

## **Corporate Governance-Its Problems & Prospects in Banking Industry in Bangladesh**

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*Corporate Governance ensures to bring transparency, accountability and professionalism in the management system of a corporate body that enhances the credibility and acceptability to the shareholders, employees, potential investors, customers, lenders, governments and all other stakeholders. This is more true in case of Banking Industry. Since Banks deal in public money, public confidence is of outmost importance in this Industry. The study aims at finding out problems & deficiencies involved in Corporate Governance practice in Banking Industry in Bangladesh and also suggesting ways and means to remove the same in order to make the Corporate Governance practice sound and effective. In this study, both the primary and secondary data were used. The primary data relating to problems involved in Corporate Governance practice and suggestions to remove the same were collected on the basis of a questionnaire by interviewing 24 randomly selected Bank personnel such as Directors of the Board as the internal part of management and the Auditors as the external group. The secondary data were collected through an extensive literature survey on the subject. The study has identified some major problems in Corporate Governance practice in the Banking Industry of the country. The prospect of Corporate Governance practice is bright in Banking Industry in the country as reported by the respondents if problems are removed by the concerned management of the Banks as well as Bangladesh Bank management as the guardian of commercial Banks.*

**Field of Research:** Finance & Banking

### **1. Introduction**

#### **1.1 Statement of the Problem**

Corporate governance is the set of process, customs, policies, laws and affecting the way in which corporation is directed, administered and controlled. The United Kingdom Cadbury Report (Cadbury, 1992, p.15) defined corporate governance as “the system by which companies are directed and controlled”. Its structure specifies the distribution of rights and responsibilities among company’s different participants, such as board, management, shareholders and other stakeholders. Transparency and accountability are its major attributes. Corporate governance covers the concepts, theories and practices of boards and their directors and the relationship

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between boards and shareholders, top management, regulators and auditors and other stakeholders. As for example, Asian Development Bank (ADB) describes corporate governance as

*“(i) a set of rules, that define the relationship between shareholders, managers, creditors, the government and stakeholders, (ii) a set of mechanism that help directly or indirectly to enforce these rules” (Asian Development Bank, 2000, p. 5).*

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;
- Operate the bank's business on a day-to-day basis;
- Meet the obligation of accountability to their shareholders and take into account the interests of other recognized stakeholders
- Align corporate activities and behavior with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and
- Protect the interests of depositors (Basel Committee on Banking Supervision, 2006).

Good corporate governance requires appropriate and effective legal, regulatory and institutional foundations. A variety of factors, including the system of business laws and accounting standards, can affect market integrity and overall economic performance. Supervisors are nevertheless encouraged to be aware of legal and institutional impediments to sound corporate governance, and to take steps to foster effective foundations for corporate governance where it is within their legal authority to do so (Basel Committee on Banking Supervision, 1997).

The corporate governance of banks in developing economies is important for several reasons. First, banks have an overwhelmingly dominant position in developing-economy financial systems, and are extremely important engines of economic growth (King and Levine, 1993a,b; Levine, 1997). Second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for the majority of firms (Levine, R. 2004). Third, as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for the economy's savings. Fourth, many developing economies have recently liberalized their banking systems through privatization/disinvestments and reducing the role of economic regulation.

However, Corporate Governance practices play the pivotal role in the banking industry in Bangladesh. This is because of the fact that Banks deal in public money. So, public confidence is of outmost importance for the development of banking industry in Bangladesh. But, it is an alleged that the practice of Corporate Governance in banking industry in Bangladesh is not up to the mark, because, a number of problems is reported to exist in corporate governance practices. If such problems can be removed, there is a great potentiality for the prospect of Corporate

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Governance in the banking industry in the country. The present study is an effort to identify the major problems involved in Corporate Governance practices in the banking industry in Bangladesh and also examining the prospect of Corporate Governance in this industry.

The research findings of the present study are quite different from those of previous studies already mentioned in literature review. All the previous findings were related to governance role of financial accounting information, an overview of corporate governance practices, impact of corporate governance on performances, relationship between proportion of independent directors in the performance of the banks, identifying the best practices of corporate governance in Bangladesh, board composition and firm performance etc. No study was so far conducted on the problems of corporate governance and the measure for the removal of the same in the context of Bangladesh. The present study is an effort to this end.

