A Conceptual Review on Corporate Governance and its Effect on Firm’s Performance: Bangladesh Perspective

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A Conceptual Review on Corporate Governance and its Effect on Firm’s Performance: Bangladesh Perspective

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ABSTRACT

Corporate governance – a concept referring to the ideal mode of ensuring firm’s accountability to its stakeholders, has ascended to its current level of importance owing to corporate level scandals in the large economies of the world; experience gained from which has brought some positive changes in the less developed economies – changes that are proactive and are aimed at enhancing corporate responsibility and performance. The objective of this study has been to review this concept as is being practised, the problems being faced, the schools of thought, its implication on firm valuation and performance and lastly, to see its relevance in the context of Bangladesh, where the listed firms are mostly owned and managed by family members. Suggestions to improve corporate governance and accountability, also in line with SEC guidelines, is to have an active board with well proportioned executive vs non-executive members, along with representatives from all groups of shareholders/stakeholders; separation of the role of CEO and the chairperson; creation of board committees; changing audit firms periodically etc, to name a few.

1.0 INTRODUCTION

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way in which a corporation is directed, administered or controlled. The aim of corporate governance is to ensure that companies that are not managed by their owners are run in the best interest of the shareholder. Although in recent times, too much focus has fallen on deterring fraudulent activities and on issues of

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transparency owing to some scandals of big corporations in the major economies of the world. In this paper, the concept of corporate governance is being revisited not only in light of these scandals with means / ways to counter such attempts in future but also in terms of taking the concept further / beyond to make it a way of “corporate life” rather than just an option that may be followed for mostly gaining investors’ confidence.

The level or the state of corporate governance in a country plays an important role in attracting and holding the foreign investments, for building a robust capital market and for maintaining/ restoring the confidence of both domestic and foreign investors. Corporate Governance thus has a special significance to Bangladesh. Towards achieving these goals, regulators in Bangladesh has brought a number of changes in laws and regulations over the last 5 years, of which, the recent one enacted by the Securities & Exchange Commission (SEC) is a significant one as it has been aimed at bringing a substantial change in the arena of corporate governance in Bangladesh.

The aim of the guidelines issued by the SEC is to enhance corporate governance in the listed companies in the interest of the investors in the capital market. It is expected that the guidelines will be practiced as a code of good corporate governance and therefore have not been made mandatory to be followed. The guidelines, in fact, in the meantime have drawn attention of different stakeholders and management. Different professional institutes, Chambers, and associations are examining these SEC guidelines and discussing their effects upon acceptance and practice on business, behavior of management and investors. Many companies, however, yet remain unconvinced of the value of good governance.

**Objectives**

- To study the concept of corporate governance and its implications in developing corporate culture that benefit shareholders.

- To find the models of corporate governance practised in various countries.
• To overview the corporate governance situation in Bangladesh and make some suggestions in the light of corporate governance practised in other countries.

2.0 CORPORATE GOVERNANCE FRAMEWORK

Corporate governance is defined as the system by which companies are directed and controlled and this responsibility principally lies with the Board of Directors. Shareholders and the management are also principal players in the corporate governance process. Besides the board of directors, shareholders and the management, other stakeholders included in the process are employees, suppliers, customers, creditors, regulators, the environment and the community at large.

The corporate governance structure specifies the rules and procedures for making decisions on corporate affairs. It also provides the structure through which the company objectives are set, as well as the means of attaining and monitoring the performance of those objectives. It is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements.

Gabrielle O'Donovan (2003) defines corporate governance as 'an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity and integrity. Sound corporate governance is reliant on external marketplace commitment and legislation, plus a healthy board culture which safeguards policies and processes'. In other words, corporate governance defines the legal, ethical and moral values of a corporation in order to safeguard the interests of its stakeholders. According to O'Donovan 'the perceived quality of a company's corporate governance can influence its share price as well as the cost of raising capital’. The concept thus works both ways, ie not only in the interests of the stakeholders, but also for its own long term sustenance.
Quality of corporate governance is determined by the financial markets, legislation and other external market forces plus the international organisational environment, how policies and processes are implemented and how people are led. External forces are, to a large extent, outside the circle of control of any board. The internal environment is quite a different matter, and offers companies the opportunity to differentiate from competitors through their board culture. To date, too much of corporate governance debate has centered on legislative policy, to deter fraudulent activities and transparency policy which misleads executives to treat the symptoms and not the cause.

