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**IMPACT OF CORPORATE GOVERNANCE PRACTICES
ON PERFORMANCES IN SOME SELECTED PRIVATE
COMMERCIAL BANKS IN BANGLADESH**

The study covers 7 local private commercial banks of Bangladesh and 14 respondents who are in charge of HRM division and accounts and finance division of the selected banks. The study used both primary and secondary data and it reveals the corporate governance practices in the selected banks have been far from the satisfactory level of performance when examined in terms of internal and external corporate governance mechanisms. This study seems to have displayed that all the selected bank board size, bank age, bank size, capital adequacy ratio (CAR), loan to deposit ratio (LDR) and debt to equity ratio (DER) have been found to be far from satisfactory and in this case leading to poor corporate governance practices. Furthermore, during this study period, in the case of the selected banks, returns on total asset (ROTA) was also found not satisfactory with less than 5% ROTA in all of the selected banks. Therefore, from this seemingly unsatisfactory circumstance, there are wide rooms for improvement of corporate governance practices in terms of both internal and external mechanisms which in turn will lend weight to improve the ROTA of the selected banks.
Keywords: corporate governance, private bank, return on total assets.

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**ВПЛИВ ПРАКТИКИ КОРПОРАТИВНОГО УПРАВЛІННЯ
НА ПОКАЗНИКИ ПРИВАТНИХ КОМЕРЦІЙНИХ БАНКІВ
У БАНГЛАДЕШІ**

У статті досліджено 7 приватних комерційних банків Бангладеш, опитано 14 керівників їхніх структурних підрозділів, відповідальних за кадри і фінанси. Використано як первинні, так і вторинні дані опитування, показано, що практика корпоративного управління в цих банках була нижчою за необхідний рівень з точки зору як внутрішніх, так і зовнішніх механізмів. Такі параметри як розмір ради директорів, термін роботи банку, розмір банку, коефіцієнт достатності капіталу, співвідношення кредитів і депозитів і відношення позикового капіталу до власного, мають бути суттєво покращені. Крім того, дохід від загальної суми балансу виявився занадто низьким – до 5% у всіх банках, які брали участь у дослідженні.

Ключові слова: корпоративне управління, приватний банк, дохід від загальної суми балансу.
Табл. 3. Літ. 30.

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В БАНГЛАДЕШЕ**

В статье исследованы 7 частных коммерческих банков Бангладеш, 14 руководителей их структурных подразделений, отвечающих за кадры и финансы. Использованы как первичные, так и вторичные данные опроса, показано, что практика корпоративного управления в этих банках была ниже необходимого уровня с точки зрения как внутренних, так и внешних механизмов. Такие параметры как размер совета директоров, срок работы банка, размер банка, коэффициент достаточности капитала, соотношение кредитов и депозитов и отношение заёмного капитала к собственному, должны быть существенно

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улучшены. Кроме того, доход от общей суммы баланса оказался слишком низким – до 5% во всех участвующих в исследовании банках.

Ключевые слова: корпоративное управление, частный банк, доход от общей суммы баланса.

1. Introduction.

The meaning of corporate governance is influenced by different views from different authors. For example, one group described it as a "system" by which companies are directed and controlled (Cadbury Report, CFACG 1992), and for another group, it is concerned with the 'structure and processes' on decision-making, accountability, control and behavior in the governing body (Public Accounts and Estimates Committee, 2002), while another corporate governance would emphasize on finding ways to ensure effective decision-making (Pound, 1995). But it should be noted that the term "corporate governance" is an exclusive entity in itself and cannot be considered as the same to "management". The term "management" is highly related to the day-to-day management of a company's operations whereas "corporate governance" considers this task of management as under a harmonized structure (Khan et al., 2004a).

A good corporate governance requires an appropriate and effectively legal, regulatory and institutional foundation. A variety of factors, including the system of business laws and accounting standards, can seriously affect market integrity and the overall economic performance of financial institutions. Supervisors are nevertheless encouraged to be aware of the ever present legal and institutional impediments to sound corporate governance, and to take steps to foster effective foundations in corporate governance where it is within their legal authority to do so (Basel Committee on Banking Supervision, 2007).

