BEYOND GROWTH – THE GOVERNANCE AS A FORMULA FOR SUCCESS

Chundika Ariyawansa

Senior Executive Internal Audit, Sampath Bank PLC

Introduction

This article discusses the key factors that are vital for the sustainability and growth of the financial services industry of Sri Lanka in relation to governance aspects based on the lessons of recent world financial crisis. The significance of this essential element is appraised amidst the growth trajectory of the Sri Lankan economy in the aftermath of thirty years of civil war and the prevailing corporate governance framework.

The present economic outlook of Sri Lanka

The present positive momentum maintained by the Sri Lankan economy is expected to achieve a growth rate of 7.5 per cent of GDP by end 2013 as per forecasts made by the Central Bank of Sri Lanka in its latest press release – September 2013.

The release further states that it is expected that the global economy is to recover by the second half of the year which is likely to generate a healthy demand for exports with a boom in the tourism industry. Thus, the external demand along with the domestic demand with the increasing purchasing power would favourably affect the manufacturing sector. At the same time banking sector would be benefited by relaxed monetary policy measures introduced from end 2012. Further, the private sector could access alternative sources of finance, such as non-bank credit, debenture issues and funds from international capital markets etc., thus making it possible for access to cheaper funding sources.

This indicates the opportunity to expand the businesses in terms of volumes as well as into new avenues. During this period, it is very likely that the existing businesses would plan for ambitious expansions/diversifications etc. in order to obtain first mover advantage. This phenomenon is applicable for financial institutions like banks as well. It was witnessed with the opening up of North & East, how banks and other financial institutions set up their branches in double quick time.

On this backdrop it is worthwhile finding out the strategic importance of governance frame work established for business entities, especially banks in Sri Lanka and its adequacy given the fact that any inadequacy would be fatal to the entire economy of the island in the long run. This could be aptly demonstrated with the analysis of recent financial crisis that plagued the so called well developed economies with sophisticated financial institutions and how it led to chaos in the respective countries.

Brief analysis of world financial crisis

a) The **2008–2011 Icelandic financial crisis** was a major economic and political crisis in Iceland that involved the collapse of all three of the country's major privately owned commercial banks, following their difficulties in refinancing their short-term debt and a run on deposits in the Netherlands and the United Kingdom. Relative to the size of its economy, Iceland's systemic banking collapse is the largest suffered by any country in economic history.

b) The **2008–13 Irish banking crisis,** is a crisis in Ireland which led to a number of financial institutions requiring government assistance, and subsequently led to a number of unexpected revelations about the private affairs of some banks.

   In the 1995–2006 *Celtic Tiger* period of growth, development capital was raised in the interbank market, typically on a three-month basis, but with repayment not expected until two or three years later. Inadequate and/or lax supervision of the Irish banking system had allowed excessive borrowing by the Irish Banks on the corporate and international money markets. Much of the capital invested in Irish banks was from abroad with 80% from the UK, 13% from the US, 5% from off-shore funding and only 2% of the total Irish bank funding came from the Euro Zone in 2008. Most of this borrowing was re-cycled by the banks into property loans. This, in turn, led to a massive increase in the price of Irish property assets. The freezing-up of the world's interbank market during the financial crisis of 2007–2008 caused two problems for Irish banks. Firstly, with no new money available to borrow, withdrawal of deposits caused a liquidity problem. In other words, there was no cash available to honour withdrawal requests. A liquidity problem on its own is usually manageable through Central Bank funding. However, the second problem was solvency and this was much more serious. The lack of new money meant no new loans which meant no new property deals. No new property purchases both exposed fragile cash-flows of developers and highlighted the stratospheric valuations. With the value of most of their assets (loans) declining in line with the property market, the liabilities (deposits) of the six Irish domestic banks were now considerably greater than their assets. Insolvency loomed and Irish banks would need major cash injections (recapitalization) to stay open.