The aim of corporate governance is to ensure that companies that are not managed by their owners are run in the best interests of the shareholders. This applies primarily to listed companies, where the majority of the shareholders are not in a position to participate in the management of the company. Corporate governance is not, however, merely an issue for companies without active shareholders, but also for companies with other ownership structures such as (1) companies with one or very few principal owners and a large group of smaller shareholders, (2) public corporations, where all citizens could be regarded as having an ownership interest (3) partner-owned companies, and (4) privately owned companies where the ownership has been divided through inheritance in one or several generations.

The essence/main objective of corporate governance is establishing transparency and accountability throughout the organization. The practice of effective corporate governance, therefore, benefits everyone- entrepreneurs, investors, suppliers, lenders, managers, auditors and regulators. The corporate governance system thus may also be defined by legislation, self-regulation and tradition. The main pieces of legislation include the Companies Act and the Accounting Act. In addition to these, there are a number of self-regulating frameworks of rules, such as the Code of Corporate Governance.

Under administrative governance, almost every part of the economy, including the stock market, is heavily regulated. As a consequence, it is difficult to separate business from politics. The quality of public governance thus is of first-order importance in shaping the overall quality of corporate governance (Chen, Fan and Wong 2004). Politicians or politician-connected businessmen can easily hijack any
governance systems and seek rents for themselves (Clarke 2003). As a matter of fact, almost every corporate governance practice in a country can trace its origin to a certain deficiency in public governance and is, directly or indirectly, related to politicians or politician-related businessmen's rent-seeking incentives.

At firm / micro level, the seminal work by Berle and Means (1932) suggests that, in practice, managers of a firm pursue their own interests rather than the interests of shareholders. In recent years, another set of conflicts of interest has arisen as controlling shareholders take actions to benefit themselves at the expense of minority shareholders. La Porta et al. (1998) even assert that the central agency problem in large corporations is to restrict expropriation of minority shareholders by controlling shareholders.

In this context, our profession's understanding of corporate governance has been broadened. Taking different sets of conflicts of interest due to the separation of ownership and management into consideration, Denis and McConnell (2003) define corporate governance as a set of mechanisms, both institutional and market based, that induce the self-interested controllers of a company (including both managers and controlling shareholders) to make decisions that maximize the value of the company to its owners. Practitioners share the same view. For example, Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) defines corporate governance as a set of mechanisms that maintains an appropriate balance between the rights of shareholders and the needs of the board and management to direct and manage the corporation's affairs. These definitions, in retrospect, are expressing the view that the managing / administrative authority of the Board and controlling shareholders ought to be limited only to the extent that while they may still maintain control / reign of the organization, the interests of the other stakeholders and even the society in general cannot be hampered.

Becht et al. (2003) provide a relatively more general conceptual framework. They define corporate governance as a set of mechanisms that are necessary for two reasons: "first, to overcome the collective action problem resulting from the dispersion among shareholders and second, to ensure that the interests of all relevant constituencies besides shareholders face the same basic collective action problem"; that is, addressing the consensus views of all dispersed stakeholders.
The corporate governance system is based on a strict division of power and responsibilities between the shareholders (through the annual general meeting), the board of directors, the executive management and the auditors.

The basic structure of a system can be illustrated as follows:

![Figure 1: Basic Structure of a Corporate Governance System](image)

The system is based on the interplay between the four main corporate bodies, each with its specific role. The shareholders’ meeting is a company’s highest decision-making body and the forum where the shareholders can directly exercise their power. Shareholders meet at least once a year to approve the company’s annual report, discharge the directors and the CEO from liability and decide on the appropriation of profits for the previous financial year. The AGM also elects board members and, when required, auditors for the coming term.

The board of directors is appointed at the shareholders’ meeting to manage the company’s affairs on behalf of the shareholders. The board has broad powers to manage the company without the involvement of the shareholders. However, the shareholders always have the right to call an extraordinary general meeting, (EGM), at any time and replace the board members.

All public companies must have a Chief Executive Officer. The CEO is appointed by the board and is responsible for the day-to-day management of the company according to the instructions issued by the board of directors. The division of
responsibilities between the board and the managing director is stipulated in a set of written instructions that is approved by the board of directors. The managing director may or may not be a member of the board.