Though corporate governance practices intrinsically play the pivotal role in the banking industry in Bangladesh, it is alleged that the practice of corporate governance in Bangladeshi banking is not up to the mark in the sense that internal as well as external corporate governance mechanisms do not convincingly reflect its holistic helpful functions and performances for the good of corporate governance, especially, in the said industry. We know that better corporate governance practices lead to better banking performances and vice versa. Good accountable corporate governance can be pragmatically ensured through the use of external corporate governance mechanism instead of being wholly internally oriented. As far as we know, previous studies have advocated through scientific analyses conducted on the impact of corporate governance practices on the performance of banks in Bangladesh and, thus, the present study is a continuation of the attempt to accomplish towards this end. Thus the following objectives and hypotheses are formulated to critically examine the impact of corporate governance practices on the performance of some selected private commercial banks in Bangladesh.

2. Objectives.

1) To review the present scenario of corporate governance in the selected private commercial banks (PCB's);

2) To examine the relationship between corporate governance practices as a whole in terms of corporate governance's internal as well as external inter-related factors and profitability;

3) To examine the impact of corporate governance practice in terms of corporate governance specific performances, internal as well as external contributory factors on the profitability of the selected private commercial banks (PCB's).

2.1. Hypothesis. In line with the specific objectives of the study, the following null and alternative hypotheses have been developed:

Ho₁: There is no significant relationship between corporate governance selected variables and bank performances.

Ha₁: There is a significant relationship between corporate governance selected variables and bank performances.

Ho₂: Corporate governance selected variables have no significant impact on the profitability of the selected PCB's.

Ha₂: Corporate governance selected variables have significant impact on the profitability of the selected PCB's.

3. Methodology.

3.1. Sample Selection. The sample size was selected using the two-stage sampling. In the first stage, 7 local private commercial banks, namely, One Bank Ltd., City Bank Ltd., Islami Bank Bangladesh Ltd., National Credit and Commerce Bank Ltd., Pubali Bank Ltd., Social Islami Bank Ltd. and Mercantile Bank Ltd., were selected randomly out of the total number of 29 PCBs operating in Bangladesh. Foreign private banks as well as public sector banks have been kept outside the sample mainly because banks operate in a different environment where rules and regulations are quite different from private local banks. In the second stage, the total number of respondents was 14 and 2 from each bank had been selected on the basis of purposive sampling, for easy and smooth data collection. Of the 2 respondents, 1 was in charge of HRM division and the other was in charge of finance and accounts division of the selected banks.

3.2 Data collection. *Secondary data:* The study had mostly used the secondary data relating to banks' returns on total asset (ROTA), board size, bank age, bank size, capital adequacy ratio (CAR), loan to deposit ratio (LDR) and debt to equity ratio (DER), and so on. These data were collected from the annual reports of the selected PCBs for the study period.

Primary Data: Primary data, from the respondents' opinions on the prevailing positions of corporate governance practices were gathered and using structured close-ended questionnaire through a direct interview method.

Period of empirical analysis: A period of 3 (three) financial years (2008 to 2010) was selected for the specific purpose of the study.

Data analysis: In order to examine the relationship between corporate governance practices and banks performance, the Pearson correlation techniques had been used. Furthermore, in order to examine the impact of corporate governance practices on bank performance, multiple regression models had been used. To this end, the banks' returns on total assets (ROTA) had been taken as the dependent variable, while board size, bank age, bank size, capital adequacy ratio (CAR), loan to deposit ratio (LDR) and debt to equity ratio (DER) had been taken as the independent variables.

4. Literature review.

4.1. Corporate governance practice. In the area of corporate governance practice of banks, 3 strands of literature are found, wherein the first strand focused on how

