IOSR Journal of Business and Management (IOSR-JBM)
e-ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 19, Issue 12. Ver. II (December. 2017), PP 76-91
www.iosrjournals.org

Corporate Governance Index of Banks In Bangladesh And Its Determinants

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Abstract: *This paper examines the extent to which the commercial banks of Bangladesh listed in Dhaka Stock Exchange comply with the voluntary Code of Corporate Governance. It measures the corporate governance index (CGI) of these banks and assesses the parameters that explain the value of CGI. It has found that the average CGI score of these banks is 86.52% but the determinants like profitability of banks, their age, and the type of auditors of their accounts have little effect in variation of the CGI score. The findings also suggest that although the banks appear to have reasonably good records in terms of compliance of mandatory provisions of the code of corporate governance, they are reluctant to comply with the voluntary provisions of the code and they perform poor in maintaining credit discipline. Based on findings, the paper made some conclusions that may lead to recommendations of taking a few steps in order to enhance the corporate governance standards in the banks.*

Date of Submission: 02-12-2017 Date of acceptance: 11-12-2017

I. Introduction: The Background of the Study

Corporate scandals around the world have increased concern for ensuring good governance in companies. Company failures are also not uncommon in emerging markets. It is in this common backdrop, the World Bank (WB), Organization for Economic Cooperation and Development (OECD) and many other international institutions having concern about social and economic development of the nations worldwide, as well as the policymaking bodies in many different countries have picked up the issues of creating better governance standards. They also develop principles of corporate governance and compliance and prescribe certain standards for good governance. All such bodies albeit with varied degrees of depth and intensity, conduct studies and public consultations on how to ensure the corporate governance in various sectors of business and customize provisions according to the local context and develop their own code and guidelines on corporate governance.Bangladesh has been in the group of least developed countries even in a very near past and some studies have identified the status of the country as a “bottomless basket” (Mahmud et al. 2008) to characterize the results of the efforts in its development with the help of external assistance. The failures have been attributed mostly to week management, poor ability in utilization of internal and external assistance and an overwhelming absence of corporate governance. However, despite the limitations, the economy of Bangladesh could overcome many of the problems that initially arrested its progress and it is now showing commendable performance in rising through a path of development. The country is now treated as an emerging market with the potential to become a middle income economy within a relatively short period. The average GDP growth rate of Bangladesh during the period from 1994 to 2012 was 5.58%. The achievement is quite impressive in the context of gradual reduction in dependence of the country on foreign aid and worldwide recession during the period. This growth rate has been the result of a consistent increase in the share of industry sector in GDP that has been 28.6% in 2012 (CIA World Factbook, 2012). The foreign direct investment has also played a key role in the modernization of the Bangladesh economy in the last 15 years. In 2007, the inflow of foreign direct investment in the country was $666m, which rose to $1086m in 2008 and $1136.38m in 2011 (Board of Investment Bangladesh 2013). The scenario however, was not all pleasant during the period. The stock market has collapsed two times: one in 1996, and the other in 1910, when the impact of the first one was still not recovered and the confidence of the investors was still not fully recovered (Byron and Rahman 2011, Ahsan 2011, Ahmad 2011). The Dhaka Stock Exchange General Index (DGEN) fell by 21% in just one year (2010-2011) recording the highest fall in the history of stock market in Bangladesh.[1] It is widely believed and some

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[1] "Probe panel finds massive manipulation at Bangla stock market", India Times, 7 April 2011.

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probe efforts also suggest that the stock market crashes did not take place as just phases in the trade cycle but had been the creations of fraudulent trades and scam and lack of corporate governance at regulatory levels.

Stock market was not the only major area to demonstrate lack of corporate governance. This problem seems to have been strongly present in the banks of Bangladesh also, which is now revealed with the facts that the people of the country now know about companies, including some fake ones taking large loans from banks with the bad intention of misappropriation of funds in collaboration with inefficient and/or dishonest bank executives and even members of the banks' board of directors. One may check cases of the Hallmark, Destiny, and Bismillah groups in Bangladesh in this regard. Lack of inefficiency/skills of the bank officers and their inability to execute functions with proper understanding of rules and procedures are often used as reasons why such forgeries in bank fund may happen. But in many cases, the governance systems, rules and procedures are faulty with loopholes that are 'intelligently' used by miscreants including dishonest authorities in the banks. An alarmingly increasing number of cases of corporate governance failure is being disclosed in the recent years and these are causing damage to the economy in two ways: (a) resources are diverted causing loss in potential growth, and (b) investors' confidence is being shattered. Corporate governance issue has therefore become important in the context of the need for sustained economic growth and establishing a discipline in the country's money and capital market. The government of Bangladesh and the policy makers at different levels are now taking initiatives of establishing and improving corporate governance in banks with emphasis on developing code of corporate governance for ensuring good governance and making the corporate practices internationally compatible. Being funded by the donor agencies, the Bangladesh Enterprise Institute (BEI) has introduced the first voluntary Code of Corporate Governance for Bangladesh (hereafter 'the Code') in 2004. The Securities and Exchange Commission (SEC) has introduced a Guideline for Corporate Governance (hereafter 'SEC Guideline') in 2006 for listed companies and it was revised in 2012.

Nevertheless, development of code is just the beginning, it needs to be implemented and complied in letter and spirit. Policy makers now encourage research in identifying the extent companies are complying with the code provisions which will help them to identify the gaps between standard and reality and take necessary actions. The present study has been undertaken in the above context to investigate the corporate governance practices in banks in Bangladesh. Critics argue that compliance in paper may not reflect compliance in practice unless the companies are convinced enough to ensure compliance. Compliance is not free of cost and resistance becomes inevitable if the benefit does not outweigh the cost. Realization of the need is reflected in a number of studies (Choi et al. 2008, Bhagat and Black 2002), which analyzed the impact of compliance on firm-level performance. Interestingly, the evidence is mixed. Whist the study of Dahya et al. (2002) has found positive impact, the study of Weir and Laing (2000) indicates the opposite. However, an analysis of the impact is necessary as, the positive impact helps companies to ensure full compliance and to restore investors' confidence; negative evidence sends a signal for the policy maker to investigate into the causes behind. Following this part on introduction, this paper has six more sections: section 2 provides a brief review of literature of the issues relevant for the paper, sections 3 and 4 presents the scope and objectives of the study and the methodology covering the theoretical framework and the research attributes and variables, Section 5 contains information on data collection and analysis, and sections 6 and 7 presents the findings and conclusions.

