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Benchmarking the State of Corporate Governance in Bangladesh

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Abstract

Now-a-days corporate governance (CG) is considered to be one of the most vital factors for improving the overall business practices in the globalized world and in maximizing value of the shareholders and stakeholders. Bangladesh should not be lagging behind in recognizing the importance of having good governance mechanism. Accordingly, this study aimed at benchmarking the status of corporate governance in Bangladesh, as future policy direction should start with assessment of the present standing. Both primary and secondary survey instruments are applied to attain the aforementioned objective. The results of the study revealed that, core elements for ensuring good governance, such as: regulations, auditing, stakeholder engagement etc. needs development and enforcement. Also some institutional set up should be established to train and educate stakeholders to get familiarized with the corporate governance concepts and practices.

Keywords: Corporate governance, Bangladesh, Institutional arrangement

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1 . Introduction

Corporate governance is a mechanism by which companies are governed and/or monitored by the stakeholders: shareholders, auditors, regulators, credit agencies, and so forth. It is most often viewed as both the structure and the relationships which determine corporate direction and performance. The board of directors is typically central to corporate governance. Its relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors. The structure of corporate governance also depends on the legal, regulatory, institutional and ethical environment of the country, as Uchida (2002) has reviewed many main academic thoughts of studies in Economics, Business Administration and others.

The concept of corporate governance is a new concept to the corporate arena of Bangladesh. In the face of corporate failure around the world especially of Enron, World Com etc. debacles, it has demanded much attention of both regulatory bodies and the investors. The enactment of Sarbanes Oxley Act. in 2002, elicits the importance of good governance in a corporate entity. In Bangladesh, aftermath, Securities and Exchange Commission (SEC) came across with the code of corporate governance (it comprises certain provision met by the corporate bodies enlisted at stock exchange), which are in practice from 2006. In fact, the concept of corporate governance i.e. good governance encircles many aspects of corporate activities like internal control, executive remuneration, control structure, board structure, audit committee, stakeholder engagement, conflict resolution etc., which are not well apprehended by the corporate personnel of Bangladesh. It is not due to the fact that they lack apt knowledge in academia; rather the concept is a new

one, which is yet to be conceptualized by both academician and practitioner around the world including Bangladesh.

On this background, the purpose of this study is to assess the state of corporate governance practice in Bangladesh, as there can be no policy without approximating the current condition. The findings of the study are expected to provide concrete guidelines for setting good governance policy guidelines in Bangladesh.

2 . Objective of the Study

The prime objective of the study is to assess and benchmark the status of corporate governance in Bangladesh. The more specific objectives of the study are as follows:

- a) To review the available literatures for having an idea about the regulatory environment prevailing in Bangladesh.
- b) To assess the level of understanding of corporate governance by the corporate sectors.

3 . Data and Methods

Both primary and secondary data sources are used in this study. A primary survey was conducted during a four week timeframe (September 26 , 2007 - October 23 , 2007) with a sample of 46 companies operating in Bangladesh using a structured questionnaire. The sample companies were selected randomly.

The majority (76%) of the respondents were from the organizations listed in the stock exchanges and the remaining 24% are non-listed organizations

(among which 4.3% are government owned) . In the total response categories, the percentage of public limited companies, private companies and foreign companies were 87 percent , 11 percent and 2 percent, respectively .

The respondents in the survey comprised of Chief Executive officer/ Managing Director, Company Vice-president, Chief Financial Officer as well as Company Secretary and officials from different senior management positions. The industrial sectors covered under the survey are shown by Table 1.

Table 1 Sector-wise Response Rate

Sector	Number
Banks	15
Insurance	11
Non Banking Financial Institutions	5
Pharmaceuticals and Chemicals	5
IT	2
Tannery	2
Real Estate	1
Textile	1
Engineering	1
Food and Allied	1
Miscellaneous	2

4 . Corporate Governance in Bangladesh

4.1 Findings from literature Survey

Good governance practices in Bangladesh are quite absent in most companies and organizations. In fact, Bangladesh is lagging behind her neighbors and the global economy in corporate governance (CG). However, since the

early 1990s, CG has been receiving increasing attention from regulatory bodies and practitioners worldwide. Corporate sectors are still in its initial stage; nevertheless awareness of the importance of CG is growing. Bangladesh's small size and lack of natural resources have necessitated an open trade policy. Bangladesh also has a liberal policy towards foreign direct investment (FDI). However, when compared to those of the India, Sri Lanka, Pakistan, Thailand and Malaysia, CG in practice and philosophy have up till now remained relatively under-developed in Bangladesh.