### 1.2 Objective of the Study

**The main objective of the study** is to pinpoint the major problems of Corporate Governance practices in the banking industry in Bangladesh and also examining the ways and means to overcome such problems, thereby highlighting the prospects of corporate governance practice in banking industry.

To achieve the main objective, the study highlights the following specific objectives.

1. To examine the composition of Corporate Governance in the selected banks of Bangladesh.
2. To examine the pre-requisites of a good Corporate Governance practice in the context of the sample banks.
3. To find out the major problems hindering good Corporate Governance practice in the banking industry.
4. To highlight the prospects of Corporate Governance practices in the banking industry by removing the problems involved therein.

## 2. Literature Review

In the area of corporate governance practices of banks, three strands of literature are found. First strand focuses on how the corporate governance practices in banks differ from those in non-banking firms (Prowse, 1997; Furfine, 2001; Morgan, 2002; Macey and O'Hara, 2003). Banks have two related characteristics that inspire a separate analysis of the corporate governance of banks (Furfine, 2001). First, banks are generally more opaque than non-financial firms. Although information asymmetries plague all sectors, evidence suggests that these informational asymmetries are larger with banks (Furfine, 2001). From the perspective of banking, loan quality is not readily observable and can be hidden for long periods. Therefore, Morgan (2002) found that bond analysts disagree more over the bonds issued by banks than by non-financial firms. The comparatively severe difficulties in acquiring information about bank behavior and monitoring ongoing bank activities hinder traditional corporate governance mechanisms (Levine, 2004).

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The second strand of literature looks at how better governance practices in banks can help their financial development and growth (Levine, 1997; Bushman and Smith, 2003). Bushman and Smith discussed economics-based research focused primarily on the governance role of financial accounting information and propose future research ideas. As presented in their study, a framework that isolates three channels through which financial accounting information can affect the investments, productivity, and value-added of firms namely the use of financial accounting information by managers and investors, the use of financial accounting information in corporate control mechanisms and the use of financial accounting information to reduce information asymmetries among investors.

The third strand looks at corporate governance practices in banks from the perspective of its impact on performance and efficiency of the banks themselves (Jensen and Meckling, 1976; Hovey et al, 2003).

Andres and Vallelado (2008) have examined the corporate governance in banking: the role of the board of directors. They pointed out that bank board composition and size are related to directors' ability to monitor and advice management, and that larger and not excessively independent board might prove more efficient in monitoring and advising functions, and create more value.

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

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

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

Rashid et al (2009) have made an overview on corporate governance in Bangladesh. The study has identified six specific corporate governance characteristics in relation to current corporate governance practices in Bangladesh namely legal and regulatory frame work, weak institutional control, pre-dominant of individual investors, limited transparency & weak disclosure practices etc.

### 3. Methodology and Research Design

#### 3.1 Scope of the Study

The present study is limited to a total number of six private commercial banks operating in the country on the basis of Islamic principle, in one hand, and conventional principle, on the other. Out of the seven (7) Islamic banks operating in the country, the study has covered three Islamic banks namely Islami Bank Bangladesh Limited, Exim Bank Ltd & Shahjalal Islami Bank Ltd. Again out of twenty three (23) private conventional commercial banks currently operating in the country, three banks namely AB Bank Limited, National Bank Limited & Dutch Bangla Bank Limited have been selected for the study. The justification for limiting the study to three Islamic Banks and three conventional banks was time & fund constraint at the disposal of the researches in one hand, and the negative attitude of the respondents providing requisite primary data on the other.

#### 3.2 Data Collection Methods

The study is the outcome of both the primary & secondary data. The primary data relates to problems faced by the selected banks and suggestions to remove the same in order to examine the prospects of Corporate Governance. The opinions on the prospect of Corporate Governance have been collected from the respondents on the basis of a prepared questionnaire. The requisite primary data were collected from 24 randomly selected bank personnel out of 66 in number from six selected banks. Therefore, a questionnaire method of data collection was extensively used in collecting primary data. The problems of corporate governance and the measures to overcome the same were gathered from the selected bank personnel. The question was an open-ended one. The respondents were asked to identify the problems of corporate governance as well as measures for the removal of the same. The secondary data used for the study have been organogram of the selected groups of banks namely Islamic & conventional. These were collected from annual reports of the selected banks.

