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Corporate governance and banking performance: A comparative study between Islamic and conventional banking sector in the context of Bangladesh

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Abstract
Corporate governance (CG) is a set of principles that should be included into every aspect of the firm in order to ensure accountability and responsibility. The purpose of this research is to look at the state of corporate governance (CG) in banking sector of conventional banks and Islamic banks. Because the rules, regulations, and operating processes of conventional and Islamic banks differ significantly, the corporate governance (CG) practices of these two banking sectors are likewise distinct. In this work, the authors attempt to give a clear comparative assessment of corporate governance (CG) practices in these two banking sectors. This research looked at four dimensions of corporate governance: board size, board diversity, board diversity, and CEO duality. Return on Equity (ROE) and Return on Assets (ROA) have been used to evaluate banking performance. Regression analysis is used to evaluate the banking performance of the said banking sectors. It is found that BS, IND and BD have positive impact on ROE in Islamic banks sample. On the other hand, in terms of the coefficient of independent variables from sample banks of conventional sector are found to be negative influence on ROE in where IND and CEO duality shows significant result. Both conventional and Islamic banks are under pressure to enhance their corporate governance (CG) practices, since both banking sectors are seeing considerable improvements. However, when compared to conventional banks, Islamic banks lag behind in terms of corporate governance (CG). Companies must comprehend the advantages of implementing strong governance techniques and accompanying activities that aid in enhancing financial performance.

Keywords: Banking performance, Banking sector, Conventional banks, Corporate governance, Islamic banks.
JEL Classification: G30; G38; G39; O16.

1. Introduction

Corporate governance is all about adhering to values, conducting business ethically, and distinguishing between personal and corporate funds when it comes to firm management. Conflicting interests of the parties involved create ethical difficulties. Managers make decisions based on a set of principles influenced by the values, surroundings, and culture of the company. Ethical leadership is advantageous to a corporation since it demonstrates that the organization is operating in accordance with all stakeholders' expectations. In Bangladesh, corporate governance plays a significant role. Corporate governance has recently surfaced as a critical concern for Bangladesh's financial institutions. There are no employment contracts or agency relationships in the majority of Bangladeshi financial institutions. As a result, the expense of running an agency is rising every day. Corporate governance is increasingly a big issue in financial institutions in order to lessen the corporate problem. Economic development and social advancement are inextricably linked to financial performance, whether public or private. Any interruption in this sector caused by inadequate governance can result in anguish and suffering for the general public and the impoverished in particular.

Corporate governance, according to Shleifer and Vishny (1997), is the mechanism by which financial suppliers to firms ensure that they will obtain a return on their money. According to Ruin (2001), corporate governance is described as a collection of individuals who come together one united entity with the job and obligation of leading, regulating, and governing with authority. This body is given the authority to control, regulate, restrict, control, and exercise the powers that have been delegated to it through a collective effort. However, corporate governance (Cadbury, 1992) refers to the set of practices, norms, rules, regulations, and organizations that regulate how a company is managed, operated, or regulated. Melvin and Hirt (2005), on the other hand, described corporate governance as "corporate decision-making and control, notably the organization and working techniques of the board of directors." It may also be employed extremely literally, referring to a company's adherence to best practice code standards, or very widely, referring to a company's relationships with a diverse variety of stakeholders. Furthermore, Thomas (2002) defined corporate governance as the process and methods through which a company's government (the directors) is held responsible to its shareholders (the shareholders).

Although Corporate Governance has established a lot of attention and is a blistering topic in recent years. In comparison to industrialized countries, the Bangladesh Securities and Exchange Commission has created some mandatory requirements relating to corporate governance procedures, yet all banks do not follow these guidelines as per the legislation enacted. In several industries, there is a lack of accountability, justice, and transparency. Several scams and corruptions have already occurred in Bangladesh's banking industry, which has tarnished the country's reputation abroad. As a result, the intention of this study is to learn more about corporate governance practices in Bangladesh's banking business. It is critical to understand corporate governance's proclivity for disclosure and whether it complies with the Bangladesh Securities and Exchange Commission's guidelines. The functioning of effective corporate governance is crucial to Bangladesh's financial health, as recent events have demonstrated. Bangladesh's proactive approach to corporate governance necessitates the adoption and enforcement of a suitable corporate governance model. Though Corporate Governance has gotten a lot of attention in recent decades as a control mechanism, most of the research on it has been done in the context of industrialized countries.