II. Literature Review

2.1Corporate Governance – an overview

Corporate governance in general means establishing and enforcing a set of internal and external arrangements in business organizations in order to ensure a discipline in management and activities in the interest of all stakeholders and covers formation of the organizations' board of directors, policies, strategies, reporting system, reporting and disclosures etc. on the internal side and operations in the market, and legal and ethical compliance of corporate social responsibility towards outside stakeholders such as the community, environment and government on the external side. It is not always easy to identify whether a business organization is good or bad in corporate governance but one can look at the performance of an organization and locate areas where the corporate governance in the organization is failing or following a proper direction in the investigation of reasons for the good or bad performance. Corporate Governance is however, defined by different experts in different ways. One of the pioneering definition has been given by Sir Adrian Cadbury (Cadbury, A 1992) as "Corporate governance is the system by which companies are directed and controlled". He further stated that

1. The boards of directors are responsible for the governance of their companies;
2. The shareholder's role in governance is to appoint the directors;
3. The auditors are to satisfy themselves that an appropriate governance structure is in place;

4. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship; and
5. The board's actions are subject to laws, regulations and the shareholders in general meeting.

Organization for Economic Cooperation and Development (OECD) has defined corporate governance in a much broader aspect - "[It is the] procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making". In whatever way the researchers define corporate governance, the core concept remains the same. In its essence, corporate governance deals with the ways an organization should be governed to ensure fairness, transparency, accountability and independence. The requirement of regulation for ensuring good governance is not a new idea. Before formulation of any formal code, corporate governance has been in company laws for decades. However 'Codes' of corporate governance are intended to specifically guide behavior regardless of the adequacy of legal provisions. Whilst the journey of code of corporate governance began with the publication of Cadbury Code (1994), today more than 80 countries have issued their code as a guide for the companies for ensuring better governance standard [source: ECGI, www.ecgi.org].

The significance of code is well-evidenced with the increasing number of literature measuring compliance and its empirical findings on the impact on firm performance (e.g. Akkermans et al. 2007, Werder et al. 2005, Pass 2006, Conyon and Mallin 1997, Brenman and McCafferty 1997, Dahya et al. 2002). One of the pioneering studies has been conducted by Conyon and Mallin (1997) which investigated the extent UK listed companies implemented the recommendations of the Cadbury Code of Best Practices. The study analyzed the case of companies listed in London Stock Exchange and confirms that there has been a very high level of compliance with the Code. Full compliance was reported in the case of both audit and remuneration committees. According to the authors, the London Stock Exchange rule requiring listed companies to disclose their level of compliance has worked as an important factor behind this high compliance standard. Stiles and Taylor (2001) used data collected from the annual report of The Times top 100 UK companies, find that 73 percent of these companies have complied with four or more compliance factors from their list of six used for their research. Conyon (1994) uses a postal survey sent out to the 1992/93 Times Top 1000 Companies to examine changes in the governance structures of UK firms between 1988 and 1993. He finds that 58% of quoted responding firms have complied with the provision to separate the roles of chairman and chief executive in 1988; by 1993, this proportion had risen to 77%. The Conyon and Mallin survey (Conyon and Mallin 1997) found that 98.6% of the companies established an audit committee, 95% set-up a remuneration committee and 50% established nomination committee. In line with the findings of Stiles and Taylor (1993), Davies (2006) also found high level of compliance rate within the 100 listed companies of FTSE. Werder et al. (2005) also found similar result in 408 listed companies of Frankfurt Stock Exchange. Klapper & Love (2004), in one of their extensive study have found impressive level of compliance on 14 emerging countries (South Africa 66.53%, Singapore 65.34%, Chile 61.63%, Malaysia 54.44%, Hong Kong 58.57% and Brazil 57.26%).

Though an increased number of studies worldwide have shown interest in identifying the impact of corporate governance and firm performance (Choi et al. 2008, Bhagat, et al 2008), there are only a few empirical studies on the relationship between compliance with Code and firm performance in developing and emerging economies. Dahya et al. (2007) empirically find that UK listed companies which comply with the Code recommendations show a significant improvement in corporate performance (measured by ROA) which goes with the likelihood that there is a positive relation between good governance and value of the firm. But Weir and Laing (2000), using a sample of 320 UK listed companies have found that the Code recommended governance structure did not generate the desired effect of better firm performance and instead, they reported that 'the best performing group had the lowest incidence of compliance'.

An empirical analysis taken by Habib (2004) on 143 listed companies of Dhaka Stock Exchange (DSE) Bangladesh has found that ownership structure, an important component of Corporate Governance is not related to firm performance. Again, study taken by Imam and Malik (2007) on Bangladeshi non-financial listed firms has found empirical evidence of higher firm performance (measured by dividend payout ratio) related with greater ownership concentration and vice versa. Though some studies in Bangladesh have been conducted to observe the impact of different tools of corporate governance on firm performance (measured with different indicators by different researchers), a segmented rigorous empirical analysis needs to be done for better understanding of the relation. Akhtaruddin (2005) in his study conducted on 94 listed companies in Bangladesh found that on an average only 44% of the items of information under the mandatory compliance requirement is complied by the studied firms, which put a question mark to the effectiveness of the monitoring system. Again, he found that the level of mandatory compliance is not significantly related to factors like, age, company size and profitability.

The literature from developed and developing countries has found mixed evidence of level of compliance with Code and relation of Code compliance and firm attributes. So this research would like to take the opportunity to conduct a research on the level of compliance by the Bangladeshi listed firms and on the relation between compliance of SEC recommended Code and financial performance of Bangladeshi publicly listed companies.

Corporate Governance Framework in Bangladesh

The issue of corporate governance has not been in focus in Bangladesh until the stock market crush of 1996 and following efforts of various national and international organization, concerns of academics business people and the society's opinion leaders expressed in seminars, symposia and publications in research journals and media, the government gradually started coming up with organized initiatives in establishing corporate governance in business organization. One of the major catalysts in the process was the publication (by a Bangladesh Enterprise Institute in 2004) of a code of corporate governance for private sector businesses, financial institutions, state-owned enterprises and NGOs. This Code for Bangladesh (2004) explains: "The obvious function of a Code of Corporate Governance is to improve the general quality of corporate governance practices. The Code does this by defining best practices of corporate governance and specific steps that organizations can take to improve corporate governance. The Code, thereby, begins to raise the quality and level of corporate governance to be expected from organizations; in some areas the Code specifies more stringent practices than is required by Bangladeshi law, but it should be emphasized that these additional requirements are in keeping with international best practices."