4.1.1 Governance Regulations

The legal system of Bangladesh is inherited from the British administration and is a mixture of contemporary laws with the former (Chowdhury and Chowdhury, 2004). The Companies Act of 1994 serves as the basic law for the locally incorporated corporations. Some other significant laws which has important role in governing the corporate sectors are: Securities and Exchange Ordinance 1969, Bangladesh Bank Order 1972, Bank Companies Act 1991, Financial Institutions Act 1993, Securities and Exchange Commission Act 1993 and the Bankruptcy Act, 1997. A description of the relevant regulations and their problems are discussed in Table 2. Weak regulatory system along with board interference with the management hinders the improvement of CG in the country.

4.1.2 Corporate Ownership Structures

All corporate governance systems revolve around four core principles: Fairness, accountability, responsibility and transparency. The specific challenges of upholding these principles depend on the ownership structure of the corporate sector. However, in Bangladesh, general practice is that the

corporate structure is dominated by family members. Although generally share are floated on a 50:50 basis in the primary market, original sponsors often buy additional shares from the market to increase their control (Alam, 1989).

4.1.3 Audit and Accounting Standards

Auditors in Bangladesh are not considered independent or sufficiently qualified to attest to the validity of the financial statements of corporate entities. A study by Raihan (2003) shows that, 64.4 % of the companies conduct regular audit for effective implementation of the core labor policies. Also the internal auditors lack audit charter and independence (Iqbal, 1997). However, some major developments took place during 1993 to 2000, which would lead a long positive way towards raising the accounting and auditing standards in Bangladesh (Chowdhury and Chowdhury, 2004). This includes: establishment of Securities and Exchange Commission (SEC) in 1993, enactment of Companies Act 1994, amendment of Securities and Exchange Rule of 1987.

4.1.4 Inadequate Bankruptcy Laws

Bankruptcy laws and processes are inadequate in terms of provisions and not strong in terms of enforcement in Bangladesh. No country can have good CG standards with poor bankruptcy laws and processes. Besides, inefficient foreclosures and securitization processes have compounded the problems in Bangladesh (Hossain, 2005).

4.1.5 Capital Market

The capital market of Bangladesh consists of two organized exchanges:

Table 2 Assessment of the Corporate Governance Regulations and Practices in Bangladesh

	Relevant Law/ Regulators/ Institutions	Problems
1. Companies and Corporate Laws	<ul style="list-style-type: none"> i) Securities and Exchange Ordinance 1969 ii) Bangladesh Bank Order 1972 iii) Financial Institutions Act 1993 iv) Securities and Exchange Commission Act 1993 v) Bankruptcy Act 1997 	<ul style="list-style-type: none"> i) Conflict among shareholders and directors on dividend declarations ii) Lack of awareness regarding minority shareholders right protection provisions. iii) AGM concentrating on trivial matters and inadequate disclosures of financial information iv) Independent directors lacking new ideas v) Lack of reliable audit reports
2. Financial Sector	<ul style="list-style-type: none"> i) Bangladesh Bank ii) Credit Information Bureau (CIB) 	<ul style="list-style-type: none"> i) Lack of professionals possessing banking expertise ii) CIB resulting in delayed loan approvals iii) Weak capital market forces reputed companies to raise capital from banks iv) Underdeveloped debt market minimizes pressure on companies to enforce CG.
3. Accounting Standards & Disclosures	<ul style="list-style-type: none"> i) The Institute of Chartered Accountants of Bangladesh (ICAB) ii) International Auditing Standards (IAS) iii) Bangladesh Accounting Standards (BAS) 	<ul style="list-style-type: none"> i) Accounting Standards followed in Bangladesh are not in conformity with international Standards ii) Inconsistent application of accounting standards by the companies.
4. Independent Regulations	<p>Government Regulations:</p> <ul style="list-style-type: none"> i) Registrar of Joint Stock Companies and Firms (RJSC) ii) Bangladesh Bank (BB) <p>Non-Government Regulations:</p> <ul style="list-style-type: none"> i) The Institute of Chartered Accountants of Bangladesh (ICAB) ii) Chittagong Stock Exchange (CSE) iii) Dhaka Stock Exchange (DSE) 	<ul style="list-style-type: none"> i) Inefficiency and incapability of regulators to guide the companies without harassment. ii) Less trustworthy audit reports - low audit fee structure: resulting into inadequate disclosure of financial statements
5. The Judiciary	<ul style="list-style-type: none"> i) Company Bench, Supreme Court, Money Loan Court 	<ul style="list-style-type: none"> i) Large Blockage of cases ii) Lacks specialist knowledge to support corporate needs.
6. State Owned Enterprise	<ul style="list-style-type: none"> i) Office of the Comptroller and Auditor General (CAG) ii) Public Accounts Committee of Parliament (PAC) 	<ul style="list-style-type: none"> i) Reluctance to apply CG norms as view them differently from corporate entities. ii) Lack of monitoring from majority shareholders. iii) Need to focus more on a commercial basis.
7. Existence and Role of Pressure Points		<ul style="list-style-type: none"> i) Lack of knowledgeable pressure from financial journalists ii) Lack of organized pressure from the shareholders to force better company performance iii) Weak presence of private investors to initial changes in the corporate sectors iv) Absence of international pressure for better CG because of having less involvement