#### 3.3 Data Analysis and Interpretation

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

#### 3.4 Limitation of the Study

The present study suffers from the following limitations:

- i. The sample size was relatively small as compared to the total population.
- ii. The study was limited to only two aspects of corporate governance practices in Bangladesh namely problems and prospects.
- iii. The number of respondents for collecting primary data were also few as compared to the total population.

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However, the responses reflect the opinions of the whole community of bank executives of both Islamic and conventional.

### **4. Discussion of Findings**

The following sub points present the analysis of the results as the outcome of the findings of the research:

#### **4.1 Composition of Corporate Governance in Banking Industry in Bangladesh**

For effective Corporate Governance practice in Bangladeshi banking industry, it requires complete picture of composition of Corporate Governance in the context of banks & also a clear understanding of the respective roles of the board, members of the senior management including CEO & their relationship with others in the corporate structure. In Appendix, figures 1 and 2 have shown the composition of Corporate Governance of the selected Islamic banks as well as conventional banks under the title “Organogram of selected Islamic banks” and “Organogram of selected conventional banks” respectively.

Organogram of selected Islamic banks shows that, at the apex, there are two authorities namely Board of Directors, in one hand, and the Shariah Council on the other. The Board of Directors is the outcome of company law and the Shariah Council is the outcome of Quran & Sunnah. As a result, the Board of Directors guides the banks on the rules & regulations of the company law. But the Shariah council guides the banks on the principles of Islamic rules & regulations.

The Board of Directors is headed by the Chairman. Under the guidance & supervision of the Chairman, there are five directors. Under the Board of Directors, there exists Executive Committee & Audit Committee. Each of the committee is headed by chairman. Under the direct control & supervision of the chairman of Executive Committee there are five members. Again under the chairman of Audit committee these are three members. Shariah Council is headed by the chairman under whose there are ten members.

Organogram of selected conventional banks indicates that, at the apex, there is a Board of Directors headed by chairman. Managing Director works directly under the supervision of chairman. Under the supervision of Managing Director, there are twelve members. There are two committees under the Board of Directors, namely Executive Committee & Audit committee. Executive Committee is headed by chairman under whose direct supervision, there are eight members. Audit Committee is also headed by chairman under whose supervision, there are two members.

#### **4.2 Pre-Requisites of Effective Corporate Governance**

The effectiveness of Corporate Governance in Bangladesh depends on the major Key Corporate Performances which are nothing but the pre-requisites. These are as follows:

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- i. Effective corporate governance requires a clear understanding of the respective roles of the board
- ii. The selection, compensation and evaluation of a well qualified and ethical CEO is the single most important function of the board
- iii. A corporation should have a code of conduct with effective reporting and enforcement mechanisms.
- iv. A substantial majority of directors of the board of publicly owned corporation should be independent of management.
- v. Every publicly owned corporation should have an audit committee
- vi. Audit committee meetings should be held frequently
- vii. An effective internal control system should be in existence at all corporations
- viii. Ensure corporate ethical behavior;

### 4.3 Problems in Practice of Corporate Governance in Banking Industry in Bangladesh

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

**Table 1: Problems faced in practicing Corporate Governance in Banking Industry in Bangladesh**

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

Source: Field Survey

A brief discussion of the above mentioned problems in Practice of Corporate Governance in Banking Industry in Bangladesh is given bellow:

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**Corporate ownership structures are dominated by family members:** All corporate governance systems have four core principles: Fairness, accountability, responsibility and transparency. In Bangladesh, general practice is that the corporate structure is dominated by family members which were mentioned by 100% respondents. Such practice hinders the level of fairness, accountability and transparency.