The capital market in Bangladesh comprises operations of banks and financial institutions and the in the country's two stock exchanges – the Dhaka Stock Exchange and the Chittagong Stock Exchange. The stock exchange operations however, do not comprise a large part of the capital market of the country. According to World Bank estimates Bangladesh Stock the average value for market capitalization as percent of GDP in Bangladesh during the period from 1988 to 2012 was 5.55 percent with a minimum of 0.87 percent in 1991 and a maximum of 21.04 percent in 2011 [*www.theglobaleconomy.com/Bangladesh/Stock_market_capitalization]*, while the average market capitalization as percent of GDP in India, Pakistan and Sri Lanka are around 55%, 30% and 20% GDP respectively. The corporate governance practices in the companies listed in stock exchanges in Bangladesh were also not very satisfactory. Some studies observed that there had been a low level of financial disclosure practices and corporate governance in them with low level of investors' confidence (Du, 2006). Even researchers with a positive mindset towards the development of capital market in Bangladesh observed that "the awareness about corporate governance practice among companies is increasing at a slow pace" (Khan, 2007) and the study recorded that by 2006, 66.7% of the companies had adopted code of corporate governance and 43.3% complied according to national and international benchmarks.

Bangladesh is found to lag behind in adoption rate of corporate governance as compared with neighboring countries (Gillibrand, M. 2003). One reason for this slow progress in adopting corporate governance is the fact that most companies are family oriented. A study by Ferdous et al. (2013), has revealed that in Bangladesh 72.5% of the outstanding shares are owned by households and individuals and company management is an extension of dominant owners (Farooque et al. 2007). Imam and Malik (2007) studying 219 companies listed in Dhaka Stock Exchange reported that on average, 32.33% of the shares are held by the top three shareholders. Such concentrated ownership structure affects the effectiveness of corporate governance mechanisms and cannot be retrieved by law and regulations (Ahmed and Yusuf 2005).

Bangladesh corporate sector is characterized by high ownership concentration, dependence on bank financing, poor enforcement and monitoring of regulations (Siddiqui 2010). Again, Bangladesh government is dependent on international financial agencies for financing different development projects, and there is considerable donar influence in government policy making (Sobhan and Werner 2003). Bangladesh legal system is biased by the British common system. The Companies Act 1994 (revised from Companies Act 1913), Securities and Exchange Commission Ordinance 1969, Securities and Exchange Commission Act (1993), Banking Companies Act (1994), Financial Institution Act (1993) are the legal measures that govern the corporate environment in Bangladesh. Though, the acts specifically define the structure of firms, composition of board of directors, appointment of CEO and auditor etc. the poor implementation of laws and regulations has made all these ineffective (Gillibrand 2003). According to a study on the governance of Bangladesh, World Bank (2009) states that the shared responsibility among joint stock companies, Securities and Exchange Commission, professional bodies and judiciary complicated the enforcement and reduced overall effectiveness of legal system. In line with the findings, Ferdous (2013) also held weak regulatory system along with board interference with the management hitch for the improvement of corporate governance in the country.

Bangladesh Bank has developed a fairly detailed general framework for corporate governance in the bank companies in the country (Bangladesh Bank, 2013). The special circular of Bangladesh Bank issued in this regard in October 2013 is a consolidated document reflecting provisions created in all previous circulars, including supplementary instructions for such institutions developed by Bangladesh Bank from time to time under changed circumstances. The Bangladesh Bank corporate governance framework provides the mandatory guideline for banks and financial institutions on formation and reconstitution (if necessary) of the board of directors, the duties, responsibilities and authorities/powers of the board of directors and its chairman and members relating to policy formulation and strategic management, credit and risk management, internal control, human resources management, financial management, formation by the board of directors and functioning of three important committees (the Executive Committee, the Audit Committee, and the Risk Management Committee), and the principles of reporting and disclosure of accounts. The corporate governance framework however, is not very effective in terms of ensuring compliance in maintaining credit discipline in banks and financial institutions leaving scopes for sanctioning and disbursement of funds to ‘wrong projects’ and to ‘wrong borrowers’ and failures in recovery of outstanding loans and the interest thereof.

The recent scenario of the health of the banks and financial institutions of Bangladesh may be demonstrated by the fact that on 30 September 2014, the quantum of classified loan (covering sub-standard loans i.e., loans due or overdue for three months or beyond but not more than six months, doubtful loans and bad loans/loss) accounted for 11.58% of the total outstanding loans and the amount of the outstanding loan on the date was Tk 572.91 billion (Bangladesh Bank, 2014). The comparative figure was 10.75% in the previous (2nd quarter of the year ending on 30 June 2014) and 10.45% in the first quarter (ending on 31 March 2014). Table-1 below presents the amount of classified/default loans in different categories of banks/financial institutions (FIs) in Bangladesh.

Table – 1: Classified/Default Loans in Banks and Financial Institutions of Bangladesh

Type of Bank/FI	(Q3) July – September 2014		Q2 (April – June 2014)	
	Amount in Billion Taka	% of Total for all banks/FIs	Amount in Billion Taka	% of Total for all banks/FIs
State-owned Commercial Banks (4)	207.97	36.30	197.19	38.40
Private Commercial Banks (39)	221.94	38.74	191.51	37.30
Foreign Commercial Banks (9)	16.38	2.86	14.23	2.77
Development Financial Institutions (4)	126.62	22.10	110.52	21.52
Total	572.91		513.45	

These figures may not reflect the real weakness in corporate governance in banks of Bangladesh in terms of the situation with credit discipline leading to the growth of non-performing loans (NPL). The amounts published as NPL do not include the write offs and also, most loans sanctioned and disbursed in the last five years or so have not yet ‘matured’ for being included in the estimates for NPL/default. Also, the figures for total of a type of bank/FI do not say much about the situation with individual ones belong to a type. Available data show that on 30 September 2014, the NPL in public sector banks like Janata Bank and Sonali Bank accounted for 14.81%, 9.07% of their total outstanding loans, while the corresponding figures for BASIC Bank, a development financial institution was 54% and for private banks like Mercantile Bank and South East Bank 5.08% and 5.04% respectively. Remarkably, the NPL in BASIC Bank recorded at 54.35% on 30 September 2014 was 23.08% on 30 June 2014 (Bangladesh Bank, 2014a).

