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An analysis of corporate governance practices in government controlled versus private banking institutions in Zimbabwe

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Abstract

The significance of good corporate governance practices is of paramount importance. It can be posited that the Zimbabwean banking sector crisis of the period 2003 to 2004 was largely due to poor corporate governance practices. Most of the banking institutions that faced closure in that era were of domestic origin. This crisis however did not affect the Government owned banks. This was a paradox as private banks are seen as profitable compared to Government owned banks. The paper sought to ascertain who between the government and private banks better adhered to corporate governance principles. Twenty one banks were involved in this study. A total of 39 questionnaires were sent, three per bank. Ten face to face interviews were conducted with the banks' directors and managers. The paper unearthed that corporate governance practices are observed by both private banks and government controlled banks; however private banks appear to have a slighter edge. Government owned banks do have good corporate practices in place.

Keywords: Four to eight keywords come here. Divide the keywords by semicolon.

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1. Introduction

Corporate governance is now considered as a key success element as it improves economic efficiency, growth and stability as well as encouraging public and private sector investments. It is for this reason that governments now play a pivotal role in promoting good corporate governance within their socio-economic realm of polity. The current wave of reform on corporate governance commenced with the Cadbury Code of practice established by the London Stock Exchange in 1992. Of late there have been pronounced shifts in corporate governance, given the recent global financial crisis. The focus on corporate governance grew as it was believed that poor corporate governance practices contributed to the subprime crisis of the last decade. In addition, the crisis affected some of the world's biggest companies such as The Lehman Brothers, Deutsche Bank and Northern Rock.

In Zimbabwe Corporate Governance is gaining momentum as evidenced by the publishing of Corporate Governance Guidelines by the Reserve Bank of Zimbabwe (RBZ) in 2004. The financial crisis that affected the banking sector in the period 2003 to 2004 saw five banks placed under curatorship, two liquidated and four rescued through the Troubled Bank Fund. These failures were largely attributed to poor corporate governance practices. The Government controlled institutions are those in which in the Government has a more than 51% shareholding or controlling stake. The private controlled category is divided into those foreign owned and those locally owned. An outline of the Zimbabwean banking sector is shown below. Commercial banks are 17 in total and merchants are 4.

2. Literature review

In the banking sector, the regulator and the regulatory sphere represent external forms of corporate governance mechanism. As a governance force, regulation aims to serve the public interest, particularly the interests of the customers of the banking service (Ciancanelli and Gonzales, 2000). Depositors rely on the government regulatory role to safeguard their bank deposits from expropriating management. The Basel Committee (2005) posits that effective corporate governance practices, on both a system wide and individual basis are essential to achieving and maintaining public trust and confidence in the banking system. Trust and confidence are critical to the proper functioning of the banking sector and economy as a whole. Poor corporate governance practices can lead markets to lose confidence in the ability of a financial institution to properly manage its assets and liabilities including deposits. This could in turn trigger a liquidity crisis or a run on the deposits. Levine (2004) noted that banks have greater opaqueness and more government regulation. Banks are generally opaque than other non-financial systems. Although information asymmetries plague all sectors of the economy, evidence suggests that these informational asymmetries are larger within banks (Furfine, 2001). The focus on the regulation of banks is more intense than other industries. Levine (2004) argues that banks are critically important for industrial expansion, the corporate governance of firms and capital allocation.

Tandelilin et al. (2007) noted several reasons for governments increased role in regulatory and supervision of the banking sector:

i. Bank depositors sometimes do not have much information on banks' modus operandi. The Basel Committee (2005) and RBZ Guidelines (2004) support the above by indicating that there is need to safeguard depositors' funds
ii. Bank instability leads to the contagion effect, which can affect a class of banks or even the entire financial system and the economy. The Basel Committee (2005) notes that banks and other financial systems can lose large amounts of money in the case of events such as fraud.
iii. Banks play a vital role in the financial system (King and Levine, 1993 a, b; Levine, 2004).