The most significant processes to concentrate on for excellence in Corporate Governance are:

- The Strategy Process provides: – A link between Strategy and Operations; - Establishes a strategy review mechanism.
- A link between people and operations is provided by the People Process.
- A link between strategy and people is provided by the operations process. The corporate structure and the methods through which the activities are structured and conducted are the link between the Core Objectives of Corporate Governance and the relevant processes.

2. Literature Review

As a result of the economic crisis, many industrialized nations are facing financial difficulties, and many enterprises are declaring bankruptcy. In those conditions, several states implemented interest-free projects, and businesses who used free interest products were proven to be stable throughout recessions in other scenarios (Ahmed, 2009). Liu (2015) explored the relationship between corporate governance procedures and disclosures in a low-information environment: the Chinese stock markets. This study discovered that the incorporation of monitoring and control mechanisms, such as financial knowledge on audit committees and independent directors, can improve disclosure latitude. Corporate governance policies and the quality of reporting can have an impact on the value of a public company. According to this research, there is a positive relationship between corporate governance and business value. They discovered a negative relationship between reporting quality and business value. According to Hasan and Hossain (2012), the total disclosure level is 67 percent, which is a poor outcome since it does not provide a clear signal to stakeholders. Furthermore, this proportion falls short of demonstrating effective governance and openness. Though the technique was suitable for obtaining a satisfying outcome, the data gathering procedure may be the root of the issue. This study made use of information, disclosure distribution, disclosure checklist, disclosure scoring, disclosure index formulation, dichotomous process, and Partial Compliance approach.

Bauer, Guenster, and Otten (2004) discovered that corporate governance and a firm's value have a combined effect on profitability. Many studies have been conducted that suggest there is no link between corporate governance and a company's profitability. Some studies are still underway to study the link between business performance and corporate governance factors, despite the fact that the findings do not entirely support it Elmagrhi et al. (2017). In a huge way, corporate governance is powerless. Businesses are frequently a fertile ground for those looking for illegal benefits in the workplace. Giving minority investors certification of benefits and less corruptive relationships between big company and government power may result in an increasingly fantastic situation for small businesses and a more equitable distribution of rewards (Iskander & Chamlou, 2000). Interest-free banking provides advances based on shariah and other Islamic principles such as Modarabah, Musharika, and Ijara. The Islamic banking system has been steadily growing over the last two decks, and its market share has reached 7% in recent years (Samad, 2004).

Ho and Wong (2001) examined a theoretical model connected to four fundamental corporate governance issues with the degree of disclosure provided by Hong Kong-listed companies. These corporate governance qualities include the percentage of independent directors to total number of directors, the entity of prominent individuals, and the entity of an audit committee. To weigh voluntary disclosure, they created a weighted relative disclosure index. They asserted that the existence of an audit committee is tied to voluntary disclosure. Lipto and Lorsc (1992) proposed an effective method for strengthening corporate governance and, as a result, boosting performance and competitiveness of US enterprises. They demonstrated that their suggestions could be approved by individual boards of directors with very minor revisions. They also discovered that their strategy will lessen conflict between activist institutional investors, shareholder advocacy groups, and companies. Dezoort and Salterio (2001) revealed the outcomes of a research examining whether audit committee members' corporate governance experience, financial reporting, and audit knowledge influence their decision in auditor-company management disagreement situations. Among the study tools are an accounting policy dispute assignment, knowledge and competence tests, and an experience questionnaire. The findings showed that an independent director's experience with expanding and broader audit expertise was associated with improved audit committee member support for an auditor.

According to Maher and Andersson (2002) the structure of corporate governance is concerned with the control and economic position. It is widely acknowledged that excellent governance has a substantial impact on a company's financial and operational performance, as well as market growth. Eng and Mak (2003) finds the impact of ownership structure and board composition on voluntary disclosure. They reported that Ownership structure is distinguished by block holder ownership and government ownership, managerial ownership, and board composition and these are measured by the percentage of independent directors. Their results revealed that both ownership structure and board composition affect disclosure. Reaz and Arun (2006) demonstrate the issues with corporate governance in the banking sector, as well as the influence of political interference and regulator failure. In addition, the weakening of the corporate governance structure in Bangladesh's banking industry has been highlighted, with the participation of ownership structure, executive elements, transparency and auditing practices, and so on.

