

Corporate Governance Practices in Bangladesh with Reference to SEC Corporate Governance Guidelines

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Abstract

Corporate governance is the set of laws, policies and procedures, and institutions affecting the way a corporation is directed, administered and controlled. It also includes the interrelationship of the stakeholders, i.e., shareholders, management, and the board of directors, employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large. This study investigates the extent to which the Bangladeshi listed companies comply with the corporate governance guidelines of SEC. To achieve this objective, annual report (2007) of fifty one companies listed in Dhaka Stock Exchange have been examined. The findings of this study reveal that all the companies under review reported corporate governance in the annual reports. The results indicate that the level of disclosure is not also poor (mean disclosure is 85.81 percent). Among the different types of industries, tannery and cement industries disclose more variables of corporate governance while insurance companies are in lowest level of disclosure.

Keywords: Corporate governance, Compliance, SEC, Disclosure level

Introduction

Sir Adrian Cadbury in ‘Global Corporate Governance Forum’ defined Corporate governance as “Corporate Governance is concerned with holding the balance between economic and social goals and between individuals and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society” (Cadbury, 2000) Corporate Governance acts as prerequisite for nurturing transparency, accountability and creating long-term value. In recent years, corporate stakeholders across the globe have become more concerned than ever about the quality of corporate governance (CG) practices and a series of recent corporate collapses (for example, Enron, WorldCom, OneTel) in different parts of the world has contributed to their interested concern. Sound CG practices are the foundations upon which the trust of investors (stakeholders, banks, and nonbank financial institutions) and other stakeholders is built; whereas poor CG practices lower the confidence level of a company’s stakeholder, specially that of investors as

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they are the providers of corporate finance and require assurance that their investment will generate reasonable returns and be protected (Afroze and Jahan, 2005). Companies with poor corporate strategies are more likely to under perform in the long terms. They will have less access to corporate finance or capital because of poor corporate practices. Sound corporate governance (CG) is a prerequisite to develop a well functioning capital market and it improves access to capital for both public and private entities. The low level of investor confidence, which serves as one of the impediments to increased investments, needs to be addressed for the future growth and development of the capital market of Bangladesh. Taking this into consideration, the Securities and Exchange Commission (SEC) has issued the corporate governance guidelines on February 20, 2006. These guidelines have been made mandatory on the listed companies on “comply or explain” basis. The present study aims at examining the extent to which the Bangladeshi companies comply with the corporate governance guidelines issued by the Securities Exchange Commission (SEC).

Objectives of the study

The present study will embark upon the following objectives:

1. To examine the extent to which the Bangladeshi listed companies comply with the corporate governance guidelines provided by Security Exchange Commission.
2. To explore the corporate governance (CG) practices in terms of disclosure in the Bangladeshi companies listed in Dhaka stock exchange.

Research methodology

As on 1st April, 2008, there are 293 companies (excluding Treasury bond) of 18 industries listed with Dhaka Stock Exchange (DSE). Fifty one listed companies are selected randomly from different industries as the sample of the study. Annual reports of 2007 of those companies have been taken as sources of data. In the study, a Disclosure Index (DI) comprising of seventeen disclosure variables (See Appendix-Table2) was developed by reviewing Security Exchange Commission corporate governance guidelines and relevant literature.

In this study, the approach to scoring items is essentially dichotomous. If an item scores one (1), only if disclosed and zero (0), if not disclosed. However, if an item of disclosure is clearly not relevant to a particular company, the entity is not penalized for nondisclosure.

The disclosure model ¹ thus measures the total disclosure (TD) score of a company as follows:

$$TD = \sum di$$

$$\text{Disclosure Index (DI)} = m/n$$

Where, $d=1$, if the information item (ith relevant item) is disclosed.

$d=0$, if the information item (ith relevant item) is not disclosed.

m =the number of variables which the company actually disclosed.

n =the number of variables which the company is expected to disclose.