The auditors – one or more – are appointed by the shareholders at the annual general meeting, (AGM), to audit the company’s annual report and accounts, as well as the running of the company by the board of directors and the managing director. Formally, the auditors report to the shareholders, but in practice they also have an important role in supporting the board in its task of overseeing the CEO’s running of the company.

In corporations, the decision making rights are delegated to the managers by the shareholders to act in the best interests of the principal. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions and as a result of this, a system of corporate governance controls is implemented to assist in aligning the incentives of the managers with those of the shareholders.

The structure of the market has changed over time. Many years ago, buyers and sellers of corporation stocks worldwide were individual investors like wealthy businessmen or families, who often had a vested, personal and emotional interest in the corporations whose shares they owned. Over time, markets have become largely institutionalized: trading of shares significantly moved within the hands of institutions (e.g., pension funds, insurance companies, mutual funds, hedge funds, investor groups, and banks).

Shareholding structure of firms has likewise changed. The rise of the institutional investors has brought with it the advantage of increased professional diligence which has tended to improve regulation of the stock market, although not necessarily in the interest of the small investors. This process occurred simultaneously with the direct growth of individuals investing using professionals to manage their funds. In this way, the majority of investment now is described as "institutional investment" even though the vast majority of the funds are for the benefit of individual investors.
Previously, the Board of Directors of large corporations used to be chosen by the principal shareholders, who usually had an emotional as well as monetary investment in the company, and the Board diligently kept an eye on the company and its principal executives. Nowadays, if the owning institutions do not like what the President/CEO is doing and they feel that firing them will likely be costly and/or time consuming, they simply sell out their interest in those corporations.

Now, the Board is mostly chosen by the President/CEO, and may end up being made up primarily of their friends and associates. Since the (institutional) shareholders rarely object, the President/CEO generally takes the Chair of the Board position making it more difficult for the institutional owners to terminate him. Occasionally, but rarely, institutional investors support shareholder resolutions on such matters as executive pay and anti-takeover measures.

Lastly, this change in shareholding structure in corporations by the large institutions is based on the strategy of eliminating individual company, financial or other risks by investing funds in a very large number of different companies with sufficient liquidity. These institutional investors, therefore, have even less interest in a particular company's governance.

3.0 CORPORATE GOVERNANCE & FIRM VALUATION

A firm's various corporate governance practices shape its behavior and eventually affect its stock market performance and accounting performance (Chow G. 2005). Various researches examined the relation between state ownership and firm performance. Tian (2002) finds that government ownership worsens a firm's performance when government ownership is small, but improves a firm's performance when government ownership gets significantly larger.

Several other studies examine the impact of other governance mechanisms on listed firms' performance. Ning and Zhou (2005) find that employee stock ownership does not improve firm performance significantly in China, suggesting that a negligible fractional ownership does not provide a meaningful employee incentive. Kato and Long (2005) find evidence that CEO turnover-firm performance sensitivities are
larger for privately controlled listed firms than for state controlled firms, indicating the inefficiency of state ownership from the CEO turnover perspective.

Bai et al. (2004) offer a comprehensive analysis of the impact of various governance mechanisms on firm market valuation. They find evidence that the degree of concentration of shares held by other large shareholders positively affects firms' market valuation. It is argued that when shares are concentrated in the hands of other large shareholders, they are more likely to monitor the largest shareholder and prevent him from tunneling a firm's resources. Bai, Lin and Song (2004) provide evidence that the degree of concentration of shares by other large shareholders is a good proxy for the likelihood of an emerging corporate control market. As such, it captures the effects on firm performance of an active takeover market, which has been widely touted as an effective external governance mechanism.

Bai et al. (2004) find that issuing shares to foreign investors helps to improve firms' valuation, partly due to the monitoring effect of the relatively more sophisticated foreign investors, and partly due to more transparent financial disclosure required for cross-border listings. Among other governance mechanisms, they find that CEOs being the chairmen of boards negatively affect firm valuation, indicating that increasing the independence of boards of directors helps to enhance firm performance. They also find that when the largest shareholder is the state, the firms tend to have lower market valuation.

The control-based corporate governance model may hurt the performance and corporate governance of newly listed state enterprises. Chen, Fan and Wong (2004) find that the 3-year post-IPO average stock returns of these politically connected firms under-perform the market by almost 30 percent. They conclude that the appointment of politically connected CEOs does not enhance shareholder value but rather fulfills the political goals of politicians.

