between owners and controllers (Jensen and Meckling, 1976). All these together imply that effective corporate governance in a particular corporate culture and regulatory framework can resolve many of the problems the corporate world is usually facing.

Widespread improvements in corporate governance have the potential to promote a fairer and trustworthy environment. Corporate governance devices can defend investors from the opportunistic behavior of managers or overprotective shareholders include market mechanisms, institutional norms and standards, individual and stakeholder requirements and a strong legal framework. In the absence of such devices, asymmetric information between managers and external investors may facilitate the misappropriation of corporate resources. Consequently, in 2002 the US federal government issued the Sarbanes-Oxley Act with the objective to restore public confidence in corporate governance. "The provision of financial and non-financial information, on a regular basis, to those is interested in the economic activities of an organization. This information is normally given in an annual reports and accounts, which includes financial statements and non financial information. The annual report and accounts of a listed company is regulated by company legislation, accounting standards, and in the case of quoted company, by stock exchange regulations" (Hussey, 1999). According to John et al. (1998) CG is a mechanism devices and structures which again act as check on managerial self-centered behavior. Besides it creates a structure to control the internal management that reduces agency problem as well (Hossain et al., 2009). In Bangladesh, Bangladesh Securities and Exchange Commission (BSEC) gave some guidelines for proper CG of listed companies in 2006 for the first time.

Corporate boards have long and the legal authority and shareholders support create supervised executive decision making. Boards with in line knowledge, skills and abilities have the potential for proffering unique tactical and strategic advantages to corporation (Finkelstein and Hambric, 1996).

In the height of the 1997 Asian financial crisis, the success of good governance in Asian economies has been a challenging issue. In this context the key issues of corporate governance come up with regard to how efficiently oversee managers and to exercise control so that managers act in the best interest of the shareholders. In order to mitigate this problem, Rose (2005) argues that the corporate board plays a key role in executive management and organizing their interests with the best interests of shareholders.

The board is considered to be an initial internal corporate governance mechanism as it observes and directs management and provides management deliberated guidelines. It may act to access and consent management's suggestions (Johnsson, 2005). A board works to intensify the firm performance and approve legally authorized responsibilities and trustee duties (Zahra and Pearce II, 1989). The board's knowledge in that field can also spot problems early and may 'blow the whistle' (Salmon, 1993). It needs to be mentioned that the study focuses on the banking sector of Bangladesh. Bangladesh Securities and Exchange Commission (BSEC) has initiated corporate governance guidelines for listed corporate organizations and banks on February 9, 2006. The number of directors in the board should not be less than 5 and more than 20. The banks and non bank financial institutions, statutory organizations and insurance companies will follow the direction of their specific primary supervisors in this regard. Appointment of at least one fifth of the total number of directors should be independent directors in the board. The CEO and Chairman simultaneously can't be the same person and the board should clearly define their respective roles and responsibilities. In most studies about board effectiveness, the main concern is whether the board "structure" may influence the financial performance. Applying the structure approach, it has been questioned if the ratio of outside director on the board impacted the board's activities and the firm's profitability or not. However, past studies about the relationship between the board structure and corporate performance did not produce consistent results (Dalton et al., 1998).

Meaning of Corporate Governance: The term "corporate governance" refers to institutional practices designed to get optimal performance out of managers. Corporate governance is a set of mechanisms used to manage the relationship among stakeholders that is used to determine and control the strategic direction and performance of organization. It has been used in different ways and the boundaries of the subject vary widely. In the economics debate concerning the impact of corporate governance on performance, there are basically two models of the corporation, the shareholder model and the stakeholder model. In the narrowest sense (shareholder model), corporate governance often describes the formal system of accountability of senior management to shareholders. In its widest sense (stakeholder model) corporate governance can be used to describe the network of formal and informal relations involving the corporation (OECD, 1999). At its core, corporate governance is concerned with identifying ways to ensure that strategic decisions are made effectively. Post Sarbanes-Oxley identifies a corporate governance structure consisting of six interrelated mechanisms of oversight: managerial, compliance, audit, advisory, assurance, and monitoring. Rezaee (2004) pointed out following three aspects of corporate governance:

a) Fiduciary aspect involves ensuring safeguard company's assets providing internal control systems.

b) Shareholder aspect is viewed as inducing management to make decisions that maximize shareholder value and ensuring a desired return on their investment (Shleifer and Vishny, 1997).

c) Stakeholder aspect relates to the primary objective of creating shareholder value while protecting the interest of other stakeholders.

From this perspective, corporate governance would focus on: the internal structure and rules of the board of directors, the creation of independent audit committees; rules for disclosure of information to shareholders and creditors, and control of the management. From the academic standpoint, corporate governance is seen as one that addresses "the problem that results from the separation of ownership and control." Thus it is understandable that good governance is of paramount importance for optimizing corporate behavior that will result in maximum benefits to a society.

1.2 Governance Function of Board of Directors

The board of directors has the prime role in corporate governance mechanism. It is considered as a primary means for shareholders to exercise control on top management.

1.2.1 Monitoring Role of Board: Most papers in the area tend to show the board with a utility function significantly aligned with the interests of the shareholders in order to accomplish its monitoring role (Warther, 1994; Hirshleifer and Thakor, 1994). Noe and Rebello (1996) took a different view on it by questioning its strength in achieving the necessary alignment. They emphasized instead on the role of compensation of board members to achieve the efficient outcome. The empirical literature provides substantial evidence that the boards play a monitoring role. The literature also has presented a number of determinants of effectiveness of the board. The effectiveness is based on some performance measures as well as discipline brought on top management.

1.2.2 Outside Directors and Board Independence: Usually it is observed that board independence is closely related to its composition. In a study (Bhagat and Black, 1997) it was found that half of the 100 largest American public corporations had one or two inside directors and the impact of board independence due to outside directors on shareholders wealth and the discipline of CEO, has received ample attention in the empirical literature. However, the evidence is mixed.

1.2.3 Shareholders Wealth and Cash flow: Rosenstein and Wyatt (1990) indicated that the announcements of appointment of an outside director are associated with increase in shareholders wealth. This was supported by Brickly et al. (1994) which investigated the question whether outside directors promote shareholder interests for the sample firms adopting poison pills. The main finding of this study is statistically significant and positive relation between stock-market reaction to the adoption of poison pills and the fraction of outside directors.

The inconclusive part of board composition effects had been shown by Harmalin and Weisbach (1991). The major conclusion was that there was no relation between board composition and performance, while there was a strong relationship between ownership structure and performance. But a negative bearing on the role of outside directorship was found and the average fraction of outside directors was found to increase with board size (Yermack, 1996).

1.2.4 Committee Structure: the effectiveness of the board may be affected not only by its composition (i.e., proportion of outside directors) and size but also by its internal administrative structure. Klein (1998) evaluated the effects of different committees and proposed a committee structure with specialized roles to enhance the board' performance in its productivity and monitoring.

1.3 Corporate Governance in Banks

Broadly, banks deal in other people's money. These are institutions that deal directly with the general public. There are different types of banks specialized in different areas. We know of commercial banks, specialized development banks and merchant banks. Commercial banks specialize in business connected with bills of exchange, specially the acceptance of foreign bills. Merchant banking includes a wide range of activities such as management of Customers' securities, portfolio management, project counseling and appraisal, underwriting of shares and debts, loan syndication, acting as banker for refund orders, handling interest and dividend warrants etc. thus a merchant banker renders a variety of services to its customers and promotes industrial development in the country. However, some of the functions of merchant banks are often performed by commercial banks in Bangladesh.

Sometimes banks are set up to provide specialized services for a particular sector of the economy called 'development bank'. Examples of such banks in Bangladesh are Development Bank of Bangladesh, Bangladesh Krishi (agriculture) Bank, Export-Import Bank etc.

Banks are thus a critical component of any economy. They provide financing for commercial enterprises, basic financial services to a broad segment of the population and access to payment systems. In addition some banks are expected to make credit and liquidity available in difficult market conditions. The importance of banks to national economies is underscored by the fact that banking is virtually universally a regulated industry and banks have access to government safety nets. Consequently banks should have strong corporate governance.

Governance in Bangladesh: In Bangladesh, the process of industrialization suffered a lot in the past due to different factors. With the adoption of a socialistic approach in economic management and nationalization of virtually all large scale industry immediately after liberation of the country in 1971, Dhaka Stock Exchange the only bourse of the country at that time, was closed. With the change of government policy towards free market economy it reopened in 1976. The corporate culture and financial system of Bangladesh is still at its early stage of development. In its efforts to design a sound corporate governance structure, Bangladesh has had the opportunity to observe other governance system in their development experience. In this perspective our aim is to study the governance structure of Japanese corporations and to assess the ways and means of adopting it in a different corporate culture and socio economic background of Bangladesh.

Effective corporate governance practices in Bangladesh are very much lacking in most companies. In fact, Bangladesh is lagging behind even its neighbors. One reason for this is that most companies are family oriented. Besides, motivation to disclose information and improve governance is felt negatively. The current system does not provide sufficient legal, institutional and economic motivation for stakeholders to encourage and enforce corporate governance practices; hence failure of most of the constituents of corporate governance is witnessed in Bangladesh. Poor bankruptcy laws, no push from the international investor community, limited or no disclosure regarding related party transactions, weak regulatory system, general meeting scenario, lack of shareholder active participation are some of the reasons responsible for it (Ahmad et al., 2005).

There are some studies on the corporate governance in Bangladeshi Banking Industry. Most of these studies have indicated poor corporate governance in Bangladesh (Haque et al., 2007; Begum et al., 2012; Rahman, 2016 and Rahman et al. 2014). Mahmud and Jesmin Ara (2015) has indicated lack of accountability, lack of fairness and transparency in practices, and faulty incomplete and ineffective audit and disclosure have led to widespread corruption in banking industry of Bangladesh. Not only that, Bangladesh also had lagged behind its neighbors and the global standard in corporate governance (Gillibrand, 2004). One of the principal reasons of weak corporate governance is that most of the organizations are family orientated and the Board of Directors is actively involved in management (Haque, Jalil and Naz, 2007). In the framework of Bangladesh, independent directors do not act as a supporter of majority stakeholders or as a source of innovative ideas (Bangladesh Enterprise Institute, 2003). The Company Act 1994 provides for many strict rules regarding any negligence, default, breach of duty or trust on the part of the director, manager or officer of a company. But, these rules are more honored in the breach than observance (Ahmed and Yusuf, 2005). Mahmood and Islam, (2015) has found a large financial fraud and high nonperforming loan of Bangladeshi banks during 2010-2012.

However, recently corporate governance and monitoring mechanism focused on matters like the composition of Board of Directors, regular monitoring by shareholders, voting rights of shareholders and detailed disclosure of company information that are material for decision making by interested parties. Anyway, Bangladesh has much to learn to practice effective corporate governance although the process of strengthening it is ongoing.

1.4 Objectives of the Study

The objectives of the study are to examine the internal corporate governance mechanism in private banking sector of Bangladesh. Specific objectives are noted below:

1. To investigate the evolution of corporate governance system of Bangladesh in terms of accountability to its stakeholders including financial institutions.

2. To evaluate the immediate short-term impact of outside directors in the newly reformed boards of listed banks of Bangladesh on the financial performance.

3. To assess how corporate governance mechanism influence the top level management's duties and responsibilities along with determination of remuneration in private banking sector of Bangladesh.

1.5 Scope and Methodological Approach of the Study

In this study, I would like to cover the role, actual and potential, of corporate governance structure of Bangladesh. In order to attain the objectives of the study various methods of data and information collection and analysis will be used. For collecting secondary basic data and information relating to Bangladesh corporate governance structure, I will largely rely on various publications of Bangladesh Bank, Dhaka Stock Exchange, Securities and Exchange Commission of Bangladesh, annual reports of each sampled banks and various government publications and so forth. Analysis has been carried out through ordinary least squares (OLS) and fixed effect model of OLS.

Chapter-2
Corporate Governance: An Overview

2.1 Introduction

Corporate governance (CG) is a system that provides a relationship among stakeholders established through some laws, rules, regulations and practices. The objective of corporate governance is to ensure that companies which are not managed by their owners are run in the best interests of all stakeholders. It primarily aims to enhance corporate transparency and accountability (Thapa, 2008). In the recent times, too much focus has fallen on deterring fraudulent activities and on issues of transparency owing to some scandals of big corporations in the major economies of the world. Moreover, it is a very essential element for the banking system because bank and financial institutions depend on other people's money (Abbasi, Kalantari and Abbasi, 2012). The necessity for CG arises from the possible conflicts of interest among different stakeholders in the organization. These conflicts of interest often arise for two reasons. First, different stakeholders have different preferences and objectives. Second the stakeholders have inadequate information as to each other's knowledge, preferences and activities (Osman, 2006).

The level or state of corporate governance in a country plays an important role in attracting and holding the foreign investments, for building a robust capital market and for maintaining the confidence of both domestic and foreign investors.

2.2 Concept of Corporate Governance

Corporate governance means a set of rules, process, customs, policies that affect the way a company is directed or controlled. Cadbury Committee of U.K. defined corporate governance as "the system by which companies are directed and controlled" (Cadbury, 1992). It is a mechanism through which a company is run with certain objectives. According to the report of the SEBI Committee of India on Corporate Governance, February 2003- the fundamental objective of corporate governance is to enhance the long term shareholder value while at the same time protecting the interest of other stakeholders by improving the corporate performance and accountability (SEBI, 2003). Corporate Governance lays down the framework for creating long term trust between companies and the stakeholders. The World Bank (2001) defines CG from two different perspectives. From the standpoint of a corporation, the emphasis is placed on the relations between the owners, management, board and other stakeholders (employees, customers, suppliers, investors and communities). Major significance in corporate governance in this narrow perspective is given to the board of directors and its ability to attain long-term, sustainable value by balancing these interests. From a public policy perspective, CG refers to providing mechanism for the survival, growth and development of the company and simultaneously, its accountability in the exercise of power and control over companies. The role of public policy is to discipline companies and at the same time, to stimulate them to minimize differences between private and social interests. In 2001, the Organization for Economic Co-operation and Development (OECD) also offers a broader definition: "Corporate governance refers to the private and public institutions including laws, regulations and accepted business practices which together govern the relationship in a market economy, between corporate managers and entrepreneurs (Corporate insiders) on the one hand, and those who invest resources in the corporations, on the other". Corporate governance is very integral to the existence of a company. It is generally perceived as a set of codes and guidelines to be followed by companies. But governance is more than just board processes and procedures. It involves relationship between a company's management, its board, shareholders and other stakeholders. It inspires and strengthens the investors' confidence by ensuring companies commitment to higher growth and profits. There are four principles of good corporate governance such as transparency, accountability, responsibility and fairness. CG conveys different meanings to different people. But to all, CG is a means to the long-term shareholder value, and more importantly stakeholder value. Thus all authorities on the subject are in recognizing the need for good corporate governance practices to be achieved in the end.

The companies are required to disclose their governance structure in their corporate report. The standard disclosure under governance aspect as the G4 Sustainability Reporting Guidelines by Global Reporting Initiative (GRI) include

- Governance structure and its composition
- Role of highest governance body and its purpose, value and strategy
- Competencies and performance evaluation of the highest governance body
- Role of highest governance body in Risk Management
- Role of highest governing body in Sustainability Reporting

The quality of corporate governance primarily depends on the following factors, which consequently affect the corporate performance.

- Integrity of management
- Size of the board
- Ability of the board, qualifications and commitment of the board
- Frequency of Board meetings
- Quality of corporate reporting
- Stakeholders engagement/ participation in the management
- Independent directors

Thus we see that corporate governance has focused traditionally on the problem of the separation of ownership by shareholders and control by management. It is now accepted that firms should respond to the expectations of more categories of stakeholders. The wide range corporate governance practices include business ethics, social responsibility, management discipline, corporate strategy, life-cycle development, stakeholder participation in the decision making processes and promotion of sustainable economic development.

2.3 Evolution of Corporate Governance[1]

According to Chaucer concept of governance is as old as it is originated in ancient time (1343-1400). But the phrase 'corporate governance' did not come into use until the 1980s. However it has been quickly adopted worldwide although research into corporate governance from the early days to the present that is likely to create some ambiguity, complexity and rapid changes in the present day corporate governance.

The Early Days of Corporate Governance: In medieval Europe, weavers, tailors, wheelwrights and so on ensured standards and regulated the price of products. They also controlled training and entry to their trade. Only masters of the each trade could be members of their representative associations. Members of the association elected the association's governing body.

Corporate governance systems have evolved over centuries particularly in response to corporate failures or economic crises at different points of time in the economic history. The first well-documented failure of governance was the South Sea Bubble in the 17th century that revolutionized business laws and practices in England. Similarly, much of the securities laws and regulations in the U.S. were put in place following the stock market crash of 1929. As democracy flourished in Europe and USA, it created a context for the free market economic system usually labeled as capitalism. During early days of Industrial Revolution, an unrestrained form of capitalism resulted in a very small number of people becoming very wealthy while most stayed poor. The political system responded to the situation with laws and regulations intended to limit the excesses and abuses of the free and unrestrained markets of the time. Consequently capitalism prevailed under the watchful eye of the government.

[1] Bob Tricker (2012), Corporate Governance: Principles, Policies and Practices.

By the 17th century, economic, political and military competition was growing among European countries. At that time companies were established by charter from the monarch or the state. In 1600, England's Queen Elizabeth I granted a royal charter to the East India Company, giving in a monopoly over all trade between Europe and Asia. The company was established as a joint-stock company with over 1000 stockholders. Each year, these stockholders elected a governing body of 24 directors. From this description I can see that the elements of corporate governance such as joint-stock companies, stockholders, government, directors, and governing board were present in the seventieth century. As early as 1776 Adam Smith, in his book, *The Wealth of Nations,* warned of the potential problems with the directors of the companies as they deal with others' money. His oft-quoted comment on businessmen behavior offers a classic corporate governance perspective:

The directors of companies, being the managers of other people's money rather than their own, cannot well be expected to watch over it with the same anxious vigilance with which they watch over their own.

There has been renewed interest in corporate governance practice of modern corporations since 2001, particularly due to high profile collapse of a number of large U.S. firms. In 2002, the U.S. federal government issued the Sarbanes-Oxley Act, planning to restore public confidence in corporate governance. Corporate boards have long and legal authority and shareholder support to create supervised executive decision making. Boards with in line knowledge, skills, and abilities have the potential for proffering unique tactical and strategic advantages to corporations (Finkelstein and Hambrick, 1996). In the light of 1997 Asian financial crisis, the success of good governance in Asian economies has been a challenging issue. Agency problems appear when ownership is distracted from management. This situation raised the key issue in corporate governance of how to efficiently oversee managers and to exercise control so that managers act in the best interest of the shareholders. To mitigate the agency problem, it is argued that the corporate board plays a key role in executive management and organizing their interests with the best interest of shareholders (Rose, 2005). The board is reckoned to be an initial internal corporate governance mechanism (Brennan, 2006) as the board observes and directs management, and provides management deliberated guidelines. It may act to assess and consent management's suggestions (Johnsson, 2005). A board works to intensify the firm performance approve legally authorized responsibilities and trustee duties (Zahra & Pearce II, 1989). The board's knowledge in that field can also spot problems early and may "blow the whistle" (Salmon, 1993).