**Accounting standards and disclosure and its impacts on CG and management practices in Bangladesh are mixed:** Following the tradition of English law, Bangladesh accounting standards (BAS) are not based on codified law, but rely on Generally Accepted Accounting Principles (GAAP) developed by accounting profession. It was mentioned by the 100% respondents.

**Inadequate Bankruptcy Laws:** 60% respondents pointed out that Bankruptcy laws and processes are inadequate in terms of provisions and not strong in terms of enforcement in Bangladesh.

**Inconsistency between Companies Act, Bangladesh Accounting Standard and Security Exchange Commission requirements:** In many cases, the Act, 1994 lacks clarity with regard to statutory requirements on disclosures in the financial statements of listed companies which was mentioned by 80% respondents.

**Weak Regulatory System:** Bangladesh still follows the hybrid system of legal system inherited from the British administration as responded by 100% respondents. Therefore, weak regulatory system along with board interference with the management exists in CG in the country.

**Weak Capital Market Role:** Capital market facilitates good governance through information production and monitoring. The capital market of Bangladesh consists of two stock exchanges: Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). Bangladesh does not have depth in its equity market. 100% respondents pointed out that the capital market of Bangladesh is still a weak link in the movement towards strengthening CG.

**No Market for Corporate Control:** A market for corporate control plays an important monitoring function in CG, as poorly managed companies will become takeover targets. In Bangladesh, there seems to have no market for corporate control as mentioned by the 75% respondents.

**60% respondents mentioned that most companies in Bangladesh are closely held and a negative correlation exists between good Corporate Governance and defaulting in holding annual general meetings in due time.**

**Independent directors do not act as an advocate for minority shareholders or as a source of innovative ideas:** The Companies Act, 1994 provides many rules in respect of any negligence, default, breach of duty or trust on the part of director, manager or officer of a company. In the context of Bangladesh, independent directors do not act as an advocate for minority shareholders or as a source of innovative ideas mentioned by again 60% respondents.



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**Lack of Shareholder's Activism:** General shareholders do not pay attention on issues of performance, business strategy, future business plans, disclosures and processes that could give them a greater voice in the policy decisions of a company. Therefore, the respondents pointed out that 50% shareholders' activism are still an illusion in Bangladesh.

**Weak Pressure Groups:** Shareholders, investor associations, institutional investors and the financial press can play significant role in ensuring better CG. Each of these potential pressure groups is weak in Bangladesh as responded by the 75% respondents.

**Lack of Auditor Independence:** 80% respondents pointed out that the auditors in Bangladesh are not considered independent or sufficiently qualified to assess the validity of the financial statements of corporate entities.

**Poor Audit Report:** Audited financial reports are rarely reliable and free from the control of the owners. Despite irregularities (in respect of non compliance with the applicable IASs) in the audit report, the auditors issue unqualified audit report on the financial statements reported by 60% respondents.

### 4.4 Prospects of Corporate Governance practice in Banking Industry in Bangladesh

**Table 2: Suggestions for the removal of the problems**

S.No.	Specific suggestions	% of respondents
1	Code of Corporate Governance and Best Practice Recommendations	80%
2	Implement Competition Policy	70%
3	Improve the capacity of the Boards of directors	100%
4	Ensure the legal and regulatory framework	100%
5	Strengthening the Capacity of the Government	90%
6	Strengthening the Capacity of Public and private sector institutions	80%
7	Institutional Capacity Building	75%
8	Introduction of Good Governance Practices in State Owned Enterprise (SOEs)	70%
9	Improving the quality of Financial Reporting	80%
10	Role of Dhaka Chamber of Commerce and Industry	90%

Source: Field Survey

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

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The suggestions to remove the problems in practice of Corporate Governance in Banking Industry in Bangladesh can be discussed in the following manner:

### a. Short-Term

#### **Code of Corporate Governance and Best Practice Recommendations:**

Like other countries, Bangladesh needs to have a “Code of Corporate Governance and Best Practice Recommendations” which can be either rule based or principles based. Bangladesh Enterprise Institute, Corporate Governance Committee of ICAB, and SEC have developed separate Codes for Corporate Governance for Bangladesh. 80% respondents mentioned that the Government must take initiatives to make these implemented by making necessary changes in the Companies Act.

