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Sustainable Development of Commercial Banks in Bangladesh

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Abstract

The global profile of risk management and internal control issues has risen significantly during the past two decades, precipitated in part by major incidents such as the recent stock market crash in Bangladesh in 1996 & 2010 and Hallmark scam. These events received worldwide media attention and increased concerns over major issues such as cracks in management and monitoring systems of banks. For the purposes of protection of investors' rights and legal interests, the Bank shall create the effectively system of sound internal control over the own financial and economic activities. The Bank's internal control system is designed to provide an appropriate level of reliability relevant to the scope and nature of the Bank's activity, and to fulfill the objectives set by the Bank's Management Bodies, as well as requirements stipulated by the current law of The Bank Company Act, 1991, The Companies Act (Bangladesh), 1994 and corporate governance rules and regulations. The purpose of this paper is to analyze the knowledge and inclusion of the concepts of internal control systems, risk measurement and bank sustainability in the main institutions of the banking sector of Bangladesh. To do so, 25 top executives in the five Bangladeshi banks were interviewed, and 25 questionnaires were addressed to the interviewees and mid-management. This study unveiled that those responsible for strategic thinking already acknowledge the importance of the issue and are already making changes in their strategies, modifying their long-term outlooks, organizational structures and business practices in order to adopt the topic of corporate sustainability. However, for the sector to be able to act as a catalyst of effective change, it still has some challenges to overcome. There is the challenge of improving transparency in the socio-environmental performance of the banking institutions. Many of the sustainability projects of Bangladeshi banks are not disclosed and consequently do not receive due recognition by stakeholders. Moreover, the conspicuous absence of indicators in companies' public documents prevents more in-depth socio-environmental performance assessment. This higher level of transparency will show their true commitment to the topic and encourage society engagement with the institution, contributing, in fact, to better understanding of the role of banks in society.

Keywords: *Risk Management, Risk Management Techniques, Banks Social responsibility, Corporate Social Responsibility, Corporate Citizenship; bank sustainability.*

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Introduction

This paper is the result of research undertaken between July - October 2012 for internal control systems, risk management and Sustainable Development. The study, which was also given research support from Green University of Bangladesh (GUB), used interviews, questionnaires and corporate information in order to assess the business case for corporate sustainability in the banking sector in Bangladesh.

This study is carried on five commercial banks operating in Bangladesh. The objective of the study was to critically examine risk management practices of Bangladeshi banks i.e., types of risk facing a bank, procedure and techniques used to minimize the risk etc. The study also examines how far the banks follow the guidelines of Bangladesh Bank regarding risk management. The Board of Directors performs the responsibility of the main risk oversight, the Executive Committee monitors risk and the Audit Committee oversees all the activities of banking operations. Based on these interviews and questionnaires, as well as on secondary data, an assessment was made of aspects of corporate sustainability in a group of major financial institutions.

Objectives of the Study

The study has the following specific objectives:

- To analyze the knowledge and inclusion of the concept of sustainability in the main institutions of the Bangladeshi banking sector.
- To identify the components of sound internal control systems
- To identify the risks faced by the selected banks.
- To trace out the process, techniques and system of risk management of the sample Banks.

Methodology

It is a descriptive research based on survey. The study is the based on the primary data. The primary data, on types of risk, techniques to measure risk etc. have been collected through a structured questionnaire. In the questionnaire, only closed ended options have been considered. Five profitable commercial banks, namely Mercantile Bank Ltd., Dhaka Bank Ltd., Jamuna Bank Ltd Shahjalal Islami Bank Ltd and Dutch-Bangla Bank Ltd have been selected for the study. A total number of twenty five bankers, five from each bank have been interviewed. The status of each respondent (banker) is senior executive officer or above who carries out risk management activities of the banks under study. The collected data have been processed with the help of the computer by using statistical software. Five point Likert – Scale has been used to analyze the data.