Corporate governance practices shape a firm's behavior. It is therefore natural to expect that they also affect a firm's stock returns (Gompers et al. 2003). Wang and Xu's (2005) argue that due to the speculative nature of the capital markets and low quality of the accounting information, book-to-market does not reflect fundamentals in the stock market. Instead, they suggest that a firm-specific floating ratio is a good
proxy for expected corporate governance, which helps to predict a firm's future cash flow.

4.0 CORPORATE GOVERNANCE & FIRM PERFORMANCE

Corporate governance has emerged as a concept that can no longer be underplayed in the market: it has relevance to the performance of firms. In a 'Global Investor Opinion Survey' of over 200 institutional investors by McKinsey & Company - a privately owned management consulting firm, first undertaken in 2000 and later updated in 2002. McKinsey found that 80% of the respondents would pay a premium for well-governed companies. According to these respondents, a well-governed company is one that had mostly outside directors with no management ties, who undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues.

In another survey in 2005 on over 1,000 directors around the world, McKinsey & Company found that directors want to do more than monitor the short-term financial performance of their companies. Directors say they want to spend more time on issues that impact longer-term corporate health such as strategy and leadership development. However, many directors lack the information needed for sound decision-making.

Different studies / researches conducted on establishing relationships between various aspects of corporate governance and firm performance yielded differing results. Some researchers have found support for the relationship between frequency of meetings and a firm’s profitability; others found a negative relationship between the proportion of external directors and firm performance, while others found no relationship between external board membership and performance. In a research carried out by Bagahat and Black, it was found that companies with more independent boards do not perform better than other companies. It is thus unlikely that board composition has a direct impact on firm performance.

The results of prior research on the relationship between firm performance and executive compensation have failed to find any consistent or significant relationships. Low alignment of average level of pay to performance do not necessarily imply
inefficient form of governance control. Not all firms experience the same levels of agency conflict, and external and internal monitoring devices may be more effective for some than for others.

Some researchers have found that the largest CEO performance incentives came from ownership of the firm's shares, while other researchers found that the relationship between share ownership and firm performance was dependent on the level of ownership. The results suggest that increases in ownership above 20% cause management to become more entrenched, and less interested in the welfare of their shareholders.

Some argue that firm performance is positively linked with share option plans and these plans direct managers' energy and extend their decision horizons toward the long-term, rather than the short-term, performance of the company. This view however, came under substantial criticism owing to various security scandals including mutual fund timing episodes and, in particular, the backdating of option grants as documented by University of Iowa academic Erik Lie and reported by James Blander and Charles Forelle of the Wall Street Journal.

5.0 CORPORATE GOVERNANCE MECHANISMS

In essence, good corporate governance comprises a set of mechanisms to ensure that suppliers of funds get an adequate return on their investment. To better describe the current corporate governance practices, it is required to focus on a particular set of corporate governance mechanisms.

Broadly speaking, there are two types of mechanisms that resolve the conflicts among different corporate claim-holders, especially, the conflicts between owners and managers, and those between controlling shareholders and minority shareholders. The first type consists of various internal variables, e.g. (1) the ownership structure, (2) board of directors (3) executive compensation and (4) financial disclosure. The second includes external mechanisms with variables, e.g. (1) effective takeover market, (2) legal infrastructure and (3) product market competition.
5.1 Internal Mechanism

Ownership Structure
Among the aforementioned four internal governance mechanisms, ownership structure is crucial to the firm's value maximization. Concentrated equity ownership gives the largest shareholders a substantial discretionary power to use the firm's resources for personal gain at the expense of other shareholders (Claessens, Djankov and Lang 2000).

Board of Directors
The board of directors is the second mechanism through which shareholders can exert influence on the behavior of managers to ensure that the company is run in their interests (Hemailin and Weisbach 2003). The monitoring role of the board of directors is compromised when a CEO controls the board fully or partially. Therefore, we expect this variable to have a negative impact on a firm's overall corporate governance level. If the board is dominated by members of the management team, it is not expected that the board could play an effective monitoring role.

Executive Compensation
Providing the executives with incentive-related pay is another powerful mechanism to govern their behavior (Jensen and Murphy 1990; Murphy 1999). The interest of the top managers can be better aligned with that of the shareholders if they have a
larger stake in the firm. It may be measured by the percentage of shares held by these top executives as a measure of their economic interest in a company.