Organizations are racing to institutionalize corporate governance to combat accounting, leadership, and governance problems, according to Kocourek, Burger, and Birchard (2003) which may be counterproductive. Governance, according to Kocourek, begins at home, in the boardroom, among the directors. It's in the "soft" stuff, including how, when, and why they gather, engage, and cooperate with one another and with management. However, qualitative changes to the directors' and CEO's actions, relationships, and goals are useless unless they are subjected to the "hard" mechanisms of performance standards, processes, and assessment. This combination of soft and hard solutions, according to Kocourek, can transform corporate governance from a hazy concept into a tool for ensuring organizational resilience, robustness, and continual improvement. Ibrahim, Rehman, and Raoof (2010) took a broader view of corporate governance in the context of planning, describing it as "the way in which a bank's structures, methodologies, procedure, and execution are administered so as to allow positive associations and the concentrated utilization of intensity in the organization supervising favorable linkage of benefits with the goal of pushing up offers cost and investor satisfaction while improving responsibility by a direct overseeing.

3. Methodology

For the study, Islamic and non-Islamic banks have been selected where all the product and services are analogous that helped us to compare among the banks more transparently. Both qualitative and quantitative approaches were employed in conducting this study. This research paper is based on the secondary data and information gathered from published annual reports of the respected banks and also from the literature review to reach the objectives of the study. Different national and international articles, dailies, books, journals are examined and collected in writing this paper. Websites were also browsed. The study covers five years period from 2016 to 2020. Some data to be obtained was ordinarily being expressed in nonnumeric forms. It was quantitative in the fact that some variables were expressed in numerical form. In conducting this study, the population was all of the banks currently operated in the banking sector of Bangladesh. Among these banks purposively, 6 Islamic and 6 Conventional banks were selected purposively for this study. This sampling selection of banks was made on a convenient sampling technique. We used correlation and multiple regressions to examine our data in this study. The entire analysis for the study is done on a personal computer. To evaluate the data, a well-known statistical tool such as 'Statistical Package' (SPSS) 20.0 Version was utilized.

4. Results and Discussion

Banks performance can be evaluated by assessing the effect of corporate governance. For this purpose, the following two models have been developed impact.

$$ROE = \beta_0 + \beta_1 BS + \beta_2 IND + \beta_3 BD + \beta_4 CEODT + e \qquad (1)$$

$$ROA = \beta_0 + \beta_1 BS + \beta_2 IND + \beta_3 BD + \beta_4 CEODT + e \qquad (2)$$

Equation 1 presents the return on equity model with independent variables, whereas Equation 2 argues the model of return on assets.

The model implies that the performance of banking businesses is influenced by a number of corporate governance variables. The board size, board number of independent directors in the board, board diversity, and CEO duality are the corporate governance variables.

Table 1. Correlation matrix for Islamic banks.

Variable	ROE	ROA	BS	IND	BD	CEO duality
ROE	1					
ROA	-0.87	1				
BS	0.14	0.15	1			
IND	0.08	-0.17*	0.03	1		
BD	0.82	-0.56	0.33	0.76**	1	
CEO duality	-0.07	-0.10	0.24	-0.03	0.13	1

Note: ** Correlation is significant at 0.01 level *Correlation is significant at 0.05 level.
Here, ROE = Return on equity, ROA = Return on assets, BS = Board size,
IND = Number of independent directors in the board, BD = Board diversity.

4.1. Correlation Analysis

Table 1 displays the correlation values of Islamic banks. Except for CEO duality, corporate governance has a non-significant positive correlation with ROE and a negative correlation with ROA. In this case, IND has a considerable negative association with ROA, which is significant at the 5% level. However, board size, the number of independent directors on the board, and board diversity all have a positive link with ROE, however CEO duality is adversely connected. On the other side, there is a negative association between ROE and the dualism of IND, BD, and CEO. ROA is influenced positively by BS.

Table 2. Correlation matrix for conventional banks.

Variable	ROE	ROA	BS	IND	BD	CEO duality
ROE	1					
ROA	0.86**	1				
BS	-0.57*	-0.42	1			
IND	-0.32	-0.39	-0.20	1		
BD	-0.52	0.45	-0.17	0.19	1	
CEO duality	0.12	0.01	-0.13	-0.08	0.24	1

Note: ** Correlation is significant at 0.01 level *Correlation is significant at 0.05 level.

