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The Impact of Corporate Governance on Bank Performance: Empirical Evidence from Bangladesh

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Abstract- This paper effort to find out the impact of corporate governance practices on bank performance in Bangladesh. In this paper, we examine 85 observations from 17 publicly traded commercial banks listed in Dhaka Stock Exchange (DSE) over the period of 2013-2017. We use the econometric model and pooled ordinary least square regression analysis to find out the correlations and regression among independent variables (size of the board, board composition, and chief executive officer status) and dependent variables (return on asset, return on equity and earnings per share). This research reveals that the board of director has a positive significant impact on ROA, ROE, and EPS. Independent board of director has a positive significant impact on ROE and EPS. Chief executive officer has a positive significant impact on ROA. In addition, most of the cases large bank size positively affecting the performance of Bangladeshi bank. Finally, there is a positive significant relationship between corporate governance and bank performance in Bangladesh.

Keywords: *corporate governance, board of directors, ROA, ROE, EPS.*

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The Impact of Corporate Governance on Bank Performance: Empirical Evidence from Bangladesh

Md. Ataur Rahman [α] & Jahurul Islam[σ]

Abstract- This paper effort to find out the impact of corporate governance practices on bank performance in Bangladesh. In this paper, we examine 85 observations from 17 publicly traded commercial banks listed in the Dhaka Stock Exchange (DSE) throughout 2013-2017. We used the econometric model and pooled ordinary least square regression analysis to find out the correlations and regression among independent variables (size of the board, board composition, and chief executive officer status) and dependent variables (return on asset, return on equity and earnings per share). This research reveals that the board of director has a significant positive impact on ROA, ROE, and EPS. Independent board of director has a significant positive impact on ROE and EPS. Chief executive officer has a significant positive impact on ROA. Also, most of the cases large bank size positively affecting the performance of Bangladeshi bank. Finally, there is a significant positive relationship between corporate governance and bank performance in Bangladesh. The findings of the paper will help the Bangladeshi banks to ensure proper corporate governance practices to optimize the performance of the banks leads to maximization of the stockholder's wealth.

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I. Introduction

In current time, banking sector financial crisis is common issues around the world. One of the major reasons behind this problem is an inadequate practice of corporate governance. Corporate Governance is the technical, process and relations by which organization are regulated and directed towards the wealth maximization of shareholders. All organization should have practiced good corporate governance (Steger and Amann, 2008). This paper demonstrates the effects on corporate governance and banking sector performance. A lot of studies have on corporate governance but few on banking corporate governance (e.g., Adams and Mehran, 2005; Caprio et al., 2007; Levine, 2004; Macey and O'Hara, 2003). This all studies are analyzed on the proper corporate governance practices. However, banking business has become more complex. It is impossible to monitor all of the activities of banks and its manager decision. That is why banking business is frequently facing the crises. Most of the crises are happened due to the lack of practices of corporate governance. In Bangladesh, corporate governance practices are a rare case. So, Bangladeshi bank faces financial crises in several times. Generally, banks are subjected to dual monitoring system by the regulatory body and bank board. The monitoring of the regulatory authorities and bank board provides a sound banking governance practice (John, Mehran and Qian, 2003). These practices develop the performance of the banking companies. Banking governance practices are mobilized by Bangladesh Bank. Bangladesh Bank capped the number of director of a bank. It is also set up a rule of establishing the private commercial bank on its official website.

To maintain the good corporate governance, the legal act and law were given by Bangladesh Bank like the Banking Companies Act 1991, the Security and Exchange Commission Act 1993, The Financial Institutions Act 1993, etc. It is good news that corporate governance practices in Bangladesh have improved day by day in the banking industry. Corporate governance notification is issued by the Securities and Exchange Commission (SEC) in 2006. It specifies the board composition, Chief Executive Officer (CEO) status.