That the overall corporate governance scenario in banks in Bangladesh is not up to the mark is also evidenced by the insolvency risk index (Z-score) of these banks measured as under:

$$Z - score = \frac{ROA - \sum \frac{Equity}{Assets}}{S_r},$$ where ROA = Return on Assets;

Equity = Total Bank Equity, Assets = Total bank Assets, and S_r = standard deviation of ROA

Table-2 presents the estimates for the Z-score of public and private banks of Bangladesh in recent years presented in a Bangladesh Bank publication (Bangladesh Bank, 2014b).

Table – 2: Z-score of Public and Private Banks of Bangladesh

Bank	2008	2009	2010	2011	2012
Public banks (cumulative score) for all public banks	5.08	24.06	12.43	11.90	2.58
Private banks (cumulative score for all private commercial banks)	18.50	14.26	17.16	16.05	5.71
Islamic banks (cumulative score for all Islamic banks)	50.75	10.54	13.55	– 9.27	12.43
ICB Islamic Bank	– 0.70	– 1.39	– 12.25	– 98.40	– 1.56

Source: Bangladesh Bank, 2014a

The data show that the health of the public banks in Bangladesh in terms of insolvency risk is not very satisfactory as compared to that of private banks. The Bangladesh Bank publication explains the low z-score for Islamic banks in the recent years by the poor performance of the ICB Islamic Bank in the group. But the general comparison of the values for z-score suggests that the insolvency risk situation of banks in Bangladesh significantly deteriorated during the period between 2008 and 2012, and one of the major reasons for the situation is the weakening of corporate governance in them.

Despite substantial evidences of a lack of corporate governance in banks of Bangladesh, the people of the country are hopeful about changes in the scenario and have some confidence in the efforts in the country in improving overall management. This has been reflected in a recent survey of the Pew Research Center, Washington according to the findings of which 81% of the people of Bangladesh are confident that the country's future is 'bright', while the comparative figure for Brazil, Jordan and Poland are 72%, 38% and 29% respectively (TIMEMagazine, 2014).

III. The Scope and Objectives of the Study

There are many dimensions of corporate governance and also, there are many ways of measuring the compliance and its impact. Researchers are now conducting studies on these issues but the impact of compliance of whatever standards have so far been developed in Bangladesh has not yet been studied at any length. This study is limited to measurement of corporate governance index (CGI) of the bank companies of Bangladesh listed in the country's stock exchanges and will look into the impact of the factors that determine the CGI. This study will also address the following specific research objectives:

a. To identify the extent to which companies are complying with the Code.
b. To identify the extent to which the level of compliance varies with firm level attributes
c. To develop some policy recommendations for ensuring better governance stand

The number banks and financial institutions in Bangladesh in 2014 was 56, of which 4 were state-owned commercial banks, 39 private commercial banks, 9 foreign commercial banks and 4 development financial institutions. Only 30 commercial banks are listed in the Dhaka and Chittagong stock exchanges. The present study covers twenty five listed banks since it was not possible to collect relevant data from the available reports/documents of the remaining 5 listed banks.

One of the major limitations of the study has been the difficulty in collection of the full set of data required for a comprehensive study on the issues to be covered in its analysis. The study used only the publicly available data and it had practically no scope getting into file information of the banks. However, some primary data could be collected for understanding the corporate practices that have relevance with compliance status commercial banks of |Bangladesh listed in the country's main stock exchange – the Dhaka Stock Exchange Limited.

IV. Methodology of the Study

4.1 Theoretical Framework

The present study laid its provisions based on the arguments of the agency theory and the idea that the corporate governance framework of Bangladesh comprising Code of Corporate Governance developed for banks and financial institutions of the country and the Guidelines of the country's Securities and Exchange Commission reflects the shareholder model of governance is based on the agency theory. In its simplest form, agency theory explains that in companies where share ownership not concentrated and the management is separated from ownership functions, managerial actions and behaviors may not always ensure the best interest of the company. As Berle and Means (1932) argued, in such companies managerial actions may depart from the activities required to maximize shareholders' interest. In other words, as Davis et. al (1997) explained, "[Agency theory] provides a useful way of explaining relationships where the parties' interests are at odds and can be brought more into alignment through proper monitoring and a well-planned compensation system". In fact, a number of corporate governance researchers (Dalton et al. 1998, Krambia-Kapardis and Psaros 2006, Roberts 2004, Hendry 2005, Ermongkonchai 2010) stated that agency theory is the most dominating theory in any kind of researches relating corporate governance. Hence, this study has taken the similar approach and measures the Corporate Governance Index (CGI) to reflect the agency perspective of governance.

By emphasizing on the theoretical propositions, shareholder model of governance considers that the best way to address agency issues is to develop effective contracts for the agents. The 'shareholding camp' of governance argues that the best solution to the agency problem is to determine the most efficient contract governing the principal-agent relationship and an optimal incentive scheme to align the behavior of the managers with the interest of owners (Letza et al. 2004). In addition, as explained in the study of Ferdous (2013), 'to secure shareholders' interests and to ensure a better governance standard in companies, a three tier hierarchical governance mechanism (shareholders' general meeting, the board of directors and executive managers) is designed as a checks and balances mechanism in the corporate structure. While these studies focuses on the internal mechanisms, the shareholder perspective of governance also considers that hostile takeovers, mergers and acquisitions are some of the most effective mechanisms through which the market can control under-performing corporations and thus protect the rights of its investors (Rwegasira 2000).

The effectiveness of the shareholder model is dependent on several assumptions as laid by the agency theory. Ferdous, (2013) in her study summarized these presuppositions as, "Low degree of concentration of ownership and limited bank shareholdings (Rwegasira 2000, Krambia-Kapardis and Psaros 2006, Berle and Means 1932, La Porta et al. 1999); strong market (product, financial, managerial talent), maintaining a competitive international market (Reed 2002); accurate, reliable and timely information flows to the capital market (Fama 1980, Krambia-Kapardis and Psaros 2006, Long 2004); sophisticated and liquid securities market; and last but not the least, there is a well-developed legal infrastructure to protect against wealth transfer and insider trading (Krambia-Kapardis and Psaros 2006)". Stressing on the importance of strong legal system, Mallin (2010) stated that the propositions of agency theory is largely applicable to the US and the UK, where the legal system provides good protection of minority shareholders; and that may not be the situation in many other countries.