c) The **2008–2009 Russian financial crisis**, part of the world Economic crisis of 2008, was a crisis in the Russian financial markets as well as an economic recession that was compounded by political fears after the war with Georgia and by the plummeting price of Urals heavy crude oil, which lost more than 70% of its value since its record peak of US$147 on 4 July 2008 before rebounding moderately in 2009. According to the World Bank, Russia's strong short-term macroeconomic fundamentals made it better prepared than many emerging economies to deal with the crisis, but its underlying structural weaknesses and high dependence on the price of a single commodity made its impact more pronounced than would otherwise be the case.

d) The **automotive industry crisis of 2008–2010** was a part of a global financial downturn. The crisis affected European and Asian automobile manufacturers, but it was primarily felt in the American automobile manufacturing industry. The downturn also affected Canada by virtue of the Automotive Products Trade Agreement.

e) The U.S. **subprime mortgage crisis** was a set of events and conditions that led to a financial crisis and subsequent recession that began in 2008. It was characterized by a rise in subprime mortgage delinquencies and foreclosures, and the resulting decline of securities backed by said mortgages. These mortgage-backed securities (MBS) and collateralized debt obligations (CDO) initially offered attractive rates of return due to the higher interest rates on the mortgages; however, the lower credit quality ultimately caused massive defaults. Several major financial institutions collapsed in September 2008, with significant disruption in the flow of credit to businesses and consumers and the onset of a severe global recession.

   There were many causes of the crisis, with commentators assigning different levels of blame to financial institutions, regulators, credit agencies, government housing policies, and consumers, among others. A proximate cause was the rise in subprime lending. The percentage of lower-quality subprime mortgages originated during a given year rose from the historical 8% or lower range to approximately 20% from 2004 to 2006, with much higher ratios in some parts of the U.S. A high percentage of these subprime mortgages, over 90% in 2006 for example, were adjustable-rate mortgages. These two changes were part of a broader trend of lowered lending standards and higher-risk mortgage products. Further, U.S. households had become increasingly indebted, with the ratio of debt to disposable personal income rising from 77% in 1990 to 127% at the end of 2007, much of this increase mortgage-related.

f) The **Euro zone crisis** (often referred to as the **Euro crisis**) is an ongoing crisis that has been affecting the countries of the Euro zone since late 2009. It is a combined sovereign debt crisis, a banking crisis and a growth and competitiveness crisis.

   The crisis made it difficult or impossible for some countries in the euro area to repay or re-finance their government debt without the assistance of third parties. Moreover, banks in the Euro zone are undercapitalized and have faced liquidity problems. Additionally, economic growth is slow in the whole of the Euro zone and is unequally distributed across the member states.

   From late 2009, fears of a sovereign debt crisis developed among investors as a result of the rising wave of downgrading of government debt in some European states. Causes of the crisis varied by country. In several countries, private debts arising from a property bubble were transferred to sovereign debt as a result of banking system bailouts and government responses to slowing economies post-bubble. In Greece, high public sector wage and pension commitments were connected to the debt increase. The structure of the Euro zone as a monetary union (i.e., one currency) without fiscal union (e.g., different tax and public pension rules) contributed to the crisis and harmed the ability of European leaders to respond. European banks own a significant amount of sovereign debt, such that concerns regarding the solvency of banking systems or sovereigns are negatively reinforcing.

Concerns intensified in early 2010 and thereafter, leading European nations to implement a series of financial support measures such as the European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM).

Aside from all the political measures and bailout programmes being implemented to combat the Eurozone crisis, the European Central Bank (ECB) has also done its part by lowering interest rates and providing cheap loans of more than one trillion Euros to maintain money flows between European banks. On 6 September 2012, the ECB also calmed financial markets by announcing free unlimited support for all euro zone countries involved in a sovereign state bailout/precautionary programme from EFSF/ESM, through some yield lowering Outright Monetary Transactions (OMT).

The crisis did not only introduce adverse economic effects for the worst hit countries, but also had a major political impact on the ruling governments in 8 out of 17 euro zone countries, leading to power shifts in Greece, Ireland, Italy, Portugal, Spain, Slovenia, Slovakia, and the Netherlands.