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). Firstly, banks are generally more opaque than non-financial firms. Although information asymmetries plague all sectors, but the evidence suggests that these informational asymmetries are much larger with banks (Furfine, 2001). From the perspective of bonds, loan quality is not readily observable and can be hidden for long periods of time. Therefore, Morgan (2002) found that bond analysts more disagreed over the bonds issued by banks rather than by non-financial firms. The comparatively severe difficulties in acquiring information on banks' behavior and the monitoring of ongoing banking activities had likewise greatly hindered the smooth flow of traditional corporate governance mechanisms (Levine, 2004). The second strand of literature looks at how better governance practices in banks can help their financial development and growth (Levine, 1997; Bushman, Smith, 2003). Bushman and Smith discussed the economics-based research focused primarily on the governance role of financial accounting information and had accordingly proposed future research ideas. The third strand looks at corporate governance practices in banks from the perspective of its impact on the performance and the efficiency of banks themselves (Jensen, Meckling, 1976; Williamson, 1985; Hovey et al., 2003). Andres and Vallelado (2008) have examined corporate governance in banking, especially, the role of boards of directors. They pointed out that the bank board of directors' composition and size were closely related to directors' ability to monitor and advice the management while those larger and not excessively independent boards might prove more efficient in monitoring and advisory functions and were, thus, more able to create more values. Kutubi (2011) has examined the board of directors' size, independence and performance through the analysis of private commercial banks in Bangladesh. This study has examined the impact of bank board size and independent directors on the performance of local private commercial banks in Bangladesh. The study has found that statistically significant positive relationship exists between the proportions of independent directors and the performance of banks. Hossain (2011) has likewise highlighted the corporate governance practices in Bangladesh. The study has emphasized in no uncertain terms that good corporate governance has manifestly highlighted the corporate governance practices in Bangladesh. The study has also vehemently pointed out that a good corporate governance has a direct implication on a company's behavior towards its employee's governance which can significantly provide rewards to both individual companies and countries. Afroze & Jahan (2005) in their study entitled "Corporate Governance practices in Bangladesh" have tried to identify the best practices of corporate governance and the necessary proactive steps to be taken so that organizations can improve the deteriorating situation of corporate governance in Bangladesh. Improving corporate governance can provide significant confidence to investors in both individual companies and the country. The paper also tries to identify critical areas where institutions, regulations or economic factors could be strengthened to improve not only functional performance but also the integrity of corporate governance. Khan, Siddiqui and Hossain (2004) have conducted a study titled "Reporting on corporate Governance as a Voluntary Disclosure, A study on the Annual Reports of BEXIMCO

Group." In which the principal findings are twofold: firstly, they find that BEXIMCO makes some disclosures on corporate governance on a voluntary basis. Secondly, they find that BEXIMCO's user groups are in favor of such disclosures. However, disclosures are not adequate in its entirety to meet the goals of corporate governance.

4.2. Corporate governance practices scenario in Bangladesh. Corporate control mechanisms in Bangladesh are mostly insider (internal) oriented, such as ownership structure, as core investors own significant stakes of shares and is also known as "ownership structure", or as "ownership control approach" and, in general, they are in the board of directors (Rashid and Lodh, 2008). There is a high degree of ownership connection by founding family members leading to a high degree of ownership. Any well-governed corporation needs to balance the roles of 4 groups which are an integral part of the organization, namely: 1) shareholders; 2) board of directors; 3) managers, and 4) stakeholders.

Shareholders provide the (risk) capital in return for the opportunity to benefit from the profits and increase in corporate value. Shareholders may have a range of rights and powers under commercial laws and regulations that include, 1) the right to elect and remove directors and auditors; 2) to appoint and approve or disapprove fundamental changes; 3) to allow shareholders to register and transfer their shares in a corporation, and 4) to protect shareholders' rights, including their rights to buy, own, sell and transfer their stocks.

The board of directors (BOD) represents the interests of shareholders and may have the obligations to other stakeholders under various statutory and voluntary provisions. The BOD is the core internal governance mechanism, because it provides the bridge between management and owners as well as other stakeholders and the outside world. The BOD needs to be independent, particularly from management, and its members should be well-versed with the firm's line of business.

The best practices for the board of directors are: (a) board size should reflect the complexity of the corporation and the need for an effective decision-making; a 15-member board-size is the upper limit for effectiveness in most cases; (b) a board should include a significant proportion of independent directors who are likely to make objective judgments because they have no ties with management; (c) the board should meet often enough – at least once a quarter year – to effectively perform their job; (d) agenda and briefing materials should be sent to board members before meetings to give members time to prepare; and (e) board meetings should be used for discussions, and not lengthy management presentations.