Banks have access to confidential customer information which can potentially be misused by employees for personal gains (The Basel Committee, 2005). The RBZ Guidelines (2004) and the OECD Principles (2004) place emphasis on integrating risk management with board practices. It is the ultimate responsibility of the board to ensure the all potential risks are identified and mitigatory measures were put in place. Markets have no adequate power to control the operations of banks. Hence, it needs government intervention to overcome market failure. Corporate governance also offers some fair incentives, compensation, and career plans for the managers who reduce agency costs. There is little evidence to suggest that private banks are more efficient than state owned banks (Tandelilin et al., 2007). The main role of bank managers is to serve shareholders' interest, which are to maximize return on shareholders' investment (bank performance) (ibid). The role of bank managers is inter alia to represent the shareholders' interest and maximize their returns.

3. The theoretical framework

The variables that were identified are listed below (see Figure 1);

- Dependent variable: Level of corporate governance
- Independent variables: These included board structure and composition, risk management structures, internal audit and control, equitable treatment of shareholders, ownership structures and agency relationship
- Intervening variable: The requirement by the regulator, Reserve Bank of Zimbabwe for implementation of new corporate governance frameworks or practices which are different from the existing ones.
- Moderating variable: Knowledge and expertise of corporate governance issues by board members and management team.

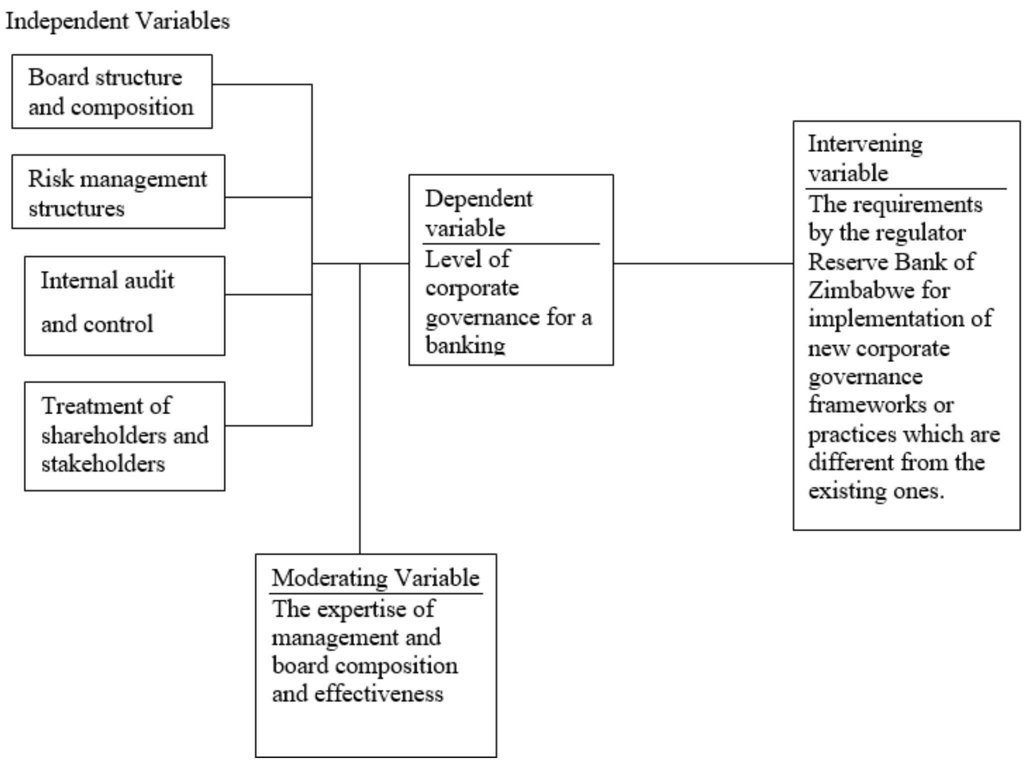

Figure 1. The conceptual framework showing the linking of the variables

4. Methodology

The target population was made up of all merchant and commercial banks in Zimbabwe. Over the period under review there were twenty-one (21) banks in total. The banks were put into stratums (categories) based on their ownership structures of government and private ownership. The private owned banks were further subdivided into those that are locally owned and that foreign in entity Government controlled banks were four (4), foreign owned six (6) and then locally owned were sixteen (16). All government controlled banks were included in the sample given their number. Sample elements were then selected randomly from the private ownership stratum. As a result, four (4) foreign owned banks and five (5) local owned banks were sampled, giving a total of thirteen (13) banks. In sampling the paper aimed at a sample equally representative of the whole population.

The questionnaires targeted three respondents per bank (the executive directors, non-executive directors and representatives for management). There were two sets of questionnaires, one for the directors and the other one for management. The questionnaire for directors included question regarding board composition, the effectiveness of the board in carrying out its functions and the board's view on corporate governance practices. The questionnaires for managers had set questions inter alia on the rights and treatment of shareholders, disclosure and transparency, internal controls and audit. The questionnaires were open and closed ended questions depending of the variable to be measured and were distributed via email or hand delivered. A total of 39 questionnaires were sent, three per bank. Ten face to face interviews were conducted with directors and managers.