The Invention of the Limited-Liability Company: For the first time, the limited liability companies were created by the French. From 1807, the *Societe en Commendite par actions* limited the liability of external investors. However executive directors were individually responsible to their companies' debts. In British Companies Act of 1855 and 1862 gave limited liability to all shareholders whether they were involved in the management of the company or not.

The corporation revolution in the USA occurred between 1880 and 1930. During this period industrial factories began to evolve from private ownership to public ownership. Ownership structure of numerous companies drastically changed in the twentieth century. Ownership structure changed because of merging among corporations. These mergers were often financed by public offering of corporate stock. The purpose of public offering was to raise capital from the public. In the early 1900s businesses began to separate its owner from the function of management. This was inevitable due to the distribution of corporations' ownership among wide range of investors.

The Separation of Ownership from Operations: Limited liability companies were relatively small and simple in the early days. Shareholders were mostly from the wealthier classes of society. They had influence over the company and attended in annual general meetings of the company. Many companies of economically advanced countries had become large and complex in the early twentieth century. The number of shareholders was numerous, geographically widespread and differed in both their time horizons and their expectations about dividends and capital growth. Most of the public companies were listed in different stock exchanges. Many other stakeholders like financial institutions, insurance companies and other intermediaries stood between companies and the votes of their shareholders in company meetings. Thus, links between management and investors in their companies were becoming distant.

The seminal work of Berle and Means (1932) drew attention to the growing separation between corporate management and their diverse and distant shareholders. Although the term corporate governance was not used in their work, still it was most frequently cited in corporate governance study today.

R. Edward Freeman stated in his 1984 book, *Strategic Management: A Stakeholder Approach* that the corporation exists for the purpose of serving its stakeholders. Stakeholder means a broad spectrum of business organizations that must be considered in the decision making process. Management, shareholders, employees, customers, suppliers, community and competitors are considered as stakeholders.

The Developments during Last Three Decades of Twentieth Century: 1970s observed significant development in corporate governance constituting three aspects i, e, audit committees, two-tire board and corporate responsibility. There audit committee required by SEC of USA in 1972, comprising independent outside directors, were to provide a bridge between the external auditor and the main board. Specially, outsiders led to move emphasis on checks and balances at board level.

The European Economic Community (EEC) Draft Fifth Directive (1972)[2] proposed unitary boards represented by both executive and outside directors to be replaced by the two tire board form of governance practiced in Germany and Holland. That means companies have two distinct boards with no common membership. The upper supervisory board monitors and oversees the work of management board that run the business. The 1970s also observed the role of major corporations in the society. Broadly, in addition to the prime legal responsibility to the shareholders, board should report and be accountable to a range of stakeholders who could be affected by board decision-customers, suppliers, employees, the local community and the state. The Accounting Standards Steering Committee produced The Corporate Report (1975)[3] called for all economic agents to report publicly and accept accountability to all affected by the directors' decisions.

In the 1980s, broader stakeholders were concerned by the market-driven, growth oriented attitude of Regan and Thatcher economics. Directors were reinforced to increase their shareholdings value. To increase the profit, most of the state entities of UK, USA and other countries were privatized. The threat of hostile takeover bids was seen in Anglo-American circles as the market for corporate control and hostile bids were often financed by the high risk and high rated junk bonds. Research on corporate governance was expanded in the mid 1980s. Baysinger & Butler (1985) used the phrase "Corporate Governance" and looked at the effects on corporate performance with respect to change in board composition. Mintzberg (1984) raised the question "Who should control the corporation?" At that time, official inquiries carried out only in response to the corporate collapses. When the institutional investors became proactive in corporate governance then the boards and the directors of different US companies were coming

[2] European Communities Committee on the Draft Fifth Directive on Company Law: Two-Tier Boards and Worker Participation (R/2128/72).

[3] The Corporate Report was a discussion paper submitted to ICAEW's Accounting Standards Steering Committee in 1975. It was a foundational document for a wider discussion on corporate reporting in the UK.

under pressure. Drucker (1991) brought the attention on shareholders' proxy votes for the potential governance power. Companies needed to manipulate their share prices to use the increasing pension funds and savings throughout the world. The preference of institutional investors was expected to improve. At the same time there was an urgency to put an end to the corporate governance practices benefitting the incumbent boards. And, abating the probability of the company being subjected to hostile bid was also targeted. In order to tackle fraudulent corporate financial reporting, The US Treadway Commission was formed in 1985. In the context of its first report of COSO marked its debut. A private-sector initiative to encourage executive management and boards towards more effective business activities was reinforced.

In UK, during 1990s corporate governance code was arrived incorporating wider use of independent nonexecutive directors, introduction of an audit committee, division of responsibilities between chairman of the board and the chief executive and so on, according to Cadbury Report, 1992. In USA companies must follow the company law of the state, comply with the GAAP rules of the SEC and stock exchange on which they are listed. However, the Cadbury Report had significant influence around the world. In 2002 the US Sarbanes-Oxley Act placed stringent demands for the governance of all listed companies. Towards the end of the 20th century the concepts and principles of corporate governance developed for listed companies were also found relevant for unlisted companies.

Global Financial Crisis and Corporate Governance: In the US for a decade long substantial growth of house prices began to fall in 2007 and subsequently spread chaos in the financial sector. This has called for the announcements by the government to take a $ 700 billion equity stakes in banks. Central banks had to make special arrangements to provide money to meet some institutional liabilities. In 2007, Northern Rock bank, a century old UK bank was taken over by the British government. Government nationalized three banks including Royal Bank of Scotland. Other countries around the world also experienced liquidity problem. All these raised some fundamental corporate governance issues pertaining to the role of director particularly, independent directors and regulators of the banks, auditors, credit rating agencies, experts designing loan securitization, financial institutions' activities and the like.

In view of the above, regulatory authorities sought to improve regulatory structure. In the USA Securities and Exchange Commission suggested for changes in regulatory procedures of listed companies as well as the separation of the role of CEO from that of board chairman implying accountants' liability to shareholders. Similar types of changes were brought in the regulatory structure in the UK. Corporate governance principles were designed by OECD countries to develop their own corporate governance codes. They felt four broad areas as identified deserve attention: board practices, risk management, top-level management remuneration and shareholders right.

2.4 Theoretical Development:

Scholars around the world have defined the role and importance of Board of Directors (BOD) and how the characteristics of BOD impact the performance of the firm from various perspectives. Hawley and Williams (1996) surveyed literature on CG in the US as a background for the OECD. This part focuses on the major theoretical perspectives of boards of directors' role and corporate governance mechanisms. The agency theory, stakeholder theory, stewardship theory and political model are discussed below to make the analysis more relevant with theory.

Agency Theory: The concept of corporate governance came from the agency theory. Agency theory originated with the transfer of corporate power to management in the early 1900s. Corporate managers serve as agents for owners. Agency theory analyzes the conflict in this type of relationships.

In the finance view, the central problem in corporate governance is to construct rules and incentives (that is, implicit or explicit 'contracts') to effectively align the behavior of managers (agents) with the desires of principals (owners) (Hawley and Williams, 1996). Based on the idea of agency theory, it is believed that there is a separation of ownership between the management and shareholders or investors in the corporation. Management wants to make the firm more profitable in short term to increase self-interest whereas investors and shareholders expect to maximize the wealth in long term. Management may want to set up a luxurious office and to take various financial and non-financial company benefits. On the other hand, investors and shareholders tend to invest in business expansion rather than investing in office benefits.

More specifically, the managers who possess superior knowledge and expertise about the firm are in a position to pursue self-interests rather than shareholders (owners) interests (Fama, 1980; Fama & Jensen, 1983a). This pursuit of self-interests increases the costs to the firm, which may include the costs of structuring the contracts, costs of monitoring and controlling the behavior of the agents, and loss incurred due to sub-optimal decisions being taken by the agents. Shareholder interests can clearly be compromised if managers maximize their self-interest at the expense of organizational profitability, i.e., the managers expropriating shareholders' interests. In essence, the managers cannot be trusted and therefore there is a need for strict monitoring of management by the board, in order to protect shareholder's interest. These problems of focusing self-interest between the management and investors are called agency problem. Scholars have suggested various governance mechanisms to avoid agency problem in practice. There are two governance mechanisms are board of directors and compensation schemes to meet the interests of both the agent and the principal. Fama (1980) said that the board is a low-cost mechanism to avoid agency problem in comparison with other alternatives.

The agency model depicts a number of corporate governance mechanisms that are designed to reduce the agency costs associated with the separation of ownership and control (Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983a). Their purpose is to align shareholder and manager interests. Governance mechanisms can be split into two categories, internal and external. The achievement of corporate performance relies on the mechanism efficiency of Corporate Governance both internally and externally. Internal mechanisms include board structure variables such as duality and the proportion of non-executive directors, debt financing and executive director shareholdings. The quality of the internal mechanism is closely related to a better corporate performance (Aman & Nguyen, 2008). Whereas the external mechanism is derived from the capital market, corporate control market, labor market, state status, court decisions, stock holders, and investor activities. The balance and effectiveness of the corporate governance mechanism can create a better corporate financial performance.

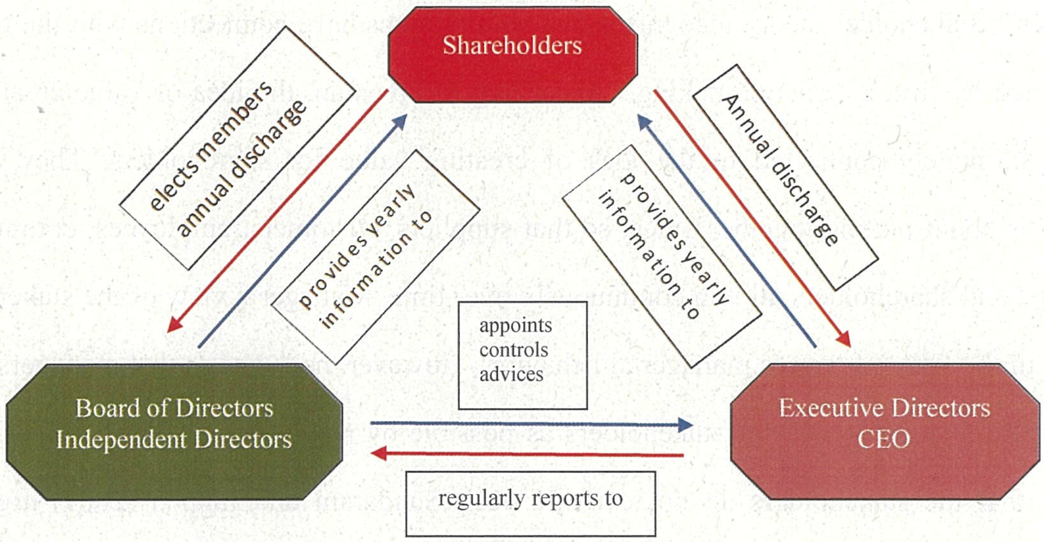

Figure 2-1: Types of Corporate Governance Mechanisms

Figure 2-1 shows the relationship and activities among three different parties from governance mechanism perspective. The member of board of directors is elected by shareholders. Through annual general meeting board of directors provide information regarding companies to shareholders. Board members appoint executive directors and CEO as the manager of the company. Executive directors bound to provide information to board members in board meeting about the company activities and they also get advices or decisions from board of directors to run the company. Executive directors are also responsible to provide annual information to shareholders.

Stakeholder Theory: Clarkson (1994) defines 'stakeholder theory as "The firm" is a system of stakeholders operating within the large system of the host society that provides the necessary legal and market infrastructure for the firm's activities. In case of Stakeholder theory, companies and society are interdependent and therefore the corporation serves a broader social purpose than its responsibilities to shareholders. Freeman (1984) defines stakeholder as "any group or individual who can affect or is affected by the achievement of the organization's objectives". Stakeholder theory recognizes that many groups have connections with the firm and are affected by firm's decision making. According to Freeman, the idea of value creation and trade is intimately connected to the idea of creating value for shareholders. They observe business is about putting together a deal so that suppliers, customers, employees, communities, managers, and shareholders all win continuously over time. Manager's view of the stakeholders' position in the firm influences managerial behavior. However, he suggests that managers should try to create as much value for stakeholders as possible by resolving existing conflicts among them so that the stakeholders do not exit the deal. Sundaram and Inkpen (2001) argue that objective of shareholder value maximization matters because it is the only objective that leads to decisions that enhance outcomes for all stakeholders. They argue that identifying a myriad of stakeholders and their core values is an unrealistic task for managers. Proponents of stakeholder theory also argue that shareholder value maximization will lead to expropriation of value from non-shareholders to shareholders.

Stewardship Theory: Stewardship theory is the opposite perspective of Agency Theory that assumes that the agents or management are essentially trustworthy and well stewards of the resources. In the stewardship model, 'managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholder return' (Donaldson and Davis, 1994). The stewardship perspective considers the directors and managers as stewards of firm. As stewards, directors are intended to maximize the shareholders' wealth. Stewardship theory suggests that managers should be given autonomy based on trust, which minimizes the cost of monitoring and controlling behavior of the managers and directors.

Unlike agency theory, this theory believes that the managers and agents are also influenced by non-financial motives, such as need for achievement and recognition, the intrinsic satisfaction of successful performance, plus respect for the work they do. Therefore, managers operate the firm in a manner that maximizes financial performance, including shareholder returns, as firm performance directly impacts perception about managers' individual performance. Fama (1980) suggests that managers who are effective as stewards of the firm are also effective in managing their own careers. Muth and Donaldson (1998) compared the assumptions of stewardship theory with that of agency theory and found support for stewardship theory as a good model in practice.

The Political Model: The political model recognizes that the allocation of corporate power, privileges and profits between owners, managers and other stakeholders is determined by how government favors their various constituencies. The ability of corporate stakeholders to influence allocation among themselves at the micro level is subject to the influence of the corporate sector. However, Hawley and Williams (1996) concentrated their discussion on the micro aspects of how shareholders can influence firms. They also highlighted on the micro level of the political model as articulated by Gunfest (1990). In political model of governance usually active investors seek to change corporate policy by developing voting support from dispersed shareholders.

2.5 Corporate Governance, CEO Compensation, Firm Performance and Valuation

Corporate governance has emerged as a concept that can no longer be underplayed in the market. It has relevance to the performance of firms. In a "Global Investor Opinion Survey" of over 200 institutional investors by McKinsey and Company – a privately owned management consulting firm, first undertaken in 2000 and later updated in 2002, it was found that 80% of the respondents would pay a premium for well-governed companies. According to these respondents, a well-governed company is one that had mostly outside directors with no management ties, who undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues. In another survey in 2005 on over 1000 directors around the world, it found that directors want to do more than monitor the short term financial performance of their companies. Directors say they want to spend more time on issues that impact longer-term corporate health such as strategy and leadership development. However, many directors lack the information needed for sound decision-making.

A firm's various corporate governance practices shape its behavior and eventually affect its stock market performance and accounting performance (Chow, 2005). Various researchers examined the relation between state ownership and firm performance. Tian (2002) found that government ownership worsens a firm's performance when government ownership is small, but improves it when government ownership is significantly large.

CEO compensation is composed of both the financial compensation (salary) and other non-financial benefits received by an executive from their employing firm in return for their service. It is typically a mixture of fixed salary, variable performance-based bonuses such as cash, shares or call options on the company stock and benefits and other perquisites all ideally configured to take into account government regulations, tax law, the desires of the organization and the executive. The three decades from the 1980s saw a dramatic rise in executive pay relative to that of an average worker's wage in the United States, and to a lesser extent in a number of other countries. Observers differ as to whether this rise is a natural and beneficial result of competition for scarce business talent that can add greatly to stockholder value in large companies, or a socially harmful phenomenon brought about by social and political changes that have given executives greater control over their own pay. Recent studies have indicated that executive compensation should be better aligned with social goals. The rate of executive pay is an important part of corporate governance, and is often determined by a company's board of directors.

Ning and Zhou (2005) found that employee stock ownership does not improve firm performance significantly in China, suggesting that a negligible fractional ownership does not provide a meaningful employee incentive. It was reported that CEO turnover sensitivities to firm performance are larger for privately controlled listed firms than for state controlled firms, indicating the inefficiency of state ownership (Kato and Long, 2005). Bai et al. (2004) showed the impact of various governance mechanisms on the firm valuation. They found evidence that the degree of concentration of shares held by other large shareholders positively affects firms' market valuation.

Corporate governance practices shape a firm's behavior. It is therefore natural to expect that they also affect a firm's return (Gompers et al., 2003). Wang and Xu's (2005) argued that due to the speculative nature of the capital markets and low quality accounting information, book-to-market does not reflect fundamentals in the stock market. Instead they suggest that a firm-specific floating ratio is a good proxy for expected corporate governance, which helps to predict a firm's future cash flow.

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how they set corporate objectives, perform the bank's business on a daily basis, meet the obligation of accountability to their regulators, depositors, shareholders and take into account the interests of other recognized stakeholders. Bank activities should be aligned with the expectation that banks will operate in a safe and sound manner, in compliance with applicable laws and in protecting the interests of depositors.

There are number of time the word "Accountability" has been used in corporate governance definition. In governance and ethics, accountability refers answerability, blameworthiness and liabilities. Accountability is an obligation or willingness to accept responsibility or to account for one's actions. An effective Board is more than a sum of its individual members. Whilst each board member has duties to perform set out in the Companies Act, the responsibilities of the board to set strategy, and to direct and control the activities of the company for the benefit of stakeholders, is much more onerous. In management point of view, accountability is also a management process in which responses are given for a person's actions. These responses can be positive or negative. Depending on the response, the person might need to correct his or her error. In other words, accountability refers to individual responsibility for the work performed and answering to peers and superiors for performance.

Finally, the intensity of CG appears to be a deep-seated concern in the corporate sectors. It is particularly noteworthy in view of the advent of the financial chaos in 1980s and the later part of 2000s. It is observed that strong legal environment has important bearing in protecting the investors' right, in fostering good corporate governance practice. A weak regulatory framework limits it. Despite the hindrances, officials and business leaders must improve the firm's CG in order to increase the chances of continued vigorous economic growth. It is now imperative that CG system needs to be rebuilt to promote the long-term health of the corporations. This task question the efficacy of the managerial discipline model of CG where stockholders wish dominates, instead of all corporate constituencies and the society as whole.

Chapter-3
Corporate Governance in Banks: Bangladesh Scenario

3.1 Introduction

Corporate governance is the set of process, customs, laws and individuals affecting the way a corporation directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are shareholders, board of directors, management committee, executive committee and other stakeholders including labor or employees, customers, creditors (e.g., banks, bondholders), suppliers, regulators and the community at large. Corporate governance is a multifaceted subject. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principle-agent problem. A related but separate thread of discussions focuses on the impact of a corporate governance system in economic efficiency, with a strong emphasis on shareholder's welfare. There has been renewed interest in the corporate governance practices of modern corporations since 2001, particularly due to the high-profile collapses of a number of large US firms such as Enron Corporation and MCI Inc. (formally WorldCom). Sarbanes-Oxley Act was passed by US federal government in 2002 aiming to restore public confidence in corporate governance.