5. Variable definition.

5.1. Proxy variables for corporate governance practices assumed as independent variables in this study. *Board Composition Firm Performance Hypothesis:* The board composition refers to the ratio of non-executive (outside independent) directors and executive directors (including the chief executive officer) on the board as a means of monitoring the management. Outside independent directors are appointed due to their special qualifications, expertise and experience and they may effectively influence the board's decision and ultimately add value to the firm (Fields, Keys, 2003).

Debt to Equity Ratio: Debt to equity ratio (DER) is measured as the total long-term debt to total equity and calculated by scaling the total long-term debt by the average total equity. In case of banks, the debt to equity ratio (DER) represents fixed

and term deposits as divided by total equity. The more the value of the DER is the better are corporate governance practices and vice versa.

Control Variables: The control variables are the (1) board size, (2) bank size, (3) bank age, (4) growth, (5) liquidity and (6) risk.

Board Size: The board size has a number of implications for board functioning and thereby firm performance (Yermack, 1996; Barnhart and Rosenstein, 1998; Raheja, 2005; Coles et al., 2008). Zahra and Pearce II (1989) argued that: "larger boards assume to have directors with diverse educational and industrial backgrounds and skills and with multiple perspectives to improve the quality of actions taken by the firm size as board size increased, CEO domination of the board became more difficult and directors were in better positions to exercise their power in governing the corporation".

Bank size: Firm size may influence company's performance as large firms have more capacity to generate internal funds (Short and Keasey, 1999), a greater variety of capabilities (Majumdar and Chhibber, 1999), and unsolved problems of coordination may influence performance negatively (Williamson, 1967). Consistent with Morck et al. (1988), McConnell and Servacs (1990) and Short and Keasey (1999) this study considers the natural logarithm of the total assets as the bank size (Size).

Bank Age: Firm performance may also be influenced by bank age; older firms are likely to be more efficient than younger firms (Ang et al., 2000). Therefore, consistent with Majumdar and Chhibber (1999) and Ang et al. (2000), a variable AGE is defined as the natural logarithm of the number of years a firm has been operating.

Growth: Consistent with Morck et al. (1988) and short and Keasey (1999), the control variable may be growth, as measured in the percentage of the annual change in sales. Growth is considered to denote the impact of growth on a firm's performance. In case of bank loans, advances and investment represent sale.

Liquidity: liquidity may have huge impact on firm's profitability. The bank which has a high liquidity is less likely to become bankrupt or default.

Loan to Deposit Ratio (LDR): LDR is calculated as loan, advance and investment divided by the total assets. The larger the ratio is, the better is corporate governance.

Capital Adequacy Ratio (CAR): This is also an important external corporate governance mechanism. Capital deposit ratio was the first measurement used to determine capital adequacy. The mostly used 4 other ratios for the purpose are: 1) Equity capital to total assets; 2) Equity capital to risky assets; 3) Equity capital to total deposit; 4) Equity capital to loans and discounts.

5.2. Proxy variable for banks' performance is assumed to be the dependent variable in this study. *Bank profitability measures in terms of returns on total assets (ROTA):* Of the various measures for banks' profitability, returns on equity (ROE), returns on total assets (ROTA), returns on investment (ROI), earning per share (EPS), price earning ratio (PER), ROTA is the most important one as it is computed as the income divided by the total bank assets.

6. Limitations of the study.

The present study suffers from the following limitations:

- 1) The sample size was relatively small as compared to the total population.
- 2) The study was limited to only two aspects of corporate governance practices and the performances of the banks.

3) The number of respondents for collecting primary data was also few as compared to the total population.

7. Results and discussion.

7.1. Position of corporate governance practices in terms of internal and external corporate governance mechanisms and bank performance. The average positions for the 3 financial years from 2008 to 2010 are shown in Table 1.

Table 1. Average position of the CG practices in terms of internal and external mechanism and bank performance

CG Mechanism	Bank Name						
	OBL	CBL	IBBL	NCCBL	PBL	SIBL	MBL
Internal							
Bank Board Size	10.67	11.67	13.33	25.67	10.67	16.33	21.00
Bank Age	11	27	27	24	26	15	11
Bank Size	45204.00	74826.67	279922.70	65137.74	104361.57	41652.75	69745.12
External							
CAR	6.90	7.40	7.26	8.27	6.75	6.73	6.43
LDR	83.05	78.53	89.03	94.15	83.79	82.91	86.21
DER	74.48	39.42	37.53	36.33	39.36	74.87	80.03
Bank Performances							
ROTA	4.64	1.40	1.36	2.35	1.34	2.76	1.32

Source: Appendix 1 (Annual Reports-2010).