5. Results and discussion

5.1. Questionnaire response rate

Government controlled banks had a response rate of 100%, whilst private controlled banks had a response rate of 70% (see Tables 1, 2, and 3)

Table 1. Total Response Rate for the whole sample

	Independent non-executive directors	Executive directors	Managers	Total/Average
Number of questionnaires sent	13	13	13	39
Total responses received	8	10	12	30
Total responses received as a percentage	62%	77%	92%	77%

Table 2. Response Rate for the Government Controlled Banks

	Independent non-executive directors	Executive directors	Managers	Total/Average
Number of questionnaires sent	4	4	4	12
Total responses received	4	4	4	12
Total responses received as a percentage	100%	100%	100%	100%

The high response rate for government controlled banks was attributed to their small number of four.

Table 3. Response Rate for the Private Controlled Banks

	Independent non-executive directors	Executive directors	Managers	Total/Average
Number of questionnaires sent	9	9	9	27
Total responses received	5	6	8	19
Total responses received as a percentage	56%	67%	87%	70%

5.2. Data analysis and presentation on the questionnaire for directors

5.2.1. The significance of corporate governance practices

An overwhelming majority argued that corporate governance practices are significant to their organizations. Generally, this is the requirement from the regulator, (The Reserve Bank of Zimbabwe) for banks to implement good corporate governance practices and also the regulator conducts onsite and offsite scrutiny. In private controlled banks, directors are elected either through the nomination committee or by the existing board or individual shareholders for listed companies. However, all government controlled institutions indicated that the election process is done by the state as the major shareholder. The average number of members on board ranged from 8.1 to 12 for government banks and 8 to 13 for private banks. It was noted from the sample that in all banks the role of the CEO is separate from that of the chairman. Therefore, it appears that all banks comply as per the RBZ Guidelines which require that these two roles be separated. It appears women's presence on the board of directors is limited; the highest mean was 2, 9 for government controlled banks whilst that of private banks was only 2,2. The Regulator (RBZ) requires that institutions conduct a minimum of four board meetings per year. All banks in the sample complied, as the minimum number as per the responses was given as 4 and the average minimum number of meetings per year was 4.1 for government banks and 4.2 for private banks. The maximum mean figure was 5.9 for government and 6.2 for private banks. It appears in both categories that 2008 had the highest average number of frequency of board meeting per year.

5.2.2. Whether the board of directors is acting in good faith, with due diligence and care in the best interest of the organization?

For private banks, 95% of the respondents were of the view that board of directors were indeed acting in good faith in the best interest of the organization whereas it was 90% for the government banks.