**Financial Disclosure**

Finally, financial transparency and adequate information disclosure are crucial in developing countries. Sufficient, accurate and timely information regarding the firm's operations, its financial status and the external environment is important for shareholders to be able to monitor the firm, to make investment decisions affecting the firm, and to exercise control over the firm through other means (Bushman and Smith 2001). Regarding financial transparency, local accounting firms audit most listed companies in Bangladesh. However if one wants to look for information on the reputation/performance of these accounting firms no such recognized report/data exists.

**5.2 External Mechanism**

**Effective Takeover Market**

An active market for corporate control is considered to be essential for the efficient allocation of resources. This market allows able managers to gain control of sufficient shares in a short period of time to remove inefficient managers. Proxy fights are not usually successful in deposing the existing management or board of directors because share holdings are often dispersed among small shareholders. Friendly mergers and takeovers occur in all countries and account for most of the transactions in the market for corporate control. In developed countries, the percentage of these activities ranges from 60 to 90 percent. Hostile takeovers occur fairly frequently in the US and the UK, but much less so in Germany, France and Japan. Empirical studies suggest that takeovers significantly increase the market value of target firms, although the gain for bidding firms is zero and possibly even negative (Shleifer and Vishny 1997).

This variable should have a positive impact on a firm's overall corporate governance level for three reasons. First, large shareholders other than the largest one are obstacles to tunneling activities by the largest shareholder because these shareholders have incentives to monitor and restrain the largest shareholder. Second, the efficiency of the market for corporate control is enhanced because these
large shareholders can either initiate a fight for corporate control or assist an outsider’s fight for control when the existing management underperforms. Third, these large shareholders have an incentive to monitor the management directly.

**Legal infrastructure**
Regarding overall legal environment, another important external mechanism, companies that have issued different types of shares are subject to stricter legal rules.

**Product Market Competition**
Lastly, we consider one final variable to indicate whether or not the controlling shareholder is the government. The government is likely to have goals other than profit maximization, such as maintaining employment and social stability. A controlling government stakeholder can use the listed company as a vehicle to achieve these other policy goals even though they may conflict with shareholders’ interests (Bai et al. 2000).

### 6.0 CORPORATE GOVERNANCE MODELS AROUND THE WORLD

There are many different models of corporate governance around the world. These differ according to the level of capitalism in which they are embedded. The liberal model common in Anglo-American countries tends to give priority to the interests of shareholders, while the coordinated model in Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. The liberal model of corporate governance encourages radical innovation and cost competition, whereas the coordinated model of corporate governance facilitates incremental innovation and quality competition. Both models have their distinct competitive advantages, but in different ways.

**Anglo-American Model**
In USA, a corporation is governed by a board of directors, which has the power to choose an executive officer, often known as the chief executive officer, who is given the broad power to manage the corporation on a daily basis. The CEO however, needs board’s approval for certain major actions, such as hiring his/her immediate subordinates, raising money, acquiring another company, major capital expansions,
or other expensive projects etc. Other duties of the board may include policy setting, decision making, monitoring management's performance, or corporate control.

The responsibility of selecting the board of directors rests on the shareholders, but the bylaws of many companies make it difficult for all but the largest shareholders to have any influence over the makeup of the board. Individual shareholders normally are not even offered a choice of board nominees among which to choose from, but are merely asked to rubberstamp the nominees of the sitting board. Other problems in board composition include questionable incentives given to the board members, who then become beholden to the very chief executive whose actions they are intended to oversee. Also, frequently, it is seen that members of the boards of directors are CEOs of other corporations, which may be seen as a conflict of interest.

United Kingdom (UK) has pioneered a flexible model of regulation of corporate governance, known as the "comply or explain" code of governance. This is a principle based code that lists a dozen of recommended practices, such as the separation of CEO and Chairman of the Board, the introduction of a time limit for CEOs' contracts, the introduction of a minimum number of non-executive Directors (independent directors), the designation of a senior non executive director, the formation and composition of remuneration, audit and nomination committees etc.

Publicly listed companies in UK have to either apply those principles or, if they choose not to, to justify in a designated part of their annual reports why they decided not to do so. The monitoring of those explanations and their subsequent acceptance is left with the shareholders of the respective organizations. The companies have some flexibilities so that they can make choices most adapted to their circumstances. If they have good reasons to deviate from the sound rule, they should be able to convincingly explain those to their shareholders.