Table 1 shows that in terms of bank board size, it is the highest in the case of NCCBL followed by MBL, SIBL, IBBL, CBL, OBL and PBL. Furthermore, in terms of bank age, CBL ranks first followed by IBBL, PBL, NCCBL, SIBL, MBL and OBL. In terms of bank size (total assets of bank), MBL ranks first followed by SIBL, IBBL, PBL, CBL, NCCBL and OBL. The average position of the CAR is the highest in the case of NCCBL followed by CBL, IBBL, OBL, PBL, SIBL and NBL. The average position of LDR is again the highest in the case of NCCBL followed by IBBL, MBL, PBL, OBL, SIBL and CBL. Lastly, the average position of the DER is the highest in the case of MBL followed by SIBL, OBL, CBL, PBL, IBBL and NCCBL. All these figures indicate that both internal mechanisms, in terms of bank board size, bank age and bank size have not been satisfactory in most of the selected banks. The external mechanisms in terms of CAR, LDR and DER are also not satisfactory in the selected banks. The average position of the ROTA is again the highest in the case of OBL followed by SIBL, NCCBL, CBL, IBBL, PBL and NBL. All these statistics show that the selected bank performances in terms of ROTA are not satisfactory in all the selected banks since ROTA is less than 5% in all the banks selected. From the above analyses, it can be confidentially said that corporate governance practices are far from satisfactory in the selected banks during the study period leading to poor corporate governance practices. Therefore, there are still vast rooms for improving corporate governance practices in terms of internal and external mechanisms.

7.2. Impact of corporate governance practices on banks performances. Before examining the impact of corporate governance practices on bank performances, it is essential to examine the relationship between each of the independent variables, such as, board size (x_1), bank age (x_2), bank size (x_3), CAR (x_4), LDR (x_5), and DER (x_6) and the dependent variable ROTA (y_0). Table 2 below shows the existence of such a relationship:

Table 2. Relationship between each of $x_1, x_2, x_3, x_4, x_5, x_6$ and y_0 correlation coefficient (r)

		Y_0	X_1	X_2	X_3	X_4	X_5	X_6
Pearson Correlation	Y_0	1.000	-0.103	-0.526	-0.371	0.045	-0.028	0.353
	X_1	-0.103	1.000	-0.141	-0.172	0.194	0.602	0.036
	X_2	-0.526	-0.141	1.000	0.529	0.141	0.109	-0.836
	X_3	-0.371	-0.172	0.529	1.000	-0.020	0.299	-0.452
	X_4	0.045	0.194	0.141	-0.020	1.000	0.123	-0.078
	X_5	-0.028	0.602	0.109	0.299	0.123	1.000	-0.283
	X_6	0.353	0.036	-0.836	-0.452	-0.078	-0.283	1.000
Sig. (1-tailed)	Y_0	0.000	0.301	0.002	0.026	0.411	0.444	0.033
	X_1	0.301	0.000	0.238	0.190	0.161	0.000	0.429
	X_2	0.002	0.238	0.000	0.002	0.237	0.291	0.000
	X_3	0.026	0.190	0.002	0.000	0.460	0.061	0.008
	X_4	0.411	0.161	0.237	0.460	0.000	0.267	0.346
	X_5	0.444	0.000	0.291	0.061	0.267	0.000	0.072
	X_6	0.033	0.429	0.000	0.008	0.346	0.072	0.000
N	Y_0	28	28	28	28	28	28	28
	X_1	28	28	28	28	28	28	28
	X_2	28	28	28	28	28	28	28
	X_3	28	28	28	28	28	28	28
	X_4	28	28	28	28	28	28	28
	X_5	28	28	28	28	28	28	28
	X_6	28	28	28	28	28	28	28

Source: SPSS (Analyses of the data taken from Annual Report-2010).