There are two types of completed questionnaires: sustainability officers and general managers. The sustainability officers' questionnaires were sent to those employees in operational areas directly related to sustainability, such as socio-environmental responsibility, social responsibility or sustainable development. The general manager questionnaire was sent to all other employees. In addition to questionnaires and interviews, information was collected on the practices of sustainability in the institutions under research. The reports and company websites were analyzed in order to understand the extent to which the practices are effectively disseminated in the Bangladeshi banking sector.

Corporate Sustainability

This study defines corporate sustainability as the integration of social and environmental aspects into business strategy, business operation and stakeholder interactions. It is evident, therefore, that social and environmental activities that are not related to the business operation and strategy, such as work done by the different foundations associated with financial institutions, are not included in the scope of this paper. The emphasis here is on the word integration: the purpose of this study is to investigate how social and environmental aspects relating to everyday business are being addressed by the organizations.

Often associated with the term corporate sustainability, and of the utmost importance in understanding the subject, is the concept of the triple bottom line (TBL) proposed by John Elkington in 1998 in his book *Cannibals with Forks*. The TBL concept refers to economic prosperity, environmental quality and social progress, and to building metrics that help measure the performance of a company not only in the economic but also social and environmental spheres (see Figure-6).

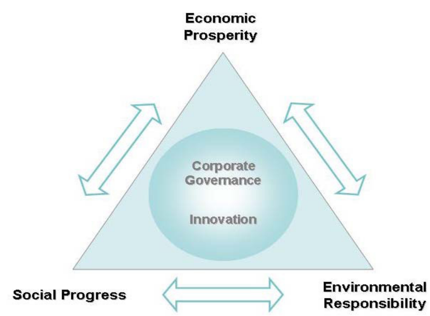

Figure-6

Bank sustainability does not necessarily imply higher costs, more bureaucratic processes and lower financial returns. Sustainability is firmly rooted in a business perspective where socio environmental performance goes hand in hand with economic performance – a change of paradigm that prioritizes permanence and perpetuation of the organization. In some situations, improvement in the socio-environmental performance can generate short-term financial gains for the organizations – see, for example, opportunities from carbon credit trading. In other situations, this improvement may not bring immediate benefits but does give the company long-term gains, which contribute precisely to the ongoing and permanent success of the organization. So, a situation where socio-environmental improvements are primarily linked to economic losses violates one of the three supports of the TBL, and is not sustainable.

Two principles are extremely important in promoting corporate sustainability: corporate governance and innovation. A company can guarantee that the interests of the various stakeholders are preserved only when it has good corporate governance practices, and a sustainable company is one that recognizes and values its internal interdependence not only with internal agents, such as its employees, but also with players outside the company, such as suppliers and clients. On the other hand, innovation is the catalyst of the aforementioned change in paradigm, creating new products, redesigning existing processes and rethinking the business model of the organization.

Corporate sustainability can be found in different forms within the financial sector. In some cases, it is more apparent in the creation of new products with specific characteristics relating to social inclusion or environmental preservation, for example. In others, there is a greater effort to change the existing processes, to include socio-environmental risk analysis in the credit risk assessment process, or even use sustainability criteria to select suppliers. A third group of companies is concerned with both dimensions.

Today most banks announce their information security policies on their website, and it has become a client requirement rather than a cutting edge approach.

Socio-Environmental Risk Assessment in Finance

Although internal environmental management of financial businesses makes sense from an economic viewpoint, the direct impact of their activities is considerably restricted in comparison with that of their corporate clients. In this way, banks' financing activities are the main channel having impact on the environment and communities in the financial sector.

When they include a socio-environmental risk assessment in decisions to grant credit, financial institutions diminish credit risk and default of their client portfolio, and assure that the value of their guarantees is not considerably altered. For example, when granting credit to companies in the oil sector, a firm with a high oil spill risk may have to deal with environmental liabilities, which influences its capacity to honor the credit commitment. When identifying this risk, financial institutions can act to guarantee that corporate clients have a risk management plan, otherwise the financing could be ultimately refused.

