CORPORATE GOVERANANCE THEORIES APPLIED TO SUPERVISORY BOARDS OF COMMERCIAL JOINT-STOCK BANKS IN UZBEKISTAN

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Abstract: *The current situation of corporate governance in Commercial Joint-stock Banks in Uzbekistan tells us that state-owned banks tend to disclose more information compared to privately owned banks. Although CEO duality is prohibited by law, independence of supervisory boards is biased because of lack of disclosure about the relationships of board members to the management.*

Key words: *corporate governance, banks, theories, board of directors*

Introduction

The main focus of this paper is to analyze the mainstream academic thoughts on the roles of governing boards. Six major roles are identified: linking, coordinating, control, strategic, maintenance and support roles. These roles are consistent with, and at the same time reflecting one of the main arguments of six different schools of thoughts: resource dependency theory, stakeholder theory, agency theory, stewardship theory, institutional theory and managerial hegemony. A classification of the relationship between these theories and the six identified roles is made by using a typological approach. The typological parameters used are extrinsic and intrinsic influences, the impact of external and internal environments, as well as functional and behavioral approaches. The typology gives rise to the need of a new theory on the roles and functions of governing boards.

In the first part of this article we will shortly list the corporate governance theories that are linked with board roles. The second part will describe the current situation of boards in commercial joint-stock banks in Uzbekistan. We will conclude our paper by giving some recommendations to improve the board composition according to the existing theories.

Literature review

Although a considerable amount of efforts have been spent on studying governing boards, there is no single competent and integrative theory or model to explain the roles played by governing boards. From a legal perspective, the American Law Institute defines the functions of a governing board as follows:

1. Select, regularly evaluate, fix the compensation of, and, where appropriate, replace the principal senior executives.

2. Oversee the conduct of the corporation's business to evaluate whether the business is being properly managed.

3. Review and, where appropriate, approve the corporation's financial objectives and major corporate plans and actions.

4. Review and, where appropriate, approve major changes in, and determinations of, other major questions of choice in respect of the appropriate auditing and accounting principles and practices to be used in the preparation of the corporation's financial statements.

5. Perform such other functions as are prescribed by law, or assigned to the board by the charter of the corporation.

Scholars comment that statements such as that of the American Law Institute, while ``better capturing reality than those in traditional language'', are nevertheless vague. They do not provide much guidance as to what a governing board is actually supposed to do. The Australian Independent Working Party into Corporate Governance recommends that the board's key role is to ensure that the corporate management is continuously and effectively striving for above-average performance, taking account of risk. This is not to deny the board's additional role with respect to shareholder protection. In this connection, the Working Party proposes that the functions of a governing board should cover the following:

1. The appointment of the CEO (chief executive officer) and human resources issues.
2. Formulation of strategies and policies.
3. Budgeting and planning.
4. Reporting to shareholders on regulatory compliance.
5. Ensuring the board's own effectiveness.

This is somewhat different from that of the American Law Institute's definition by the attempt of operationalizing the functions into more observable action. In both cases, governing boards are considered to have the ultimate responsibility for corporate performance. From an agency theory perspective, Fama and Jensen (1983) propose that the role of the governing boards is to act as a ratifier of the decision to be implemented and a controller in monitoring the implementation and performance of the decisions. According to Aram and Cowen (1986), the primary role of a corporate board of directors is to be the supporter of management in increasing the economic value of the firm. Mills (1981) argues convincingly that the outcomes of corporate performance responsibility should include the corporation's impact on the society at large: the customers, the shareholders, and the creditors and lenders. While the targets of corporate performance seem slightly clearer than before, management scholars have not yet reached a general conclusion on the real roles and functions of a governing board. Mintzberg (1983) attempts to fill the gap by providing a comprehensive overview on the issue and thus identifying 7 roles of a governing board:

Role 1: Selecting the chief executive officer

Role 2: Exercising direct control during periods of crisis

Role 3: Reviewing managerial decisions and performance

Role 4: Co-opting external influences

Role 5: Establishing contacts (and raising funds) for the organization

Role 6: Enhancing the organization's reputation

Role 7: Giving advice to the organization

These roles, according to Mintzberg, will depend on the situations and environments the boards are facing. He argues that boards are places where ``internal and external coalitions" meet face to face. A board's structure and functions are determined by power politics in the form of a complex network of power relations. This is consistent with his view on emergent and realized strategies. Zahra and Pearce (1989), having reviewed the relevant published research of the past 25 years, identify three sets of interrelated roles played by governing boards: strategy, control and service. The first role is to formulate and disseminate corporate goals and policies as well as the allocation of the resources necessary to implement the board's strategies. The second role is corporate control which includes monitoring and rewarding executive action and performance. The last but not the least role is related to its institutional function which includes representing the organization's interest in the society, linking the firm with its external environment, and securing critical resources. While acknowledging the multifunctional aspects of governing boards, scholars have yet to identify the inter-relationship among the diversity of these functions. An attempt is made in this paper to synthesize the various theories to explain the roles of governing boards.