Table 2 shows the relationship (correlation coefficient – r) between the dependent variable (y_0) and each of the independent variables (x_1, x_2, x_3, x_4, x_5 and x_6) as well as in between the independent variables. The table points out that each correlation coefficient (r) between y_0 and x_1, y_0 and x_2, y_0 and x_3, y_0 and x_4, y_0 and x_5, y_0 and x_6 , have been calculated as negative 0.103, negative 0.526, negative 0.371, positive 0.045, negative 0.028, and positive 0.353, respectively. Therefore, it can be said that there exists no significant correlation between y_0 (ROTA) and x_1 (board age), y_0 (ROTA) and x_4 (CAR) and y_0 (ROTA) and x_5 (LDR). But there is a negative significant correlation between y_0 and x_2 (bank age) and between y_0 and x_3 (bank size) of below the 5% level of significance. Such negative correlations imply that the more is bank age, the less is the ROTA and vice versa, and the bigger is the bank size, the lesser is the ROTA and vice versa. In real life situations, bank customers and clients usually prefer younger banks than older ones because of more modern banking facilities are available in newer banks than the old ones. The negative correlation between the ROTA and the investments in total representing bank size again signifies that there are occurrences of overcapitalization in the selected banks, thus, deriving lower ROTA. The table also points out to the significant positive relationship between ROTA (y_0) and x_0 (DER) of below 5% level of significance. This means that the higher is the DER, the higher is the ROTA and vice versa. The said table also reveals that there is no colinearity problems between the independent variables since no pair of the independent variables shows a high relationship ranging from 0.70 to 1.00.

At this stage, the impact of corporate governance practices on the banks' performances measured in terms of the ROTA is examined below.

Table 3 shows the multiple regression between the dependent variable ROTA (Y_0) and the selected independent variables (x_1, x_2, x_3, x_4, x_5 and x_6).

Table 3. **Variables Entered/Removed**

Model	Variables Entered	Variables Removed	Method
1	X ₆ , X ₁ , X ₄ , X ₃ , X ₅ , X ₂ ^a	.	Enter

a. All requested variables entered.

Model Summary^b

Model	R	R ²	Adjusted R ²	Std. Error of the Estimate	Change Statistics				Durbin-Watson	
					R ² Change	F Change	df1	df2		Sig. F Change
1	0.662 ^a	0.438	0.278	1.05561	0.438	2.730	6	21	0.040	2.340

a. Predictors: (Constant), X₆, X₁, X₄, X₃, X₅ and X₂

b. Dependent Variable: y₀

ANOVA^b

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	18.251	6	3.042	2.730	0.040 ^a
Residual	23.401	21	1.114		
Total	41.651	27			

a. Predictors: (Constant), X₆, X₁, X₄, X₃, X₅, X₂

b. Dependent Variable: y₀

Table 3 shows that the values of R , R^2 and adjusted R^2 are equal to 0.662, 438 and 0.278 respectively. The values of R^2 and adjusted R^2 show the impact of the independent variables (board size, age, bank size, CAR, LDR, DER) together on the dependent variable ROTA. If we consider the value of R^2 , it can be said that all 6 independent variables jointly influence the dependent variable to the extent of 43.8%. Again, if we consider the value of adjusted R^2 it can be said that all 6 independent variables jointly influence the dependent variable to the extent of 27.8%

8. Conclusion.

The above findings reveal that corporate governance practices in the selected banks in terms of internal and external mechanisms have been far from satisfactory during this study period leading to the poor performance of corporate governance practices in these cases. The internal corporate governance mechanisms considered in the study are the bank board size, bank age and bank size. From the analyses performed, the capital adequacy ratio (CAR), loan to deposit ratio (LDR) and debt to equity ratio (DER) have been found to be the variables of external corporate governance practices. The study further reveals that the composite impact of all the independent variables on the dependent variable returns on total assets (ROTA) was found to be significant. It is seen that all 6 independent variables have jointly influenced the ROTA to the extent of 27.8% considering the significant value of the adjusted R-square. Therefore it is recommended that the banking authority should immediately take proper pragmatic remedial measures to improve banking corporate governance practices unsatisfactory situations so that it can become more effective in the selected banks in the near future. In this respect, the role of Bangladeshi Bank as the guardian body of all private banks is no less important whereby it should vehemently and rigorously ensure that the guidelines provided by Bangladeshi Bank are fully and properly adhered to by commercial banks operating in the country.

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