3.2 Institutional and Legal Frame Work in Bangladesh

It has now become the conventional wisdom all over the world that market dynamics must prevail in economic matters. This has made the market the most decisive factor in settling economic issues. In the context of Bangladesh, the need for corporate governance has been highlighted because of the series of scams that had become almost a regular feature in recent times. The legal and administrative environment in Bangladesh provides greater scope for corrupt practices in banks.

The following institutions are directly/indirectly involved in the governance system in Banks of Bangladesh:

1. Ministry of Finance
2. Bangladesh Bank- The Central Bank of Bangladesh
3. Bangladesh Securities and Exchange Commission
4. Stock Exchanges

Ministry of Finance prepares different laws and Acts to govern the corporate culture in Bangladesh. The following legal measures are in practice at present:

1. Securities and Exchange Ordinance 1969
2. Bangladesh Bank Order 1972
3. Bank Companies Act 1993
4. Financial Institutions Act 1993
5. Securities and Exchange Commission Act 1993
6. Companies Act 1994
7. Bankruptcy Act 1997

By dint of Bangladesh Bank (Central Bank of Bangladesh) Order 1972 has the authority to supervise and govern the banking system and other non banking financial institutions of the country. Bangladesh Securities Exchange Commission and stock exchanges regulates the capital markets and enlistment of institutions.

We should approach the issue of corporate governance in Bangladeshi banks not only from the point of view of rules and regulations or guidelines but look at the entire network of various rules and regulations impinging on business so that there is an integrated holistic system, created for ensuring that transparency and good corporate governance prevail.

In order to much institutionalize the practice of corporate governance in Bangladesh, it has been observed that first initiative was taken by the Bangladesh Securities Exchange Commission. It issued a notification on corporate governance guidelines for the publicly listed companies of Bangladesh under the power vested on the commission by Section 2CC of the Securities and Exchanges Ordinance, 1969. The Corporate Governance guidelines were issued on a "Comply or Explain" basis, providing some "breathing space" for the companies to implement on the basis of their capabilities. After revising some issues, BSEC issued another notification in 2012 which requires the companies to 'comply' with all the guideline conditions. Nevertheless, the framework of the investor protection and corporate governance has a number of weaknesses that hindered development of capital markets. Business organizations usually depend on the banks as their main source of financing.

One major problem of banks, particularly state owned banks in the high rate of non-performing loans. Eight state owned banks have new default loan of about 74% of total default loans (The Daily Star dated March 5, 2017.) Even after rescheduling "A big portion of the loans that were regularized under the large loan rescheduling scheme has turned defaulted again," said Zaid Bakth, chairman, Agrani Bank, one of the largest banks in Bangladesh. He added "Cases should now be filed against those who took large loans as they cannot be spared anymore." Wholesale rescheduling of loans in the pretext of political instability is not right; it should have been given according to merit.[4]Many borrowers, specially the influential borrowers and willful defaults, place unethical requests and create pressure on banks to regularize their problem loans by rescheduling, without proper justification" (The Daily Star dated March 5, 2017)

3.3 Performance of Banking Sector

Bangladesh is one of the world's least developed economies. A low level of corporate governance is an impediment to the economic development of the country. However, there is enormous possibility of improvement which is an important reason to implement corporate governance in business practice. Sound corporate governance will encourage investors' confidence by improving awareness and consistency of business rules and regulations.

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[4]Interview with Salehuddin Ahmed, former Central Bank Governor

Widespread improvements in governance have the potential to promote a fairer and more trustworthy environment. Corporate governance devices that defend investors from the opportunistic behavior of managers or overprotective shareholders, include market mechanism, institutional norms and standards, individual and stakeholder requirements and a strong legal framework. In the absence of such devices, asymmetries of information between managers and external investors may facilitate the misappropriation of corporate resources. Given the important financial intermediation role of banks in an economy their high degree of sensitivity to potential difficulties arising from ineffective corporate governance and the need to safeguard depositors' funds, corporate governance for the banking organizations is of paramount importance. But the real situation in banking sector is full of scam and irregularities in Bangladesh. Instances of such scams are noted below.

Banking sector portraits the whole economy due to its linkage with all other sectors. It plays a vital role in developing countries like Bangladesh which is now transforming from agriculture based economy to industry based economy. Being the largest unit of financial sector, banks must operate at its best with utmost efficiency to contribute in the economic development of the country. Pressure of sound corporate governance and its proper practices is the key requirement for efficient and stable banking system. Country like Bangladesh where prudential regulations and supervision is inadequate to provide a safety net for the depositor and stakeholders of the banks, special attention on corporate governance is required on a priority basis. However, except few foreign and private commercial banks, most other banks lack quality credit analysis and asset management practices. Health check fails to conceal the problems suffered by the sector from time to time. Mahmood and Islam (2015) has provided the current situations of large financial fraud and high non performing loan of banks. Between 2010 and 2012 the largest state-owned commercial bank, Sonali Bank Ltd. illegally distributed loans of BDT 36.48 billion (US$ 460 million). The largest share of BDT 26.86 billion (US$ 340 million) went to the infamous Hallmark Group. Other companies who participated in the fraudulent activities were T & Brothers (BDT 330 million), Khanjahan Ali (BDT 50 million). The Hallmark Group swindled about BDT 3.92 billion from Jamuna Bank, BDT 3.06 billion from Prime Bank, BDT 1.469 billion from Shahjalal Islamic Bank and BDT 0.63 billion from Premier Bank by placing counterfeit export documents, taking government's cash incentives to open business firms abroad and with accommodated bills through letter of credits. Six commercial banks i.e, Premier Bank, Shahjalal Islami Bank, Jamuna Bank, Janata Bank and Southeast Bank were involved with BDT 2.0 billion loan scam of Bismillah Group. Swindlers are not ready to miss a single opponent to take loans with counterfeit documents as it is easy in Bangladesh. Basic Bank scam of about BDT 45.0 billion loan without proper documentation. Board of Directors and the top management of the bank were found guilty in these scams. Many irregularities regarding loan disbursement of nearly 44.25 billion between December 2009 and November 2012 were found by Bangladesh Bank inspection team.[5] Instances of credit card fraud can be found in India and other Asian countries. United Commercial Bank Ltd. (UCBL) was the first such instance in the banking sector of Bangladesh. Such fraudulent activities indicate lack of Corporate Governance and its improper practices among the banks.

It is observed that top management and chief finance officers formulate the credit policies and the policies are approved at board meeting. Sometime banks failed to communicate their credit policies down the line. In order to make the policies efficient and effective, all the associated officials must know the policies very well. The credit policy of each bank must reflect the roles and responsibilities of all relevant officials such as who make proposal, who analyze the loan applications, who disburse loans, who supervise and monitor clients and who recover the loans. It has been found that bank's credit policy shows specific roles and responsibilities of the associated people but in the informal discussion it has been formed that the assigned people do

[5]These figures were collected from different daily news papers noted in Reference section.

not or cannot do their duty properly. This is the likely reason for increasing classified loans. The conventional banks follow the Credit Risk Grading and the Islamic Shariah based banks follow Investment Risk Grading. Officials of the banks informed that the efficiency of audit team is important in case of detecting fraud and scam. The audit committee must disclose the detected scams so the board of directors to take necessary steps. Sometimes the audit committee has nothing to do because of political and management pressure. From the discussion it is seen that conflict of interest exists between the board of directors and audit committee. Invisible clashes between them were found in some cases, i.e., the audit committee tries to detect shortfalls but some members of the board want to ignore those shortfalls.

The Basel Committee on Banking Supervision 1 (the committee) published guidance in 1999 to assist banking supervisors in promoting the adoption of sound corporate governance practices by banking organizations in their countries. This guidance drew from the principles of corporate governance that was published earlier that year by the Organization for Economic Cooperation and Development (OECD) with the purpose of assisting governments in their efforts to evaluate and improve their frameworks for corporate governance and to provide guidance for financial market regulator and participants in financial markets. 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 would set up a banking business itself guarantees flow of enormous amount of funds in the form of deposits. The general approach to corporate governance argue in favor of the shareholders rights only, as managers/executives may not always work in the best interest of the shareholders (Henderson, 1986; Jenson and Meckling, 1976; Fama and Jenson, 1983a). But the shareholders actually account for a very tiny portion of the bank's assets and funds. In case of losses or failures it will be depositors' savings that the banks would lose. Such risks would demand priority in protection of depositors that ushers in a broader view of corporate governance that suggests the interests and benefits of the suppliers of fund for a firm should be upheld (Shliefer and Vishny, 1997; Vives, 2000; Oman, 2001). Macey and O' Hara (2001) also argue that a broader view of corporate governance should be adopted in the case of banking institutions, arguing that because of the peculiar contractual form of banking, corporate governance mechanisms for banks should encapsulate depositors as well as shareholders. Arun and Turner (2003) supported the need for the broader approach to corporate governance for banking institutions and also argue for government intervention to restrain the behavior of bank management. In many countries, deposit insurance is used as a mechanism to safeguard the banking system as well as the depositors.

Sound corporate governance is considered to the proper functioning of the banking sector and the economy as a whole. Banks serve a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are keys to financial stability and the manner in which they conduct their business. The Basel Committee on Banking Supervision or BCBS (BIS, 2015) defines the following critical areas of corporate governance:

Responsibilities of the Board:

The board has overall responsibility for the bank including approving and observing the implementation of the bank's strategic objectives, governance framework and corporate culture. The board is also responsible for providing oversight of senior management.

Board Qualifications and Composition:

Board members should be and remain qualified, individually and collectively for their positions. They should understand their oversight and corporate governance and be able to exercise sound, objective judgment about the affairs of the bank.

Board's Own Structure and Practice:

The board should define appropriate governance structure and practices for its own work and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.

Senior Management:

Under the direction and oversight of the board, senior management should carryout and manage the bank's activities in a manner consistent with the business strategy, risk appetite, inclusive compensation and other policies approved by the board.

Governance of Group Structure:

In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring a clear framework appropriate to the structure, business and risks of the group and its entities. The board and senior management should know and understand the bank's operational structure and the risks that it passes.

Risk Identification, Monitoring and Controlling:

Risk should be identified, monitored and controlled on an on-going bank wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructural should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.

Compliance:

The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance functions.

Internal Audit:

The internal audit function provides independent assurance to the board and supports board and senior management in promoting an effective governance process and the long-term soundness of the bank. The Internal audit function should have a clear mandate, accountable to the board, be independent of the audited activities and have sufficient standing skills, resources and authority within the bank.

Disclosure and Transparency:

The governance of the bank should be adequately transparent to its shareholders, depositors other relevant stakeholders and market participants.

Role of Supervisors:

Supervisors should provide guidance and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors.

Added to this, the group has stated on shareholder rights and disclosure of information, financial reporting, audit practices, activity of different committees, board's effectiveness, role of independent directors and management performance as broad areas of corporate governance practices.

3.4 Governance Structure in Banking Sector

The legal framework refers to the laws, rules and regulations as these relate to government organizations, the public and private sectors and financial institutions made through the Government of Bangladesh. In Bangladesh although separation of the judiciary from the administrative arm of the government has officially done, still the institutions of Parliament, the

Judiciary and Executive branch do not cooperate in a coherent manner. This may tell upon the sound corporate governance of the country.

As the subprime crisis in the US and UK has demonstrated non-transparency and non-disclosure of financial obligations is not confined to developing countries. Wise (2012) argued that for all countries, it has become very important to revisit banking, auditing and accounting standards and lay down guidelines which would ensure full disclosure of all obligations, including "off balance sheet" items. Private ownership of business is the dominant entity form, with most companies small in size (about 90% small and medium size) and family oriented. This form of intense ownership structure limits the usefulness of corporate governance devices, a flaw cannot be rectified by setting laws. As such the implementation of sound corporate governance principles in the country is problematic.

In 2004, the Bangladesh Enterprise Institute (BEI) had started to take initiative to publish a code of corporate governance for Bangladesh suitable for the private sector, financial institutions, state owned enterprises (SOEs) and non-government organizations (NGOs). According to BEI (2004) the relevant laws and supervision applying to all commercial enterprises owned and undertaken by the government and their directors should be clearly stated and preferably all government entities engaged in commercial activities should be governed by the BEI code of corporate governance.

The Bangladesh Company Act 1994 sets the rules for companies with regard to its management and administration. Before its enhancement in 1994 companies were governed by the Company Act 1913.

The major regulations in the Bangladesh corporate sector and capital market are the Bangladesh Securities and Exchange Commission (BSEC), Dhaka Stock Exchange (DSE), Chittagong Stock Exchange (CSE) and the Registrar of Joint Stock and Companies (RJSC). In the monetary sector the main regulator is the Bangladesh Bank. In Bangladesh, shareholder activism indicates that the share market is immature, regulating forces are weak, shareholders are not properly educated, and manipulative trading occurs. Boards of directors of banks tend to be populated on the basis of political affiliation and familial connection.

There are some studies on the corporate governance in Bangladesh Banking Industry. All these studies have indicated poor corporate governance in Bangladesh. Not only that, Bangladesh also had lagged behind its neighbors and the global standard in corporate governance (Gillibrand, 2004). One of the principal reasons of weak corporate governance is that most of the organizations are family orientated and the Board of Directors is actively involved in management (Haque, Jalil and Naz, 2007). In the framework of Bangladesh, independent directors do not act as a supporter of majority stakeholders or as a source of innovative ideas (BEI, 2003). The Companies Act 1994 provides for many strict rules regarding any negligence, default, breach of duty or trust on the part of the director, manager or officer of a company. But, these rules are more honored in the breach than observance (Ahmed and Yusuf, 2005). Weak regulatory system has also been identified as a barrier in the way of achieving sound corporate governance. The presence of weak regulatory system prevents the current laws and statutes from being applied. There are some Board Committees which are responsible to ensure sound corporate governance. These are Audit Committee, Executive Committee. Besides, Remuneration Committee and Nomination Committee work in many cases.

Audit Committee monitors the integrity of financial statements, reviews internal financial controls, recommends appointment of external auditor, reviews auditor independence and objectivity and audit effectiveness.

Executive Committee suggests the Board policies and programs of banks. It also recommends amendment of Company's articles of Association, delegation of power, Employee

Service Rules, Organizational Structure, Appointment and Promotion, Procurement Policy or any other policies that the committee feels to be placed before the Board.

Remuneration Committee is accountable for reviewing the remuneration of the directors and senior management and advisor of the Board whether the amounts are reasonable in comparison with the industry and corporate yardsticks.

Nomination Committee is liable for proposing new nominees to the Board and advising the Board on the fundamental skill required of new directors (Psaros and Seamr 2002).

As in other developing countries, banks play a vital role in Bangladesh economy as the dominant finance provider for the industrial and commercial activities since the independence in 1971, until 1982, when the 'ownership reform' measures started in the financial institutions. During the reform period, two out of six Nationalized Commercial Banks (NCBs) were denationalized and private commercial banks were allowed to operate in the country. Despite gradual expansion of activities, the operational efficiency of the banking institutions has continued to be dismal (Sayeed, 2002, Raquib, 1999). The sector observed diminishing profitability, growing non-profit assets, capital shortfalls, eroded credit discipline, rampant corruption patronized by political quarters, low recovery rate, inferior asset quality, managerial weakness, executive interference from government and owners, weak regulatory and supervisory role etc. (Hasan 1994, USAID, 1995). Internal Control system along with accounting and audit qualities are supposed to have been insufficient (Raquib, 1999; CPD, 2001). Banking Reform Commission (1999) and Bangladesh Enterprise Institute (2003) raise serious concern on the banking sector and criticize the quality of governance that shows an impetus to explore the governance issues in detail.

There are some additional issues that are required to the financial sector that deserve attention. The rapid changes brought about by globalization, deregulation and technological advances are increasing the risk of banking system. The failure of bank affects not only its own stakeholders, but many have a systematic impact on the stability of other banks. Private sector banks are motivated by profit maximization and their own financial stakes are limited and relatively low and they are, therefore, prone to excessive risk taking with the depositor money.

3.5 Limitations to Corporate Governance in Bangladesh Banking Sector[6]

Emergence of private banks in Bangladesh has nearly 40 years of history. Most of the private banks of Bangladesh are either family controlled or controlled by one or a few substantial shareholders, paving the way for the interests of minority shareholders to be expropriated by corporate insiders. There are some limitations which are responsible for poor management and performance in banking sector of Bangladesh. These limitations are mostly related to the lending process of the bank.

Borrower Selection Criteria: To select the right individuals or organizations for lending is a challenging task for some banks. If the selection of borrower becomes faulty then the whole lending process will fail. Banks need to select the persons or organizations as borrowers who are financially as well as mentally fit for the borrowing. So in case of selecting the right borrower, the bank should be knowledgeable or aware of the information of the borrower through Know Your Customer (KYC).

Political Influence: Though the officials informed that there is no political influence in the lending decision making process, but in reality there is a suspect of having acute political pressure in this issue. Politically biased board's decisions lead the loans towards being default and the banking sector towards a vulnerable position.

Board of Directors Influence: Board of directors of banks plays a vital role in lending process. The board members are assigned to take appropriate decision on loan or investment

[6]This section is mainly adopted from Mahmood and Islam (2015).

sanction, disbursement, recovery, reschedule and write-off. By ignoring this important role, sometime the board members are biased to the loan appraisals of their friends and familiar faces.

Management Influence: Management has also influence on banks' lending process. The higher management such as Chairman, board of directors, Managing Directors and other high officials have an important command on the lending process. They show biasness to their near and dear ones. Sometime the management approves loans at a special rate even with shortage of documents and not having enough collateral as security.

Role of Independent Directors in Board: Independent Directors are considered as safeguard of the broader interest of the stakeholders works as an important tool to ensure sound corporate governance in firms. They have become a vital instrument in representing the interests of all stakeholders ranging from the tax authority to the minority shareholders. Thus, regulators and other stakeholders have expressed their concerns regarding the independence and expertise of the independent directors serving in the board in many occasions. BSEC has ordered to consist of board with independent directors but the authority has not mentioned about the appointment of independent directors. Independent directors are appointed by other executive board members. So they cannot play appropriate role in the board.

Lack of Audit Committee Independence: An audit committee is a sub-committee of the Board of Directors that makes arrangements for the audit and also as a subcommittee of the Board, this committee tries to enhance the ability of the Board to fulfill its legal responsibilities and ensure the credibility and objectivity of the financial reports. Audit committee members are influenced by board of directors. As a result, financial report does not reflect the authentic financial position of the banks.

Hindrance of CEO Selection, Compensation and Evaluation: In order to strengthen the financial base of the bank and obtain confidence of the depositors, one of the major responsibilities of the board of directors is to appoint an honest, efficient, experienced and suitable CEO or Managing Director. The Board of directors will appoint a suitable CEO with the approval of the Bangladesh Bank. This selection process should be more open and convincing to others. It has been observed that board of director decides the CEO pay without proper performance evolution of CEO.

Involvement of Bangladesh Bank Officials: Some dishonest officials of Bangladesh Bank are also associated in the forgery. Corrupted and dishonest Bangladesh Bank officials take bribe and help to conceal sensitive information of client by not properly analysis the data given by different commercial banks.

Unaware of Bangladesh Bank Circulars: Bangladesh Bank provides circular to the commercial banks time to time for their smooth operation and own safety and security. Unfortunately it was found that banks' officials are unaware of those circulars. This may lead the bank towards operational as well as reputational risks.