The Euro zone crisis has also become increasingly a social crisis for the most affected countries, with Greece and Spain having the highest unemployment rates in the currency area. Spain's unemployment was 26.9 % in May 2013, while Greece's rate in March was 26.8 %.

In analyzing the above instances, it is evident that the role of financial institutions had a major stake in the crisis either as the initiator or facilitator. So the golden question is how to avoid repetition of such events in the future.

On this backdrop the following reports published on governance of banks are widely regarded as important referrals by the banking community across the world that provide basis of pre-preparing to face a crisis situation.

a) Walker Report (2009) in the United Kingdom
b) Basel Committee Report (2010)

c) Organization for Economic Co-operation and Development Report (2010)
d) European Union Report (2010)

These international reports have proposed a number of guidelines to improve bank corporate governance and more specifically risk governance. Therefore, it is imperative for us to get a glimpse of the aspect of corporate governance from an academic point of view at this juncture.

Corporate Governance

"*Good Corporate Governance is essential to the effective operation of a free market, which enables wealth creation and freedom from poverty.*" (Financial Reporting Council – UK)

The term "Corporate Governance" is defined by the Organization for Economic Co-operation and Development (OECD) (1999) as follows;

'The corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it provides the structure through which the objectives of the company are set, and means of attaining those objectives and monitoring performance.'

The contribution of corporate governance for the stability and equity of society is aptly captured by the following definition of Adrian Cadbury formulated in 2004:

"*Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.*"

Prof. Samanthi Senarathne in her technical paper "Corporate Governance Reforms in Sri Lanka" (2011) to the Sri Lanka Journal of Advanced Social Studies – Vol. 1-1st Issue expresses the following views on the subject:

" The wider social and economic implications have made corporate governance a global issue. Thus, the introduction of corporate governance reforms has become a high priority in both developed and developing countries in the world. However, the impetus for corporate governance reforms in both developed and developing countries has much deeper roots relating to larger historical experience of the countries in question and structural changes in the global political economy (Reed, 2004a). These deep roots affect the nature of corporate governance reforms carried out in these countries. This has resulted in practicing different systems of corporate governance in the world.

The technical paper further clarifies the different models of corporate governance;

a) Anglo-Saxson (market-based) model of USA and UK
b) Relationship-based (insider-system) model in Europe and Asia-Pacific countries

The key distinction of the two systems is made in relation to who plays the dominant role in monitoring and control of a company (i.e. whether banks or the stock market is the main locus of monitoring and control). These systems of corporate governance that have been evolved in the developed countries have been transmitted to developing countries via corporate governance reforms."

In the context of the banking industry the continuous success of a banking entity largely revolves around the cordial relationship that exists between the directors and the corporate management of the company. At the same time directors should abstain from putting self-interest and self-preservation ahead of their stakeholders. Generally, good governance gives an entity the much needed protection to operate effectively and the ability to execute what is best for the company and shareholders.

The next part of this article deals with the comparison of governance issues in the European and Sri Lankan contexts and the adequacy of the existing governance framework in both the areas based on the research papers and the published articles of authoritative sources along with legal and regulation aspects.

a) The European context

The working paper titled "*Bank Corporate Governance, Beyond the Global Banking Crisis*" by Prof. Jean Dermine (2011) [author] discusses at length the four reports quoted earlier in this article with regard to their deficiencies which is the basis of discussion that follows in this section.

In the first part of the working paper, the author discusses the **comparability of the reports** in terms of different approaches.

