

# Chapter 11

# The Role of Corporate Governance in Bank Risk–Taking

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## **ABSTRACT**

*Bank credit risk is the significant factor that needs to be managed effectively. For better management of credit risk in banks, an effective corporate governance is an important factor. We examine the effect of corporate governance on bank risk taking. We use the data of 85 banks of South Asian countries while taking data from time period of 2010-2023. We apply the generalized method of moments (GMM) to analyze the results. We find that the corporate governance such as gender diversity, CEO duality and board meetings have significant negative effect on bank credit risk.*

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## INTRODUCTION

Corporate governance has become a significant key topic in international business practices. Corporate governance is certainly not just corporate law. The definitions of corporate governance vary. Corporate governance is the combination of rules, process, law by which business are operated, regulated or controlled. Risk taking behavior of firms or financial institution become a major research issue after 2008 financial crisis of certain extent credit to excessive risk-taking behavior by financial institution as well as banks (Moussa, 2019). Several studies have been conducted to understand those factors that influence risk taking behavior in banks or other financial institutions to make right policies from policy makers to further avoid financial crisis as a result of excessive risk taking. In addition, better corporate governance practices promoted more effective bank operating outcomes after the period of financial crisis (Calomiris & Carlson, 2016). The banking sector is mainly important in economies where banks play a primary role in the financial system. Furthermore, the corporate governance is an additional element that assign to risk exposure toward the banks. Banking sector is backbone of emerging economies (Hunjra et al., 2021) producing major part of revenues for the economies. Better corporate governance practices results in reducing the likelihood of default risk of banks. The present study aims to investigate the influence of corporate governance practices on risk-taking of banks in developing countries which will enable management of banks to employ better governance policies to handle the potential losses.

When evaluating the corporate governance, ownership structure may be particularly crucial to corporate governance in the banking sector (Barry et al., 2011). This is due to the fact that regulations frequently oblige banks to maintaining a specific level of capital, which can be altered by bank ownership. Perhaps based on how much ownership is concentrated. In recent years, the academic community has paid close attention to corporate governance and bank credit risk. Similarly, there is a chance that a consumer won't pay their invoices if a business extends credit to them. In order to better understand the connection between corporate governance and risk behavior in the banking industry of MENA nations, Oteros et al. (2019) carried out a study. Indeed, financial practices like credit pay or return back are related with corporate governance.

The effectiveness of risk management and good corporate governance implementation is needed to enable banks to identify problems early. Bank failures can stem from manager behavior or compensation contracts. Agency problems may arise from excessive salaries, inadequate risk management efforts or risk shifts from creditors to shareholders. For the banking sector, Fu et al. (2014) indicate that commercial bank can improve their public accountability, minimize risk exposure, create value and enhance operational efficiency if they have effective corporate governance.

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