So, by including such risks in its credit analysis, the bank manages its credit portfolio more efficiently and contributes to better financial performance. Moreover, the bank also operates to permit only the implementation and operation of projects and companies that contribute to sustainable development, environmental preservation and improving community living conditions.

Environmental Insurance

Environmental insurance is a reasonably new practice in the worldwide financial sector, mostly found in European banks. The product consists basically of covering expenses incurred by polluting activities, for example, relating to damages and losses caused to third parties, body and material damages, cleaning and even legal costs, which would therefore play a compensatory role in the event of an environmental accident. However, in the actual contracting act, consultants from the insurance institution would indicate problem areas in the insured company, making an accurate assessment of its environmental risk and suggesting possible actions that could already be taken to mitigate this risk. In addition, the insurance company can also monitor the behavior of the insured party to prevent it at some time be engaged in activities that may cause environmental damage. In Bangladesh, none of the bank in the study was found to offer this type of product. This could therefore be a better explored market in the future by the major Bangladeshi financial institutions, depending, of course, on increased demand.

Eco-Efficiency

Eco-efficiency is an important factor in any company seeking sustainable use of natural resources, since it reconciles the sustainable use of finite resources with efficient production and cost reduction. Banking has a high consumption of paper, due to the need to mail bank correspondence (such as statements, credit card bills, investment balance sheets and promotional material), complete forms, print reports and other activities. It is worth mentioning that, contrary to popular belief, excessive paper consumption does not have negative consequences for native deforestation, since all paper produced and consumed in Bangladesh comes from planted and not native forests. On the other hand, increasing the use of recycled paper reduces solid waste and, consequently, reduces pollution. Moreover, the increase in recycled paper consumption is an incentive for paper collectors and encourages social inclusion of the lower-income classes. However, to increase the use of recycled paper is no easy task. In addition to the acceptance of the clients toward this kind of paper, the use of recycled paper requires adaptation of printing processes, bearing in mind that recycled paper is darker and requires special treatment to maintain the printing quality, requiring more ink. Recycled paper also does not have significant price benefits; in fact, it may even cost more than normal paper.

Higher paper consumption leads to higher ink consumption. Also, consuming recycled paper increases ink consumption, which may or may not be produced with sustainable practices. Ink consumption, therefore, is also relevant in the context of eco-efficiency in the financial sector. Also, bearing in mind that a part of the banks' printed matter involves printers, a relevant question is: to what extent do banks encourage printing companies to select ink suppliers with sustainable production practices. The energy-saving measures undertaken by banks are also an important aspect of sustainability for the financial sector.

Socio-Environmental Criteria in Selecting Suppliers

Considering the large number of suppliers to financial institutions, screening suppliers for the inclusion of social and environmental aspects is particularly relevant. A service provider that overworks its employees, for example, could influence work productivity, the quality of the service provided and the operations of the financial institution itself. In many ways the socio-environmental behavior of the suppliers can have a direct influence on the financial result of the Bangladeshi banks and their image. These suppliers can be engaged in different ways, ranging from inclusion of contractual clauses on these aspects, to holding meetings and workshops to educate suppliers and raise awareness of the importance of such issues. Nor is this question restricted only to reviewing outsourced management practices.

The relationship must be reciprocal; in other words, it is also important to confirm whether the banks themselves are acting in a sustainable manner toward these companies. How much more is a bank prepared to pay for a responsible supplier? The assumption that socio-environmental responsibility should not generate any extra cost does not always apply. Some of these institutions have websites devoted solely to dialogue with suppliers, making their selection policies and contractual clauses clear and intelligible.