The Walker Report (2009, p.23), based on the UK Companies Act states; "*The role of corporate governance is to protect and advance the interest of shareholders through setting the strategic direction of a company and appointing and monitoring capable management to achieve this.*" At the same time it does not imply the exclusion of other stakeholders. Annex 3 of the report (pp135-136) includes a list of principles of management:

"To promote the success of a company, directors must have regard, amongst other matters, to the following six factors:

1) The likely consequences of any decision in the long run
2) The interests of the company's employees

3) The need to foster business relationships with suppliers, customers and others (*fiduciary responsibility*)
4) The impact of the company on the community and environment
5) The desirability to maintain a reputation (*long-term franchise*)
6) The need to act fairly between members of the company"

In the final analysis the directors should promote the welfare of the shareholders, the owners of the corporation as per this report.

The Basel Committee report "Principles for Enhancing Corporate Governance" (2010, pages 5 and 10) states "...........how the board and senior management:

1) Set the bank's strategy and objectives
2) Determine the bank's risk tolerance/appetite
3) Operate the bank's businesses on a day-to-day basis
4) Protect the interest of depositors, meet shareholder obligations, and take into account the interests of other recognized stakeholders
5) Align corporate activities and behavior with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations.

This section of the report clearly identifies the responsibility of the directors as against stakeholders.

Accordingly, the basis of recommendation of the four reports could be broadly classified as;

1) Shareholder-based approach
2) Stakeholder-based approach

Though, there are different forms of corporate governance in a market based economy the author of the working paper favours the latter approach considering the fact that certain banks have taken excessive risk leading to large losses, costly bailouts by taxpayers, large budget deficits and increase in unemployment. On the contrary, with regard to value maximization of the entity, it is difficult to address the interests of all stakeholders, so that from the governance perspective the author suggests to continue with share-holder based approach. The argument being that it is single focused as against multi-focused which may not be practical from strategic point of view.

Secondly the author discusses the **inadequacy of the governance of bank supervision**. The author supports his argument based on the following facts;

a) Few heads of national supervisory authorities have been asked to step down unlike CEOs of banks in spite of their failure to supervise effectively.

For Example; in several countries in Central and Eastern Europe some banks were allowed massive lending in foreign currency (mostly Swiss francs, euro and yen) on the individual mortgage market, thus creating a large source of systemic risk, as the devaluation of the local currency would raise the default rate across the entire banking system

b) The stress testing conducted in July 2010 was recognized as too lenient by the European bank supervisors in the wake of the Irish banking crisis in December 2010

In order to overcome these deficiencies, the author proposes;

a) Development of measures of performance for the supervisors
b) Development of a legal mechanism that forces debt holders to bear bank losses

Thirdly the author discusses on the aspects of **short term profit maximization vs**. **long term value creation**.

The view expressed by the author in this regard is very much based on the common sense approach. It is said that though financial markets reward short term reported profits, it is the responsibility of the bank's board to take care of long term value creation; even if it means hurting reported revenue and the share price in the short term. The Executives should drive business within regulations in accordance with the strategy and manner (ethics/culture) set and supervised by the board. In this regard a way out on this matter is the appointment of independent or non-executive directors as suggested by experts though in the recent past their lack of understanding has contributed negatively to the business entities world across.

Fourthly, the working paper elaborates on the issues related to **identification of risks**.

It covers following areas;

a) Identification of relevant stress tests

A necessary condition for bank soundness is that it can survive and keep the going-concern value of the franchise at a time of significant economic shock. Bank capital must be able to absorb losses at a time of a stress scenario (also referred to as *tail risk*).

b) Distinctions between situations of risk and those of uncertainty

The classic examples in this regard is the subprime lending in the US home market which ultimately led to crashing of home loan market and making the lending institutions bankrupt. However, this was a great innovation that gave access to credit and home ownership to risky borrowers.

On the contrary, lending to new ventures could not be properly assessed for their risk and uncertainty. Therefore, in a situation of risk, the probability distribution of losses can be identified with relevant data whereas in the case of uncertainty, the distribution of losses cannot be measured, as situation being new, no relevant data is available.

