Ethics Pays: Moral Compass and Performance Among Selected Philippine Government Owned and Controlled Corporations

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ABSTRACT

Public Enterprise reforms throughout the last decade have placed business ethics at the forefront of good corporate governance. Specifically, there is a scaling up of corporate governance practices through mechanisms established by the GOCC Governance Act of 2011. These include principles, processes and systems that uphold ethical values that were not considered in the past. Serving as a moral compass among public enterprises, these corporate governance practices have been found to pave the way for better financial performance in two of the country's government-owned development banks, namely Land Bank of the Philippines and Development Bank of the Philippines. Using gap analysis, the performance of these banks was analyzed from 2012 to 2016. It was found that their financial performance have been consistently improving throughout the years, especially after the enactment of the law. Indeed, when management practices are imbued with ethical values, public enterprises can truly be public agents of social and economic development.

Keywords: Ethics, Governance, Development Bank, Public Enterprise

1. INTRODUCTION

Public enterprises or government-owned and controlled corporations (GOCCs) are institutions that exhibit both "business or enterprise" and "public" characteristics as the character of a business organization and that of a national policy is found in them (Fernandez and Sicherl, 1981, as cited in Villamejor-Mendoza, n.d.). Through public enterprises, governments render services, such as public utilities and financing services, to the public for the growth and development of the economy (Bantug, 2012). They operate to generate profit and achieve societal goals at the same time. It has been noted, however, that in the Philippines, there is mismanagement of public enterprises evidenced by "misappropriation of government resources, dispensation of bloated salaries, unauthorized purchase of assets and abuse of power" (Villamejor-Mendoza, n.d., p. 13).

The GOCC Governance Act of 2011 seeks to address these transgressions initially as a rules-based approach. Acting as a contract to govern behaviour away from abuse, the law, with its written rules and provisions, establishes a "minimum standard for ethical conduct that all can abide by" (Sama and Shoaf, 2005, p.181). Ultimately, it is a move to work towards decision making in the public enterprises that ensures that efficiency is achieved and the value of transparency and accountability are reinforced towards the achievement of the enterprise's economic and social goals. Public enterprises, as social structures, depend on relevant legislation governing them as well as universally accepted ethical norms for its proper functioning (Kaminski, 2013). This means that values are incorporated into strategy. Business ethics as the "capacity to reflect on values in the corporate decision-making process with regard to how these values affect various stakeholders" (Certo and Certo, 2012, p.63) is imbibed. It enables public enterprises to develop a moral compass that embodies the right corporate governance principles, systems and processes as well as management imbued with ethical values in carrying out the public enterprise's mandate. The public enterprise effectively discharges its functions not only in compliance with the law but based on principles that enable players to perform on their own (Sama and Shoaf, 2005).

2. STATEMENT OF THE PROBLEM

As a result of the GOCC Governance Act of 2011, are mechanisms in terms of enhancements in principles, systems, processes and management practice promoting good governance in development banks such as Land Bank of the Philippines and Development Bank of the Philippines reflected in their financial performance in the period of five years (2012-16)?

3. OBJECTIVES

This study aims to look into the performance features indicative of the enhancements in principles, systems, processes and management practice, as manifested by the Land Bank of the Philippines and Development Bank of the Philippines, resulting from the GOCC Governance Act of 2011.

4. SIGNIFICANCE

In recent times, public enterprises have come under increased pressure to meet the expectations of the public with integrity, respect, transparency and accountability. Knowledge of the mechanism by which legislation improves governance practices is important in assessing the progress made by public enterprises in fulfilling its role as public agents of social and economic development.

5. SCOPE AND LIMITATIONS

The study will be limited to government-owned development banks. The results can only provide preliminary insights about the relationship between GOCC performance and enhancements introduced by the GOCC Corporate Governance Act of 2011 in terms of principles, processes and systems that uphold ethical values within the milieu of development banks.

6. REVIEW OF RELATED LITERATURE

The Organization for Economic Cooperation and Development (OECD) defined corporate governance as "that structure of relationships and corresponding responsibilities among a core group consisting of shareholders, board members and managers designed to best foster the competitive performance required to achieve the corporation's primary objective (IMF, 2001, as cited in Nwanji & Howell, 2007).