**Non Anglo-American Model**

In East Asian countries, family-owned companies dominate the market. In countries such as Pakistan, Indonesia and the Philippines, the top 15 families controlled over 50% of publicly owned corporations through a system of family cross-holdings, thus dominating the capital markets. Family-owned companies also dominate the Latin model of corporate governance, such as companies in Mexico, Italy, Spain, France
(to a certain extent), Brazil, Argentina, and other countries in South America. The characteristics in the model are: shareholder are the major stakeholder; there is a small number of listed companies with an illiquid capital market where ownership and control are not frequently traded; and there is high concentration of shareholding in the hands of corporations, institutions, families or government.

7.0 CORPORATE GOVERNANCE IN DEVELOPING COUNTRIES

Developing countries are undergoing a process of economic growth and transformation, they are also experiencing a revolution in the business and political relationships that characterize their private and public sectors. Good corporate governance systems will allow organizations to realize their maximum productivity and efficiency, minimize corruption and abuse of power, and provide a system of managerial accountability (Nicolas Meisel 2004). These goals are equally important for both private corporations and government bodies. Establishing good corporate governance practices is essential to sustaining long-term development and growth. Developing countries are moving from closed, market-unfriendly, undemocratic systems towards open, market-friendly, democratic systems.

Because of the implicit relationship between private interests and the larger government, good corporate governance practices are essential to establishing good governance at the national level in developing countries (Nicolas Meisel 2004). Judiciary and regulatory bodies as well as legislatures can play a role in corporate management and oversight. The Experiences of Brazil, Chile, India, and South Africa, a country cannot significantly change one without simultaneously instituting changes in the other (Charles 2006).

According to Nicolas Meisel, there are four priorities which developing countries should concentrate on while experimenting with new forms of corporate governance. The first is to focus on improving the quality of information and increasing the speed at which it is created and distributed to the public. Good communication is important to the functioning of any organization. The second is to allow individual actors more autonomy while at the same time maintaining or increasing accountability. Thirdly, if a hierarchical organization is used to orient private activities toward the general interest, new countervailing powers should be encouraged to fill this role. Finally, the
part the state plays and how government officials are selected must be considered if a developing economy is to achieve sustainable growth. This may involve making it easier for newcomers with new ideas incumbents who may hold to older, possibly outdated, models (Charles 2006).

8.0 CORPORATE GOVERNANCE SCENARIO IN BANGLADESH

This study overviews the practices currently employed in Bangladesh. The corporate governance practices by the Bangladeshi firms are just emerging. So, knowledge of the governance mechanisms employed in Bangladesh and how to improve their effectiveness is still limited. Establishment of a governance framework is based on the principles of "fairness, justice, and open access". The control-based governance model practiced by the Bangladeshi listed firms is damaging the investors' confidence and thus is hurting the development of the stock market.

In Bangladesh, most of the listed companies, excepting multinationals and a few large companies, are owned and managed by family members and their peers. The owners make the policy decisions as board members and dispose off the executive functions of the company, leaving no scope for separation of ownership and independence of the board. Board meetings are restricted to papers only to comply with the legal requirements.

The general scenario is entrepreneurs establish the firm by employing their innovations, hard labor, and capital; and are thus unwilling to accept independent directors and lose control over the company. They plea that the outside executives do not remain loyal to the company and never get themselves integrated with or devoted sincerely to the betterment of the organization. Therefore, they argue that “relying on part time outsiders who barely spend few hours to police board rooms is naïve and nonsense, are more harmful than executive directors who at least know the business.”

They are against delegation of authority to the outside directors and managers as it would create scope for misappropriation or embezzlement or corruption, and cause drainage out of funds for which ultimately the sponsors would have to account for. In our environment, both detection as well as recovery of misappropriation, etc are
time and cost consuming issue because there is unusual delay in our legal system to deliver justice.

Bangladesh Bank limited the number of bank’s directors, the authority of the board chairman, and period of their office holding. Many of them fought legal battle and later accepted on paper only (by appointing the spouses in the board and exercising the executive functions with more authority from behind the scene). Similarly, the current SEC efforts to appoint independent directors and separation of Chairman’s and chief executive’s office will not be accepted in proper spirit; may be practised in paper only.