Information Security

The growing virtualization of money is making it possible for banks to better understand their clients' consumption habits. Technologies such as magnetic cards, online-banking, mobile banking and e-wallet[1] are some examples of catalysts of the convergence of the IT industries and financial services. Although this movement brings with it substantial benefits for the financial institutions and their clients, it is also a major threat to client privacy. Undue transfer of this information to third parties could have undesirable results, ranging from its use for supplying other products to the malicious use of information for different objectives, such as card cloning or even theft and kidnapping. The Bangladeshi financial sector, as a whole, is already aware of how important this question is. The websites of most banks in this survey disclose policies relating to security and privacy of information, which is also a major requirement in the questionnaires on sustainability ratios.

Money Laundering

Money laundering concerns the privacy of information and ethical working standards. This issue attracts special attention in many countries' reports (in particular Swiss) on socio-environmental responsibility, since it has been a target of international criticism by facilitating traffic of illegal funds. In Bangladesh, this question is quite relevant considering the frequent accusations of corruption in the different spheres of society. The ban on money laundering is a legal obligation provided in Law .Likewise, most institutions in the study disclose information on their anti-money laundering policies to different levels of detail.

It arises from the practice of disguising the origins of illegally-obtained money (drug dealing, corruption, accounting fraud and other types of fraud, and tax evasion, etc.) through banking channel and the proceeds of crime are made to appear legitimate (Wikipedia).

Executives' Views of the Challenge of Sustainability to Banks

In this section, the results of the interviews with the top executives of the major Bangladeshi banks will be discussed, together with the analysis of questionnaires they completed and a larger contingent extending to the mid-management level. This section was divided into five topics as follows: (i) motivation for including sustainability in business; (ii) ability to implement the concept within companies; (iii) alignment of the various areas of the organization;(iv) use of related tools, and (v) national and sectorial peculiarities interfering in sustainability.

One of the key factors for further corporate sustainability is to align the different areas in understanding the concept. It has already been mentioned that there is a reasonable alignment (with few exceptions) of the opinions of the executives in the same company on understanding the concept of corporate sustainability. It is only natural that in the process of adopting the sustainability concept, there is resistance from different organizational areas. This hinders the inclusion of these aspects in all business activities.

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[1] *e-wallet* is a technology that permits financial transactions through encrypted wireless communications, and keeping personal data in a magnetic card or chip.

However, the study found that there is no organizational area, in the opinion of the interviewees that offers strong resistance to the topic. It should be mentioned, however, that resistance could still arise because social and environmental aspects have perhaps not yet been fully included in all areas of the organization and so it is still impossible to identify stronger resistance.

Figure -15 shows the composition of the answers to the questionnaires on the barriers against adopted sustainability projects in the institutions. In the perception of the executives, the two main identified obstacles are organizational culture and lack of management know-how on the subject. The result of the questionnaire contradicts the findings from the interviews that the organizational culture of Bangladeshi banks is in favor of adopting the concept (which was discussed above). This opposition may be explained by the difference between the interviewees and those answering the questionnaires; while the interviews were concentrated at executive level, the questionnaires were answered not only by executives but also by mid-management, showing a possible difference in the perception of these two groups.