To reach organizational goals, governance is exercised and distinguished in two ways: performance vs. conformance and inward-looking vs. outward-looking. This is how Robert Ian Tricker in 1994 explained the role of the board. Reed (2002) adapted Tricker's diagram of the board's roles as follows:

	Conformance roles (past and present oriented)	Performance roles (future oriented)
(Outward looking)	*Accountability* – providing feedback to shareholders, other stakeholders	*Strategy formation* – developing plans for the firm's interaction with the external environment (e.g. strategic alliances, profit strategies, financing)
(Inward looking)	*Monitoring* – questioning, judging and supervising management	*Policy making* – establishing rules and norms to guide the company in achieving its strategic goals

Source: Adapted from Tricker (1994, p. 149).

Figure 1. The roles (responsibilities) of boards of directors.

Tricker in 1994, as further discussed by Reed (2002), identified four specific roles of governance, namely: accountability, monitoring, strategy formulation and policy making. Accountability refers to the obligation to report or provide clear, timely and accurate information to individuals and institutions that have stakes in the company. Monitoring deals with the establishment of criteria with which to evaluate performance. Strategy formulation deals with the formulation and implementation of strategies through which the mission will be accomplished while policy making delves into the rules and procedures set by the board to guide the company in the achievement of its strategic goals.

Public enterprises are institutions that pursue business as well as social goals (Villamejor-Mendoza, n.d.). They are also referred to as Government Owned and Controlled Corporations (GOCC). The State is its owner and as an owner, aside from profitable investments, it also aims to reduce unemployment, increase tax collection or stabilize the financial system (Borisova, G., Brockman, P., Salas, J. M., and Zagorchev, A.,2012), among other goals. The State defines the strategy and prioritizes national interest and fiscal incomes (Ursacescu and Cioc, 2012).

There are two approaches to corporate governance: the shareholder model and the stakeholder model. The shareholder model is anchored on the owner-agent relationship in which the manager, as agent, is expected to act according to the owner's (shareholder's) interest. The stakeholder model, on the other hand, espouses for a representation of stakeholder interests by sharing the decisional power of managers with other stakeholders as well as the risks (Ursacescu and Cioc, 2012).

The shareholder model of corporate governance, when applied in the case of public enterprises, enables us to see the manager, as an agent, who is expected to act according to the owner's (shareholder's), in this case, the State, and its interest. Using the stakeholder model, on the other hand, the public is considered a primary stakeholder. Regardless of model of corporate governance used, however, since access to financing is easier and wider in public enterprises coupled with its political connections and objectives, it can lead to difficulties in monitoring (Borisova, G., Brockman, P., Salas, J.

M., and Zagorchev, A.,2012). Complacency can also result since insolvency may not be a real threat to them (Bantug, 2012) with the State's deeper pockets. Poor corporate governance can result when political decisions and non-profit maximizing goals dominate sound practices (Borisova, G., Brockman, P., Salas, J. M., and Zagorchev, A.,2012).

The manifestations of the lack of corporate governance in public enterprises in the Philippines are summarized by Bantug (2012) as follows:

1. Political interference into the decisionmaking of GOCC's Board of Directors as a result of the appointment of Cabinet Secretaries as *ex-officio* members or *ex-officio* Chairpersons to the Boards;
2. Lack of transparency and uniform rules in the selection of GOCC's Board members;
3. Lack of integrity and transparency in the monitoring mechanisms of the performance of GOCCs. (p. 15).

Principles of efficiency in production and allocation of resources, management independence, impartiality, transparency and accountability for overall firm performance, truthfulness and respect for rights (Borisova, G., Brockman, P., Salas, J. M., and Zagorchev, A.,2012; Bantug, 2012; Sama and Shoaf, 2005) are compromised. These are the principles which the Congress sought to reinforce by passing R.A. 10149, also known as GOCC Governance Act of 2011.