5.2.3. Recognition of the importance of corporate governance practices by the board of directors

Ninety percent of the responses from government banks and 95% from private banks were of the yes opinion, whilst the remainders 10% and 5% (respectively) said partially. Those who agreed highlighted the listed below as the ways in which directors ensure corporate governance practices are implemented;

i. The Board is the first port of call by ensuring that it performs its functions and is composed of the right caliber.
ii. Ensuring that there are independent non-executive members on board.
iii. Ensuring that appropriate systems and procedures are in place; these includes risk management framework, internal controls, credit controls. In addition, the board receives monthly and quarterly reports for monitoring.
iv. Strategy, policy formulation and implementation.
v. Ensuring that all the important board committees are in place, including their references, meet as required and produce board reports.
vi. Ensuring that the code of ethics and board charter is in place and the responsible beneficiaries are well aware of these.
vii. There is a clear set out policy for Corporate Governance, which is monitored through compliance checklists and reports to the board.

5.2.4. The level of corporate governance compliance as per the Reserve Bank of Zimbabwe guidelines of 2004

Ten percent of respondents from Government controlled banks indicated that their level of compliance was excellent, 60% good, 10% average and 5% poor. For private banks 55% said they complied, 30% ere on average and 10% rated theirs as poorly. As such government controlled institutions comply more to RBZ Guidelines than private institutions. Of those who indicated their levels of compliance from average up to excellent, the total for Government institutions were 90% of the respondents, whereas this was 80% for private banks.

5.2.5. Indication of how the board of directors performs its key functions

Eighty percent of the respondents for Government controlled banks answered that the board partially perform its function of strategy formulation, whilst private banks had a 90%. Half of the government banks and 80% of private banks indicated that their board ensures that their code of ethics is well permeated within their organizations. Ninety-five percent of responses from private banks confirmed that their respective boards participate in the selection, monitoring and placement of key management whereas it was 70% for the Government banks. For private banks, 80% felt that risk managements frameworks in place were effective whereas it was 75% for Government. Internal controls are essential for the proper running of banks and should be in place. Eighty percent of the respondents for government banks and 95% of the responses from private banks indicated that the board ensures that internal controls are in place. The major reason why boards are concerned with the internal control is to avoid poor corporate governance practices such as fraud which affect the institutions reputation and results in loss of customer's confidence. All the banks in the sample had the most stipulated committees as per the RBZ requirements; namely the audit, credit and risk management committees. They also have independent directors in these committees, with the mean ranging from 2 to 3.6 for both categories. However, some of the banks lacked the presence of non-executive directors in some of the committees. Ninety-seven percent of Government banks and 75% of private banks viewed the training of directors as essential and mandatory whilst the rest of the responses did not view it as that essential. RBZ Guidelines requires that there should be continuous training of directors. Some institutions noted that training was costly and usually is conducted once a year. On the other hand, those who supported the need for training indicated that it is conducted almost quarterly. The Reserve Bank of Zimbabwe conducts directorship training programs, in some times these scheduled for the sector. In addition, there is requirement that banks submit their board members' evaluations annually.

5.2.6. The prevalence of board committees

Table 4 shows the prevalence of board committees and directors in both Government and private banks.

Table 4. Board Committees prevalence

	Present(P) Absent (A)				Number of independent Directors	
	Government banks		Private Banks		Government Banks (average)	Private Banks (average)
Audit Committee	P (100%)	-	P (100%)	-	3.2	3.3
Credit Committee	P (100%)	-	P (100%)	-	2	2.3
Risk management committee	P (100%)	-	P (100%)	-	3.5	3.6
Asset and Liability Committee	P (100%)	-	P (100%)	-	0.5	0.9
Executive Committee	P (95%)	A (5%)	P (80%)	A (20%)	0	0
Nomination Committee	P (80%)	A (5%)	P (80%)	A (20%)	3	4

5.3. Response from the questionnaires (managers)

5.3.1. Shareholders rights and the equitable treatment of shareholders

Since the government is the major shareholder in the government owned banks, there was not much to explore on the shareholder treatment. Most of the issues were rated as good, for example in the board election; the state elects the board through the responsible Ministry of Finance. As such the State has access to relevant information and in overall the treatment of shareholders is good. However, this is different from private banks where the treatment varies from bank to bank.