#### **Implement Competition Policy:**

70% respondents reported that Bangladesh needs to formulate a Competition Policy which will ensure a culture of good corporate governance to thrive. Competition policy helps bring about efficiency, reduce price distortions, lower the risk of poor investment decisions, and promote greater accountability and transparency in business decisions, and lead to better corporate governance.

### b. Medium-Term

#### **Improve the capacity of the Boards of directors:**

The respondents (100%) pointed out that directors must improve their participation in strategic planning, monitoring of internal control. There is a need for director training, voluntary codes of conduct to expect professional behavior. The most vital thing that can ensure good CG is high standards of ethical and personal behavior. This can only be ensured if the value system of society imposes this on their people as the norm in every aspect of life.

#### **Ensure the legal and regulatory framework:**

Government should ensure the legal and regulatory framework which may include, among other things: (i) strengthening disclosure requirements (ii) ensuring that regulators have the capacity to monitor companies (iii) clarifying and strengthening the fiduciary duty of directors ect. mentioned by again 100% respondents.

### c. Long-Term

#### **Strengthening the Capacity of the Government:**

The Securities and Exchange Commission (SEC) of Bangladesh need to be strengthened as mentioned by 90% respondents so that it can devise and enforce a code for good CG. The Companies Act has to be amended and updated to have consistency with Bangladesh Accounting Standards (BAS), SEC requirements and the Bank Companies Act. Independent Audit Committee should be made compulsory for all listed companies.

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### **Strengthening the Capacity of Public and private sector institutions:**

About 80% respondents reported that public and private sector institutions should continue to raise awareness among companies, directors, shareholders and other interested parties of the value of good CG. To achieve the desired CG framework in Bangladesh, a strong national commitment to CG is essential.

### **Institutional Capacity Building:**

There is a need for disseminating CG and enterprise restructuring principles and for implementing the related guidelines and standards mentioned by 75% respondents. Public awareness and development of governance structure are essential for enabling a sound framework for CG.

### **Introduction of Good Governance Practices in State Owned Enterprise (SOEs):**

In order to provide a strong demonstration effect, Corporate Governance reforms in strategic SOEs that handle electricity generation and distribution, gas distribution, telecommunications, and air-transportation can be undertaken reported by 70% respondents.

### **Improving the quality of Financial Reporting:**

In Bangladesh, quality of financial reporting needs to be improved. This requires a regulatory regime and effective enforcement of the accounting and auditing standards. True independence of the auditor is at the crux of good CG. Auditors need to be able to function with real independence and without fear or favor mentioned by 80% respondents.

Finally, 90% respondents said that **role of Dhaka Chamber of Commerce and Industry** is also very important. To strengthen the overall environment for CG in Bangladesh, following issues are required to be undertaken by DCCI:

- May implement the policy recommendations that are asserted in this study and should assist the government on improving CG regulations.
- Develop and deliver CG course materials to potential researchers, business schools to ensure that future managers and lawyers understand the importance of good CG and have the skills to practice it.
- Training for the managers, board members and executives should be undertaken on regular basis.
- Adopt a long-term strategy to educate the relevant stakeholders about the issues.

## **4.5 Opinions of the Respondents as Regards the Prospects of Corporate Governance Practice in Banking Industry**

In orders to have opinions of the selected respondents as to the prospects of Corporate Governance Practice in banking industries in Bangladesh, an opinion survey on the respondents was conducted by the Likert 5 point scale as very bright, bright, neutral, gloomy & highly gloomy.