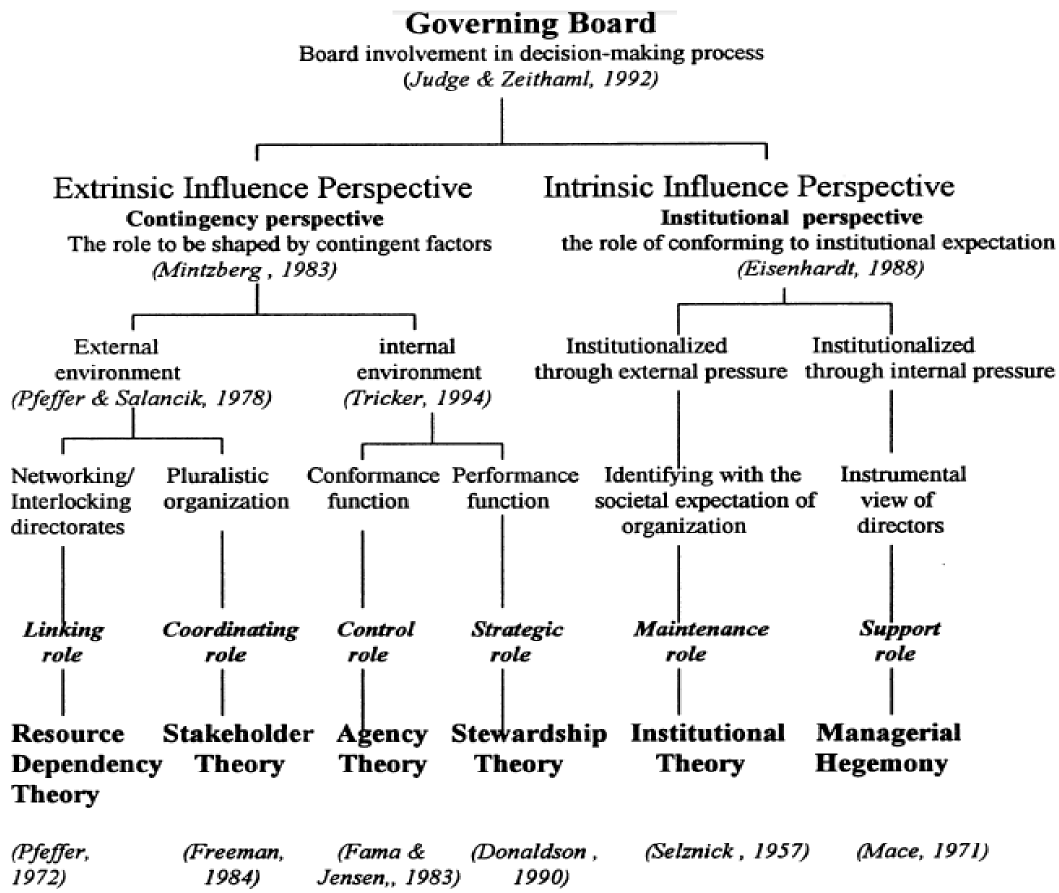

Figure 1. A typology of the theories relating to roles of governing boards

Theoretical framework

Theoretically, the board of directors is responsible to shareholders and must manage the company's management. But in many cases, the board became the servant of the chief executive officer (CEO), who, as a rule, is also the chairman of the board of directors. The role of the board of directors has increasingly become the subject of close attention in the light of corporate scandals such as Enron, WorldCom and HealthSouth, in which the board of directors is not able to act in the interests of investors. Although the Sarbanes-Oxley Act of 2002 made corporations more responsible, investors should still pay attention to the intentions of the board of directors. Here we will show you what the board of directors can tell you about how the company is managed.

The board has different roles and below we will try to link each of these roles to a theory. *Coordinating role* can be linked to *stakeholder theory*, where the theory suggests that governing boards are responsible to all parties in society, such as, employees, customers, suppliers, stockholders, environmentalists, government and other groups, rather than just owners. Sternberg (1997) however thinks that the theory is "fundamentally misguided, incapable of providing better corporate governance, business performance or business conduct" although she admits that it may be valuable as the key to "social responsibility".

The *control role* of the board can be associated with the *agency theory*. Eisenhardt (1989) describes the bases of agency theory as the relationship between a principal and an agent, who are engaged in corporate behavior but have different interests and attitude toward risk. According to Jensen (1983), agency theory attempts to reduce agent opportunism by limiting the agent's self-interest behavior in situations which the principal and agent have conflict goals.

The stewardship theory emphasizes the *strategic role* of the governing board. Unlike agency theory which takes managers as opportunistic shirkers, stewardship theory assumes that their intention is to set strategies (Donaldson, 1990).

The support role of the board is usually used as a managerial tool to support the decisions of professional managers. *Managerial hegemony* refers to a situation when the board is dependent on information from the top managers, therefore acting just like a rubber stamp to approve whatever professional managers decide. Mace (1971), found that board of directors never get involved in strategic decision making unless faced with a crisis. The support role of boards arises because of the fact that directors decline to make independent from managers decisions because most directors are appointed by the management and thus subject to managerial discretion if they want continuation of their appointment, and because they have to rely on information supplied by the management. In many cases, the directors have a relative lack of required knowledge to make effective decisions.