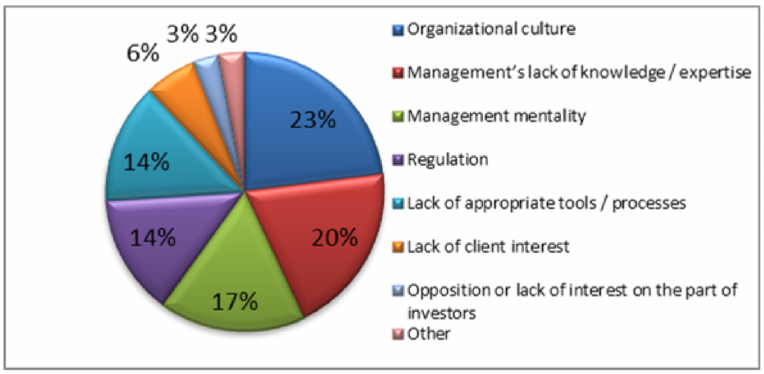

Figure -15 Main Barriers to Sustainability Projects

Not all banks, however, seem to be at the same implementation stage concerning the inclusion of sustainability in the company's strategy and its corresponding disclosure. While some executives believe that sustainability is clearly included in the company strategy – or in its strategic pieces such as vision, mission and values – others think that there is still room for improvement. With regard to disclosure of the strategy, most interviewed executives stressed that it was necessary to disseminate the organization's approach to the most effective inclusion of sustainability not only for internal but also for external publics.

Conclusions and Future Agenda for Sustainability in the Sector

Interviews with top executives in the Bangladeshi financial sector, combined with the questionnaires given to a large number of collaborators in these institutions, offered a privileged view on the status of implementing sustainability in the sector, in order to be able to chart some advances. Of course, the sector has already acknowledged the importance of the matter and is now reacting by modifying visions, organizational structures and business practices in order to include the corporate sustainability issue. Nevertheless, despite the progress in the sector, some points for improvement were identified, which may be addressed by these institutions in the short and mid-term. Some of the key points, as can be seen in Figure -20, are: (i) education and awareness of employees, (ii) upgrading of tools and (iii) more transparency in disclosing information on sustainability.

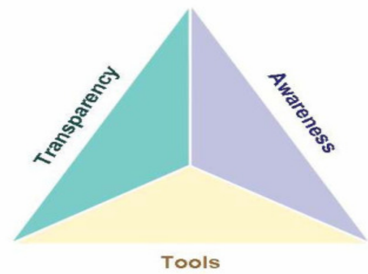

Figure -20

First, it is essential to reinforce the awareness of employees and other stakeholders on the subject of sustainability in these institutions. The sector is still firmly anchored in its attitude toward social responsibility, without perceiving that sustainability projects do not necessarily mean higher costs and lower returns for the institutions. In order for the sector to hasten sustainability, the first task, undoubtedly, is to educate and make aware those who are responsible for everyday business, since corporate sustainability corresponds to the inclusion of corporate responsibility in business activities and not in departments or institutions disconnected from the end activities of the companies.

Second, in addition to enhancing employee awareness about the need to balance short- and long term gains through responsible practices, it is also necessary to upgrade the tools currently used by institutions. Adoption of socio-environmental criteria in different management processes, such as performance assessments, construction of bank branches and corporate credit assessment, will only be efficient when tools are upgraded and based not only on qualitative but also quantitative aspects of sustainability. Behavior contributing to sustainability must be recognized and actions impairing the sustainability of the institution must be appropriately penalized. Since this is an extremely result driven sector, it is believed that the difficulty in quantifying the benefits of sustainability may be an initial challenge, but will not be a serious long-term drawback.

Third, there is the transparency in disclosing socio-environmental information. As already mentioned above, sustainability reports and websites of the companies in the banking sector have very few indicators like those assessing the economic performance today, which can assess corporate performance in the social and environmental spheres. Moreover, it is noticeable that a number of sustainability projects of the major financial institutions fail to gain corresponding disclosure and, consequently, due recognition by the consumers and other stakeholders for which the social and environmental behavior of the banks is relevant. It is not enough to only issue reports hold special events or run marketing campaigns. It is necessary for the financial sector to make a genuine effort to open up to dialogue and render accounts to society about everything their institutions do today and wish to do to encourage sustainability. This greater transparency will show their true commitment to the issue and encourage the engagement of society itself with the institution.

Having overcome these three barriers, the financial sector can then effectively play a leading role in promoting sustainable development and act as an agent of change. Although it does not have a strong, direct socio-environmental impact, the financial sector can influence the various players in society to sow the seed of sustainability in its clients, suppliers and service provider base, ultimately leveraging a change of attitude in a significant part of Bangladeshi society.

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