Obligation of Margin in Foreign Exchange (FEX): In foreign exchange, there is an obligation of having minimum 10% margin of the total Letter of Credit (LC) amount. If the client is unknown to the bank then the cash margin should be 100%. But the client makes arrangement with the branch officials and keeps the margin to 5% or sometimes they do not keep the cash margin at all. This is a complete violation of corporate governance of the bank.

Wrong Information Provided by Head Office: Bangladesh Bank is the central bank and guardian of all commercial banks in Bangladesh. So the each commercial bank has to submit different information to Bangladesh Bank through different statements. Based on those information provided by different banks, the central bank takes different decisions and makes policy. Branch offices of each bank provide statements to their respective Head Office. Those statements are finally submitted to Bangladesh Bank. Sometimes branches or even Head Offices temper the actual information.

Insufficient Personal Guarantee: Personal guarantee is a popular term in the banking sector. For taking loan from banks guarantee is a must whether it is personal guarantee or collateral. If the loan amount is lower, then the personal guarantee can be taken as the mode of security. But if the amount is higher, then personal guarantee is insufficient and further collateral required. In case of recovery of default loans, personal guarantee is becoming risky.

Lack of Proper Information about Importer and Exporter: Hallmark and Bismillah Group financial scam took place because the bank had not enough and proper information about the importer and exporter. In case of Hallmark, the arrangement of LC was arranged among the different wings of the Hallmark itself. They did not transfer or produce the goods but they submitted the papers to the bank for the payment and the bank made payment of the LC without verification. The Bismillah Group opened its wing abroad and made the same type of fraud with the bank. So it is necessary for the banks to have complete and proper information regarding the importer as well as the exporter before doing any type of dealings with them.

Investment in Risky Project: The branches have business target to fill up every year and now-a days the competition has increased so much. To survive in the competitive market, banks try to find out different projects where they can invest and get a healthy return. Where there is good return there is also high risk. Investing in high risk projects could make the banks profitable as well as looser sometimes. Another bad practice of competition is hunting of clients at any cost. This practice makes the banks to find clients desperately. For example, a person is capable of getting loan from a bank of amount of taka 5 million as his collateral valuation can support that amount maximum but another bank could snatched away that client by offering him more amount. This is very risky and bad practice by the banks. If that client collapses or makes any fraud with the bank, then the bank will be unable to recover its money by selling that collateral.

Monitoring and Supervising Borrower: A bank's main earnings come from loans and advances. So the selection of clients should be done more cautiously by the bank. If the clients' businesses are profitable then they can repay the loan amount to the bank and the bank can also make profit. So it is the responsibility of the bank not only to disburse loan to the clients but also to monitor and supervise how they use the amount and doing their business. This will also prevent fund diversion.

Fund Diversion: Fund diversion is one of the major problems in Bangladeshi banking sector which becomes more crucial now-a-days. The main differences between Islamic and conventional banking system is the mode of disbursement of money. Conventional banks disburse the money directly to the clients account and the clients can do anything with the money they want. They took loan from bank for doing business but if they spend money in any unproductive sector such as invest in share market, buy cars, purchase land, and spend without any goal then the fund becomes diverted. Fund diversion makes the clients unable to make enough return to repay the loan thus the loan fall ultimately. So, strong monitoring and supervision is a must to prevent fund diversion. On the other hand, Islamic banks buy goods forth clients rather disburse money to the clients directly. So, a little chance of fund diversion exists here. But monitoring and supervising is also needed there.

Fake Mortgage: Mortgaged property which is used to secure the loan in case of default should be evaluated properly. Sometimes the clients make arrangements of the fake property by making linkage with land officials, legal advisor of the banks and sometimes with the bank officials. Audit team is also responsible because they sometimes overlook such activities intentionally or unintentionally. Hallmark made this type of fraud with Sonali Bank. They mortgaged land as collateral but the land does not exist or the owner is not the Hallmark Group.

Lack of Proper Documentation: Proper documentation is a pre-requisite of every transaction with the clients. If there is any shortage in documentation then the problem might raise during the time of recovery. If the bank becomes unable to show proper documents then it will not get any legal protection while recovering default loans. One instance can be shown that Basic Bank provided loan against fixed deposit which is 100% secured but in the meantime the client withdrawn the fixed deposit from the bank without settling the loan.

Insufficient Audit: Proper auditing is the main tool that can eradicate all the fraud and scams from the banks. But the audit process cannot be made properly for various reasons. People who are auditing may remain under management pressure or they may be corrupted as well. In some banks, only one audit takes place in a year whereas minimum two audits are mandatory as per rules.

Lack of Shareholder's Activism: An activist shareholder is a shareholder that uses its equity stake to exercise its ownership rights in a company to put pressure on its management. Shareholder activism allows shareholders to take greater ownership and responsibility of the company and to voice their disapproval on issues ranging from "non-financial" issues such as environmental, social and governance issues to unlocking additional value and earning a better return on their investment. Activity of shareholders is less observed in Bangladesh perspective. They need to be more active in participating into annual general meeting and raise their voice to ensure their interest.

In view of our observation and discussion, it is fare to state that corporate culture in Bangladesh banking sector is still in a state of infancy. While it has been created legal requirements for good corporate governance, rushing to institutionalize the culture of governance through legal and regulatory requirements or external pressure may not bring desirable result. The objective of practicing good governance is to help the banking sector that is expected to entail such culture in all other sectors of the economy as well as the society and the nation. It is important that corporate sector is educated to understand the benefits from good corporate governance. It is under such a scenario, the state of governance in Bangladesh banking sector will mature. It is implied that monetary, fiscal and exchange rate policies should be applied with appropriate diligence by the Bangladesh Securities and Exchange Commission, Bangladesh Bank and the National Board of Revenue. Attention to inbound and outbound logistics is likely to improve financial health, profitability, long run sustainability and creating distinct competencies for Bangladesh economy.

Thus Corporate Governance is vital for growth and stability of various economic sectors. Among them the banking sector happens to be the engine behind developing economic activities which need to be seen for prudent and effective regulation both at micro (firm) and macro level. But the literature and evidences clearly suggest that the quality of the regulation in Bangladesh banking system is not at satisfactory level. The general perception is that government ownership, political interventions, concentrated ownership of private banks, lack of accountability of public sector banks, faulty, incomplete and ineffective audit and disclosure level led to widespread corruption in the banking sector.

Chapter-4

The Effectiveness of Board Composition in Banking Sector of Bangladesh: Empirical Evidence

4.1 Introduction

This chapter provides empirical evidence on effectiveness of the board composition on bank performance of Bangladesh. The board is considered to be one of the most important initial internal corporate governance mechanisms for organization. Corporate boards have long and the legal authority and shareholders support create supervised executive decision making. Boards with in line knowledge, skills and abilities have the potential for proffering unique tactical and strategic advantages to corporation (Beeks, et al, 2004; Finkelstein and Hambric, 1996). Rose (2005) argues that the corporate board plays a key role in executive management and organizing their interests with the best interests of shareholders. It is observed that differences in laws and regulations as well as corporate culture have their significant impact on corporate governance of respective countries. Although there are multiple studies on Corporate Governance of other developed countries that provide some good theories and conclusion but the number of such studies is limited in Bangladesh. In most studies about board effectiveness, the main concern is whether the board "structure" may influence the financial performance. This study will embark upon the following objectives:

1. It will investigate the influence of corporate governance on the performance of listed banks through board composition and board activity in Bangladesh.

2. It will also assess the immediate short-term impact of outside directors in the newly reformed boards of listed banks of Bangladesh on the financial performance.

This study contributes to better understanding of difference between two corporate governance guidelines of 2006 and 2012 related to the board effectiveness and audit committee affairs and impact of these two guidelines on Bangladeshi Banks' performance through empirical study.

4.2 Corporate Governance Models around the World:

There are many different models in the world which differs according to the level of capitalism in which they are embarked. The liberal model common in Anglo-American countries tends to give priority to the interest of shareholders, while the coordinated in continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers and the community. This is also known Japanese-German model. The liberal model of corporate governance encourages radical innovation and cost competition whereas the coordinated model of corporate governance facilitates incremental innovation and quality competition. Both models have their district competitive advantages but in different ways.

Anglo-American Model: In USA, a corporation is governed by a board of directors that has the power to choose a CEO. Broadly CEO is empowered to manage the corporation on a day-to-day basis. The CEO, however, needs board's approval for certain major actions, such as, hiring his/her immediate subordinates, raising fund, acquiring another companies, major capital expansions or other expensive projects etc. Other duties of the board may include policy setting, decision making, monitoring management's performance or corporate control. The responsibility of selecting the board of directors rests on the shareholders but the bylaws of many companies make it difficult for all but the largest shareholders to have any influence over the makeup of the board. Frequently it is seen that members of the board of directors are CEO of other corporations, which may be seen as a conflict of interest.

Japanese-German Model: In East Asian countries, family-owned companies dominate the market. Family-owned companies also dominate the Latin model of corporate governance, such as companies in Mexico, Italy, Spain, France (to a certain extent), Brazil, Argentina and other countries in South America. The characteristics in the model are: shareholders are major stakeholders; there is a small member of listed companies with an illiquid capital market where ownership and control are not frequently traded; and there is high concentration of shareholding in the board of the corporations, institutions, family or government sometime through interlocking of shareholdings.

4.3 Corporate Governance Regulations in Bangladesh

In the early 2000s, The Enron and other corporate failures in different parts of the world raised concerns among different community regarding the corporate governance standard. The affected economies and parties responded to such scandals by establishing different corporate governance related acts, codes, guidelines or rules. Usually, the content of the corporate governance guideline varies across the countries because of their unique economic, social, cultural and institutional characteristics. There are two common objectives in code are: (a) to improve the quality of companies' board governance and (b) to increase the accountability of companies to minority shareholders while maximizing shareholder or stakeholder value (Aguilera and Cuervo-Cazurra 2004).

In Bangladesh, the process of industrialization suffered a lot in the past due to different factors. With the adoption of a socialistic approach in economic management and nationalization of virtually all large scale industry immediately after liberation of the country in 1971, Dhaka Stock Exchange the only bourse of the country at that time, was closed. With the change of government policy towards free market economy it reopened in 1976. The corporate culture and financial system of Bangladesh is still at its early stage of development. However, there is enormous possibility of improvement which is an important reason to implement corporate governance in business practice. Sound corporate governance will encourage investors' confidence by improving awareness and consistency of business rules and regulations.

The country-level initiative to develop corporate governance regulation in Bangladesh began in 2003 by Bangladesh Enterprise Institute (BEI), a non-profit and non-political research center. But result of such initiatives started to come out through Bangladesh Securities and Exchange Commission (BSEC) a capital market regulatory authority in 2006. On 9 January 2006, BSEC issued an order requiring the listed companies to follow a number of CG related conditions. The aim was to improve the CG situation and thereby, better protect the interests of minority shareholders and develop Bangladesh capital market. In 2011, unfortunately Dhaka Stock Exchange general index (DGEN) fell sharply to 7118 point on January 11, 2011 from 8912 point on December 05, 2010 and thousands of investors lost their initial investment within one month. After continuous protestation from various stakeholders of the market, BSEC again revised its notification order of 2006 (February 20). It is to be noted that the first notification was issued under a 'comply or explain' basis. It means that although the disclosure of compliance statement was mandatory, companies had the option to comply with individual provision or explain the reasons for noncompliance with any of the provisions. However, the revised notification of 3 July 2012 however, requires the companies to 'comply' with all the guideline conditions. Therefore, the flexibility of choosing an appropriate governance structure arising from the differences in the costs and benefits of adopting the new guidelines facing an organization is greatly reduced.

A Comparison of Corporate Governance Guidelines related to board structure of 2006 and 2012 has been given below in the Table 4-1.

Table 4-1: A Comparison of Corporate Governance (CG) Guidelines of 2006 and 2012

CG Area	CG Guidelines of 2012	CG Guidelines of 2006
Board Size	• Should not be less than 5 (five) and more than 20 (twenty)	• Should not be less than 5 (five) and more than 20 (twenty)
Board Effectiveness	• Separation between the Chairman and CEO roles is required • At least 1/5th independent directors (IDs) • The definition of 'independent' director has been expanded by including additional criteria	• Separation between the Chairman and CEO roles is proposed • At least 1/10th independent directors (a minimum of one) • Specific criteria for a director to be considered 'independent' directors

	• Specific qualification criteria for independent directors • IDs need to be nominated by the Board of Directors (BOD) and approved by the shareholders at the Annual General Meeting (AGM) • The post of an ID cannot remain vacant for more than 90 days • The normal tenure of an ID is three years which can be extended for another one term only	• No qualification criteria for independent directors • No such requirement • No such requirement • Not Specified
Audit Committee (AC) Affairs	• The AC Chairman shall be an ID • 10 specific roles of AC have been identified • Professional qualification requirement for all members of the AC • At least one independent director must present to fulfill the quorum of the AC meeting	• Any member of board can be Chairman of AC • The roles of AC have been expressed in general terms • Professional qualification requirement for the Chairman of the AC only • No specific requirement for the independent AC member(s) to present in the AC meetings
Auditor Independence	• Neither any partner nor any employee of the external audit firm should hold any share of the client firm during the term of the audit assignment	• No such restriction
Additional Statements by the BOD	• Industry outlook and possible future developments in the respective industry • Segment-wise or product-wise performance • Different risks facing the organization and related concerns • An explanation when the company's financial results deteriorates after major events such as the Initial public offering (IPO), Repeat Public Offerings (RPO), Rights Offers • Reasons for significant deviation between quarterly financial performance and annual financial performance need to be discussed • Key operating and financial data of a minimum of last five years shall be summarized	• No such requirement • No such requirement • No such requirement • No such requirement • No such requirement • No such requirement
Certification by the CEO and CFO to	• The financial statements do not contain any materially untrue statement or omit any	• No such requirement

the Board	material fact or any misleading statement • The statements present a true and fair view of the company's financial affairs and are in compliance with existing laws and accounting standards	• No such requirement
Reporting and Compliance of CG	• The company shall obtain a certificate from a professional accountant or Chartered Secretary regarding compliance of conditions of CG guidelines • The company shall send the compliance certificate along with the annual report to the shareholders on a yearly basis	• No such requirement • No such requirement

Source: Biswas, P. K. (2012), "Corporate Governance Guidelines in Bangladesh: Some Observations"

The revised guidelines include many new provisions in the areas of board independence, audit committee affairs, board's declaration on the corporate governance issues to ensure good corporate governance practices among companies.

4.4 Some Relevant Literature Review

Deposits are blood of a bank which are customers' money that are used for financing banks' investments. If the investments become faulty then it will be depositors' money that the bank may lose. Such risks demand priority in protection of depositors that ushers in a broader view of corporate governance. It implies that the interests and benefits of the suppliers of funds for a firm should be upheld (Shleifer and Vishny, 1997).

Zahra and Pearce II (1989) stated more accurately that most existing reports of corporate governance finalizes that effective boards are comprised of a high proportion of outside directors. Such a preference for outside directors dominated boards was largely based on Agency Theory. Kenser et al. (1986) indicated that it is widely debated in corporate governance literature as to whether board composition in the form of representation of outside independent directors may add any economic value to the firm. Number of empirical studies demonstrated that outside directors are positively associated with corporate financial performance (Rosenstein and Wyatt, 1990). Other studies found that the positive impact of outsiders on corporate performance is not constant (Zehra and Pearce II, 1989). Thus, the relationship between independent directors in board and performance is mixed.

Meah (2013) outlines the regulatory framework and its adequacy for the rapidly evolving area of corporate governance of capital market of Bangladesh. It indicates the importance of sound corporate governance practices in the context of Bangladesh. Relationship between corporate governance and financial stability is an indirect one, companies are not obliged to pursue financial stability unless specific legislation or regulations require it. A study conducted Mahmood et al. (2015) for the banking sector of Bangladesh found that top management influences well as political pressure in banking sector affect the lending decisions. Selection of wrong borrower, unhealthy competition, among the banks, fund diversion, inefficient auditing and inefficient collateral cause major harm to the banks. It attempted to analyze CG practices in Bangladesh banking industry. It has evaluated that the quality of the regulation is unsatisfactory.

4.5 Hypothesis Development

Most other past studies on corporate governance board composition measured the effectiveness of board and financial performance of the organization but without any consistent result. In Bangladesh context it is quite difficult to get those terms appropriately. Based on the background literature hypothesis can be stated as follows:

Board Size: According to Williams (2002), the possibility of a large board size has the likelihood of having more knowledge and skills at their disposal, which will enhance performance. On the other hand, Zahra et al. (2000) argue about the information processing become faster because of small board. However, it has been considered that more directors in a board will promote the company, so that it can perform better. So the hypothesis is-

H_1: Board size is positively related to overall banks' performance

Independent Director: Independent Directors act as trustees to create a trust between a company and its investors through their active involvement with the board that ensures good governance (Bose, 2009). Added to this, independent directors are when they are in the boardroom and play a key role to protect the interest of the shareholders (Liu and Yang, 2008). So the hypothesis is –

H_2: A higher proportion of independent directors on the board is positively related to overall banks' performance

Audit Committee Size: The audit committee (hereinafter referred to as "AC") is regarded as the most important board subcommittee due to its specific role of protecting the interests of shareholders in relation to financial oversight and control (Mallin, 2007). The increased number of members in AC is argued to provide more effective monitoring and thus improve firm performance. So the hypothesis is –

H_3: Audit committee size is positively related to banks' performance.

Independent Director in Audit Committee: Effective audit committee can influence to reduce fraud and scam in the company. It is suggested that fraudulent financial reporting can be decreased through effective audit committee (Levitt, 1998; Myers and Zegenfuess, 2006). Furthermore, external auditors get assistance from audit committee through their analysis, findings and recommendations (Puri, Trehan and Kakkar, 2010). So the hypothesis will be -

H_4: Higher proportion of external audit committee members are positively related to overall banks' performance.

Board Meetings: According to Vafeas (1999), frequency of board meeting is one of the several factors that can affect how boards operate. When the board meetings will be held in frequently, there will be the chance for the board members to come together and discuss and exchange the ideas on monitoring strategies. On the other hand, frequent meetings might also be a result of board's reaction to poor performance which is considered as reactive boards. Jensen (1993) opined that routine tasks absorb much of the board's time, which limits the ability of the outside directors to exercise meaningful control over management. Thus, it is argued that frequency of board meetings may influence the firm performance. So the hypothesis will be -

H_5: Number of board meeting has a positive relationship with overall banks' performance.

4.6 Methodology

The study is mainly based on secondary data that have been collected from the data bank of Dhaka Stock Exchange (DSE). Besides, Data were collected from the annual reports of the respective banks'. I have taken 29 banks as sample out of the 30 listed banks in DSE for the year from 2006 to 2015. The analysis has been carried out using panel data.

4.6.1 Dependent Variables: Dependent variables in this study are different performance measures such as, *Return on Assets (ROA), Return on Equity (ROE)* and *Tobin's Q Ratio (TQ).* Bank regulators and analysts long believe that ROA and ROE act as appropriate proxies for profitability (Gilbert and Wheelock 2007, Mostafa 2007, Christian, Moffitt et al. 2008). ROA, ROE and Tobin's Q have been calculated as follows:

$$\mathrm{ROA} = \frac{\text{Net Income After Tax}}{\text{Total Assets}}$$

$$\mathrm{ROE} = \frac{\text{Net Income After Tax}}{\text{Shareholder's Equity}}$$

$$\text{Tobin's Q} = \frac{\text{Equity Market Value}}{\text{Equity Book Value}}$$

4.6.2 Independent Variables: The following independent variables are selected for this study:

Number of Directors in the Board (Board Size/B.Size): Rechner and Dalton (1986) have considered number of directors as independent variable for measuring the impact of CG on the profitability of a firm.