The question now is whether bankers as entrepreneurs should necessarily avoid uncertainty and overlook new business opportunities. The author argues that it is not so but the scale of exposure should be limited to an acceptable level until more information on the potential risk becomes available. Accordingly, the decision of the banks to enter subprime market was not the issue but the failure to limit the growth of this highly volatile activity to an unmanageable proportion.

c) Psychological and cognitive biases in risk management

The decision science experts (Hammond *et al.*, 1998) have identified following cognitive biases with the measurement of risks;

1) **Anchoring**: the brain appears to have a bias in fixing an estimate close to reported value

2) **Framing formulations**: this refers to the way a risk measure is expressed. For example, 50% maximum loss of *x*, or a 1% chance that the loss will be higher than *x*; accordingly, the first expression easily provide maximum loss though the latter could not.

3) **Availability**: as a result of limited memory the tendency is to remember the recent events than the historical ones, thus creating biasness.

The author suggests the assistance of independent experts in the field to measure risk.

d) Lessons from a 20-year experience with bankers using a bank simulation

This refers to the role played by board members in the Asset & Liability Committee (ALCO) in banking simulation setting. The author identifies few worthwhile lessons/experiences gained at this committee;

1) Success can bring over-confidence and complacency
e.g., predicting correct interest rates in advance over a period of time

2) Controlling the consequences of extreme events – *anchoring* bias discussed earlier

3) Over confidence in numbers and graphs – need to validate the assumptions driving numbers

4) Relative positioning – excessive risk taking to out perform the competitors

5) Group decision making – this leads to more complete identification of risk

6) Separate risk management function

Lastly, the author of the working paper discusses on **risk avoidance vs. risk taking**

The golden question is how much of risk is acceptable where the line could be drawn between taking and avoidance. There are no hard and fast rules in this regard where the judgments could be based on a number of facts such as the economic outlook, nature of the project in terms of long term value creation, the ability of the institution to absorb the shock etc. The best suggestion of the author is running a diversified financial group instead of a single entity which was aptly supported by the Standard & Poors (2010) proposal on rating methodology for banks.

In the final analysis, as per the author of the working paper, the four reports have following two key deficiencies;

1) The focus of the reports is exclusively on risk avoidance
2) Little or no guidance as to how boards should define acceptable level of risk

Hence the working paper concludes with following recommendations;

1) The bank governance should concern not only the boards but also the governance of banking supervision with clearly identified accountability principles
2) Since biases for short-term profit maximization are numerous in banking, boards of banks should focus on long-term value creation
3) Board members and banking supervisors should pay special attention to cognitive biases in risk identification and measurement
4) A value-based approach to risk taking must take into account the profitability of stress scenarios and associated costs of financial distress

b) The Sri Lankan context

The corporate governance reforms in Sri Lanka date back to the latter part of 1990, where the first voluntary code of best practices on matters relating to financial aspects of corporate governance was issued in December 1997 by the Institute of Chartered Accountants of Sri Lanka (ICASL). Since then with the passage of time there have been a number of additions to the corporate governance mechanisms, especially for banks with the adoption of Basel II guidelines.

In essence, the most comprehensive guidelines were issued to the banks by the Central Bank of Sri Lanka as the apex body of the financial system of the country in terms of powers vested on it under section 5 of the Monetary Law Act, No. 58 of 1949. Accordingly, the Bank is expected to achieve following objectives, namely, *(a)* economic and price stability and *(b)* financial system stability. Further, under the provisions of the same Act the supervision of banks has been made a duty of the Central Bank. This is where the Sri Lankan context is different to the first recommendation of the working paper discussed earlier, i.e., accountability of banking supervision, which is very clearly framed in this part of the Act. So that, the accountability issue will not arise at the very outset. However, the mechanism of accountability cascading down to the individuals is not an issue here also considering the principle of vicarious liability.

In the balance part of this article the reference is drawn from directives issued under corporate governance by the Central Bank of Sri Lanka.