¹ Taken from the article “Extent of Mandatory Compliance in the Corporate Annual Reports of Indian Companies- An Empirical Study”

Review of related literature

A number of studies on the state of corporate governance in Bangladesh were undertaken before the arrival of the corporate governance guidelines of Security Exchange Commission (SEC). All these studies concluded that corporate governance (CG) practices in companies and organizations were poor and that Bangladesh had lagged behind its neighbors and the global economy in corporate governance (CG).

Studies have discovered number of reasons for malpractices of corporate governance (CG) in companies listed with the Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). One of the principal reasons for poor corporate governance (CG) is that most of the listed companies are family oriented (Ahmed and Yusuf, 2005) and these companies prefer to keep ownership holdings within the family connections (The Daily Star, May 17, 2006), i.e., these companies are closely held. As a result, small group of shareholders own or control the majority of shares and by using that majority, control the decision-making processes of the companies (Bangladesh Enterprise Institute 2003). “In an overwhelming majority of the non-bank listed companies, sponsor shareholders, who generally belong to a single family, heavily dominate the Board of Directors. The Board of Directors is actively involved in management. Most independent directors represent current or former government officials or bureaucrats. They are appointed directors to assist company in getting licenses or as payback for previous favors” (Ahmed and Yusuf, 2005). In the context of Bangladesh, independent directors do not act as an advocate of majority shareholders or as a source of innovative ideas (Bangladesh Enterprise Institute 2003). But ironically, the companies Act 1994 provides for many stringent rules regarding any negligence, default, breach of duty or trust on the part of director, manager or officer of a company. But these rules are “more honored in the breach than observance” (Ahmed and Yusuf, 2005). In addition to this, annual general meetings (AGM) of many listed companies are not held in time, which also implies poor corporate governance (CG) practice.

Ahmed and Baree (2000) summarizes the principles and standards of corporate governance as agreed and put forth by Organization for Economic Co-operation and Development (OECD) , Cadbury committee (UK) and other international committees. The authors identified problems of implementing international corporate governance norms in Bangladesh and finally make certain recommendations for reform of corporate governance as well. The article recommends three substantive actions be taken to improve corporate governance scenario in Bangladesh. First, a ‘high powered committee’ including members from government, regulatory agencies, companies and ICAB should write a code for corporate governance in Bangladesh. Second, amendments to existing laws should be adopted to enforce corporate governance norms. Third, academic and professional institutions should include corporate governance principles in their syllabus.

Sarkar and Ahmed (2007) depicted the scenario of corporate governance disclosure by listed public limited companies in Bangladesh. They identified some information items which companies tend to disclose much such as ‘disclosure of remunerations committee’. They

observed that there are some information items, which companies tend to disclose less or try to conceal purposively, such as 'stock code'. They observed that 25 companies out of total 257 companies as listed on DSE up to June 30, 2005 reported Corporate Governance Report in the annual reports voluntarily. The mean disclosure of corporate governance items is 40.84 percent. Sarkar, Khan and Alam (2007) studied the response rate of different companies (industry-wise) with a special reference to the SEC corporate governance guidelines and the compliance rate for corporate governance guidelines by the companies who have reported the compliance with such guidelines in 2005-06 and 2006.

A comprehensive diagnostic study was conducted by Bangladesh Enterprise Institute (2003) as a project, which seeks to focus on the key areas that have been identified internationally as important to good corporate governance.

Weak regulatory system has also been identified as a roadblock in the way of achieving sound CG. The existence of weak regulatory system prevents the current laws and statutes from being implemented.

Incompleteness of Board committees hinders good CG in Bangladesh. Board committees which are very important for sound CG are composed of Audit Committee, Remuneration Committee, Nomination Committee. The Audit Committee monitors the integrity of financial statements, reviews internal financial controls, recommends appointment of external auditors and reviews auditor independence and objectivity and audit effectiveness. The Remuneration Committee is responsible for reviewing the remuneration of directors and senior management and advising the Board whether the amounts are reasonable in comparison with industry and corporate yardsticks. The Nomination Committee is responsible for proposing new nominees to the Board and advising the Board on the core competence required of new directors (Michael Seamer, 2002). Despite significant importance of the Board committees, new boards (except of banks) have been found to have audit committees and almost none has been found to have nomination or remuneration committees in Bangladesh (BEI, 2003).