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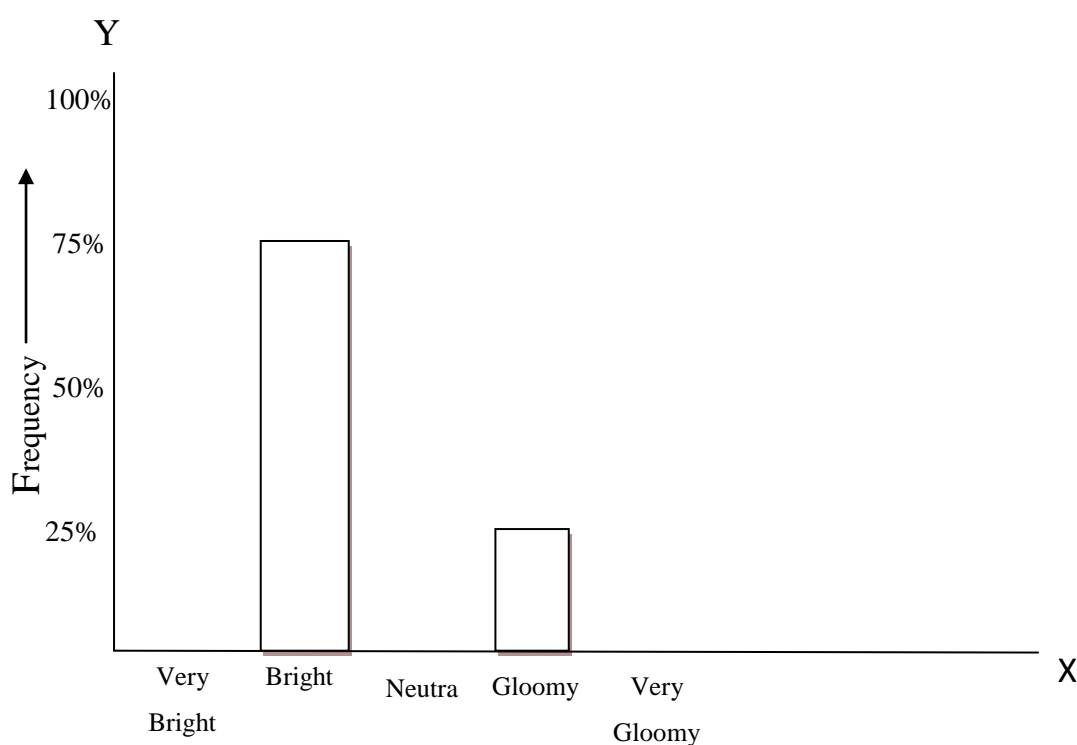
The following table 3 shows the pictures in this regards:

**Table 3: Opinions of the Respondents as Regards the Prospects of CG**

Opinions of Respondents (24 respondents)					
Very Bright	Bright	Neutral	Gloomy	Highly Gloomy	WAS
0	18(75%)	0	6(25%)	0	3.33

The above table shows that of the total respondents numbering 18(75%) opined that the prospect of Corporate Governance practice in banking industry in Bangladesh is bright. On the other hand the remaining 6(25%) gave their opinion in negative form in the sense that the Corporate Governance practice in Bangladesh in banking industry in Bangladesh is gloomy. However, the position of Corporate Governance practice in banking industry in Bangladesh shows the weighted average scores 3.33 out of 5.0 scaling. This means that, the position of Corporate Governance practice in banking industry in Bangladesh is much more than average position of five points.

The above findings may be shown in the following diagram:



## 5. Conclusion

This study pinpoints a number of problems involved in Corporate Governance practice in banking industry in Bangladesh. These problems are related to the composition of board, role of shareholders, annual general meeting of the board, role of senior management, role of auditors and position of capital market for corporate control in Bangladesh. These problems may be overcome on the basis of short term, medium-term & long-term initiatives. Short-term suggestions include complete code

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of corporate governance & implementation of competition policy. The mid-term suggestions mainly include strengthening disclosure requirements and fiduciary duties of directors and ensuring monitoring of the companies by improving the capacity of the board of directors. Long-term suggestions include strengthening capacity of private & public sector institutions, building institutional capacity including qualities of financial reporting.

If the above mentioned suggestions are implemented, the future of Corporate Governance is very bright in the context of banking industry in Bangladesh. Therefore, it is concluded that the suggestions and recommendations as put forward in the study need to be implemented as early as possible. The implementation does not depend only on the banking authority, but the role of government and other agencies e.g. SEC & DCCI etc. is also very significant in this context. It is to be mentioned here that the findings of the study are the outcome of the original works of the researchers.