Table 2 exhibits the correlation analysis of conventional banks. BS is negatively correlated with ROE which is significant at 5% level of significance. ROE has a negative relationship with IND and BD whereas CEO duality is positively correlated. On the other hand, CEO duality has very less impact on conventional bank's ROA. There exists negative association in ROA with BS and IND in where BD has positive impact on ROA.

Table 3. Corporate governance and Islamic banks performance.

Details	ROA	ROE
BS	0.01*(1.76)	0.02(1.51)
IND	0.03***(2.89)	0.11(0.94)
BD	0.12(-0.22)	0.30(55.26)
CEO duality	-0.01(-0.89)	-0.03(-0.43)
Constant	0.016*(6.991)	0.07(5.40)
Adjusted R^2	0.30	0.28
F-stat	2.51***	3.22***

Note: ** *significant at 0.01 level, level. *significant at 0.1 level.

Table 4. Corporate governance and conventional banks performance.

Details	ROA	ROE
BS	0.01(0.09)	-0.01(-0.81)
IND	-0.03 (-1.52)	-0.13*(-1.92)
BD	0.38 (0.15)	0.40(-0.02)
CEO duality	-0.01(-0.13)	0.13*(-1.92)
Constant	0.01 (14.40)	0.11(6.34)
Adjusted R^2	0.49	0.43
F-stat	5.27***	5.23***

Note: ***significant at 0.01 level, level.*significant at 0.1 level.

4.2. Regression Analysis

In Islamic banks sample, BS and IND are found positively significant with the banks performance proxies for ROA, which clearly confirms that these variables increase the profitability of Islamic banks, whereas regression result of conventional banks shows that BS and BD have positive impact on ROA (Table 3 and Table 4). This indicates that larger the BS and BD higher would be the return on assets. However, the beta coefficient is not significant at 5% level. It is also revealed that, corporate governance related banks specific variables such as BS, IND and BD have positive impact on ROE in Islamic banks sample. On the other hand, in terms of the coefficient of independent variables from sample banks of conventional sector are found to be negative influence on ROE in where IND and CEO duality shows significant result. All of the foregoing findings indicate that each individual variable has an impact on bank performance.

5. Recommendations

After the investigation, it can be concluded that Islamic banks lag behind non-Islamic banks in terms of corporate governance in their respective banking sectors. Many of the banks do not present the previous five years financial statements in their report. But according to the amended notification 2012 provided by Bangladesh Securities and Exchange Commission, it is mandatory for all of the banks in the banking industry. As this helps to make the financial statements more understanding about the current performances as well as the previous performances of the respective banks. Therefore, all of the banks should present at least five years financial data of their financial performances. In terms of the report to the shareholders, Islamic banks are also in a bad position and they should obey the rule. All the banks should obey the rule for ensuring better transparency, fairness, and accountability in the banking sectors.

Bangladesh bank should enhance their current level of supervision over currently operated banks in the sector where there exists deficiency in corporate governance and ethical issue. Financial distress reduces the confidence level of investors in investing in the economy. And it hinders the development of our country. This paper strongly recommends that all the banks of Bangladesh should follow the CG practices to ensure accountability and Transparency in each and every corporate sector for the improvement of the current position of corporate governance practice.

6. Conclusion

Bangladesh is currently is in the process of transforming from the agro-based economy into the industry-based economy. Nowadays banking industry is considered a great crucial financial sector. By ensuring accountability, transparency, and fairness in banking activities, countries economic development can be accelerated. Bangladesh is already backbencher in the practices of sound corporate governance policies, laws, and regulations especially in the banking industry in conducting banking activities. As result transparency, accountability, credibility, and fairness are almost absent in some sectors of corporate culture and it causes their long-term prosperity falls down. By ensuring good corporate governance we can facilitate minority shareholders rights protection. This study, it is found that a majority of the selected banks follows the CG practices but not all of the sectors. It is also understood from the analysis that in terms of their rules, regulations and operating procedures non-Islamic Banks and Islamic Banks are different from each other. In terms of practicing corporate governance, it can be concluded from the study, Islamic banks performance are not good in comparatively Conventional banks.

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