Source: Ahmed and Huq (2008)

Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). The capital market of Bangladesh is still a weak link in the movement towards strengthening CG. One primary reason for this is non-sensitivity of stock returns to corporate performance. This demotivates a firm to ensure good governance and lowers the incentive in becoming a public company and listing on the stock exchange in Bangladesh. Overwhelming presence of the banking companies in the financial markets leads firms with good reputations to go for bank financing which is relatively easier than issuing shares. Moreover, there are no bonds, fixed income or debt instruments in the capital market. This means there are no pressure groups for enforcing CG principles. Unlike the private mutual funds, the state owned investment company - Investment Corporation of Bangladesh (ICB) - has not, until recently, been required to publish the net asset value of its mutual funds or submit performance reports to the SEC (Ahmed and Yusuf, 2005).

4.1.6 Board Committees

Board committees (audit, remuneration and nomination) are of critical importance in CG. Audit Committee is now being treated as a principal player in ensuring good CG and rebuilding public confidence in financial reporting. The role of Audit Committee, among others are: monitoring integrity of financial statements, reviewing internal financial controls, recommending appointment of external auditor and reviewing auditor independence and objectivity and audit effectiveness. The Remuneration Committee's responsibilities include establishment and review of the Managing Director's remuneration package and senior management salary packages. Remuneration Committee assists the Board to attract, retain and motivate high caliber executives and director through proposing remuneration that commensurate

to their performance. Despite significant importance of the board committees (as described), few boards (except for banks) has Audit Committees and almost none have nomination or Remuneration Committees in Bangladesh (Iqbal, 1997; BEI, 2003 and 2004).

In spite of having weakness in almost all of the elements of good corporate governance, in the past few years we have witnessed a silent positive tendency towards CG in Bangladesh due to a variety of forces that are acting today and would become stronger in years to come. Deregulation, disintermediation, institutionalization and globalization all these factors will make the markets more effective in disciplining the dominant shareholder. However, there are many things that the government and the regulators are yet to do to enhance this ability.

5 . Findings of the Survey

5.1 Level of Understanding

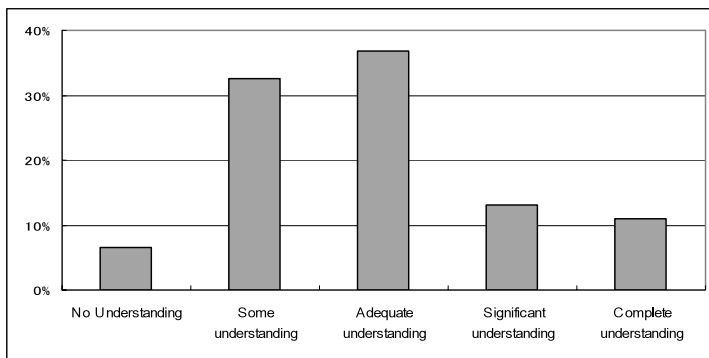


Figure 1. Understanding on issues of CG
(Total respondents = 40)