Methodology

In order to assess the current situation of boards in commercial joint-stock banks in Uzbekistan, we collected data from twenty-one commercial joint-stock banks listed in

Tashkent stock exchange. The data was collected manually from banks’ web-sites and by calling the bank if the data was not available in their website.

The date was collected on: direct and indirect state ownership, board size, board independence, board diversity (percentage of female directors in the board), number and the name of committees under the board and CEO duality.

In the Uzbek model of corporate governance, the board of directors is called a supervisory board and the law does not allow the CEO to occupy the position of chair of the board, so no bank practices CEO duality.

Table 1: Board composition of Uzbek JS Banks

		State ownership				
		Direct	**Indirect**	**B_size**	**B_ind**	**B_fem**
1	<Ipoteka-bank> ATIB	21.32	NA	9	1.00	0.11
2	<Asia Alliance Bank> ATB	0	0	5	1.00	0.00
3	<Agrobank> ATB	60.08	27.31	8	1.00	0.00
4	AT <Aloqabank>	56.6	0	8	1.00	0.13
5	<Asaka> bank	54.14	42.06	8	1.00	0.00
6	<Hamkorbank> ATB	0	0	9	1.00	0.00
7	ATB <InFinBank>	0	0	5	1.00	0.00
8	AITB <Ipak Yo"li>	0	0	NA	NA	NA
9	<KDB Bank O"zbekiston> AJ	0	10.31	5	1.00	0.00
10	ATB <Qishloq qurilish bank>	78.88	NA	11	1.00	0.00
11	<Kapitalbank> ATB	0	0	5	1.00	0.11
12	<Orient Finans> XATB	0	0	5	1.00	0.20
13	<Ravnaq-bank> XATB	0	0	5	1.00	0.20
14	<O"zsanoatqurilishbank> ATB	64.33	26.01	9	1.00	0.00
15	AT <Savdogarbank>	0	0	9	1.00	0.11
16	<Turkiston> XATB	0	0	5	1.00	0.20
17	<Turonbank> ATB	63.15	NA	11	1.00	0.00
18	<Trastbank> XAB	0	0	5	1.00	0.00
19	<HI-TECH BANK> XATB	0	0	3	1.00	0.00
20	<Mikrokreditbank> ATB	87	NA	9	1.00	0.00
21	XATB <Universal bank>	0	0	7	1.00	0.00

Source: Obtained from the official websites of commercial banks and through telephone conversation with bank representatives

Concerning the state ownership, eight out of 21 banks are directly owned by the state, and the average share of state in these banks is 61%, ranging from 21.31% of direct state ownership in Ipoteka bank, to 87% of direct state ownership in Microcredit Bank. The state also has about 20% of indirect shares in these eight banks. KDB bank Uzbekistan is the only foreign bank that is indirectly owned by the state, through the National Bank of Uzbekistan (10.3%).

State-owned banks in Uzbekistan tend to have larger boards, consisting of average of 9.1 members, while private banks have smaller size boards on average consisting of 5.7 members. The average size of all boards is 7.05 members, ranging from 3 in High-Tech bank (private) to 11 in Qishloq Qurilish Bank and Turon Bank, both are state owned.

All of the listed banks are presented to have entirely independent from management boards, that is none of the managing directors are in the supervisory board. However, we cannot claim that there is no managerial hegemony, since we do not possess any information about the relationships between the managers and board members. The possibility of managerial hegemony is greater in private banks, because in state owned banks, almost all of the supervisory board members are appointed by state.

Gender diversity of the board is believed that higher proportion of women in board is more likely to bring international diversity, which in turn brings a unique set of human capital resources, such as expertise, reputation and his/her networks and ties to other organizations and nations, which is beneficial for the company. In the case of Uzbek listed banks, only 7 out of 21 banks have at most one woman in their boards, which comprises only 5% of all boards.

It is suggested that boards must consist of a remuneration and audit committees, where all members of these two committees must be completely independent from the management in order to avoid conflict of interests. From the date available for us, 18 out of 21 banks have audit committees in their supervisory boards, while one bank (Asaka Bank) does not have any committees in its board and other two banks does not have this information available for public. The remuneration committee operates only in two of the bank’s boards while in other banks the remuneration policies are decided in other committees.

Conclusion and recommendations

Based on the available information to public, it can be noted that state owned banks have larger boards (up to 11) vs private banks (starting from 3). Although CEO duality is prohibited by law, the board independence of banks is biased because no detailed information is available about its members, their experience and relationships with the management. Shortage of publicly available information in websites, very closed or unexperienced call center staff of private banks leads us to conclude that private banks are less transparent which is not a good indicator for potential investors. Based on the knowledge from existing theory, we would recommend banks in Uzbekistan to increase the importance and performance of their supervisory boards by increasing the number of skilled board members who have expertise, reputation and their networks and ties to other organizations and nations and are able to make decisions independently from bank management. Concluding our small research, we would recommend the banks to open a position of corporate governance clerk and hire a well trained and highly skilled specialist who would work with potential investors, shareholders and coordinate the process of information sharing.

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