Number of Outside Independent Directors (%.I.Dir): Board composition in this study refers to the percentage of membership held by the outside independent directors which has been considered in prior studies (Rechner and Dalton, 1986; Zahra and Stanton, 1988).

Number of Directors in the Audit Committee (A.Comt): Number of directors in the audit committee is believed to have significant impact on the performance and governance of the company. Audit committees have oversight responsibility over corporate governance and monitor the integrity, quality, and reliability of the financial reporting process.

Number of Outside Independent Directors in Audit Committee (%.I.Dir.A.Comt): Bangladesh CG code of 2012 has emphasized about the independent director in audit committee. An independent director should be the chairman of the audit committee and at least one independent director must present to fulfill the quorum of the audit committee meeting.

Number of Meetings (N.B.Meet): Number of board meeting is considered to measure the effectiveness of CG. Relationship between performance and number of board meetings is likely to exist in banks of Bangladesh.

4.6.3 Control Variables: The analysis has considered following control variables which are firm size, debt to equity ratio, general public ownership and financial institution ownership. Firm size *(F.Size)* has been measured by the natural log of total assets. Firm size was believed to be largely related to corporate governance reform and firm performance. Large firms experienced more outside pressure for governance reform. Debt to equity ratio *(DER)* is calculated by dividing a company's total liabilities by its stockholders' equity, is a debt ratio used to measure a company's financial leverage. Financial leverage can positively influence firm performance because leverage can be treated as a tool for disciplining management. The debt to equity ratio indicates how much debt a company is using to finance its assets relative to the value of shareholders' equity. The shareholding pattern of general public ownership *(G.P.O)* and financial institution ownership *(F.I.O)* has been collected from annual report of each bank. I am expecting all of these control variables have positive relation with bank's performance.

Regression Equation Specification: In order to investigate the impact of board effectiveness to the performance of listed banks of Bangladesh, I have formulated regression equations to see the magnitude of relationship between corporate board structure and banking performance.

(1) $ROE_{it} = \alpha+\beta_1 B.Size_{it} + \beta_2 \%I.Dir_{it} + \beta_3 A.Comt_{it} + \beta_4 \%I.Dir.A.Comt_{it} + \beta_5 N.B.Meet_{it} + \beta_6 F.Size_{it} + \beta_7 DER_{it} + \beta_8 G.P.O_{it} + \beta_9 F.I.O_{it} + \varepsilon_{it}$

(2) $ROA_{it} = \alpha+\beta_1 B.Size_{it} + \beta_2 \%I.Dir_{it} + \beta_3 A.Comt_{it} + \beta_4 \%I.Dir.A.Comt_{it} + \beta_5 N.B.Meet_{it} + \beta_6 F.Size_{it} + \beta_7 DER_{it} + \beta_8 G.P.O_{it} + \beta_9 F.I.O_{it} + \varepsilon_{it}$

(3) $TQ_{it} = \alpha+\beta_1 B.Size_{it} + \beta_2 \%I.Dir_{it} + \beta_3 A.Comt_{it} + \beta_4 \%I.Dir.A.Comt_{it} + \beta_5 N.B.Meet_{it} + \beta_6 F.Size_{it} + \beta_7 DER_{it} + \beta_8 G.P.O_{it} + \beta_9 F.I.O_{it} + \varepsilon_{it}$

4.7 Data Analysis

Table 4-2 depicts the descriptive statistics of banks' governance and performance variables of Bangladesh in two different periods 2006-2011 and 2012-2015. I have shown the changes of board composition variables and performance variables of Bangladeshi banks due to the revision of CG guidelines.

Table 4-2: Descriptive Statistics

	2006-2011					2012-2015				
	Obs.	Mean	Std. Dev.	Min	Max	Obs.	Mean	Std. Dev.	Min	Max
B.Size	174	14.298	4.331	6	28	116	14.094	3.558	7	21
%.I.Dir	172	3.937	6.177	0	42.85	115	16.002	9.470	0	50
A.Comt	172	3.238	0.617	2	5	115	4.243	0.884	3	6
%.I.Dir.A.Comt	172	10.943	14.907	0	33.33	115	37.643	21.319	0	75
N.B.Meet	174	18.551	9.337	2	53	116	20.353	9.227	7	58
ROE(%)	173	19.501	8.503	-11.68	48.96	116	11.614	3.791	1.84	23.40
ROA(%)	173	1.836	1.024	0.24	9.11	116	1.041	0.436	0.08	2.75
TQ	174	2.608	1.381	0.88	7.74	116	1.139	0.343	0.71	2.04
F.Size	174	11.080	0.609	9.73	13.13	116	12.101	0.452	11.31	14.25
DER	174	12.931	17.486	1	230.98	116	11.868	4.283	4.45	32.10
G.P.O (%)	160	41.202	20.982	0	96.81	114	40.124	16.416	6.60	76.16
F.I.O (%)	159	12.398	11.356	0	64.58	114	14.908	11.566	0	57.06

Average of board size is almost similar during these two periods. Average percentage of independent directors in board is 3.937% and ranging from 0% to 42.85% has been observed in 2006-2011 period. In later 2012-2015 period, we can see that the average percentage of independent directors in board has been increased to 16.002%. It means that board structure has been reconstructed with independent directors. The audit committee size has also been increased by 1 person compare to 2006-2011. Comparison between these two periods, average percentage of independent director in the audit committee has been increased from 10.943% to 37.643%. This is also resulted from the inclusion of independent directors in audit committee. Regarding performance variables, the mean value of ROE, ROA and TQ have been declined in 2012-2015 session.

Table 4-3: Correlation Matrix: 2006-2015

	B. Size	%.I.Dir	A.Comt	%.I.Dir.A .Comt	N.B.Meet	F.Size	DER	G.P.O	F.I.O	ROE	ROA	TQ
B. Size	1											
%.I.Dir	-0.334***	1										
A.Comt	0.256***	0.148*	1									
%.I.Dir.A.Comt	-0.190**	0.806***	0.161*	1								
N.B.Meet	0.109	-0.0332	0.190**	-0.0601	1							
F.Size	0.00901	0.516***	0.539***	0.544***	0.244***	1						
DER	-0.236***	0.0121	-0.0757	0.00310	-0.0375	-0.0230	1					
G.P.O	0.0677	-0.0141	0.0640	-0.0235	0.192**	0.0168	-0.194**	1				
F.I.O	0.139*	0.0611	0.149*	0.0783	-0.0411	0.125	-0.159*	-0.161*	1			
ROE	0.0683	-0.117	-0.206**	-0.0650	-0.106	-0.203**	0.172*	0.0382	0.0468	1		
ROA	0.242***	-0.118	-0.0743	-0.0722	-0.0416	-0.128	-0.0851	0.198**	0.0314	0.828***	1	
TQ	0.0790	-0.320***	-0.425***	-0.309***	-0.0686	-0.353***	-0.0486	-0.037	-0.006	0.349***	0.318***	1

*$p < 0.05$, **$p < 0.01$, ***$p < 0.001$

The results in terms of correlation between explanatory variables are presented in Table 4-3. The Table indicates significant correlation among some variables while there is no significant correlation among others. The result of this study is consistent with some earlier studies implying that board composition consisting of independent directors has negative impact on firm performance although it is generally expected that independent directors enhance firm performance. However, we observed mixed results in different studies on this relationship.

4.8 Regression Result Analysis

I have divided the 10 years data ranging from 2006 to 2015 into two sub periods; the first period is from 2006 to 2011 and second period from 2012 to 2015. Since we know that Bangladesh made its corporate governance guidelines in 2006 for the first time, the guidelines were issued under a 'comply or explain' basis. In 2012, Bangladesh Securities and Exchange Commission changed and modified the corporate governance guidelines. This guideline requires the companies to 'comply' with all the guideline conditions. To make a comparison between these two periods, I have generated two regression results of these two periods. Table 4-4 presents regression result of first period (2006-2011) and Table 4-5 presents regression result of second period (2012-2015). At the end I have generated Table 4-6 the regression result of whole 10 years period which is from year 2006 to year 2015.

Table 4-4: Regression Analysis from Year 2006-Year 2011

Hypothesis			Expectation Sign	Firm Performance		Market Valuation
				ROE	ROA	Tobin's q
CG Variables	H_1	B.Size	(+)	0.594	0.128^{**}	0.0575
				(0.064)	(0.001)	(0.065)
	H_2	%.I.Dir	(+)	0.0788	0.0195	0.00795
				(0.777)	(0.563)	(0.769)
	H_3	A.Comt	(+)	-2.984	-0.221	-0.780^{***}
				(0.165)	(0.394)	(0.000)
	H_4	%.I.Dir.A.Comt	(+)	0.174	0.0131	0.00150
				(0.155)	(0.377)	(0.900)
	H_5	N.B.Meet	(+)	-0.163	-0.0160	-0.0102
				(0.255)	(0.355)	(0.463)
Control Variables		F.Size	(+)	2.126	0.0681	1.057^{***}
				(0.497)	(0.857)	(0.001)
		DER	(+)	0.195^{**}	0.00451	-0.00339
				(0.003)	(0.563)	(0.588)
		G.P.O	(+)	0.0896	0.0175^{*}	-0.00336
				(0.134)	(0.016)	(0.561)
		F.I.O	(+)	0.199	0.0138	0.00479
				(0.092)	(0.332)	(0.675)
		N		122	122	122
		R^2		0.154	0.163	0.183

***Note:* p-values in parentheses, $^{*}p< 0.05$, $^{**}p< 0.01$, $^{***}p< 0.001$**

Table 4-4 shows that the size of the board and percentage of independent directors in board have the positive impact on ROE, ROA and Tobin's Q (TQ). Among them the relation between board size and ROA has the positive and significant influence at 1%. The size of the audit committee has the negative and insignificant influence in ROE, ROA but significance at 0.1% level in Tobin's Q. Percentage of independent directors in audit committee has the positive sign but does not have robust influence on banks' performance measured by ROE, ROA and Tobin's Q for the period of 2006-2011. The number of board meeting has mostly negative relationship and does not have robust influence on banks' ROE, ROA and Tobin's Q.

The result also confirms that the control variables are showing positive relation with both ROE and ROA. Among them, DER has the positive relationship with ROE at 1% level of significance while G.P.O. has also positive relationship with ROA at 5% significance level. DER and G.P.O have negative relation with Tobin's Q.

Table 4-5: Regression Analysis from Year 2012-Year 2015

Hypothesis			Expectation Sign	Firm Performance		Market Valuation
				ROE	ROA	Tobin's q
CG Variables	H_1	B.Size	(+)	0.0461	-0.0162	-0.00681
				(0.755)	(0.309)	(0.543)
	H_2	%.I.Dir	(+)	0.0772	0.00388	-0.000454
				(0.259)	(0.597)	(0.930)
	H_3	A.Comt	(+)	1.182^{*}	0.184^{**}	-0.0870^{*}
				(0.031)	(0.002)	(0.036)
	H_4	%.I.Dir.A.Comt	(+)	0.0567^{*}	0.00456	-0.00321
				(0.044)	(0.132)	(0.130)
	H_5	N.B.Meet	(+)	-0.0671	-0.00616	-0.00393
				(0.117)	(0.181)	(0.224)
Control Variables		F.Size	(+)	0.390	0.257^{*}	-0.217^{**}
				(0.716)	(0.028)	(0.009)
		DER	(+)	-0.0261	-0.0279^{*}	-0.00566
				(0.810)	(0.019)	(0.492)
		G.P.O	(+)	-0.00639	0.00497	-0.00331
				(0.817)	(0.098)	(0.117)
		F.I.O	(+)	-0.0818^{*}	-0.0111^{**}	-0.00796^{**}
				(0.023)	(0.004)	(0.004)
		N		92	92	92
		R^2		0.214	0.335	0.324

***Note:* p-values in parentheses, $^{*}p< 0.05$, $^{**}p< 0.01$, $^{***}p< 0.001$**

Table 4-5 shows that the estimated coefficient of board size has the positive sign and does not have robust impact on ROE. However, the board size has the negative and insignificant influence on ROA and Tobin's Q. Percentage of independent directors in the board appears to have positive impact on both ROE and ROA with insignificant influence. The size of the audit committee has the positive and significant influence in both ROE at 5% level and ROA at 1% level respectively. However, audit committee size has the negative and significant influence on Tobin's Q at 5% level. Percentage of independent directors in audit committee has the positive sign on banks' performance measured by ROE at 5% significance level and ROA also has positive sign but not significant. The number of board meeting has negative relationship and does not have robust influence on banks' performance measured by ROE, ROA and Tobin's Q for the period of 2012-2015.

This result is showing that among four control variables three of them: DER, G.P.O and F.I.O are having negative relation with ROE and ROA. Firm size has the positive relation with both ROE and ROA at 5% level of significance. Financial institution ownership is having negative and significant relation with ROE at 5% level, ROA at 1% level and Tobin's Q at 1% level. All of the variables have been seen as negative relation with Tobin's Q.

Table 4-6: Regression Analysis from Year 2006-Year 2015

Hypothesis			Expectation Sign	Firm Performance		Market Valuation
				ROE	ROA	Tobin's q
CG Variables	H_1	B.Size	(+)	0.428	0.0901^{***}	0.0352
				(0.055)	(0.001)	(0.133)
	H_2	%.I.Dir	(+)	-0.0911	-0.00145	-0.0172
				(0.532)	(0.932)	(0.261)
	H_3	A.Comt	(+)	-2.280^{*}	-0.165	-0.619^{***}
				(0.031)	(0.182)	(0.000)
	H_4	%.I.Dir.A.Comt	(+)	0.0586	0.00304	-0.00787
				(0.351)	(0.679)	(0.235)
	H_5	N.B.Meet	(+)	-0.0761	-0.00902	-0.00107
				(0.371)	(0.366)	(0.905)
Control Variables		F.Size	(+)	-2.228	-0.181	0.00103
				(0.204)	(0.379)	(0.996)
		DER	(+)	0.171^{**}	0.00126	-0.00436
				(0.001)	(0.836)	(0.424)
		G.P.O	(+)	0.0707	0.0148^{**}	-0.00157
				(0.087)	(0.002)	(0.718)
		F.I.O	(+)	0.120	0.00624	0.00544
				(0.089)	(0.448)	(0.462)
		N		214	214	214
		R^2		0.130	0.127	0.269

***Note:* p-values in parentheses, $^{*}p< 0.05$, $^{**}p< 0.01$, $^{***}p< 0.001$**

Table 4-6 represents the regression result from year 2006 to 2015. The estimated coefficient of board size has the positive influence on ROE, ROA with 0.1% significance level and Tobin's Q. Percentage of independent directors in the board appears to have negative and insignificant impact on all of the dependent variables. The estimated coefficient of audit committee size has the negative and significant influence at 5% level on ROE, 0.1% level on Tobin's Q but the negative influence of ROA appears to be not robust. Percentage of independent directors in audit committee has the positive sign on banks' performance measured by ROE and ROA. The number of board meeting has negative relationship and does not have robust influence on banks' performance measured by ROE, ROA and Tobin's Q in this ten years data from 2006 to 2015.

This result is showing that among four control variables three of them: DER, G.P.O and F.I.O are having positive relation with ROE and ROA. Firm size has the negative relation with both ROE and ROA. DER and G.P.O have the positive and significant relation with ROE at 1% level and with ROA at1% level of significance respectively.

4.9 Robustness Check

Robustness testing analyzes the uncertainty of models and tests whether estimated effects of interest are sensitive to changes in model specifications. After running the robust regression in STATA, standard error of basic model and robust regression model are more or less similar this means there is no evidence of a violation of the assumption concerning constant variances or homogeneity variances.

4.10 Conclusion and Discussion

This study has shown that there is little statistically significant relationship of board composition in terms of number of directors, audit committee size, independent directors in the audit committee and board, number of board meeting on the financial performance of banks measured by ROE, ROA and Tobin's Q of Bangladeshi banking sector. This means that the independent variables used in the study have negligible contribution in the financial value of the banks in most cases. Of course, when we look into different sub periods, the result appears to be mixed. Reform of corporate governance guidelines in Bangladesh shows corporate governance variables have stronger influence on banks performance variables during 2012-2015 than those of previous sub period of 2006-2011. This is likely to be due to reform in the corporate governance guidelines introduced in 2012. It is believed that a well-balanced functioning of different variables is likely to result in better corporate performance. It is likely that independent directors may not be able to contribute in checks and balances among different activities implied by the corporate governance guidelines of 2006. From empirical result of 2012-2015, it is observed that independent directors are influencing significantly to the firm performance. However, all of the corporate governance variables are seen as negative relation with market based performance measured of Tobin's Q in the period of 2012-2015. After the revision of CG guidelines, board composition variables have a positively significant effect on ROE and ROA but the market does not evaluate that revision. Further in-depth research covering more relevant variables in this area may generate ways and means so that independent directors will have more effective role to play for better functioning of banks in Bangladesh.

Chapter-5

How Corporate Governance Mechanism Determines the CEOs Compensation: An Empirical Study on Listed Banks of Bangladesh

5.1 Introduction

The potential conflict of interest between owners and managers has been extensively discussed in the literature, particularly since the seminal work of Berle and Means (1932) and as the management-controlled form with diffused ownership has progressively become the dominant organizational form in US and the UK. The change of ownership structure and control of firms is also spread in all over the world. Investigations into the both possible and actual economic consequences of such conflict of interest and the extent to which the interests of shareholders and management can be better aligned by various organizational, contractual and incentive mechanisms, has been the main focus of academic research over recent years.

Banks' CEO Compensation has received massive attention in recent years because of the poor performance and lots of controversies have been revealed in the banking sector of Bangladesh. Compensation of CEO plays a pivotal role to meet the company's objectives or shareholders goals. The vast majority of studies that have examined the relationship between senior executive remuneration and firm performance have adopted an agency theory perspective and have concentrated upon the presumed incentive and control aspects of the relationship (Main 1991, Pavlik et. al. 1993). As Jensen and Meckling (1976) and Fama and Jensen (1983 a, b) have suggested that within the context of agency theory, the writing of employment contracts is an important means by principle (shareholders or their representatives and non-executive directors) can control the activities of the agent (senior management). From an agency theory perspective, where it is usually assumed that the principal is either risk-neutral or risk-averse and the agent is assumed to be both risk-effort and risk-averse, contracts have both insurance and incentive effects. In situations where the agent's efforts and outputs are observable the principal can eliminate shirking by the agent through monitoring. (Holmstrom 1979) and the agent's compensation will be a flat wage irrespective of the level of output. This clearly establishes a strong link between firm performance and executive compensation.

This study focuses on to find out the relationship between CEO pay and bank performance in terms of return on asset (ROA), return on equity (ROE) and non-performing loan (NPL); evaluates the effectiveness of board composition through size of board of directors, the proportion of independent directors in the board and board member change in setting CEO pay; impact of ownership structures through shareholding of financial institutions, and directors and their spouses ownership on CEO pay. This empirical study has been conducted on listed banks of Bangladesh during the period from 2006 to 2017.