Banking Act Direction No. 11 of 2007 – Corporate Governance for LCBs in Sri Lanka

a) Directive 2

This part is referred to only for explanatory/clarification purposes.
The most important part of this directive is 2(1) (vi), which states;

The directors should be aware of potential civil and criminal liabilities that may arise from their failure to discharge their duties diligently. They should also understand that they should act with due care and prudence. In addition, the directors of state owned banks should be aware of the additional liabilities that arise from the status of such banks being state enterprises and consequently being accountable to the public. It is, therefore, necessary that directors commit sufficient time and energy to fulfilling the board's responsibilities in managing the affairs of the bank in a prudent manner.

This section very clearly covers the aspects of accountability of directors in a comprehensive manner.

b) Directive 3

This part provides the mandatory rules for compliance by LCBs without exception. The areas covered are;

1) The responsibilities of the Board
2) The Board's composition
3) Criteria to assess the fitness and propriety of directors
4) Management functions delegated by the Board
5) The Chairman and Chief Executive Officer
6) Board appointed Committees
7) Related party transactions
8) Disclosures
9) Transitional and other general provisions

Following sections of this directive are important;

Independent directors

3(2) (iv) – *the board shall appoint at least three independent non-executive directors or*

1/3 rd of the total number of directors whichever is higher.

Chairman

The chairman shall be a non-executive director and preferably impendent director as well. If not the board shall designate an independent director as the Senior Director.

It is evident that this part ensures smooth functioning of the apex body of a bank, the Board with clear objectives and directions as well as in a more independent and transparent manner.

Banking Act Direction No.7 of 2011- Integrated Risk Management Framework (IRM) for LCBs

The main objective of this directive is to promote the soundness of banks and banking system. The directive covers following areas;

A. Integrated Risk Management
B. Credit Risk Management
C. Market Risk Management
D. Operational Risk Management
E. Liquidity Risk Management
F. Interest Rate Risk Management
G. Stress Testing
H. Disclosure Requirements

At this juncture it is not necessary to elaborate in detail on the areas of risk management given above since the objective of this article is to assess the degree of sophistication of the parameters set for evaluating different risks compared to recommendation made by the author of the previous section. Further, it can be stated with confidence that the deficiencies highlighted by the author under the European context is greatly over come by Sri Lanka, though it is too premature to state the adequacy of the same without being tested under a real life situation.

Companies Act No. 7 of 2007

In addition to the directives issued by the Central Bank of Sri Lanka, there is another defence line under the above Act. This Act is applicable for LCBs with public ownership.

The significant sections are;

187 – Duty of the directors to act in good faith and in the interest of the company
188 – Directors to comply with the Act and company's articles
189 – Directors standard of care
190 – Use of information and advice

Suffice it to say that in the Sri Lankan context, serious work has been envisaged with regard to setting up of proper mechanism in corporate governance with adequate checks and balances on paper.

Recent financial issues in Sri Lanka

The events that unfolded in the last few months in Sri Lanka were bit disturbing from the point of view of a prudent banker though the actual situation is yet to be assessed.

a) The Pawning crisis

Pawning has been a popular mode of borrowing from banks and financial institutions in Sri Lanka for a long time. The underlying assumption was the relative stability of the price of gold where the tendency was to increase in price over a period of time. So that it was given zero risk weight in calculation of regulatory capital ratios as well as there were no restrictions on the loan-to-value ratios. At the same time, there have been no checks on the ability of the prospective borrower's repayment capacity. If the borrower defaulted the regulations does not require reporting the same to Credit Information Bureau. In a nutshell no prudential norms in lending have been followed in this segment.

Though the experts have expressed their confidence that the present state of overall exposure of banks in this segment as closer to 18%, the issue is that some banks have more than 20% exposure which is almost 1/5th of the total loan portfolio of respective individual banks. At the same time, it was argued that the NPL in this segment is below the industry average compared to other loans and advances. However, all such positives need to be dependent on the stable gold prices in the world market though it is too premature to express any opinion of the same given the volatility in the precious metal markets in the world.