Whilst, the theory has addressed some fundamental problems of corporate governance and has been successful in bringing solutions, it has also attracted some criticisms. Daily et al., (2003), argued that the theory is a conceptually simple that reduces the corporation to two participants, managers and shareholders; however, the notion of human beings as self-interested is a generally accepted idea. Researchers like, Blair (1995) raised argument against the fundamental proposition of the theory in emphasizing on the shareholders' interest only; they argue that companies should maximize the value of the other stakeholders such as employees, creditors, suppliers, customers and local communities. Again Rwegasira (2000) and Paredes (2005) investigated shareholder model and found consistent evidence of lack of advanced markets as a major factor to make shareholder model inappropriate for emerging economies. Shapiro (2005) argues that the agency theory perspective is a "peculiar way of understanding the social reality", that the assumptions therein are detached from reality and purely made in order for the model to be workable mathematically. This argument is also supported by some other studies (e.g. Hartman 2008, Surendra 2010). This leads to an oversimplified way of characterizing and solving problems in the organizational setting that may be potentially dangerous (Kanter 2005).

Despite of these criticisms, it is empirically proved that once the prerequisites are met, the agency theory is an effective way to address the universal agency problem of corporate governance and thus it is dominating in literature for decades.

4.2 Research Attributes and Variables

Firm-level Attributes (Independent Variable)

Firm attributes are identified following previous studies (Akhtaruddin 2005, Mutawaa and Hewaidy 2010). In particular, 3 major attributes were considered to understand the extent level of compliance varies across different firm attributes, profitability (measured by ROA), age (measured by the date of inception till date) and external auditor.

Corporate Governance Index (Dependent variable)

Most studies on code compliance (i.e. Akkermans et al. 2007, Leal and Carvalhal-da-Silva 2005, Klapper and Love 2004, Mutawaa and Hewaidy 2010, Garay and González 2008, Mallin and Ow-Yong 2012) have gathered compliance related information using a corporate governance index (CGI). According to this method, each company's CGI is defined as:

$$CGI_y = \sum_{i=1}^{n_y} C_{iy}$$

Where,
n_y = number of provisions complied with by the y^{th} company
C_{iy}= 1 if the i^{th} provision of the Code is complied with; 0 otherwise.

Since the survey data are nominal and numeric in nature, descriptive statistics (e.g. mean value, percentage, ratio) are used to measure extent to which companies are complying with the Code provisions. Earlier studies (e.g. Mallin and Ow-Yong 2012, Mutawaa and Hewaidy 2010, Khan-M and Belal 1999, Jackling and Johl 2009, Bajo et al. 2009, Samaha and Stapleton 2008) have also used mean values for understanding the level of compliance with code provisions.

To investigate the influence of the company attributes over the level of compliance, the study used inferential statistics (e.g. univariate and multivariate regression)[2]. This kind of investigation using regression has been used by other scholars (like Akhtaruddin 2005, Cooke 1989, Owusu-Ansah 1998, Wallace et al. 1988, Rashid et al. 2010, Bhuiyan and Biswas 2007, Kha et al. 2009, Hossain 2008)

Whilst the univariate analysis includes the Spearman's correlation coefficients[3] to identify the statistical relationship between the dependent (CGI) and independent variables (six company attributes, see Table 5.3), the ordinary least square (OLS) regression is used to estimate parameters in the multivariate analysis. The OLS regression framework will incorporate a corporate governance index (CGI) as the dependent variable and other firm-specific characteristics as independent variables, and findings are presented.

V. Data Collection and Data Analysis

As the demand of the research, this study collects data from secondary sources about the first two research questions and then makes a quantitative analysis to show the relationship of level of compliance and firm attributes. Data are collected primarily from secondary source. Company website, published annual reports and DSE websites are used for data related to CGI and firm attributes.

The questionnaire used for collecting primary data has been developed by adopting the code provisions and indicators of compliance outlined in the method applied in the studies by Akkermans et al. 2007, Leal and Carvalhal-da-Silva 2005, Klapper and Love 2004, Mutawaa and Hewaidy 2010, Garay and González 2008, Mallin and Ow-Yong 2012). The questions checklist based opinion survey conducted in the 25 banks of Bangladesh included 6 'old' banks (established during the period between 1971 and 1986) and 19 'new' ones (established after 1986). It may be mentioned here that for the purpose of the study, all banks (other than those having the status of specialized financial institutions) established in the country before 1986 have been treated as the old ones and their total number was 12, of which 9 are listed in the Dhaka Stock Exchange (DSE) and the total number of new banks i.e., the banks established after 1986 and listed in DSE) was 24.

Data Analysis

As per the quantitative nature of the research questions of the study Statistical Package for the Social Science (SPSS 17) has been used for the statistical analysis through several trial and error processes. For measuring the CGI, an un-weighted approach (for instance Wallace et al. 1994, Cooke 1989, Hossain 2008, Mallin and Ow-Yong 2012) has been followed. Here an item of the Code scores "One" if complied with, and "Zero" if not.

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[2]The inferential statistics measure relationships between features, and create models to make predictions Lewin, C. 2005, 'Elementary Quantitative Methods' in B. Somekh and C. Lewin (Eds.) *Research Methods in the Social Sciences,* London: Sage Publications. Regression analysis is a feasible empirical statistical technique to control the variables in social science that may affect the phenomenon being studied (see Ethridge, D. 2004, *Research Methodology in Applied Economics,* Lowa: Blackwell Publishing.

[3]For identifying correlation between variables, the present study uses Spearman's correlation coefficient (instead of Pearson correlation coefficient because the data of the present study is not normally distributed. (for theoretical justification, see Field, 2009; Acton et.al, 2009).