5.3.2. Appointment of external auditors

An overwhelming majority from government institutions highlighted that external auditors were appointed by the State as the major shareholder. For private banks the responses were mixed, external auditors are appointed at the Annual General Meeting, Extra General Meeting, Special Annual Meetings, by the Board, others indicated appointment is done in consultation with the Audit committee.

5.3.3. The organization's interaction with key stakeholders

This required the respondents to rate the organization's interaction with its key stakeholders, on a scale of 1 up to 5, with 1 being the lowest and 5 being the highest. The findings indicate that government controlled institutions had lower levels of interaction with their key stakeholders than private institutions. For all the categories the level of interaction with employees was the lowest which shows that generally the organizations do not interact well with their employees.

5.3.4. On whether the company had any mechanism for soliciting feedback from employees

Seventy-five percent of the responses from private banks and 70% from government banks indicated that they have the mechanism for soliciting feedback from employees.

Further to above question on how the firm ensures the mechanism for soliciting feedback from employees is conducted, the answers varied as below:

i. Employee's satisfaction surveys and other respondents indicated that these are done on a quarterly basis.
ii. Suggestion boxes
iii. Workers Committees
iv. Managing director's communiqué
v. Newsletters
vi. Involving workers in company programs such as road shows and sales campaigns

5.3.5. Social responsibility programs being undertaken by the banks

All the respondents indicated that they have social responsibility programs that they undertake as organizations. Private banks undertake more social responsibility programs than the government banks. The social programs mentioned by the respondents are mentioned below:

i. Offer of educational scholarships to the less privileged
ii. Donations to children's homes, old people's homes and Universities.
iii. Cleaning of the community including the roads, clinics, hospitals
iv. Painting of buildings.
v. Drilling of boreholes

5.3.6. Unique characteristics of banks that attracts customers

Competition in banking industry is stiff and each bank aims to be unique and different. The unique characteristics which attract customers to them were grouped in two categories.

For government banks:

i. Bank safety, depositors feel government banks are more secure than private (mainly local) banks since most of these were affected in the 2003-2004 Zimbabwe Banking crisis. This affected the confidence of customers.
ii. Wide branch networks which stretches to all corners of the country even in rural areas
iii. Unique service delivery.
iv. The ability to serve a segment of the market with special needs.

For private banks:

i. Brand name
ii. Practice of good corporate governance
iii. International, financially sound and reputable banks- this answer was given by the private foreign banks which relied on their international exposure
iv. Service delivery which is unique
v. Competitive advantage over other banks because of competitive pricing, professional and skilled staff.
vi. Ability to segment the market and offer special service to all sectors and thrive to meet customers' needs.
vii. Ability to source liquidity form eternal sources which are other affiliates of the bank.
viii. Customers' confidence in some banks which are well established and adequately capitalized.

5.3.7. The level of profitability between government owned banks and private owned banks?

Ninety-five percent of the responses indicated that private banks are more profitable while 5% were in favor of government banks as they pointed out that some of the private banks were making losses due to excessive spending by the owner managers. Those in favour of private banks listed their reasons:

i. Private Banks are more capitalized than government banks.
ii. Private Banks seek to achieve wealth maximization for the shareholder, which is one of the main objectives of running the organization.
iii. Private Banks have less bureaucracy than government banks and hence are able to make quick decisions and to take advantage of the changing economic environment.

5.4. Data gathered through the use of interviews

The interviews were as follows;

5.4.1. On board structure and composition

The trend had been the move towards increases in board members. However, there was need to increase board diversity and the presence of non-executive directors in the boardrooms.