Discrepancy between International Accounting Standards (IAS) and Bangladesh Accounting Standards (BAS) and inconsistency between the Companies Act, 1994 and IAS are other factors, which have been found to be responsible for poor CG practices. The Institute of Chartered Accountants of Bangladesh (ICAB) adopted 30 IAS as BAS but subsequent amendments of these BAS were not made and consequently, BAS significantly differ from IAS in material aspects. The situation aggravates when provisions regarding preparation and presentation of financial statements, disclosures and auditing that are mentioned in the Companies Act, 1994 are incompatible with IAS, which are required by the SEC. The Companies Act, 1994, for example, does not require the preparation and presentation of a consolidated Balance Sheet for a holding company, but it is required under the IAS.

In order to improve the present situation and to raise the awareness of the need for good CG practices, a number of initiatives have been taken at the non-governmental level. The establishment of the Center for Corporate Governance and Finance Studies (CCGFS) at the

University of Dhaka is one of the examples of the most recent initiatives. The CCGFS, DSE, the OECD and the Asia Foundation jointly organized an international conference on corporate governance on July 30 and July 31, 2005 for the first time in Bangladesh. The Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) organized another conference on the same topic. The Task Force on Corporate Governance of Bangladesh Enterprise Institute (BEI) undertook a project supported by Department for International Development, World Bank and the OECD and developed the “Code of Corporate Governance for Bangladesh” in April, 2004. But at the government level, the SEC has made the most important move by issuing the corporate governance guidelines on February 20, 2006 and making them mandatory on the listed companies on “comply or explain” basis.

The Dhaka Chamber of Commerce and Industry (DCCI) has been implementing a project, entitled Economic Reform and Research Enterprise, in co-operation with The Center for International Private Enterprise (CIPE)- an affiliate of the US Chamber of Commerce, Washington D.C. Haque, Jalil and Naz (2007) studied that one of the objectives of this project is to prepare economic policy papers on selected business sectors. DCCI requested to prepare a paper on “Principles of Corporate Governance for Public and Private Enterprise in Bangladesh.” According to the Term Of Reference (TOR) the scope of the study was limited to analyze the situation of corporate governance in the three types of Enterprises: Public limited companies- Financial and Non-Financial institutions and State Owned Enterprises (SOE).

Findings

In this study, total fifty-one companies (which are listed with the DSE) from different industries have been randomly selected. No statistical methods have been employed in order to select sample and determine the size thereof. Total seventeen variables have been identified on the basis of Security Exchange Commission corporate governance guidelines.

It is evident from table 1 that the mean disclosures (0.97) of tannery and cement industry rank the highest. The disclosure index table also reveals that banks and financial institutions and textiles are in the second and the third position respectively. If the various industries are compared, the differences among those are not significant.

It is observed from table 2 (See appendix) that all companies disclose 100% in respect of Fairness of Financial Statements, Maintenance of proper books of account, Adoption of appropriate accounting policies and estimates, Compliance with International Accounting Standards variables. Only 2% companies do not disclose two variables, namely Presentation of at least preceding three years financial data and Non-engagement in Book-Keeping. Most of the companies do not feel interest to disclose Non-engagement in appraisal or valuation variable. So its disclosure percentage (47%) is at the minimum among all the variables. To get a clear picture of the disclosure level of the companies under different industries, researchers use scoring scale. Table 3 (See appendix) shows that the highest rate of disclosure is 43% which is in the area of 0.90-1.00 disclosure index. One-fourth companies have fallen between 0.80 and 0.90. The lowest disclosure index is 0.50-0.60, which occupies only 8%. It clearly depicts that most of the

companies fall in the higher disclosure index level and lower level of disclosure index occupies lower percentage.