VI. Findings

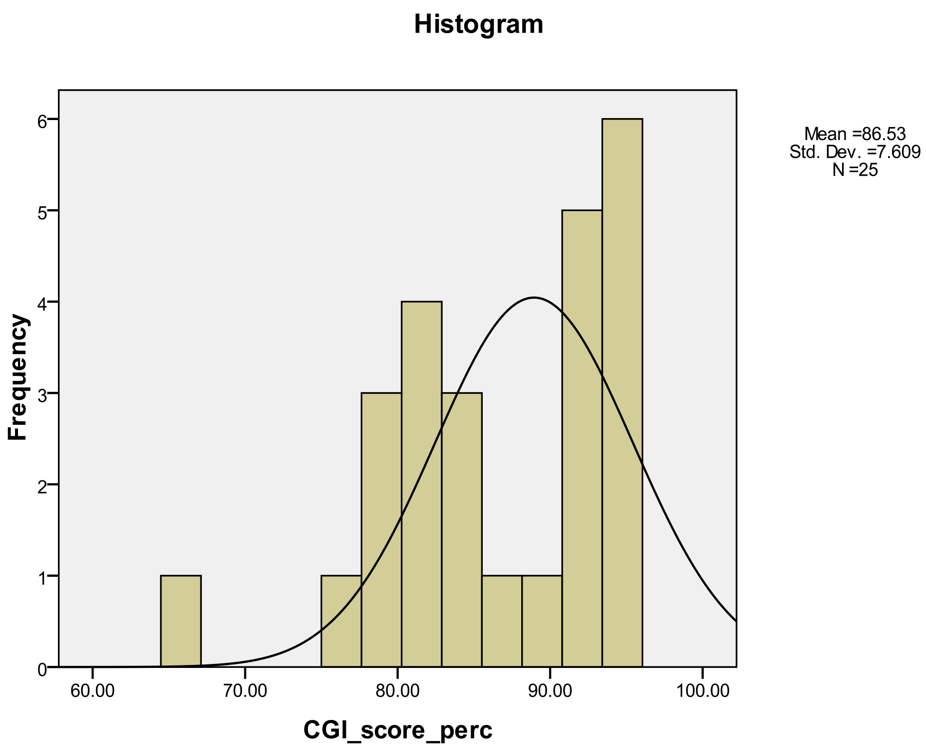
6.1 Overall Compliance level with the Code

The descriptive statistics of CGI score as presented in table – 3 prepared on the basis of the findings from the data on overall compliance level of the sample banks of Bangladesh show that the mean CGI score of the banks (N=25) are 86.52 percent.

Table – 3: CGI score descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
CGI score	25	65.79	94.74	86.5263	7.60886	-.781	.464
Valid N (listwise)	25						

According to the compliance framework used by prior studies (Mutawaa and Hewaidy 2010, Ferdous 2013) this mean value (86.52%) indicates a highly compliant CGI score[4]. This means that on an average, the banks comply with 86% of the corporate governance codes. From the statistics (Table – 3) we can see that the overall compliance level ranges between 65% and 94%. Although this indicates an overall high degree of compliance, the statistics however, suggest that the curve is skewed on the left (skewness – 0.781), which means that the data set is not normally distributed.



6.2 Level of Compliance by the CGI Determinants

6.2.1. Level of Compliance by Profitability

Profitability is a popular variable among researchers (Akhtaruddin, 2005; Ferdous 2013; Mutuwaa and Hewaidy, 2010). Though several ratios are available to measure profitability, rate of return of asset (ROA) is used in this study for convenience. In this study ROA is grouped in five categories keeping in mind the range of responses. Table – 4 reports that most of the banks have ROA of 1.5 to 2 and the average compliance score is lowest (84.47%) in this category. However the p-value (0.910) of Kruskal-Wallis test (K-W test) demonstrates

[4] The sample companies are considered to be highly compliant if the compliance score is 80%, intermediate compliance between 79%-60%, low compliance 59%-40% and substantial gap between company compliance and the particular provisions if score below 40%.

that there is no significant mean difference among each category. The findings suggest that although 'increase in profit' of banks is usually treated as one of the incentives in encouraging companies to ensure better compliance standards, the overall performance of banks of Bangladesh in compliance is not influenced by their profitability. It seems that the Securities and Exchange Commission of Bangladesh, the regulator of the listed companies in the country is lacking attention to the importance of relating compliance of listed banks to profitability, which may be an area of further studies.

Table – 4: CGI Score by Profitability (Return on Asset)

ROA Category	N	Mean	Minimum	Maximum	p-value of K-W Test
ROA<1.00	4	85.5263	81.58	94.74	0.910
1<=ROA< 1.5	3	88.5965	84.21	92.11	
1.5<=ROA<2.00	10	84.4737	65.79	94.74	
2<=ROA<2.5	5	88.9474	81.58	94.74	
ROA>=2.5	3	88.5965	78.95	94.74	
Total	25	86.5263	65.79	94.74	

6.2.2. Level of Compliance by Age

When companies are classified according to age[5] (see Table – 5), it was found that new banks have performed slightly better in terms of mean CGI score than the old ones. The range data suggests that regardless of the age, the maximum limit of compliance among the listed sample banks is 94%, whilst the minimum level varies. The minimum level of compliance in comparatively new banks is 66%, and in old banks it is 76%. This calls for further study to explore areas in which the new banks are finding it difficult to comply and the old ones fail to ensure full compliance of the corporate governance norms. However, the mean score varies insignificantly across the different ages of the sample banks, which has been further confirmed by the p-value of M-W test (0.974). Here the p-value is greater than 0.05, indicating the compliance score does not significantly vary with the age of the companies.

Table – 5: Compliance Score by Age

Firm category by age	N	Mean	Minimum	Maximum	p-value of M-W Test
Old	6	86.4035	76.32	94.74	0.974
New	19	86.5651	65.79	94.74	
Total	25	86.5263	65.79	94.74	

6.2.3. Level of Compliance by Auditor Type

Here data are grouped according to whether they are externally audited by internationally affiliated firms (referred to as Big4) or not externally audited by internationally affiliated firms. Though we can see from Table – 6 that 14 out of 25 banks are audited by internationally affiliated Big4 audit firms, their mean CGI score (86.27%) is slightly less than CGI score (86.84%) of those not audited by Big4 audit firms. The p-value from M-W test suggests that the level of compliance does not significantly differ with the difference in external auditors. The findings raise the question why it is so that there is almost no difference between banks affiliated with Big4 auditors and the ones which are not in terms of compliance.