5.4.2. The level of corporate governance compliance as per the Reserve Bank of Zimbabwe guidelines of 2004

The government owned banks noted that the decision making process is longer for them due to bureaucracy. In private banks, those who had good levels of corporate governance noted that in addition to the RBZ Guidelines they have to adhere to other international standards of corporate governance, whilst the foreign owned are required to comply with the requirements as per those stipulated by their international shareholders in addition to the local requirements.

5.4.3. On the level of disclosure and transparency

It was highlighted that the compensation levels for directors and the executive management for government banks is not disclosed.

5.5. Observations and discussions

The board of directors for Government banks is elected by the State which is the major shareholder, through the Ministry of Finance which is the responsible arm of the Government. For private banks the Board is selected through the Nomination Committee at the AGM and by the board of directors for listed companies. There has been a tendency towards an increase in the number of directors on both categories. In addition, the number of independent directors has been on the increase. All banks ensure that the role of the CEO and the Chairman are separated.

All banks comply with the requirements on the frequency of board meeting (above four). To a larger extent directors for both institutions act in good faith in the best interests of their organization though private banks proved to be better than government ones. The OECD Principles (2004) emphasizes that directors should act with due diligence and care in the best interest of the organization. The results unearthed that the board of directors for private banks outperform those of government banks in discharging their key functions such as strategy formulation, promotion of an ethical foundation, selection of key management, ensuring risk management frameworks are in place and the internal control systems are effective and efficient. The level of disclosure for the categories was mixed. Government had better levels of disclosure and transparency on financial statements and board composition and structures whilst private banks were better on company objectives and board and executives' remuneration. Transparency is one tool which anchors the core principles of good corporate governance (Basel, 2010).

Government banks were rated better in their treatment of shareholders than private banks. This rating was on access to relevant information, board selection and share in profits. However, the findings showed that for both categories the interaction with employees was the lowest. The most cited reason for the rise and prominence of corporate governance was the prevalence of corporate malfeasances as a result of poor corporate governance practices in Zimbabwe in the period 2003 and 2004 and the global financial crisis which involved big institutions such as Lehman Brothers, Northern Rock, JP Morgan Chase and Deutsche Bank.

Government banks had higher levels of compliance than private banks, though in the private banks category there were private banks which were foreign owned complied with international standards over and above the RBZ requirements. Bank performance as an indicator of corporate governance was also indicated using an analysis of the deposits level for the banking institutions. Generally private banks had more deposits than Government banks, and it was concluded that customers are mainly drawn to private banks because of various factors which includes; the brand name, the practice of good corporate governance by the institution, unique service delivery, availability of liquidity support from foreign partners. Customers favor banks which are adequately capitalized as they are considered safe. If a bank has good corporate governance it attracts more capital form financiers who are confident in it. Private Banks are more profitable than Government banks, the former tended to be more capitalized, seeks to maximize shareholder wealth and had structures that allowed quick decision making.

6. Conclusions

Though the Government banks recognize the importance of corporate governance and put in place systems for compliance, there is need to reduce the long procedural processes as to enhance timely decision making. Executive and director remuneration for both categories especially for government banks should be transparent and disclosed, and also it should be relative to the performance of the bank. This will instill investor confidence. Furthermore, disclosure and transparency in financial statements for private banks is also important for the institutions as the regulator is able to identify potential areas of problems during onsite and offsite examinations so that corrective action is taken before there are disastrous results. Since shareholders are the owners of the entity they should also be treated fairly mainly by private banks, as they should have access to the relevant financial information and be involved in the decision of making of the company including changes in voting rights and share in profit. Continuous training for the directors on the issues of corporate governance should be more frequent. This paper helps and serves as contribution to knowledge for policy practitioners in structuring and restructuring of corporate governance policies within the Zimbabwean sphere. This would ensure that the policies are grounded in data and hence empirically sound

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