Now this is a clear indication of the deficiency highlighted under (2) and (3) of the recommendations, i.e, short term profit maximization and cognitive biases in identifying risk. Although, still it could not be considered as a systemic risk arising from the exposure to pawning, the decisive factor is the level of defaults in the future.

b) Cash strapped Finance Companies

It has become a regular incident that finance companies tend to fail in their obligations at more regular intervals than earlier. This is in spite of all the regulations in relations to governance being in place. The main reason being mismatch of assets and liabilities of the institutions and overstating of accounts. The spate of incidents leads to public outcry and questioning the safety of deposits with the finance companies. At the same time the finger was pointed at the regulator.

This phenomenon could not be healthy in the long run for the economy and negatively affects the degree of confidence on the financial industry in particular, placed by the general public as well as potential investors.

In the final analysis, the state of governance could not be limited to strict rules, regulations, frameworks and sophisticated mechanisms which are mostly external measurers but it appears the real essence lies on the sheer integrity and the prudence of the individuals that matter most in running the companies.

The ideal model of corporate governance

In their contribution to the forthcoming book *Handbook of Strategy and Management*, Gerald Davis, professor of organizational behavior and human resource management at the University of Michigan, and Michael Useem, professor of Management and director of the Center for Leadership and Change Management at the Wharton School, observe that a few thousand corporations produce the bulk of the world's economic output and employ a significant part of the world's labor force. This then leads them to ask the question, given that large corporations have such a profound impact on the economic well-being of society, is there a best model for corporate governance? If there is such a model, they then ask, can it be easily replicated in other societies and cultures?

They note that studies from researchers throughout the world have sought to examine and discern the dynamic relations that characterize corporate governance. Economic and financial decisions are embedded in a matrix that ties company directors, senior executives, shareholders, money managers, stock analysts, and government regulators. Given the right combination of features, that matrix can yield high investment returns and robust national growth. Given the wrong amalgam, it can lead instead to self-dealing, frozen form, and economic stagnation. Thus, the question of what is the best model for corporate governance is of no little importance.

The American model for corporate structure and governance is the one that most researchers might point to as the paradigm for the new millennium. After all, American businesses have been driving the world's economy for most of the past decade. But, Davis and Useem say, it was not all that long ago when the American system had been written off in favor of a hybrid of German and Japanese management practices and structures. The answer to the question of whether there is a "best practice" model of corporate governance appears to be more elusive than a first glance would otherwise indicate.

Davis and Useem examine within the context of their overarching question: Is there evidence of convergence in management practice and corporate governance around the world? They believe the answer increasingly will be yes as a result of the inevitable forces of the global equity marketplace. "With companies seeking capital from all corners of the globe, investors predictably prefer relatively consistent models that they believe will optimize shareholder value and performance transparency." The road ahead is likely to see a greater focus on those governance arrangements and leadership styles that work well both within national settings and across cultural divides.

One factor that will be common in any context, they stress, is leadership: "Given the intensification of global competition and technological change in many markets, leadership is likely to make more of a difference in the future than it has in the past....Leadership within the company is a critical component. Unless the troops are mobilized and their mission understood, they are unlikely to deliver the value top management wants." Thus, irrespective of culture, location, and other factors, leadership will be critical to a company's success.

The "best practice model" is as yet unformed, if it indeed exists, but the path to convergence lies before us. Davis and Useem conclude, "We are more likely to discover a host of measures that, when deftly combined, adapted to legal contexts, and sensitive to cultural nuance, should produce what executives, directors, and stockholders, analysts, and regulators all want." The debate will continue, taking different forms as it takes place within various regions of our shrinking global marketplace.

Conclusion

Growth is an imperative for a developing country like Sri Lanka. At the same time such growth should be sustained over a long period of time in order to achieve much anticipated prosperity for the nation.

In a free market economy the engine of growth being private sector entities, their well-being depends on the degree of governance principles followed along with integrity and acumen of the individuals behind the steering wheel, which too is applicable for banks. However the question of judging people behind the wheel from existing facts without having any understanding of their inherent deficiencies would remain an unresolved issue. Therefore the ideal model for corporate governance could be an evolving phenomenon.

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