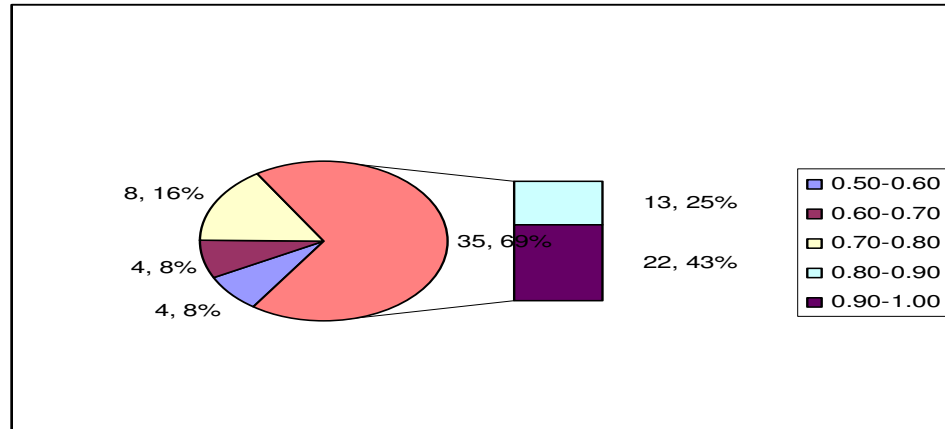


Figure-1: Disclosure level by the Companies

As the sample sizes have been collected from different industries, the researchers have provided an in-depth scenario within the industries.

From table 4, it is clear that within the banks and financial institutions the most prominent banks and financial institutions are Prime Bank, Brac Bank and Uttara finance which reveal “1” mean. In the textile sector H.R. textile, Square textile and Rahim textile have provided the highest disclosure. ACI, Beximco pharmaceuticals and Square pharmaceuticals have disclosed the maximum variables within the pharmaceuticals industry. In case of insurance companies, only BGIC’s mean is “1”. LAFSUR cement company and APEX tannery have disclosed all variables. No company provides 100% disclosure under food and allied sector.

Table 5 shows the total disclosure of fifty one sample companies. From the banks and financial institutions Brac Bank, Prime Bank and Uttara finance disclose all the seventeen variables. In the Pharmaceuticals & Chemical sector ACI, Beximco pharmaceuticals and Square pharmaceuticals have provided 100% disclosure. Among eight selected insurance companies, only BGIC has disclosed all variables. H.R Textile, Square textile and Rahim textile have disclosed the maximum variables within textile sector. LAFSUR cement company and APEX tannery have provided highest score, which is 17. No company provides highest disclosure under food and allied sector.

Conclusions

The authors basically focused on the compliance with a special reference to SEC Corporate Governance Guidelines in this study. For doing so, they developed a disclosure index based on SEC Guidelines. No attempts have been made to portray the compliance status of listed companies with respect to SEC CG Guidelines in context of Bangladesh. It is found in the study that tannery and cement disclosed the variables most (97%); more than 43% of the companies fall

in the highest disclosure score and all the companies disclose few items 100%. Though it is sanguine that all the listed companies in Dhaka Stock Exchange are in the practice of reporting corporate governance in the annual reports and the level of disclosure also provides an optimistic picture of corporate governance practice, there is still room for development of corporate governance practice in terms of its quality. Business people should cultivate ethical standards, nurture moral values, feel accountability and comply with corporate governance rules in the true spirit of the term. As even 100 percent compliance with the letter of every governance rule on paper but not with the substance may be possible. It is also evident that regulation functions better in the practice of corporate governance in Bangladesh. The authors did not make any attempt to examine these qualitative aspects of corporate governance reporting, which can create an avenue for further research.

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Appendices

Table 1: Disclosure Index by Industry type

Industry type	No. of Companies	Mean Disclosure	Standard Deviation
Banks and Financial Institutions	15	0.89	0.081
Textiles	10	0.87	0.107
Tannery	2	0.97	0.042
Pharmaceuticals & Chemical	10	0.84	0.162
Fuel and Power	2	0.76	0
Insurance	8	0.71	0.167
Cement	2	0.97	0.042
Food & Allied	2	0.79	0.208