This study will embark upon the following objectives:

1. It will investigate the influence of corporate governance mechanism on the determination of listed banks CEOs pay in Bangladesh.

2. It will also assess the impact of newly revised board mechanism to the determination of CEOs pay.

5.2 Recent Performance of Banking Sector of Bangladesh

Bangladesh is one of the world's least developed economies. A low level of corporate governance is an impediment to the economic development of the country. However, there is enormous possibility of improvement which is an important reason to implement corporate governance in business practice. Sound corporate governance will encourage investors' confidence by improving awareness and consistency of business rules and regulations. Widespread improvements in governance have the potential to promote a fairer and more trustworthy environment. Corporate governance devices that defend investors from the opportunistic behavior of managers or overprotective shareholders include market mechanism, institutional norms and standards, individual and stakeholder requirements and a strong legal framework. In the absence of such devices, asymmetries of information between managers and external investors may facilitate the misappropriation of corporate resources. Given the important financial intermediation role of banks in an economy their high degree of sensitivity to potential difficulties arising from ineffective corporate governance and the need to safeguard depositors' funds, corporate governance for the banking organizations is of paramount importance. But the real situation in banking sector is full of scam and irregularities in Bangladesh.

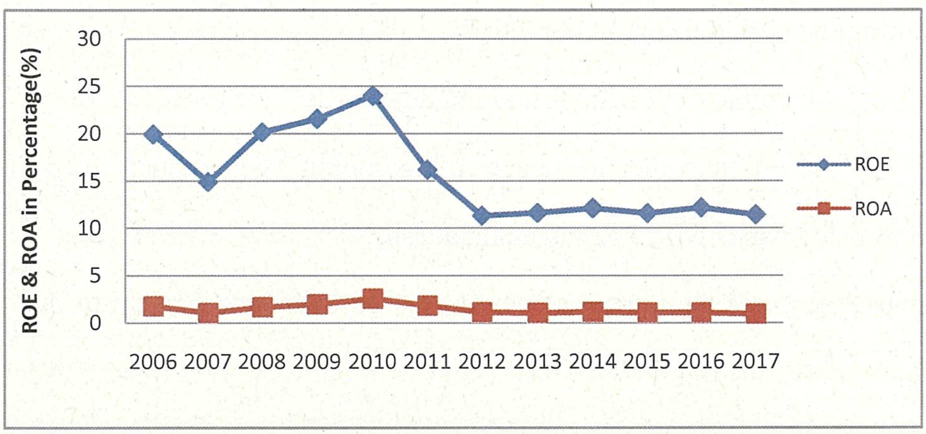

Figure 5-1: Trends of Profitability Ratios of Sampled Banks

The Figure 5-1 shows the profitability ratios of banking sector of Bangladesh from 2006-2017. Year 2006 to 2010 both ROE and ROA have been observed increasing trend. Specifically the peak of ROE can be observed in year 2010 around 25% and ROA nearly 4%. After 2010 profitability ratios ROE and ROA have declined significantly due to financial scam and irregularities have been revealed in 2011. These financial scam and irregularities mostly related to fraudulence activities in loan sanction, illegal political influence, and lack of proper documentation.

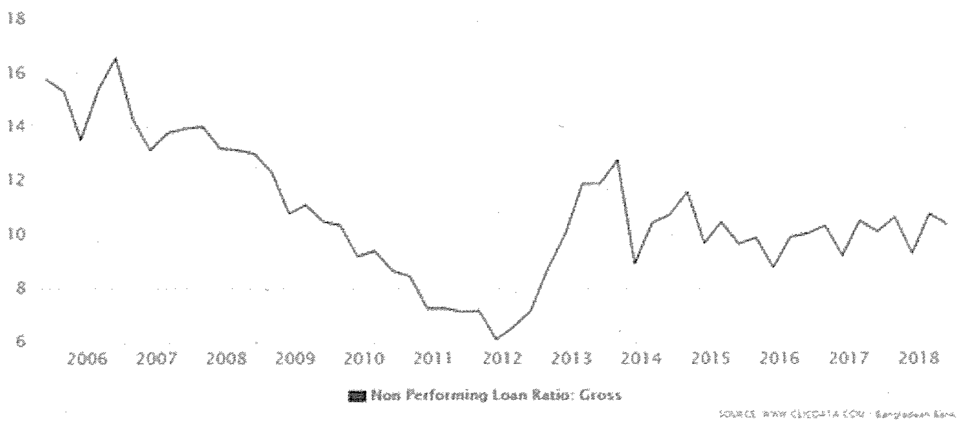

Figure 5-2: Non Performing Loan Ratio from 2006 to 2018

Another performance variable is percentage of Non-performing loan ratio which is calculated by Non-performing loans to total loans. The Figure 5-2 is showing the non performing loan (NPL) ratio from year 2006 to year 2018. As performance variable NPL ratio is also significantly increased from year 2011-2012 periods. In 2006 non performing loan ratio has been observed nearly 15% and gradually decreased to 6% in 2012. Unfortunately, in 2013 it is observed that NPL ratio increased to 13% which is considered as very high and bad for banking business.

It is observed that top management and chief finance officers formulate the credit policies and the policies are approved at board meeting. Sometime banks failed to communicate their credit policies down the line. In order to make the policies efficient and effective, all the associated officials must know the policies very well. The credit policy of each bank must reflect the roles and responsibilities of all relevant officials such as who make proposal, who analyze the loan applications, who disburse loans, who supervise and monitor clients and who recover the loans. It has been found that bank's credit policy shows specific roles and responsibilities of the associated people but in the informal discussion it has been formed that the assigned people do not or cannot do their duty properly. This is the likely reason for increasing non-performing loan.

5.3 CEO Compensation Setting in Banks of Bangladesh

Executive compensation information is not disclosed properly in many countries and even pay setting process is also not clear or transparent. Board of the director decides the Chief Executive Officers (CEOs) pay without the approval of shareholders. Most of the firms form a compensation committee comprised of nonexecutive directors or outsiders to determine the executive pay (Firth et al., 1999). Main et al. (1993) stated that compensation committee may not play the independent role due to reciprocal relationship with the executive directors. Firth et al. (1999) stated that executive compensation is also determined by comparing the size and industry of the similar group. Firth et al. (1999) also find that in UK, firms are adopting Cadbury committee's recommendation on corporate governance and setting the top level remuneration. Pay setting process is determined by the boards, or compensation committee or corporate governance guidelines or peer group review. This pay setting process also varies from industry to industry and country to country.

In Bangladesh, CEOs pay setting process in listed banks is different from other countries. There is no separate compensation committee for the executive compensation. One of the responsibilities of the board of directors is to appoint an honest, efficient, experienced and suitable CEO to obtain confidence of the depositors, strengthen the financial base and ultimately ensure better good governance.

But Banks do not disclose the pay setting process clearly and total executives information is disclosed in the financial statements. Only few banks disclose the total executive information in details with incentive information. In Bangladesh, there are no uses of stock options like other countries. CEO can't hold any shares as per bank regulation and no opportunity to earn dividend income and capital gain. CEO receives basic salary, house rent, house maintenance, medical allowance, provident fund, bonus and other facilities and components of CEO compensation varies bank to bank and performance of CEO.

5.4 Trend of CEO Compensation of Bangladeshi Banking Sector

In practice, all listed banks disclose the CEOs compensation information as separate line item in the profit and loss account and details information in the notes or director report or corporate governance report.

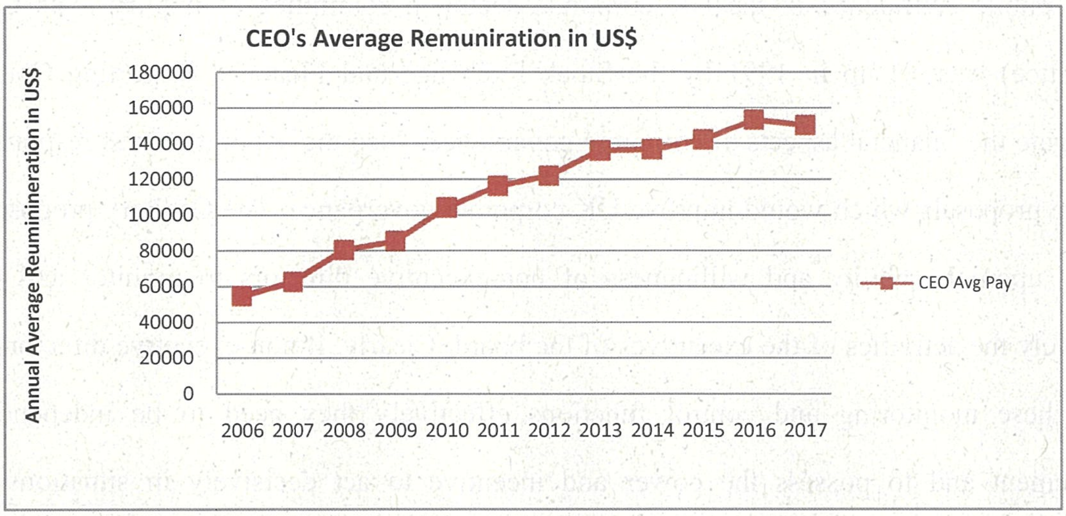

Figure 5-3: CEOs Average Remuneration in US$ (1$=81BDT)

Above Figure 5-3 shows the pattern of the CEOs remuneration from year 2006 to year 2017. From 2006 it is observed that CEOs annual remuneration has been increased by almost tripled at the year of 2017 even though the banking industry performance in terms of ROA, ROE and NPL are not favorable.

5.5 Literature Review of Executive Compensation and Corporate Governance

Over the last two decades, executive compensation has been recognized as an important internal corporate governance mechanism. Executive compensation is deserving of a better understanding by stakeholders. The size of executive compensation packages has been an issue in the U.S. for much of the past century, but it is only recently that the structure of compensation packages has become the subject of increased scrutiny as a result of the apparent relationships between failures in governance and executive compensation (Murphy, 1999). In the wake of the downturn in the UK after 1990, a series of unexpected company failure, financial scandals and example of 'corporate excesses', such as high pay awards to the executives of poorly performing companies threatened to undermine investor confidence in the corporate sector. In an attempt to restore public confidence in the UK corporate sector, a committee of inquiry (The Cadbery Committee) was set up in 1991 by the Stock Exchange and Financial Reporting Council to investigate the financial aspects of corporate governance. Also the committee was responsible to produce proposals which would improve UK corporate governance. The Cadbury proposals rely heavily upon the ability and willingness of non-executive directors to monitor and control effectively the activities of the executives of the board. Clearly, if non-executive directors are to fulfill these monitoring and control functions effectively they need to be independent of management and to possess the power and incentive to act decisively in situations where executives appear not to be acting in shareholder interest. However, the UK company law does not make any distinction between executive and non-executive board members and both groups have identical legal responsibilities. A study based on UK by Main et al. (1993) indicated that, even after controlling for differences in firm size and performance, the level of pay awarded to chief executives when the firm had a remuneration committee was significantly higher than for firms without such committees. A number of UK studies (Conyon and Leech 1994; Gregg, Machin and Szymanski 1993; Ogden and Watson 1996) have examined the relationship between changes in executive pay and firm performance and found little evidence of an economically significant relationship once firm size measures are included in the estimating equation. Clearly, since incentive-based pay is only necessary in order to mitigate monitoring and agency problems, the institutional mechanisms by which executive pay is set, i.e. corporate governance characteristics, should be important factors in explaining the relative strength of any pay-firm performance relationship. The concern about high chief executive officers (CEOs) compensation in Indian firms has risen due to the failure of corporate governance and regulation to curb rent extraction and excessive compensation (Bose, 2014; Chakrabarti et al., 2012; Ghosh, 2010;

Jaiswall and Firth, 2009; Pande and Dubey, 2014; Rai, 2009; Singh, 2007). They suggest that CEOs collude with their firm's board to draw higher compensation.

5.6 Corporate Governance Regulation for Banking Sector in Bangladesh

The country-level initiative to develop corporate governance regulation in Bangladesh began in 2003 by Bangladesh Enterprise Institute (BEI), a non-profit and non-political research center. But result of such initiatives started to come out through Bangladesh Securities and Exchange Commission (BSEC) a capital market regulatory authority in 2006. On 9 January 2006, BSEC issued an order requiring the listed companies to follow a number of CG related conditions. The aim was to improve the CG situation and thereby, better protect the interests of minority shareholders and develop Bangladesh capital market. In 2011, unfortunately Dhaka Stock Exchange general index (DGEN) fell sharply to 7118 point on January 11, 2011 from 8912 point on December 05, 2010 and thousands of investors lost their initial investment within one month. After continuous protestation from various stakeholders of the market, BSEC again revised its order by a notification dated 20 February 2006. It is to be noted that the first notification was issued under a 'comply or explain' basis. It means that although the disclosure of compliance statement was mandatory, companies had the option to comply with individual provision or explain the reasons for noncompliance with any of the provisions. The latest notification of 3 July 2012, however, requires the companies to 'comply' with all the guideline conditions. Therefore, the flexibility of choosing an appropriate governance structure arising from the differences in the costs and benefits of adopting the new guidelines facing an organization is greatly reduced. The revised 2012 CG guidelines include many new provisions in the areas of board independence, audit committee affairs, board's declaration on the corporate governance issues to ensure good corporate governance practices among companies.

5.7 Hypothesis Development

Examining the relationship among CEOs remuneration, corporate governance mechanism and firm performance I need to use CEO pay (natural log of total CEO pay) as the dependent variable. The potential independent variables are categorized into two categories, firm performance variables and corporate governance variables. Firm performance variable include return on asset (ROA), return on equity (ROE) and non-performing loan (NPL). Corporate governance variables include board size, percentage of independent directors in the board, new members in the board (board change), institutional ownership and directors and their spouse ownership. Bank size (natural log of total assets) is the control variable for this analysis. On the basis of prior empirical research, hypotheses are described below:

5.7.1 *Firm Performance:* Executive remuneration should be linked to firm performance in order to stimulate the CEO to maximize shareholders' wealth. This pay performance relationship is the basic principle of principal agent theory (Dechow and Sloan, 1991; Kaplan, 1994). The agency relationship is in which one party, called a principal delegates authority to another one – an agent (Young and Buchholtz, 2002). There is a positive relationship between executive remuneration and firm performance (Murphy 1985; Jensen and Murphy, 1990; Ramswamy et al., 2000). However, some studies report no relation between executive compensation and firm performance (Firth et al., 2006; Parthasarathy et al., 2006), and others indicate an unexpected negative association (Malmendier and Tate, 2009; Balafas and Florackis, 2013; Cooper et al., 2013). Since my sample is bank, I use the word Bank Performance instead of Firm Performance. So, the hypothesis is-

$H_{1(a)}$: Bank Performance (ROA) size is positively related to the CEOs remuneration

$H_{1(b)}$: Bank Performance (ROE) size is positively related to the CEOs remuneration

$H_{1(c)}$: Bank Performance (NPL) size is negatively related to the CEOs remuneration

5.7.2 *Corporate Governance Mechanisms:* Agency problems are greater due to weak corporate governance mechanisms which ultimately lead to higher CEO compensation in US firms (Core et al. 1999). Basu et al. (2007), using 174 large Japanese firms, also find that top executive pay is higher in firms with weaker corporate governance mechanisms. Ozkan (2007) stated that corporate governance mechanisms such as board composition and ownership structures have the influence on compensation policy and reduce the agency conflicts between executives and shareholders. Therefore, effective corporate governance mechanisms (including board composition and ownership structures) are important for controlling managerial compensation.

Board Size: A company's board is the primary internal corporate governance mechanism responsible for setting management compensation, design and implementation of incentive system and monitoring senior management (Jensen, 1993; Tosi, and Mejia, 1997). The board of directors has the power to control the activities of CEO and restrict CEO compensation. Studies related to US find that large board size is not effective in monitoring the CEOs remuneration but Fung et al. (2002) stated that firms with a large number of directors tend to restrain CEOs remuneration. Thus the hypothesis is -

H_2: Board size is positively related to CEOs remuneration

Independent Director: Board effectiveness depends on the presence of nonexecutive directors in the board (Fama and Jensen, 1983a; Weisbach, 1988 and Core et al. 1999). It is assumed that non executive independent directors are effective and independent and work on behalf of the shareholders interest. Parthsarathy et al. (2006) stated that presence of the higher number of independent directors in the board ensures proper monitoring of the firm and limits managerial power to act against the interest of the shareholders. Some other studies find a significant positive relationship of proportion of nonexecutive director with the CEO pay (Croci et al. 2012; Firth et al. 1999; and Cheng and Firth, 2006). So the hypothesis is-

H_3: A higher proportion of independent directors on the board is positively related to CEOs remuneration.

Board Change: Board change refers the number of new board member is being included in the board in every year. New member in the board may influence positively to increase the CEOs pay. New members may not go beyond the decision made by old board members or large number of board members. So they may agree on the decision on increasing the CEOs pay. On the other hand, new member in the board may negatively influence to CEOs pay. Since they are new, they may not agree to hike of CEOs pay without judging the CEOs performance and activities for the organization. Thus the hypothesis is-

H_4: Board member change is negatively related to CEOs remuneration.

Institutional Shareholdings: Institutional investors are normally banks and financial institutions and hold a large percentage of ownership of the firms and monitor the activities of the management. Parthasarathy et al. (2006) study stated that institution plays an active role in the shareholder meetings of the company, voice their opinion and ensure that managers need to win their support on matters that require shareholder approval. They also said that institution can play a monitoring role like independent directors by restricting compensation of CEO and other executives if it is unfavorable for the shareholders. The empirical evidence is mixed. There is a positive relationship between pay and institutional shareholding which implies that monitoring role of institutional shareholders is either weak or absent (Parthasarathy et al., 2006). Firth et al. (1999) and Ozkan (2007) find that institutional shareholders are negatively associated with CEOs pay. This implies that higher level of institutional share holders restrain CEOs from awarding them very high compensation. In this study, only listed banks of Bangladesh are considered. So, institutional owners of these banks are peer groups i.e. other banks and financial institution in the same industry. It is assumed that institutional owners may not play their monitoring role effectively in restricting the CEO pay in the same industry. Thus develop my hypothesis as:

H_5: Institutional shareholding is positively related to CEOs remuneration.

Directors and their Spouse Shareholdings: Directors and their spouse are more active and concern about business activities when they have share ownership in the firm. Ozkan (2007) study finds that CEO receives low compensation when director ownership is high. Firth et al. (1999) find that there is a negative relationship between director shareholdings and director's pay. Since director earns rewards based on stock price performance so they receive low cash compensation and no controversy over excessive pay exists. There is also empirical evidence of positive relationship between director shareholdings and directors pay. Basu et al. (2007) study find positive and statistically significant relation between top executive pay and director ownership which implies that top executive earned higher income when board owns a higher percentage of shares. So my hypothesis is-

H_6: Directors and their spouse shareholding are positively related to CEOs remuneration.

Bank Size: In compensation studies, firm size plays a significant role in determination of executives' remuneration. There is a positive relationship between firm size and executive compensation (Core et al., 1999; Fung et al., 2002; and Parthasarathy et al., 2006). So the hypothesis is-

H_7: Bank size is positively related to CEOs remuneration.