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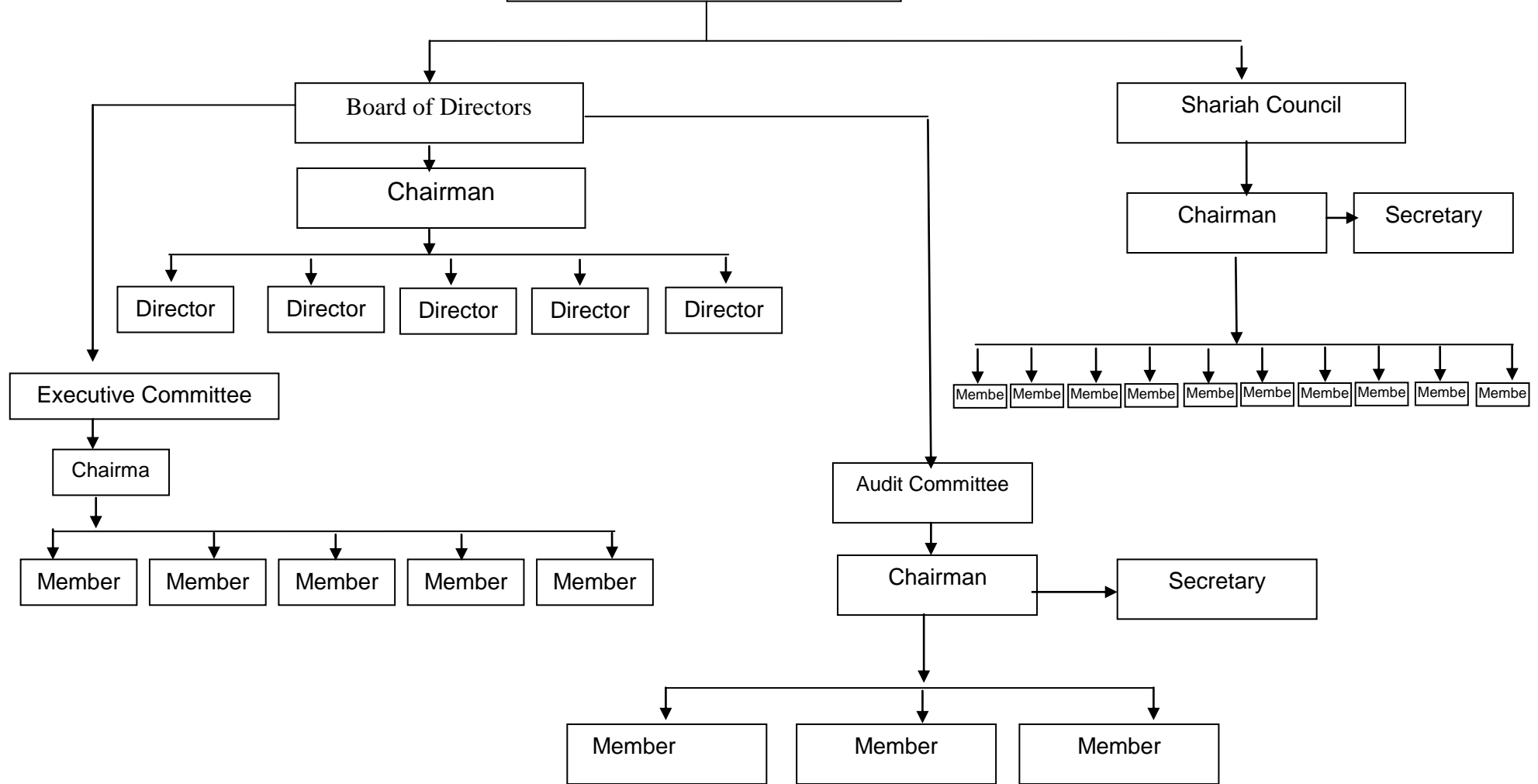
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Appendix