According to Bantug (2012), the salient features of the law are the following:

1. Exercise by the National Government of certain rights consistent with its right as owner of GOCCs, including "(a) the power to enter into and sever, within a period not longer than one (1) year agency relationships with the directors and executive officers of GOCCs; (b) unequivocal policy that such directors and officers are trustees of the State, with no appropriating power over GOCC assets; (c) unrestricted access to GOCC books of account and the right to exact strict compliance with accounting and financial disclosure standards; (d) the power to privatize, abolish or otherwise structure GOCCs without need of legislative action; and (d) the power to set standards of performance, compensation and other matters incidental to the conduct of GOCC affairs.
2. Creation of a centralized advisory, monitoring and oversight body called the GOCC Commission on Governance (GCG). Among its authorized powers, the GCG may: (a) formulate, implement and coordinate policies, which shall be presided by a Chairman with the rank of a cabinet secretary; (b) promulgate an ownership and operations manual and corporate standards for GOCCs; (c) establish a performance evaluation system and conduct periodic assessment of GOCCs' performance; (d) evaluate the conflicting mandates of a GOCC as to whether it is a regulatory body or engaged in the activity which it regulates and made recommendations to the President of the Philippines appropriate action to address such conflict.
3. Require strict disclosure by GOCCs to the public of their financial performance and audit mechanisms by the Commission on Audit.

4. Provides for a one-year terms of the members of the Board of Directors of all GOCCs subject to reappointment when such board member obtained an above average performance according to a criterion set by GCG.
5. Requires appointment to board membership by the President from candidates shortlisted by the GCG according to the Fit and Proper test set by the latter.
6. Lists a provision of standards and limitations on the compensation, allowances, per diems and incentives of the board members which shall be fixed by the GCG
7. Expresses provision on the fiduciary duty of the Board members and officers towards GOCCs and the adverse consequences in case of breach of duty.

Similarly, Villamejor-Mendoza, (n.d.), summarized the features of the said law in four (4) items, namely, (1) the creation of the Governance Commission for GOCCs (GCG) within the Office of the President, (2) the introduction of the Fit and Proper Rule in determining who are qualified as senior management and board members of public enterprises, (3) full disclosure and (4) implementing stringent requirements for the creation and acquisition of GOCCs.

Corporate governance transgressions can be addressed and prevented by laws or regulations or through norms. The former is rules-based and the latter is principles-based. The rules-based approach guides corporate behaviour through the conferment of rights and obligations with respect to corporate performance. The principles-based approach principles to guide behaviour and facilitates self-monitoring and voluntary enforcement (Sama and Shoaf, 2005).

Public enterprises are in various industries of the economy and a development bank is one prominent type of public enterprise. The World Bank defines a development bank to be “a bank or financial institution with at least 30 percent state-owned equity that has been given an explicit legal mandate to reach socioeconomic goals in a region, sector or particular market segment” (De Luna-Martínez and Vicente, 2012, p.4). It is used by governments as a tool to promote economic development by its provision of financing for strategic sectors of the economy such as the infrastructure, housing and agriculture sectors (De Luna-Martínez and Vicente, 2012). It helps achieve socio-economic objectives of equity and poverty reduction by providing finance to market segments not well served by the financial system because of risks and leadtime as they are long-term projects, yet with large scale social benefits (Thorne, J., and Du Toit, C., 2009).

According to De Luna-Martínez and Vicente (2012), development banks are typically owned and run by the State, which provides strategic direction through the senior management and board members it appoints. The State supports them by debt and liability guarantees. They are, however, expected to be self-sustaining and profitable despite the government support it enjoys.

The two foremost development banks in the Philippines are the Land Bank of the Philippines (Landbank) and Development Bank of the Philippines (DBP). Landbank and DBP were formed by law, specifically Republic Act (RA) No. 3844 for Landbank in 1963 and RA 85 in 1947 for DBP (De Vera, 2016). Landbank leads the pack in providing agricultural credit in the Philippines (Llanto, 2004). It serves the agrarian reform beneficiaries and small farmers through credit facilities for agriculture, industry, export development and the government sector particularly in the countryside and for small and medium enterprises (Caraan, 2016). The State, through the development banks, creates an environment that is conducive to financial intermediation by decreasing transaction costs to increase financial market activity and the number of market participants (Esguerra, 1996, as cited in Llanto, 2004). Through adequate governance, development banks have to identify, measure and manage their risks as well as achieve a minimum return on capital.