For effective corporate governance, in the context of the business environment in Bangladesh and style of (family controlled) management, the following important measures should be undertaken.

- Board members should be elected from all groups of the shareholders to their proportion of their shareholdings. The maximum term of chairmanship should be specified and rotated amongst the directors. The board should appoint the top 5 Managers including the CEO, who will remain accountable to the board.

- Auditors have an important role regarding compliance to the guidelines of corporate governance. After all, the investors depend on the integrity of auditing profession. They should give investors some form of assurance that they are credible. Ever since accounting shifted from the cash to accrual accounting, estimates have become a part of accounting and has played a critical role in measuring company profits, particularly for more complex businesses in ‘knowledge based economies’. This puts a greater onus on Auditors to focus on the objectivity and independence of those making the estimates and weed out good estimates from the hyped ones. Better disclosure would help investors to scrutinize the earnings/profit figures.

- Internal audit is virtually non-existent in our management system, and external audit is mostly ‘a matter of getting the annual accounts signed by a CA firm for publishing in the annual reports’ only. The recent SEC notification emphasized the establishment of internal control system and appointment of
Head of Internal Audit. If complied with proper spirit, many of the fears and pleas of the sponsors against misappropriation, etc will be outweighed. The sound internal control systems and functional audit committees within a corporation will help the auditors to focus the minds in the right perspectives.

- The wide practice and application of accounting standards will make the reported earnings, cash flows, and balance sheet more reliable and contribute to more disclosures. It will lead to enhanced investors’ confidence, accountability, and corporate governance.

- Organizations should respect the rights of shareholders and help them to exercise those rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings. Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.

- Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. Organizations should clarify and make publicly known the roles and responsibilities of the board and management.

- Companies should create stronger and purposeful boards, enhance the scope, accuracy, and timings of financial reporting, and pay more regards to the rights and interests of minority shareholders. Proper corporate and security laws, tough accounting standards, effective regulators, efficient judicial system – together can ensure the foundations of good corporate governance.

- Regulators should realize that corporate governance practices will not change overnight, so patience is needed. Getting companies to comply with new rules is a daunting process, requiring greater transparency and gradual enforcement. Without greater transparency, new governance codes will do little to build investors’ confidence.

The following internal corporate governance controls should be implemented and monitored and corrective action should be taken to accomplish organisational goals.
• The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. It is thus necessary to hold regular board meetings that allow potential problems to be identified, discussed and avoided.

• The board needs a range of skills and understanding to be able to deal with various business issues, have the ability to review and challenge management performance, have an appropriate level of commitment to fulfill its responsibilities and duties.

• The board composition should include both executive and non-executive directors. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes; while non-executive directors, being more independent, bring objectivity and fairness in the evaluation system.

• Separation of role of the Chairperson of the board and the Chief Executive will distribute power in the board set up.

• There should be a number of board committees with representative composition of both executive and non-executive directors to ensure correct reporting of financial information, to assess senior management compensation and rewards, and to nominate new candidates for the board.

• Different board structures are optimal for different firms: a two-tier board may be a better solution over unitary board while ensuring better monitoring and control of the lower executive board that runs the enterprise. Any problem relating to the objectivity and independence of outside directors does not arise here.

• Performance-based remuneration (e.g. in the form of cash or non-cash payments such as shares and share options, superannuation or other benefits etc) can be designed even for the directors to relate some proportion of salary
to individual performance. Although such incentive schemes, are seen to be reactive in nature, that they provide no mechanism for preventing mistakes or opportunistic behaviour.

9.0 CONCLUSION

Strong legal environment has important influence in protecting the investors’ right, in fostering good corporate governance practice. A weak legal system limits the spectrum of corporate governance practices by a firm. Despite the hindrances, officials and business leaders must improve the performance of the firms' corporate governance in order to increase the chances of continued vigorous economic growth.

The weakest link among all corporate governance mechanisms adopted in Bangladesh is concentrated on ownership structure. The listed firms need to take greater efforts to streamline their ownership. Floating all shares and selling off government ownership stakes is the right way to go. The level of corporate governance is strictly subject to the level of public governance and the constraints of existing institutional infrastructure. Bangladesh should take concrete measures to reform the government and continue to build a solid institutional infrastructure. Corporate governance cannot be improved without such efforts.

References

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