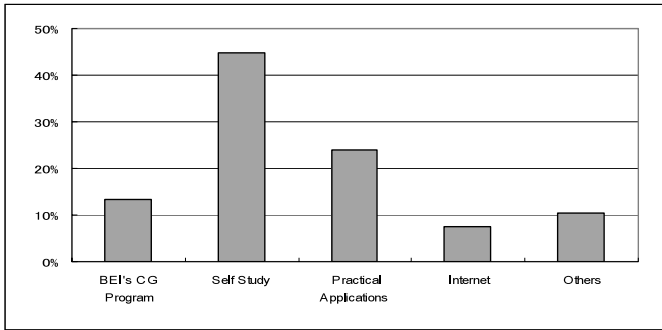


Figure 2. Sources of Understanding
(Total respondents=38)

Figure 1 shows the level of understanding of the respondents on issues of corporate governance (CG). From the figure, about 61 percent of the respondents have adequate level of understanding on corporate governance. Only 7 percent of the respondents commented that, they have no understanding of CG. Thus it can be concluded that, the level of understanding on CG as claimed by the respondents is quite significant in Bangladesh. In comparison to private limited companies, public limited companies showed higher level of understanding.

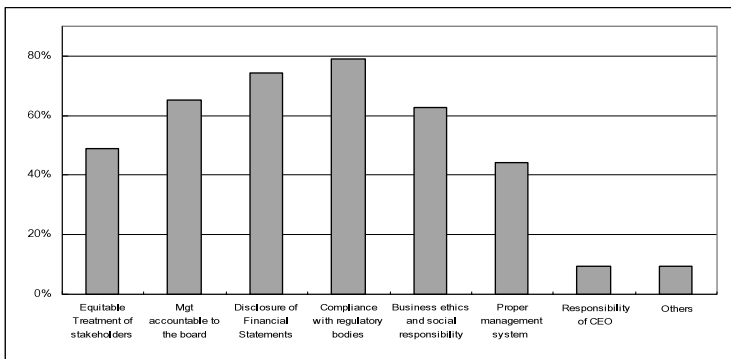


Figure 3. Respondent's Organizational Definition of CG
(Total respondents=39)

5.2 Sources of Understanding

Regarding sources of understanding on corporate governance, approximately 45 percent of the respondents commented that they have conducted self study to learn about this issue. Among other sources of information, practical application of CG, BEI's programs, internet and others were 24 percent, 13 percent, 8 percent, 10 percent, respectively.

About 14 percent public limited company respondents have come to know about CG issues from Bangladesh Enterprise Institute's CG programs. This indicates absence of institutional sources for learning about CG.

5.3 The Way Organizations Define CG

On the issue of CG definition, the highest number of respondents (69.8% public limited companies (PLC) and 9.3% private companies) think that CG is compliance with different regulatory bodies, whereas the lowest 9.3 percent of the respondents (7% PLC and 2.3% private companies) defined CG as CEO has the sole responsibility to implement CG. According to 74.4% of the respondents (67.4% PLC and 7% private companies) CG is comprehensive disclosure of Financial Statement. 48.8% companies (41.8% PLC and 7% private companies) have defined CG as Equitable treatment of all stakeholders, 65.1% companies (55.8% PLC and 9.3% private companies) have defined CG as Management accountable to the board, whereas 62.8% (60.5% PLC and 2.3% private companies) are with the opinion that CG is respect for business ethics and social responsibility and 44.2% (39.5% PLC and 4.7% private companies) thinks that CG is proper structure, system and procedure for management.

6 . Summary and Conclusion

The key findings of the study can be summarized and concluded as follows:

- a) The findings of the literature survey indicated that, Bangladesh is lagging behind good governance elements such as: regulatory framework, internal control, auditing, executive remuneration, control structure, board structure, audit committee, stakeholder engagement, conflict resolution etc. Although considerable development has taken place in these areas since 1990s, the pace is not sufficient to cope with regional and global developments.
- b) The level of understanding on CG as claimed by the respondents is quite high (61%) in Bangladesh (see Figure 1). This particular aspect is interesting, as this does not fit with the poor level governance application in the corporate sector.
- c) A major portion of the respondents (45 percent) commented that they have conducted self study to learn about corporate governance (see Figure 2). This indicates lack of institutional sources for learning about CG and urges the need for establishing institutional set up to train the corporate bodies on CG norms and practices.
- d) A large portion of the respondents (69.8% PLC and 9.3% private companies) defined CG as complying with different regulatory bodies and thinks CEO is responsible for implementing CG practices.

Finally, the study led to the conclusion that, the corporate sector in Bangladesh could be highly in need of some institutional arrangement for proper understanding and training on corporate governance for capacity building as well as to form an ethical and vibrant framework.

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