II. Objectives of the Paper

The main objective of this research is to find out the impact of corporate governance on bank performance in Bangladesh. To accomplish the main objective these papers also have the following specific objectives:

- Impact of board size on bank performance.
- Impact of board composition on bank performance.
- Impact of Chief Executive Officer on bank performance.
- Impact of bank size on bank performance.

III. Review of Related Literature and Hypothesis Development

There are so many articles on corporate governance and bank performance. They all try to consider numerous factors that affect the firm

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performance. In this paper, we mainly consider some factors that are bank size, number of board of directors, number of independent member of a board of directors, CEO's position status. We are tried to use this specific factors and show how it affects the firm performance.

a) Board Size

Board size means the number of member in the bank board. There are so many literatures on board size and bank performance. They are negatively related with each other. Generally, board sizes vary on firm size and nature of the business (Dehaence, De Vuyst, and Oogne, 2001). It also varies in different countries. When board size is too large, then different co-orientation problem arises. The CEO is lost their efficiency, and that lead the poor performance (Eisenberg et al., 1998; Fernandez et al., 1997). The empirical study also proves the negative relationship between board size and bank performance. Large board paves the way of bad performance (Jensen, 1993; yermack, 1996; Eisenberg, Sundgren and Wells, 1998; Dalton, Daily, Ellstrand and Johnson, 1998; Singh and Davidson, 2003; de Andres, Azofra and Lopes, 2005; Cheng, 2008). Mak and Yuanto (2005) provided the inverse relation on board size and firm value. They have used data in Malaysia and Singapore. Agency theory provides us an idea, about the conflict between shareholders and managers and its, also provides the tools how we should monitor the conflict and increases the firm performance (Fama and Jensen, 1983). That's means proper corporate governance increase banks efficiency.

Finally, Mak and Kusandi (2005) argued the positive relationship between small firm size and performance. So, from the prior literature, we finally say that optimal board size is positively related to the firm performance. But large boards are negatively, and small boards are positive affects the bank performance. Most of the researcher believed that large board size is increased the banks monitoring power, but it is devalued by lack of communication and decision making inefficiency. So we can say, optimal board size positively impacts on banks performance.

b) Board Composition

Board Composition is shown the number of independent, non-independent directors on the board. This combination also affects bank performance. Boards are assigned to control the internal monitoring and enhance the effectiveness of the organization. So board composition is another vital part of bank performance. In Bangladesh SEC have specified the board composition in (Feb. 20, 2008) its notification. At least one-tenth of the total number of companies think to be minimum one. According to Chiang (2005) companies performance is enriched if we keep considering on board composition. Independent board directors impact positive effects on the bank performance. There are some studies that show a negative impact on independent directors and firm performance (Adams and Mehran, 2012; Andres and Vallelado, 2008). Some authors provide a positive relationship between non-independent directors and firm performance. They are showed that if the directors are non-independent. Then the amount of agency problem is decreased (Williamson, 2002; Jenson and Meekling, 1976; Baysinger and Hoskisson, 1990). Empirical studies suggest that if the directors are independent, then bank performance is increased because of monitoring activities are developed that lead to better performance. Much existing literature proposes that there is a positive relationship between some independent board of directors and the value of the firm. That is, when the independent board of directors is not involved in banking activities, then it affected wealth maximization positively (e.g., Cornett et al., 2008; Baysinger and Butler, 1985; and Ravina and Sopienza, 2009).

c) Chief Executive Officer Status

The duality of CEO and chairman also affect the firm performance when the chairman and CEO are the same entity that increased the value of the firm (Brickley et al., 1997). The works become easy when the same person is chairman and CEO position. But now-a-days most of the frauds are occurred due to when chairman and CEO are the same people (e.g., Enron, WorldCom). According to Beasley et al. (1999), most of the frauds are involved when the same person held in two positions. Empirical studies suggest that, if we can separate the position of chairman and CEO then agency problem will be resolved, and firm performance are increased. When firm's decisions are taken by two persons in two different positions in Chairman and CEO, the firm can increase its performance (Larcker et al., 2007). Most of the agency problem decreases the firm value when we keep the same person in two positions (Carpeto et al., 2005). So if we keep two people on two positions, then we hope that the value of the banks will be increased.