5.8 Methodology

The study is mainly based on secondary data that have been collected from the data bank of Dhaka Stock Exchange (DSE). Besides, Data were collected from the annual reports of the respective banks'. I have taken 29 banks as sample out of the 30 listed banks in DSE for the year from 2006 to 2017. The analysis has been carried out using panel data.

5.8.1 Regression Equation Specification: In order to investigate the impact of corporate governance mechanism and firm performance to the determination of CEOs remuneration of the listed banks of Bangladesh, I have formulated following regression equations under fixed effect model.

(1) $CEOpay_{it} = \alpha + \beta_1 ROA_{it} + \beta_2 NPL_{it} + \beta_3 BODSize_{it} + \beta_4 \%IndDir_{it} + \beta_5 BoardChange_{it} + \beta_6 FinancialInst_{it} + \beta_7 Director \ \& \ Spous_e + \beta_8 BankSize_{it} + \lambda_t D_{year} + \varepsilon_{it}$

(2) $CEOpay_{it} = \alpha + \beta_1 ROE_{it} + \beta_2 NPL_{it} + \beta_3 BODSize_{it} + \beta_4 \%IndDir_{it} + \beta_5 BoardChange_{it} + \beta_6 FinancialInst_{it} + \beta_7 Director \ \& \ Spous_e + \beta_8 BankSize_{it} + \lambda_t D_{year} + \varepsilon_{it}$

5.*8.2 Interaction Term:* In the later part, I would like to investigate the interaction relationship between Yearduumy ($\lambda_t D_{year}$) variable and board mechanism represented by board size (BODSize), percentage of independent director (%ofindDir) and lastly new board member (BoardChange). As we know corporate governance guidelines revised in 2012 so I have created the Yearduumy ($\lambda_t D_{year}$) variable which is categorical variable. Yearduumy ($\lambda_t D_{year}$) is 1 if year is after 2012 otherwise 0. Through this analysis, the impact of newly revised corporate governance to the determination CEOs pay can be measured.

(3) $CEOpay_{it} = \alpha + \beta_1 BODSize_{it} + \lambda_t D_{year} + \beta_2 BODSize_{it} * \lambda_t D_{year} + \varepsilon_{it}$

(4) $CEOpay_{it} = \alpha + \beta_1 \%IndDir_{it} + \lambda_t D_{year} + \beta_2 \%IndDir_{it} * \lambda_t D_{year} + \varepsilon_{it}$

(5) $CEOpay_{it} = \alpha + \beta_1 BoardChange_{it} + \lambda_t D_{year} + \beta_2 BoardChange_{it} * \lambda_t D_{year} + \varepsilon_{it}$

5.9 Data Analysis

Table 5-1 depicts the descriptive statistics of banks' governance and performance variables from 2006-2017.

Table 5-1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
CEOPay(in thousands BDT)	348	9108.279	4077.789	361.08	21606.09
ROA (%)	347	1.423215	0.889403	-0.1	9.11
ROE (%)	347	15.88028	7.912258	-11.68	48.96
NPL (%)	348	4.913138	4.809633	0	58.71597
[7]Provision/Loan$_{-1}$	347	.025245	.0818898	0	1.35
BODSize	348	14.17529	4.018081	6	28
ofIndDir (%)	345	10.6096	10.18556	0	50
BoardChange (%)	304	15.04309	17.87253	0	100
FinancialInst (%)	331	14.00907	11.24831	0	64.58
Director&Spouse(%)	319	23.83402	15.67579	0	83.838
Bank Size	348	11.63141	.7856018	9.732759	14.24559

The mean value of CEO pay in thousand BDT is 9108.279 and range is from 361.08 to 21606.09. Bank performance in terms of ROA's mean is 1.42%, minimum and maximum value of ROA is from negative 0.1% to positive 9.11%. Under ROE performance measure, the mean value is 15.88% with minimum and maximum value of ROE is from negative 11.68% to positive 48.96% respectively. The mean value of NPL is 4.91% and ranging from 0% to 58.71%. The mean of the ratio of provision and previous year loan is 0.081 and ranging from 0 to 1.35. Average board size is 14.17 where the minimum number is 6 and maximum is 28. Average percentage of independent directors in board is 10.6% ranging from 0% to 50%. The mean of board member change is 15.04% with minimum and maximum is from 0% to 100%. Average percentage of financial institution ownership in bank is 14% and ranging from 0% to 64.58%. The mean value of directors and their spouses' shareholding is 23.83% with minimum and maximum is from 0%

[7] To conduct analysis from risk management point of view, the variable Provision/Loan$_{-1}$ has been used.

to 83.84%. The mean of firm size is 11.4881 ranging from a minimum value of 9.37 to a maximum value of 14.25.

5.10 Result Analysis

In this study, CEO pay are examined on the basis of firm performance, corporate governance (board composition and ownership structures) and firm size with year dummy variable for introduction of new corporate governance guidelines in 2012. Table 5-2 represents the regression results of equation 1 and 2. In regression analysis, total CEO remuneration is transformed into natural logarithm form because CEO pay is highly right skewed. Another advantage of using natural logarithm of total CEO remuneration as dependent variable is that regression coefficients measure the proportionate effects of a variable on compensation, rather than Taka value effect. Performance measures are examined separately on total CEO remuneration. Return on assets (ROA) in equation (1), Return on Equity (ROE) in equation (2) while considering all other factors are constant. The regression result from both equations represents a good fit for the model of CEO pay and explained by 39%(R^2) variability in CEO compensation.

In equation-1, the dependent variable CEO pay is positively related with ROA and negatively related with NPL but not significantly. We can also observe equation-2 where CEO pay is positively related with ROE and negatively with NPL but not significantly. All the bank performance variables' coefficients are showing expected relation with CEOs pay but insignificantly.

Table 5-2: Regression Result of CEO pay and Corporate Governance Mechanism

Hypothesis			Expectation Sign	(1) CEOPay	(2) CEOPay
Performance Variables	$H_{1(a)}$	ROA	(+)	0.0163	
				(0.466)	
	$H_{1(b)}$	ROE	(+)		0.00266
					(0.292)
	$H_{1(c)}$	NPL	(-)	-0.000630	-0.000356
				(0.913)	(0.950)
Governance Variables	H_2	BODSize	(+)	0.0300**	0.0300**
				(0.003)	(0.003)
	H_3	%ofIndDir	(+)	0.0124**	0.0123**
				(0.002)	(0.002)
	H_4	BoardChange	(-)	-0.00267*	-0.00267*
				(0.035)	(0.034)
	H_5	FinancialInst	(+)	-0.00361	-0.00339
				(0.242)	(0.272)
	H_6	Director&Spouse	(+)	-0.00641*	-0.00650**
				(0.011)	(0.010)
Control Variables	H_7	Bank Size	(+)	0.0125	0.0151
				(0.829)	(0.795)
		N		284	284
		R^2		0.391	0.393
		Fixed Effect		Yes	Yes
		Year Dummy		Yes	Yes

p-values in parentheses * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The empirical result shows that board size is positively related to CEO pay and significant at 0.1% level for both equations. The positive relationship implies that large board has the greater monitoring capacity and business expertise which implies to increase the CEOs pay. Since there is no remuneration committee for CEO pay setting so board members are solely responsible for the CEOs pay setting. In addition to this, Board members are often CEOs themselves: The fox is guarding the hen house. Talmor and Wallace (2000) provide empirical support for a positive relationship between the number of directorships of each director and CEO compensation.

The percentage of independent director in the board has significantly positive relationship with CEOs pay at 1% level for both equations. The result is consistent with Croci et al., (2012); Firth et al., (1999); and Cheng and Firth, (2006) studies. This finding can be explained in several ways. First, independent directors are not effective enough to monitor the CEO pay which indicates corporate governance is weak. Second, CEO pay is high because independent directors are satisfied enough for the performance of CEO. Third, independent directors are appointed by the board because the board tries to appoint their selected person as independent directors and the independent directors play their role on behalf of the board. Fourth, independent directors increase the CEO pay and use it as a comparison benchmark to reappoint themselves in the following years. Fifth, independent directors receive only meeting fee and the amount of meeting fee is only Taka five thousand per meeting. This amount is not sufficient enough to take the responsibilities and monitor the activities of the firm.

Board member change has negative influence with 5% level of significance for both equations. New board members are reluctant to rise of the CEO compensation. They may need some time to judge the CEOs performance and activities for the organization.

Financial Institution has negative relationship with CEO pay without any significance. This result is opposite of my prediction. The board of Bangladeshi banking sector consists without any representatives of financial institution even though the financial institution are being held the bank's ownership nearly 15% to 25% in almost every banks. However, negative relationship means institutional share holders in some way restrain CEOs to take very high compensation for them.

Shareholding of Directors and their spouse in the board influence negatively determining the CEOs pay at 5% and 1% level of significance for equation (1) and (2) respectively. This result is consistent with the study of Ozkan (2007) which finds that CEO receives low compensation when director ownership is high. Shareholding of Directors and their spouse is moderately high almost 24%. There are two possibilities one is director and their spouse shareholding in the board control the board in a way to increase their personal wealth another one is director and their spouse shareholders control the appointment and firing of CEOs so CEOs are hesitating to ask for salary increase.

Previous compensation literature finds that firm size is a significant determinant for executive remuneration. However, my result shows that firm size is positively but not significantly associated with CEOs pay.

Table 5-3: Result of interaction relationship of Yeardummy and CG mechanism to CEO pay

	(4) CEOPay	(5) CEOPay	(6) CEOPay
$\lambda_t D_{year}$	0.596^{***}	0.551^{***}	0.426^{***}
	(0.000)	(0.000)	(0.000)
BODSize	0.0219^{*}		
	(0.015)		
Board* $\lambda_t D_{year}$	-0.00139		
	(0.900)		
ofIndDir		0.0330^{***}	
		(0.000)	
Inddir* $\lambda_t D_{year}$		-0.0245^{***}	
		(0.000)	
BoardChange			-0.00274
			(0.065)
Boardch* $\lambda_t D_{year}$			0.000999
			(0.707)
N	348	345	304
R^2	0.395	0.439	0.319
Fixed Effect	Yes	Yes	Yes

p-values in parentheses * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 5-3 depicts the relationship between CEOs pay and board mechanism with interaction term. In model (4), interaction term board size and year dummy is insignificantly negative. So, interaction term of board and year dummy is diminishing the coefficient of board size to 0.02051. In model (5), interaction term percentage of independent director and year dummy is significantly negative. Interaction term for percentage of independent director is diminishing the coefficient of percentage of independent director to 0.0085. And lastly, model (6), interaction term board change and year dummy are insignificantly positive. The coefficient of board change has been diminished to -0.001741 by the interaction term. Therefore, the revised corporate governance guideline of 2012 helps to make an effective corporate board in private banks as well as this board is restricting the hike of CEOs remuneration package.

5.11 Bank Risk Management and Remuneration of CEO

Taking risk is an integral part of financial intermediation and banking business. Failure to assess and manage risks adequately may lead to loss endangering the soundness of individual financial institutions and affecting the stability of the overall financial system.

The banking sector throughout the world economy underwent a vulnerable situation due to global financial crisis. Developing countries like Bangladesh were also affected in the aftermath of the global financial crisis. Consequently, poverty and human inequality increased significantly around the world as well as the indicators of human resources development also deteriorated. Weak internal governance can be considered as a specific trigger for the financial crisis. Sound risk management practices helped institutions to endure financial crisis significantly better than others.

The definition of adequate risk management system is changing time to time, as new technology accommodates innovation and better information and as market efficiency grows.

Each banking institution should put in place a comprehensive risk management program tailored to its needs and the circumstances under which it operates. In this context, Bangladesh Bank has revised previously issued six (06) core risks guidelines to adapt with the changing banking environment as well as to deal with various risk issues prudently. Yet risk management in banks should further move from a compliance-driven function toward a top level comprehensive activity relevant at the highest levels of decision making and strategy setting.

Adequate loan review and classification policies and practices are an essential part of a sound and effective credit risk management process in a bank. Because loans are not typically traded, the market value of loans is estimated through the process of provisioning. Failure to identify deterioration in credit quality in a timely manner can aggravate and prolong the problem. Classifying a credit means allocating estimated risks of nonpayment, based on the assessment of a borrower's repayment capacity to meet his or her total obligation under the loan contract. Loan classification allows risks to be identified on a timely basis and permits appropriate loan enforcement actions such as collection or provisioning to cover potential losses. Provisioning means setting aside certain fund from current year profit against possible loan losses.

Corporate boards of directors are responsible for overseeing the company's risk exposure, which becomes more difficult in turbulent financial times. The fiduciary duty of boards includes approving a business strategy that will preserve and generate long-term shareholder value. Aligning executive compensation with the company's long-range objectives should limit executives' incentive to make decisions that improve short-term metrics but increase then company's risk exposure.

To generate shareholder value, the board should ensure that management is effectively managing key financial risks, which include:

- Liquidity risks, including the cost of capital
- Interest rate, currency and commodity price volatility risk
- Possible asset impairments resulting from fair value accounting
- Financial reporting risks, especially related to assets that are difficult to value
- Regulatory and compliance risks
- Market risks, including the impact of a recession on business operations

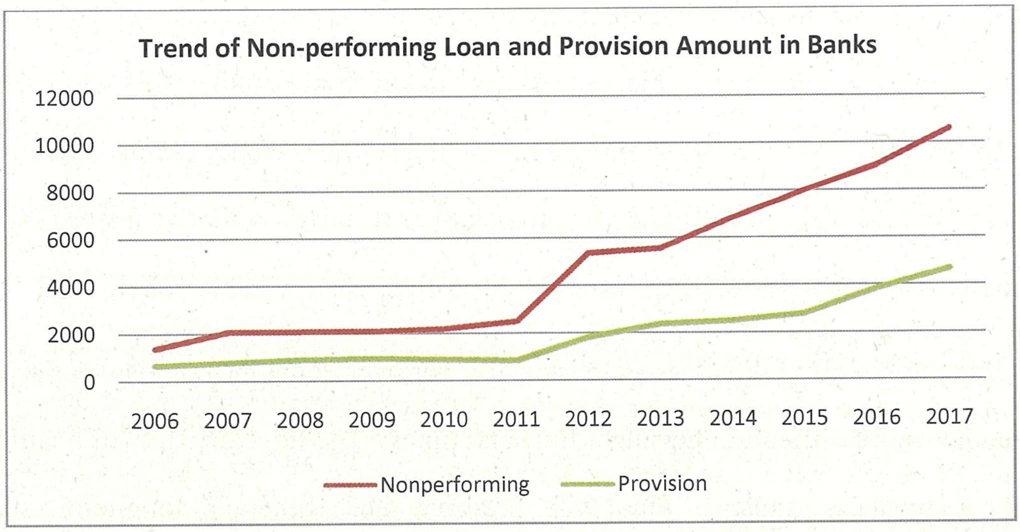

Figure 5-4: Trend of Non-performing Loan and Provision Amount in Million BDT

Above Figure 5-4 shows the trend of non-performing loan and provision maintained for nonperforming loan in banks. Both NPL and provision amount have increased significantly from year 2011. Many irregularities regarding loan disbursement have been revealed by central bank of Bangladesh in late 2010 to 2012. Board of directors and the top management of the bank were found guilty in these irregularities.

Executive compensation that is largely based on performance metrics like stock price or earnings per share can create an incentive for executives. My previous result of determination of CEO pay does not show strong relation with the bank performance. So I would like to see the relation with the determination of CEO pay and risk management issues. Banks have to make provisions on non-performing loans as per guidelines provided by the Bangladesh Bank. Provisioning has been maintained through setting aside certain fund from current year profit against possible loan losses. The amount of provision for non-performing loan has been reported on annual report. In this study, I have used $PROV/Loan_{-1}$ as the ratio of provision amount and lending amount of previous year instead of non-performing loan.

Provision for Classified Loan: From earlier discussion, provision for the classified loan is maintained through setting aside certain fund from current year profit against possible loan losses. Provisioning may result shrinking the lending capacity of the bank. After maintaining the provision for the possible loan loss, CEO may not have much money for lending. As a result bank's earning will decline. On the other hand, the maintenance larger amount of provisioning means banks are lending in very highly risky project. So the hypothesis is-

$H_{1(d)}$: Larger ratio of provision and previous year loan is negatively related to CEOs remuneration.

Table 5-4: Regression Result of CEO pay and Corporate Governance Mechanism with Ratio of Loan Provision and Previous Year Loan

Hypothesis			Expectation Sign	(7) CEOPay	(8) CEOPay
Performance Variables	$H_{1(a)}$	ROA	(+)	0.0154	
				(0.692)	
	$H_{1(b)}$	ROE	(+)		0.00354
					(0.344)
	$H_{1(d)}$	Provision/Loan_1	(-)	1.474***	1.476***
				(0.000)	(0.000)
CG Variables	H_2	BODSize	(+)	0.0248**	0.0250**
				(0.010)	(0.008)
	H_3	ofIndDir	(+)	0.00780*	0.00762*
				(0.044)	(0.048)
	H_4	BoardChange	(-)	-0.00236*	-0.00244*
				(0.050)	(0.043)
	H_5	FinancialInst	(+)	-0.00382	-0.00351
				(0.185)	(0.225)
	H_6	Directors and Spouse Share	(+)	-0.00626**	-0.00644**
				(0.008)	(0.006)
Control Variables	H_7	Bank Size	(+)	0.124*	0.125*
				(0.031)	(0.029)
		N		283	283
		R^2		0.461	0.462
		Fixed Effect		Yes	Yes
		Year Dummy		Yes	Yes

p-values in parentheses * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The result in Table 5-4 shows that provision for classified loan is positively related to CEO pay and significant at 0.1% level for both equations. These equations have around 46.1% and 46.2% of goodness of fit respectively. The positive relationship means CEO is well prepared for the unforeseen risk associated with the amount for loan disbursed. The board of directors evaluates the CEO's risk management capacity and agrees to increase the pay of CEO. The loan provision may effects on the profitability of the bank as well. But the lack of good governance in the banking sector in Bangladesh, CEOs are very much concern about maintaining the loan provision in current situation.

In this part, I would like to investigate the influence of interaction relationship of performance variables in terms of NPL and Prov/Loan$_{-1}$and board mechanism represented by board size (BODSize), percentage of independent director (% ofindDir) and lastly new board member (BoardChange). Following table 5-5 has been created to see the influence of both performance variables and board mechanism variables interaction relationship on the determination of CEOs remuneration.