Table 2: Disclosure of variables by the selected companies under review

Variables	Disclosure Percentage
Board's size: <i>should not be less than 5 and more than 20</i>	87
Independent director: <i>at least 1/10th i.e. minimum one</i>	57
Appointment of Independent Director by elected Directors	53
Fairness of Financial Statements	100
Maintenance of proper books of account	100
Adoption of appropriate accounting policies and estimates	100
Compliance with International Accounting Standards	100
Presentation of at least preceding three years financial data	98
Declaration of Dividend	89
Appointment of CFO, Company Secretary & Head of Internal Audit and defending of their responsibilities	85
Attendance of CFO & Company Secretary in the Board of Directors meeting	94
Constitution of Audit Committee	94
Chairman of the Committee	74
Reporting on the activities to the Board of Directors	77
Reporting on the activities to the Shareholders and General Investors	74
Non-engagement in appraisal or valuation	47
Non-engagement in Book-Keeping	98
Mean	85.81
Standard Deviation	17.16

Table 4: Mean Disclosure of Different Companies

Banks and Financial Institutions		Textile		Pharmaceuticals & Chemical	
ABBANK	0.94	H.R Textile	1.00	ACI	1.00
BRACKBANK	1.00	ANLIMAYARN	0.94	GLAXOSMITH	0.65
CITYBANK	0.82	STYLECRAFT	0.76	AMBEEPHA	0.71
DUTCHBAN	0.82	ALLTEX	0.82	BXPHERMA	1.00
JAMUNABANK	0.88	APEXSPINN	0.82	BXSYNTH	0.88
PLFSL	0.82	BEXTEx	0.82	IBNSINA	0.94
PREMIERLEA	0.94	SQUARETEXT	1.00	ORIONINFU	0.59
PRIMEBANK	1.00	MONNOFABR	0.82	KEYACOSMRT	0.71
BANKASIA	0.88	PADMA	0.71	SQUARPHARMA	1.00
UTTARAFIN	1.00	RAHIMTEX	1.00	KOHINOORCHE	0.94
NCCBANK	0.88	Fuel and Power		Insurance	
DHAKABANK	0.76	POWERGRID	0.76	ASIAPACINS	0.65
SHAHJABANK	0.76	SUMITPOWER	0.76	BGIC	1.00
ULC	0.94	Cement		FEDERALINS	0.82
IPDC	0.94	HEIDELBCEM	0.94	KARNAFULI	0.59
Tannery		LAFSURCEML	1.00	MERCINS	0.53
APEXTANRY	1.00	Food & Allied		PEOPLESINS	0.59
BATASHOE	0.94	BATBC	0.94	PHONIXINS	0.65
		FUWANGFOOD	0.65	POPULARLIF	0.88

Table 5: Total Disclosure (TD) of Different Companies

Banks and Financial Institutions		Textile		Pharmaceuticals & Chemical	
ABBANK	16	H.R Textile	17	ACI	17
BRACKBANK	17	ANLIMAYARN	16	GLAXOSMITH	11
CITYBANK	14	STYLECRAFT	13	AMBEEPHA	12
DUTCHBAN	14	ALLTEX	14	BXPHERMA	17
JAMUNABANK	15	APEXSPINN	14	BXSYNTH	15
PLFSL	14	BEXTEx	14	IBNSINA	16
PREMIERLEA	16	SQUARETEXT	17	ORIONINFU	10
PRIMEBANK	17	MONNOFABR	14	KEYACOSMRT	12
BANKASIA	15	PADMA	12	SQUARPHARMA	17
UTTARAFIN	17	RAHIMTEX	17	KOHINOORCHE	16
NCCBANK	15	Fuel and Power		Insurance	
DHAKABANK	13	POWERGRID	13	ASIAPACINS	11
SHAHJABANK	13	SUMITPOWER	13	BGIC	17
ULC	16	Cement		FEDERALINS	14
IPDC	16	HEIDELBCEM	16	KARNAFULI	10
Tannery		LAFSURCEML	17	MERCINS	9
APEXTANRY	17	Food & Allied		PEOPLESINS	10
BATASHOE	16	BATBC	16	PHONIXINS	11
		FUWANGFOOD	11	POPULARLIF	15