d) Bank Size

Bank size has a potential impact on bank performance. Bank characteristics and bank performance are the relevant elements that depend on each other. Any bank efficiency is closely related to bank size. Bank size increase has a positive impact on the bank. Through increasing bank size, a bank can exercise good control over efficiency and that also increase the bank performance (Molyneux and Iqbal, 2005). An increasing bank size also impacts on the economy. Increasing bank size leads to develop the performance of the bank (e.g., Akhavein et al., 1997; Bourke, 1989; Molyneux and Thornton, 1992; Bikker and Hu, 2012; Goddard et al., 2004). Sometimes increased bank size has a negative impact on bank performance too.

e) Hypothesis

H_1: There is a positive relation between optimal board size and Bangladeshi banks performance.

H_2: There is a positive relation between the outside board of directors and Bangladeshi banks performance.

H_3: There is a positive relation between Bangladeshi banks performance and CEO status. But it happens when CEO and Chairman are separated person.

H_4: Bank size positively impacts on Bangladeshi banks performance.

IV. Research Method and Econometric Model

a) Data and Sampling

To find out the impact of corporate governance and bank performance in listed banking companies of Bangladesh, 85 secondary observations are taken from annual reports of 17 banks listed in Dhaka Stock Exchange (DSE) during 2013-2017. Panel data are used to calculate the performance of the banking companies in Bangladesh. Data are taken which fulfill the research criteria otherwise rejected.

b) Econometric Model and Variables Specification

Multiple linear regression model is used on panel data with pooled Ordinary Least Square (OLS) estimator. Descriptive statistics, correlation matrix, and pooled OLS regression output are used to analyze the data. The equation of the regression model that is used in this paper is as follows:

$$BP_{it} = \propto + \beta_1 BSM_{\mathrm{it}} + \beta_2 BOD_{\mathrm{it}} + \beta_3 IBM_{\mathrm{it}} + \beta_4 CEO_{\mathrm{it}} + e_{\mathrm{it}}$$

Where,

α= constant;

$\beta_1$to β_4= Coefficient of determinants of explanatory variables;

i (banks number) = 1…..17;

t(time-interval)=1……5;

e = Error term.

Banks performance (BP) is the dependent variable and measured by the following three ratios:

- Return on assets (ROA). It is calculated by the net profit of the bank divided by the total assets.
- Return on equity (ROE). It is calculated by the net profit of the bank divided by the shareholder's total equity.
- Earnings per share (EPS). It is calculated by the net profit of the bank divided by the total number of outstanding shares.

The independent variables that are considered to measure the Bangladeshi bank's performance are shown below:

- LBSM: Banks size measure. It is the natural logarithm of the bank's total assets.
- BOD: Number of Board of directors of the banks.
- IBM: Independent Board of directors of the banks.
- CEO: It is a binary variable it equal one if chairman position and Chief Executive Officer (CEO) position is separated otherwise it is zero.

V. Findings and Analysis

a) Statistical Descriptions

Descriptive statistics of the variables that are used in the model are shown in Table 1. The table shows the corporate governance and bank performance by some specific variable effects over some time. The mean value of return on asset and return on equity are shown positive effects on the bank performance and is an increased trend notifying by ROA and ROE are 1.02% and 12.27% respectively. Bank size means 5.34 million, and the number of board of directors is 14.58 on an average. It is in the stable format set by the Bangladesh Bank.