Table – 6: Compliance Score by Type of Auditor

External Auditor Type	N	Mean	Minimum	Maximum	p-value of M-W test
Not Affiliated by BIG4	11	86.8421	78.95	94.74	
Affiliated by BIG4	14	86.2782	65.79	94.74	1.000
Total	25	86.5263	65.79	94.74	

[5] Here age is grouped into three categories: "Very Old" – banks registered before 1971, "Old" –banks registered after 1971 but before 1986 and "New" – banks registered after 1986.

6.3 Compliance on Board Issues, Financial Reporting, Auditing and Disclosure

Further analysis of the data in Table – 7 gives an idea about the compliance score on Board issues and Financial reporting, auditing and disclosure related issues. We have observed that the average CGI score on board related issues is 88.57% and it is 84.86% on disclosure related issues. These figures represent high level of compliance with the Code but at the same time, the standard deviation of compliance on board related issues is fairly high (10.10%) compared to the CGI score on disclosures related issues.

Table – 7: Descriptive Statistics

	N	Range	Minimum	Maximum	Mean	Std. Deviation	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
CGI on Board Issues	25	28.57	71.43	100.00	88.5714	10.10153	− 0.500	0.464
CGI on Financial reporting, Auditing and Disclosure issues	25	39.13	60.87	100.00	84.8696	8.70651	− 0.827	0.464

Data collected through the questionnaire survey of the 25 banks reveal that the banks are not compliant in disclosing information on qualification of Audit Committee members and also, they do not follow the limit on the number of members on Board of Directors, which however, is a voluntary compliance issue in the code of corporate governance but has the implication in terms of sanction and disbursement of loans in private interests. It has been found that 11 of the banks do not comply with the relevant provision of the Code.

Table – 8: Responses on Board Related issues

Board Related Issues	**Responses**	**Frequency**
Whether the board comprises 7 to 15 members?	No	11
	Yes	14
Whether the chairman of the board and CEO are different persons?	No	0
	Yes	25
Whether the board comprises mostly non-executive directors?	No	4
	Yes	21
Do the committees (like Audit Committee) comprise a majority of non-executive directors or are at least headed by a non-executive director?	No	4
	Yes	21
Is the Audit Committee Chairman a non-executive or independent director?	No	5
	Yes	20
Does the chairman of the Audit Committee have professional qualification and relevant financial experience?	No	2
	Yes	12
	Missing Data	11

By analyzing the financial reporting, auditing and disclosure related responses, this study has found that the annual reports of 21 out of the sample 25 banks do not specify whether their financial statements are signed (or are not signed) by the Chairman of the Audit Committee. Also, 12 banks do not disclose their management structure in the annual reports. Only 13 banks show information about director remuneration in their annual reports. However, most banks comply with the issues related to timely publication of annual reports, un-audited half yearly reports, directors' report, material risk factor, credit ratings, contingent liabilities and tax related issues.

6.4 Correlation and Regression Analysis

Correlation

The assumption that the factors like profitability of banks, their age and the type of external auditor they engage in auditing their accounts have effect on CGI of listed commercial banks in Bangladesh has been proved wrong as it has been found in the correlation analysis (see Table – 9) showing quite insignificant values of correlation coefficients between CGI and the variables considered to determine it.

Table – 9: Spearmans' Correlation Matrix of Dependent and Independent Variables

		Overall CGI score percentage	Firm category by age	External Auditor Type	ROA Category
Overall CGI score percentage	Correlation Coefficient	1.000	.007	.000	.116
	Sig. (2-tailed)	.	.975	1.000	.582
	N	25	25	25	25
Firm category by age	Correlation Coefficient	.007	1.000	-.121	-.237

	Sig. (2-tailed)	.975	.	.565	.255
	N	25	25	25	25
External Auditor Type	Correlation Coefficient	.000	-.121	1.000	.355
	Sig. (2-tailed)	1.000	.565	.	.082
	N	25	25	25	25
ROA Category	Correlation Coefficient	.116	-.237	.355	1.000
	Sig. (2-tailed)	.582	.255	.082	.
	N	25	25	25	25

Regression Model

This study develops a regression model to analyze how much the independent variables (age of the bank, Profitability and Type of Auditor) can predict the dependent variable (CGI score). A multivariate regression technique is used to test the following hypothesis:
H1= Age, profitability and type of external auditor used by the companies can predict the level of compliance with the Code.

The regression equation is, $CGI = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + e$

Where, CGI= Total Corporate Governance Index; X_1= Age, X_2= ROA; X_3= Type of external auditor; β_0= the intercept; e = the error item.

The results of the estimation procedure indicate that the company age, profitability and type of external auditor, none of the independent variables have statistically significant effect on the extent to which banks are complying with the Code. One plausible reason for such findings might be that, the questionnaire is developed using mostly mandatory disclosure requirements; the requirements banks must comply with according to the law of listing by Securities and Exchange Commission of Bangladesh. For this reason, the responses does not show any statistically significant correlation among variables and insignificant for regression analysis also.

Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics: R Square Change	F Change	df1	df2	Sig. F Change	Durbin-Watson
1	.160[a]	.026	-.121	3.09771	.026	.175	3	20	.912	.773

a. Predictors: (Constant), External Auditor Type, Log value of Age, Log value of ROA

b. Dependent Variable: Overall CGI score

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.042	3	1.681	.175	.912[a]
	Residual	191.917	20	9.596		
	Total	196.958	23			

a. Predictors: (Constant), External Auditor Type, Log value of Age, Log value of ROA

b. Dependent Variable: Overall CGI score

Variables in the Equation

Model		Unstandardized Coefficients: B	Unstandardized Coefficients: Std. Error	Standardized Coefficients: Beta	t	Sig.
1	(Constant)	36.593	5.582		6.555	.000
	Age of the Bank	-1.283	2.014	-.148	-.637	.531
	Profitability of Bank (ROA)	.603	2.073	.074	.291	.774
	External Auditor Type	-.470	1.425	-.081	-.330	.745

VII. Conclusion

The main issue addressed by this paper is the level of compliance and its relationship with firm attributes and profitability. In particular, this study has analyzed the level of compliance with the Code of corporate governance of the listed banks in Bangladesh. The overall findings indicate that on an average 86.52% of the information are complied by the sample banks and the range is from 65.79% to 94.74%, which suggest that the listed banks of Bangladesh are highly compliant with the Code provisions. Similar findings have also been reported by the study of Ferdous (2013). However, the findings also indicate that the voluntary provisions are less complied. The sample bank companies comply with most provisions of the Code that coincide with the Company Act or the listing regulations. But many of the voluntary provisions are not complied. For instance, nearly fifty percent of the sample banks do not give information on the qualification of the 'Audit Chairman' and about 44% of the sample banks do not comply with the provision relating to the board size. Also, most banks do not file information on management structure and directors' remuneration in their annual statement and on the provisions that are not included in the SEC Guidelines and in the Company Act.