7. METHODOLOGY

To examine the performance of the banks, a gap analysis will be made. A gap analysis is "an assessment tool to help identify differences between various states or governance applications" (Hincu, 2011, as cited in Ursacescu and Cioc, 2012, p. 24). It will be carried out by computing for the compounded average growth rate (CAGR) of relevant financial indicators for the five-year period covering 2012-2016. Using the gap analysis as basis, the study will analyze the financial efficiency achieved by the selected Philippine government owned and controlled development banks, resulting from the GOCC Governance Act of 2011-enhanced principles, systems, processes.

8. RESULTS AND DISCUSSION

The performance scorecard of the two government-owned development banks is best gauged by how well they provide financing to strategic sectors of the economy as well as those underserved by the financial system. Land Bank and the Development Bank of the Philippines were established by law to provide agricultural credit, serve the agrarian reform beneficiaries and small farmers through credit facilities for agriculture, industry, export development and the government sector particularly in the countryside and for small and medium enterprises.

Highlights of the performance of DBP and LBP as found below show that market segments for which the funds of these banks are intended, are served better throughout the years as evident in the compounded average growth rate of loans extended. Priority areas include Infrastructure and Logistics, Social Services and Environmental Protection. Other priority areas cover Manufacturing, Construction and Real Estate, Wholesale and Retail, Travel, Agribusiness and Financial Intermediation.

Deposits from the private sector and the countryside as well as income have like registered significant growth throughout the years following the enactment of the GOCC Governance Act of 2011.

Thus, these two banks are achieving both their social and economic goals. The GOCC Governance Act of 2011 facilitated and sustained good performance of these banks. The monitoring of specific performance indicators as mandated by the GOCC Governance Act of 2011 is essentially a rules-based approach to address corporate governance transgressions, especially for development banks, which provide financing more easily and broadly to more sectors. However, coupled with its political connections and objectives, monitoring can be challenging over the long run.

The sustained good performance of the two development banks over the five-year period immediately after the implementation the GOCC Governance Act of 2011 can be understood in a way that the law served to reinforce good performance by paving the way from rules-based to principles-based approach to addressing corporate governance transgressions. The two development banks studied are guided more strongly by principles rather than rules, as years go by. There are no traces of complacency. The banks are efficient and exercises responsibility and accountability for overall firm performance. They developed a culture of self-monitoring and voluntary enforcement.

Table 1. Highlights of DBP Performance for 2012-2016

Development Bank of the Philippines						
Total Loan Portfolio - Priority Areas (in millions)	80868	78606	96645	96902	121116	11%
Total Loan Portfolio - Other Priority Areas (in millions)	41769	50896	51224	59703	62340	11%
Total Current Account and Savings Account (CASA) Deposits -in millions	54896	64535	84649	130507	132777	25%
Total Deposits from the Countryside (in millions)	63465	69749	88768	111698	135449	21%
Net Income (in billions)	4.133	5.28	4.601	4.711	4.202	0.41%

Source: GCG Website

Table 2. Highlights of LBP Performance for 2012-2016

Land Bank of the Philippines						
	2012	2013	2014	2015	2016	CAGR
Loans to Small Farmers and Fishers (SFFs) -in billions	33.38	34.7	33.7	38.7	40.8	5%
Loans Supporting Agriculture and Fisheries (in billions)	66.53	68.1	77.9	98.9	111.1	14%

Loans Supporting Other Government Programs (in billions)						
Loans to Micro, Small and Medium Enterprises (MSMEs) - in billions	116.02	141.8	219.7	246.4	288.6	26%
Amount of Total Deposits ftom Private Sector (in billions)	156.6	210.7	288.2	340.92	405.6	27%
Net Income (in billions)	10.72	11.47	12.1			6%

Source: GCG Website

9. CONCLUSION AND RECOMMENDATIONS

The GOCC Governance Act of 2011 is a rules-based approach to improve corporate governance among public enterprises. In the case of good performers such as the Land Bank and DBP, however, it served to reinforce their ethical posture and allow them to develop a moral compass. This moral compass, as the embodiment of the right corporate governance principles, systems and processes as well as management imbued with ethical values enables them to perform their mandate as real public agents of social and economic development.

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