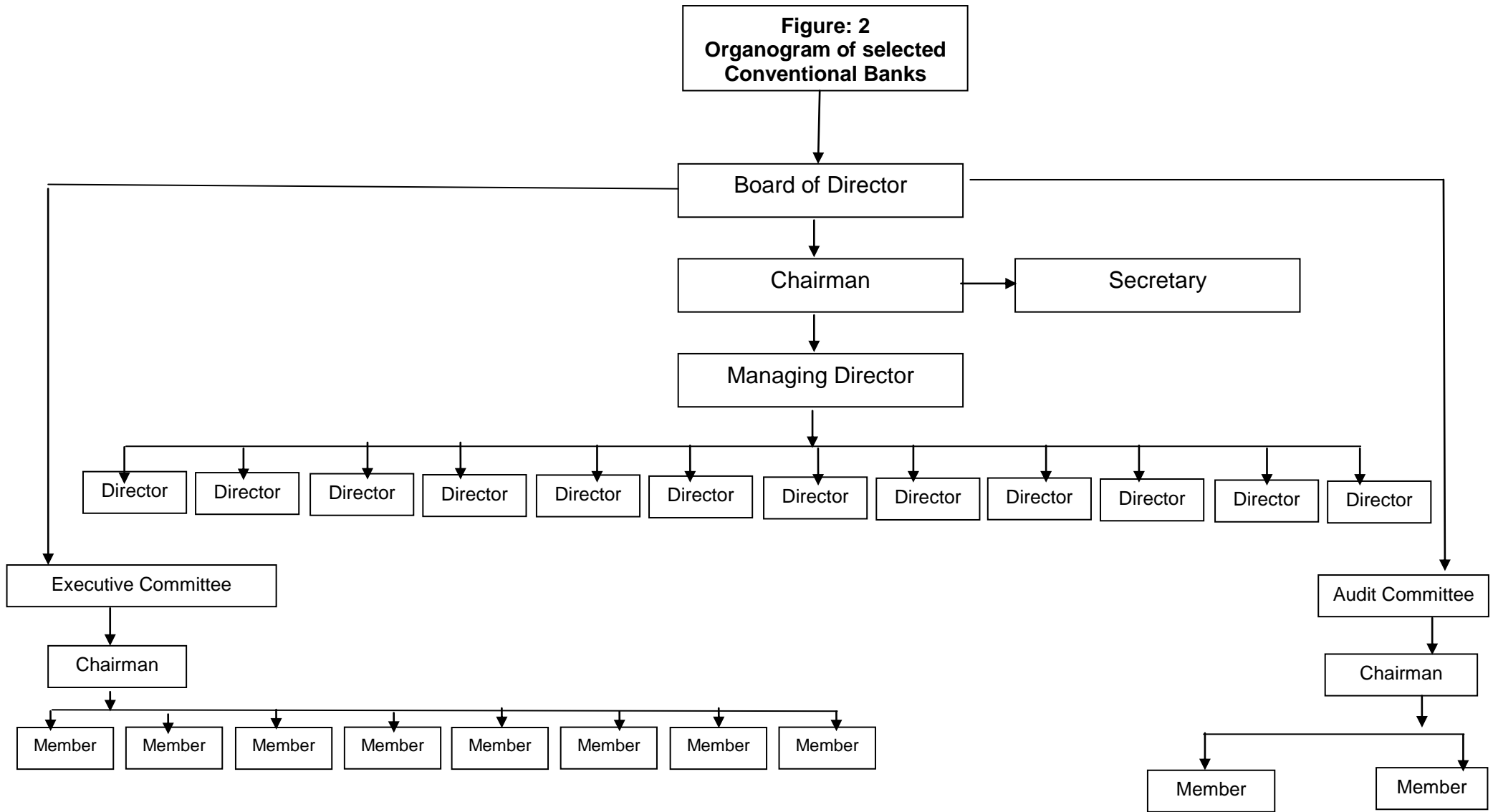
**Figure: 1  
Organogram of Selected  
Islamic Banks**



**Note:** Only the Common Directors of the Board, Common Members of Executive Committee, Audit Committee and Shariah Council are shown.

**Source:** Annual Reports of Selected Islamic Banks in Bangladesh.

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**Note:** Only the Common Directors of the Board, Common Members of Executive Committee, and Audit Committee are shown in the above figure.

**Source:** Annual Reports of Selected Conventional Banks in Bangladesh.