Table 1: Descriptive statistics of variables

Variable	Observation	Mean	Std. Dev.	Min	Max
ROA	85	1.028118	0.457562	0.01	2.36
ROE	85	12.27671	3.925215	0.13	22.16
EPS	85	2.647412	1.022058	0.04	6.14
LBSM	85	5.344132	0.189899	4.373067	6.18678
BOD	84	14.58333	4.107614	7	23
IBM	84	2.02381	1.728403	0	11
CEO	84	0.952381	0.214238	0	1

Source: Results obtained (STATA output) by the authors

The mean value of the independent board of directors is 2.02%. All the bank hold the rules, for keeping the specific number of independent directors of the banks.

b) Correlation Matrix

Nature of correlation among dependent and independent variables and its direction is presented in the following Table 2. ROA has positive correlation with LBSM(r = 0.0032), BOD (r=0.0519), IBM (r=0.1369) and CEO (r=0.2594). ROE has positive correlation with BOD (r=0.0048), IBM (r=0.077) and CEO(r=0.047). Where ROE has a negative correlation with LBSM (r=-0.1644). Finally, EPS has a positive correlation with IBM (r=0.2926). Where EPS has negative correlation with LBSM (r=-0.1613), BOD (r=-0.0137) and CEO(r=-0.0285).

Table 2: Correlation matrix: 2013-2017

	ROA	ROE	EPS	LBSM	BOD	IBM	CEO
ROA	1						
ROE	0.6313	1					
EPS	0.5208	0.7597	1				
LBSM	0.0032	-0.1644	-0.1613	1			
BOD	0.0519	0.0048	-0.0137	-0.026	1		
IBM	0.1369	0.077	0.2926	-0.2292	-0.0766	1	
CEO	0.2594	0.047	-0.0285	0.0059	-0.0502	0.0031	1

Source: Results obtained (STATA) by the authors

c) Regression Results and Description

We use pooled OLS method to find out the regression results. We measure the bank's performance by ROA, ROE, and EPS. The independent variables are the board of directors, independent board member, CEO status, and bank size measured by total assets. The coefficient of BOD and CEO has a positive impact on ROA at 5% significance level. That supports our hypothesis. The coefficient of BOD and IBM has a positive impact on ROE that means the board of directors and an independent board member can play a positive role in bank performance. This result also supports the prior hypothesis. LBSM, BOD, and IBM coefficients have a positive impact on EPS. Our results are also supported by some related literature that is discussed before. LBSM and IBM have a negative relation with ROA. This result is also matched with the findings of (Hoque et al., 2013). The coefficient of CEO has a negative impact on ROE that is mismatched with the given hypothesis. LBSM has positive effects on ROE. CEO coefficient is negatively impacted by EPS that is not satisfied with this paper hypothesis. Regression results in this paper partially supported by Al-Manaseer et al., (2012). The results R^2 we find on ROA is 0.2250 that is also fitted with the model. R^2 is also getting at 0.2579 and 0.2010 for ROE and EPS respectively. This result is also coped with the best fit results with some prior literature.

Table 3: Result of Pooled OLS regression analysis

	ROA	ROE	EPS
α	-0.002167	-6.899774	-2.96048
LBSM	-0.058313	1.188077	0.525756
BOD	0.058301*	0.957755*	0.188896*
IBM	-0.022391	0.604568*	0.16665*
CEO	0.559076*	-2.526242	-0.321102
R^2	0.2250	0.2579	0.2010
No. of Groups	17	17	17
Observation	84	84	84

** Statistically significant at 5% level*
Source: Results obtained (STATA output) by the authors

VI. Conclusion

This research finds out the relationship between corporate governance and bank performance and explores the impact of corporate governance on bank performance to what extent. We take panel data and OLS estimation to test the hypothesis. This research finds the positive relationship of an outside board member, CEO status and board of directors on the profitability of publicly traded banks in Bangladesh. The bank size has both positive/negative influence on bank performance by ROA, ROE, and EPS but not statistically significant. This paper offers the proper guideline of good corporate governance practices and increases the performance of banking companies in Bangladesh.

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