Table 5-5: Result of interaction relationship of performance variables and CG mechanism to CEO pay

	(9) CEOPay	(10) CEOPay	(11) CEOPay	(12) CEOPay	(13) CEOPay	(14) CEOPay
NPL	-0.00317 (0.818)	-0.0259** (0.006)	0.00206 (0.774)			
BODSize	0.0103 (0.328)			0.00528 (0.517)		
NPL*Board	0.000149 (0.920)					
%ofIndDir		-0.00104 (0.838)			0.00583 (0.117)	
NPL*%Inddir		0.00228** (0.001)				
BoardChange			-0.000723 (0.646)			-0.00212 (0.090)
NPL*BoardCh.			-0.000289 (0.110)			
Prov/Loan$_{-1}$				1.214 (0.298)	2.251*** (0.000)	1.688*** (0.000)
Prov/Loan$_{-1}$*Board				0.0543 (0.575)		
Prov/Loan$_{-1}$*%Inddir					-0.0215 (0.341)	
Prov/Loan$_{-1}$*BoardCh						-0.00119 (0.897)

Bank Size	0.247^{***}	0.240^{***}	0.120^{*}	0.323^{***}	0.310^{***}	0.213^{***}
	(0.000)	(0.000)	(0.035)	(0.000)	(0.000)	(0.000)
N	348	345	304	347	344	304
R^2	0.442	0.464	0.338	0.522	0.521	0.423
Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes	Yes	Yes	Yes

p-values in parentheses * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

As increase of performance of bank in terms of NPL, the effect of additional number of board size and independent directors have positive coefficient 0.000149 and 0.00228 respectively to CEO pay in which 0.00228 is significant at 5% level. Another performance variable increase of Prov/Loan-1, the effect of additional number of board size has positive coefficient 0.0543, independent directors and new member in board have negative coefficient -0.0215 and -0.00119 respectively to CEO remuneration.

5.12 Conclusion and Discussion

In this study, it is observed that the determination of CEOs compensation package is largely linked to the corporate governance mechanism specifically board members of the bank. Because all the bank performance variables in terms of ROA, ROE and NPL coefficients are showing the expected relationship with CEOs pay but insignificantly. This result is different from other previous literatures studied on both developed and developing countries. From the empirical result, board size and the percentage of independent director in the board are positively related to CEO pay and significant at 0.1% and 1% level respectively for both equations. This result implies that large board has the greater monitoring capacity and business expertise which implies to increase the CEOs pay. Independent directors are appointed by the board because board tries to appoint their selected person as independent directors and the independent directors play their role on behalf of the board. However, after the revision of CG guideline 2012, independent directors are restricting the hike of CEOs remuneration package can be concluded from adding interaction term as year dummy and corporate governance mechanism in the analysis. Board member change has negative influence with 5% level of significance for both equations. New board members are reluctant to rise of the CEOs compensation. They may need some time to judge the CEOs performance and activities for the organization. Later risk management point of view I have found that provision for classified loan is positively related to CEO pay and significant at 0.1% level. But my hypothesis is increase of the amount of provision for possible loan loss will be negatively related to the rise of CEO pay. The increase of provision for loan loss will shrink the lending capacity of the bank. Banks cannot meet the financing or loan sanction target. As a result there is a high chance to decline of the profitability. The parameters for the evaluation of bank's CEO performance are largely depended on profitability ratios of the banks. However, the empirical result shows the provision for classified loan is positively related to CEO pay and significant at 0.1% level. This implies board of directors appreciates CEO through the increase of CEO compensation considering the amount of provision maintained for the risk. CEOs are very much concern about maintaining the loan provision in current situation. There might be a possibility that banks are lending into risky projects. [8]

There are some limitations in collecting data of CEOs compensation. Only few banks disclose the breakdown information of total CEO remuneration. This makes difficult to do rigorous research by considering all the components of CEO information. The regulatory authority should more concentrate on disclosure of executives' information with breakdown in details and performance bonus or incentives should be clearly specified.

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[8] Beyond maintaining an increased amount of money as provision for loan loss, CEO could reduce the salary expenditures or other administrative expenditures as invisible risk management steps for maintaining sufficient liquidity to cover the possible loan loss.

Chapter-6
Research Summary and Conclusion

Corporate Governance has become a key interest of researchers for last few decades. The Global financial crisis and corporate scandal across the world have brought into focus the need for better supervision and governance in the banking industry. Many scholars indicate that a wide range of accounting and finance studies have contributed to governance literature. Corporate governance is a set of mechanisms used to manage the relationship among stakeholders that is used to determine and control the strategic direction and performance of organization. Post Sarbanes-Oxley identifies a corporate governance structure consisting of six interrelated mechanisms of oversight: managerial, compliance, audit, advisory, assurance, and monitoring. Broadly, corporate governance would focus on the internal structure and rules of the board of directors, the creation of independent audit committees, rules for disclosure of information to shareholders, creditors and management. The objective of corporate governance is to ensure that companies which are not managed by their owners are run in the best interest of all stakeholders. The board of director has the prime role in corporate governance mechanism. The board is considered to be an initial internal corporate governance mechanism as it observes and directs management and provides management deliberated guidelines. The effectiveness of board's performance is based on board's monitoring role, board independence and committee structure.

Corporate Governance systems have evolved over centuries particularly in response to corporate failures or economic crises at different points of time in the economic history. In 1600, England's Queen Elizabeth I granted a royal charter to the East India Company, giving in a monopoly over all trade between Europe and Asia. The company was established as a joint-stock company with over 1000 stockholders. Each year, these stockholders elected a governing body of 24 directors. From this description we can see that the elements of corporate governance such as joint-stock companies, stockholders, government, directors, and governing board were present in the seventieth century. There has been renewed interest in corporate governance practice of modern corporations since 2001, particularly due to high profile collapse of a number of large U.S. firms.

In USA, the corporate revolution occurred between 1880 and 1930. Many industrial factories began to evolve from private ownership to public ownership. In this period, ownership structure of numerous companies changed because of merging among corporations. These mergers were often financed public offering of corporate stock. The development of corporate governance systems is significant in twentieth century through constituting three aspects such as audit committees, two-tire board and corporate responsibility. According to Cadbury Report, 1992 corporate governance code was arrived incorporating wider use of independent nonexecutive directors, introduction of an audit committee, division of responsibilities between chairman of the board and the chief executive and so on. In 2002, the U.S. federal government issued the Sarbanes-Oxley Act, planning to restore public confidence in corporate governance. After the US financial crisis in 2007, regulatory authority sought to improve regulatory structure for corporate sector. Corporate governance principles were designed by Organization for Economic Co-operation and Development (OECD) countries to develop their own corporate governance code giving importance on board practice, risk management, top-level management remuneration and shareholders right.

The development and concept of corporate governance could be discussed from theoretical point of view such as the agency theory, stakeholder theory and stewardship theory. Agency theory originated with the transfer of corporate power to management in the early 1900s. Corporate managers serve as agents for owners. Based on the idea of agency theory, it is believed that there is a separation of ownership and control in the corporation. Management is considered separate from shareholders or investors in the structure of corporate governance.

Management may want to invest in luxurious office and various financial and non-financial company benefits. On the other hand, investors and shareholders tend to invest in business expansion rather than investing in office benefits. These problems of focusing self-interest between the management and investors are called agency problem. Scholars have suggested various governance mechanisms to avoid agency problem in practice. Governance mechanisms can be split into two categories, internal and external. The achievement of corporate performance relies on the mechanism efficiency of Corporate Governance both internally and externally. Internal mechanisms include board structure variables such as duality and the proportion of non-executive directors, debt financing and executive director shareholdings. The quality of the internal mechanism is closely related to a better corporate performance. Whereas the external mechanism is derived from the capital market, corporate control market, labor market, state status, court decisions, stock holders, and investor activities. The balance and effectiveness of the corporate governance mechanism can create a better corporate financial performance. In case of Stakeholder theory, companies and society are interdependent and therefore the corporation serves a broader social purpose than its responsibilities to shareholders. It recognizes that many groups have connections with the firm and are affected by firm's decision making. Proponents of stakeholder theory also argue that shareholder value maximization will lead to expropriation of value from non-shareholders to shareholders. Stewardship theory is the opposite perspective of Agency Theory that assumes that the agents or management are essentially trustworthy and well stewards of the resources. The stewardship perspective considers the directors and managers as stewards of firm. As stewards, directors are intended to maximize the shareholders' wealth. Stewardship theory suggests that managers should be given autonomy based on trust, which minimizes the cost of monitoring and controlling behavior of the managers and directors. The political model recognizes that the allocation of corporate power, privileges and profits between owners, managers and other stakeholders is determined by how government favors their various constituencies. In political model of governance usually active investors seek to change corporate policy by developing voting support from dispersed shareholders.

In the context of Bangladesh, the need for corporate governance has been highlighted because of the series of scams that had become almost regular feature in recent times. The legal and administrative environment in Bangladesh provides greater scope for corrupt practices in banks. Ministry of Finance prepares different laws and Acts to govern the corporate culture in Bangladeshi banks and other financial institutions. Beyond the Ministry of Finance, Bangladesh Bank which is central bank of Bangladesh, Bangladesh Securities and Exchange Commission (BSEC) and Stock Exchanges are directly and indirectly involved in the governance system in banking sector of Bangladesh. By dint of Bangladesh Bank Order 1972, it has the authority to supervise and govern the banking system and other non banking financial institutions of the country. Bangladesh Securities Exchange Commission and stock exchanges regulate the capital markets and enlistment of institutions. In order to much institutionalize the practice of corporate governance in Bangladesh, it has been observed that first initiative was taken by the Bangladesh Securities Exchange Commission. It issued a notification on corporate governance guidelines for the publicly listed companies of Bangladesh under the power vested on the commission by Section 2CC of the Securities and Exchanges Ordinance, 1969. In 2006, The CG guidelines were issued by BSEC for the first time. These guidelines were issued on a "Comply or Explain" basis and providing some "breathing space" for the companies to implement on the basis of their capabilities. After revising some issues, BSEC issued another notification in 2012 which requires the companies to 'comply' with all the guideline conditions. The revised guidelines include many new provisions in the areas of board independence, audit committee affairs, board's declaration on the corporate governance issues to ensure good corporate governance practices among companies.

Banking sector plays a vital role in developing countries like Bangladesh which is now transforming from agriculture based economy to industry based economy. Being the largest unit of financial sector, banks must operate at its best with utmost efficiency to contribute in the economic development of the country. Pressure of sound corporate governance and its proper practices is the key requirement for efficient and stable banking system. Country like Bangladesh where prudential regulations and supervision is inadequate to provide a safety net for the depositor and stakeholders of the banks, special attention on corporate governance is required on a priority basis. In the absence of good corporate governance mechanism, asymmetries of information between managers and external investors may facilitate the misappropriation of corporate resources. Given the important financial intermediation role of banks in an economy their high degree of sensitivity to potential difficulties arising from ineffective corporate governance and the need to safeguard depositors' funds, corporate governance for the banking organizations is of paramount importance. But the real situation in banking sector is full of scam and irregularities in Bangladesh although these are prominent in public sector banks. Unfortunately, except few foreign and private commercial banks, most other banks lack quality credit analysis and asset management practices. Between 2010 and 2012, Bangladeshi banking sector illegally disbursed loans of BDT 36.48 billion (US $460 million). It has been observed that top management and chief finance officers formulate the credit policies and the policies are approved by the board. Sometimes banks fail to convey their credit policies down the line. The credit policy of each bank specifying the roles and responsibilities of all relevant officials such as who make proposal, who analyze the loan applications, who disburse loans, who supervise and monitor clients and who recover the loans must be reflected. It has been found that bank's credit policy shows specific roles and responsibilities of the associated people but in the informal discussion it has been observed that the assigned people do not or cannot do their duty properly. This is the likely reason for increasing the amount of classified loans.

Although there are multiple studies on Corporate Governance of other developed countries that provide some good theories and conclusion but the number of such studies is limited in Bangladesh. The board is considered to be an initial internal corporate governance mechanism. It directs management and provides management deliberated guidelines. In most studies about board effectiveness, the main concern is whether the board "structure" may influence the financial performance. According to Corporate Governance structure the shareholders elect the board of directors who in turn select top management. Board composition is represented by board size, board independence, audit committee (AC) size, AC independence and the frequency of board meetings. Return on Equity (ROE) and Return on Assets (ROA) are considered as the performance of Bank. And Tobin's Q (TQ) is considered as the performance of bank from stock market point of view. In this study, it has been investigated the impact of corporate governance practices specially board composition on the performance of 29 listed private commercial banks of Bangladesh for a period of 10 years from 2006 to 2015. Total period 2006-2015 has been divided into two sub periods: the first period is from 2006 to 2011 and the second period from 2012 to 2015 to see the influence of 2006 and 2012 corporate governance guidelines respectively. Since we know that, Bangladesh made its corporate governance guidelines in 2006 for the first time. The guidelines were issued under a 'comply or explain' basis. It means that companies had the option to comply with individual provision or explain the reasons for noncompliance with any of the provisions. In 2012, Bangladesh Securities and Exchange Commission changed and modified the corporate governance guidelines. This guideline requires the companies to 'comply' with all the guideline conditions. To make a comparison between these two periods, we have generated two regression results of these two periods. At the end we have generated the regression result of whole 10 years period which is from year 2006 to year 2015. In order to investigate the impact of board composition on the performance of listed banks of Bangladesh, three multiple regression equations are formulated. Some of the findings of this research are consistent with previous studies but others are not. It is observed that differences in laws and regulations as well as culture have their significant impact on corporate governance of respective countries. This study has shown that there is little statistically significant relationship of board composition in terms of number of directors, audit committee size, independent directors in the audit committee and board, number of board meeting on the financial performance of banks measured by ROE, ROA and Tobin's Q of Bangladeshi banking sector. This means that the independent variables used in the study have negligible contribution in the financial value of the banks in most cases. When we look into different sub periods, the result appears to be mixed. The sub period 2012-2015 shows corporate governance variables have stronger influence on banks performance variables than those of previous sub period of 2006-2011. This is likely to be due to reform in the corporate governance guidelines introduced in 2012. It is believed that a well-balanced functioning of different variables is likely to result in better corporate performance. It is likely that independent directors may not be able to contribute in checks and balances among different activities implied by the corporate governance guidelines of 2006. From empirical result of 2012-2015, it is observed that independent directors are influencing significantly to the firm performance. However, all of the corporate governance variables are seen as negative relation with market based performance measured of Tobin's Q in the period of 2012-2015. After the revision of CG guidelines, board composition variables have a positively significant effect on ROE and ROA but the market does not evaluate that revision. Further in-depth research covering more relevant variables in this area may generate ways and means so that independent directors will have more effective role to play for better functioning of banks in Bangladesh.

In Bangladesh, banks' CEO compensation has received massive attention in recent years because of the poor performance and lots of controversies have been revealed in the banking sector. Compensation of CEO plays a pivotal role to meet the company's objectives or shareholders goals. From agency theory perspectives, CEOs need to be motivated to meet firms' objectives by rewarding them. The vast majority of studies that have examined the relationship between senior executive remuneration and firm performance have adopted an agency theory perspective. Usually, CEO compensation is high comparatively and board of director expects good contribution towards banks performance in exchange. High CEO compensation can indicate that CEOs have superior qualifications or even capabilities. On the other way, high CEO pay can be explained by the managerial power view point, and hence weak governance will lead to weak compensation contracts, and thus powerful CEOs can take such advantage for their own benefits. The relationship between corporate governance factors and top management pay has gain much interest by researchers due to the growing concerns by the authorities regarding firms' internal monitoring activities. In this study, it is observed that the determination of CEOs compensation package is largely linked to the corporate governance mechanism specifically board members of the bank. As because all the bank performance variables in terms of ROA, ROE and NPL coefficients are showing the expected relationship with CEOs pay but insignificantly. This result is different from other previous literatures studied on both developed and developing countries. From the empirical result, board size and the percentage of independent director in the board are positively related to CEO pay and significant at 0.1% and 1% level respectively for both equations. This result implies that large board has the greater monitoring capacity and business expertise which implies to increase the CEOs pay. Independent directors are appointed by the board because board tries to appoint their selected person as independent directors and the independent directors play their role on behalf of the board. However, after the revision of CG guideline 2012, independent directors are restricting the hike of CEOs remuneration package can be concluded from adding interaction term as year dummy and corporate governance mechanism in the analysis. Board member change has negative influence with 5% level of significance for both equations. New board members are reluctant to rise of the CEOs compensation. They may need some time to judge the CEOs performance and activities for the organization. Later risk management point of view I have found that provision for classified loan is positively related to CEO pay and significant at 0.1% level. But my hypothesis is increase of the amount of provision for possible loan loss will be negatively related to the rise of CEO pay. The increase of provision for loan loss will shrink the lending capacity of the bank. Banks cannot meet the financing or loan sanction target. As a result there is a high chance to decline of the profitability. The parameters for the evaluation of bank's CEO performance are largely depended on profitability ratios of the banks. However, the empirical result shows the provision for classified loan is positively related to CEO pay and significant at 0.1% level. This implies board of directors appreciates CEO through the increase of CEO compensation considering the amount of provision maintained for the risk. CEOs are very much concern about maintaining the loan provision in current situation. There might be a possibility that banks are lending into risky projects.

Prior literature suggests that a number of different forces influence corporate governance reform, which tends to evolve over a prolonged period of time. This kind of evolution may result corporate failures or other systematic crises. As the socio-political and economic environment differ across countries, factors driving corporate governance reform are also likely to differ from one country to another. Reform of corporate governance guidelines in Bangladesh shows stronger relation among different variables during 2012-2015 than those of previous sub period of 2006-2011. This is likely to be due to reform in the corporate governance guidelines introduced in 2012. Unfortunately, I have concluded that the market does not evaluate that revision from same analysis. In another study, I have shown that how bank's CEO pay is determined even in downward performance of Bangladeshi banking sector. From empirical study, the determination of CEO pay is significantly influenced by corporate governance variables instead of performance variables of banks. This scenario is different from the study of developed countries. Thus, I have carried out another analysis from risk management perspective. In this analysis, I have concluded that board of directors appreciates CEO through the increase of CEO compensation considering the amount of provision maintained for the possible loan loss. These two studies have been done from internal corporate governance mechanisms point of view.

Emergence of private banks in Bangladesh has been seen since 1980s and having almost 40 years of history. Most of the private banks of Bangladesh are either family controlled or controlled by one or a few substantial shareholders. This is paving the way for the interests of minority shareholders to be expropriated by corporate insiders. Weak investor protection has resulted in a less developed capital market and weak insider trading legislation and enforcement would have been associated with a higher cost of capital.

In many developing economies, the issue of bank corporate governance is complicated by extensive political intervention in the operation of the banking system. Private banking sector of Bangladesh is controlled by shareholders or entrepreneurs tend to have a significant influence in the country's political process and corporate-control politics. The entrepreneurs of private banks are mostly involved in active politics. The authority gives the banking license from political influence. In future study, political influence can be considered to reveal the true picture of corporate governance in banking sector of Bangladesh.

In this study, I have used the data from 2006 to 2017. During this period, the world economy has been affected by US financial crisis in 2009-2010. When we look at the economic indicators of Bangladesh there is observed as slightly downward trend. The economy of Bangladesh is also largely depended on exporting garments and remittance form abroad. As a result of global financial crisis, the economy of Bangladesh has been observed as slowed down. Economic factors can be considered in future study.

In Bangladesh, quality of financial reporting needs to be improved. This requires a robust regulatory regime and effective enforcement of the accounting and auditing standards. Auditors need to be able to function with real independence and without fear or favor. Auditors quality can be studied in future study.

The authority should take necessary steps to restore public confidence in the state's commitment to the rule through establishing adequate banking laws and regulations for overseeing bank's operations, adoption of international accounting standard, audit and financial disclosure standards and practices will transparency as well as comparability of information across different jurisdiction. Such elements will ensure strengthen market discipline as a means for improving CG practices.

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