The findings highlight on two major facts about the compliance behavior of the banks in Bangladesh. First, the regulatory pressure/requirements play a significant role in ensuring better governance standard in Bangladesh and second, the policy makers need to take initiatives in raising awareness about the necessity of voluntary compliance. This goes with the concerns of most researchers of corporate governance who argue that if meaningful compliance has to take place, it is very important that the companies voluntarily step forward to ensure compliance and not wait for being pressurized by the legal or regulatory bodies.

This study also examined the relationship between the level of compliance and firm attributes, namely company age, type of external auditor and profitability and it was found that although these firm attributes have significant influence in some other countries (mostly developed ones), none of these showed significant correlation with corporate governance index of the banks of Bangladesh. The finding confirms the observation of a previous study (Akhtaruddin, 2005) that the level of code compliance does not vary significantly with age of banks. But contrary to the findings of Akhtaruddin (2005), the present study found no significant relationship between level of compliance and profitability of banks. The present study further, finds that the compliance of corporate governance in bank companies audited by internationally affiliated Big4 audit firms is slightly better than that in companies which are audited by other than the Big4 audit firms. However, the difference is insignificant and it is difficult to conclude whether the type of auditors does have any impact on the corporate governance index of the bank companies in Bangladesh.

The regression analysis conducted in the present study reveals that profitability of banks, their age and the type of auditor of their accounts cannot predict the level of compliance of individual firms. Some possible explanations of the findings can be

- Firm's emphasis on complying with issues mostly related to the mandatory provisions of the Code and avoiding the voluntary provisions.
- Auditors' ineffectiveness in monitoring the actual application of the mandatory requirements of the Code.
- SEC's corporate governance requirements prioritizing the submission of 'Compliance report' along with the annual statement and not actually monitoring its adaptation in reality.
- The vague definition of the term 'Independent Auditor' used in the Code.

The following recommendations are drawn from the overall findings and the literature review to help the policy makers in their efforts in improving corporate governance standards in commercial banks in Bangladesh.

First, the Code of corporate governance for banks in Bangladesh needs to be revised in light of the recent national and international developments since before encouraging companies to comply with some provisions, it is very important that the provisions themselves are made up-to-date and appropriate enough to meet the local and international needs.

Second, the SEC Guidelines should also expand its scope to incorporate the fundamental guidelines of good governance and the regulators need to ensure that instead of the provisions being mere regulations they guide and assist companies so that they are being implemented and adopted in the banks' regular practice.

Third, for provisions like independent directors, the policy makers need to emphasize more on their expertise, integrity and commitment and the position of independent director cannot be offered to 'anyone' may turn up as a 'rubber stamp' director.

Fourth, the voluntary provisions of the code must be set with an effective implementation design and the companies must be made well aware about the provisions and should be given proper training to implement the code of corporate governance with realization of specific benefits of compliance. Fifth, the regulators should have sufficient number of skilled staff and should also have the proper training on how to extend support to companies in implementing provisions and monitor the compliance by the companies over time.

Appendix I

Board Related Issues
1. Is the chairman of the board and CEO different persons? 2. Is the board comprised of 7 to 15 members? 3. Does the board comprised of mostly non-executive director? 4. Are the key risk areas of the company identified and monitored by the Board? 5. Are the performance indicators of the company identified and monitored by the Board? 6. Does the company have an Audit Committee? 7. Does the Audit Committee exclude/ restrict the Chairman of the Board from being a member of the Committee? 8. Does the Audit Committee meet at least quarterly? 9. Are the committees (like Audit Committee) comprised of a majority of non-executive directors or at least headed by a non-executive director 10. Is the Audit Committee Chairman a non-executive or independent director? 11. Is the Audit Committee comprised of at least three members? 12. Does the chairman of the Audit Committee have professional qualification and relevant financial experience? 13. Does the board prepare a Directors' Report containing information as per the provision XI (B) of the Code? 14. Has the company appointed a company Secretary or other qualified Compliance officer or any other external advisor (other than the auditor, company lawyer or other advisor to the board)?
Shareholders Rights
15. Is the Company Handbook available and accessible to shareholders?
Financial Reporting, Auditing and Disclosure
16. Does your company ensure that the accounting standards are implemented within the time frame given by ICAB? 17. Does your company disclose both audit and non-audit fees (where applicable) to the shareholders? 18. Does your company have an internal audit function? (If no, please proceed to Question 49). 19. Does their statement further signed by the Chairman of the Audit Committee? 20. Does the company publicly disclose: quarterly un audited results? 21. Does the company publicly disclose: Half yearly Balance Sheet and Profit and Loss Accounts? 22. Does the company publicly disclose: Audited annual Balance Sheet? 23. Does the company publicly disclose: Annual Directors' Report? 24. Does the company publicly disclose: Corporate Governance Statement? 25. Does the company publicly disclose: Statement of Corporate Social Responsibility? 26. Does the company publicly disclose: Ownership Structure? 27. Does the company publicly disclose: Directors' Shareholding? 28. Does the company publicly disclose: Material risk factors? 29. Does the company publicly disclose: Senior Management Structure? 30. Does the company publicly disclose: Directors' Remuneration? 31. Does the company publicly disclose: Report on end use of funds raised from public when using shares and debentures? 32. Does the company publicly disclose: contingent liability? 33. Does the company publicly disclose: Related party transactions? 34. Does the company publicly disclose: Credit Rating? 35. Does the company publicly disclose: Details of Investment? 36. Does the company publicly disclose: Basis of estimates used in financial reporting? 37. Does the company publicly disclose: Depreciation policy? 38. Does the company publicly disclose: Tax policy?

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Dr. Chowdhury Saima Ferdous "Corporate Governance Index of Banks In Bangladesh And Its Determinants." IOSR Journal of Business and Management (IOSR-JBM) 19.12 (2017): 76-91.