



**Economic Policy Paper
on
Institutionalization of Corporate Governance in Bangladesh**

**Prepared
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The DCCI-CIPE, ERRA Project
(CIPE is an affiliate of the U. S. Chamber of Commerce, Washington,
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Institutionalization of Corporate Governance in Bangladesh

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Introduction:

Corporate governance (CG), a term that not long ago meant little to all but a handful of scholars and shareholders, has now become a mainstream concern for the policy circles around the globe. Two events are liable for the heightened interest in CG. During the wave of Asian financial crises in 1997-98, the activities of the corporate sector affected entire economies, and deficiencies in CG endangered the stability of the global financial system. Confidence in the corporate sector was further shattered by corporate governance scandals in the United States and Europe that triggered some of the largest insolvencies in history. In the aftermath, not only has the phrase Corporate Governance become nearly a household term, but economists, the corporate world, and policymakers began to recognize the potential macroeconomic consequences of weak CG systems. In this background, this policy paper considers that good CG practice:

- reduces risk, leads to better company performance, higher profitability and efficiency
- stimulates performance
- improves access to capital markets
- enhances the marketability of goods and services
- improves leadership
- demonstrates transparency and social accountability.¹

This policy paper is structured as follows. It starts with a definition of corporate governance from Bangladesh's perspective, as that determines the scope of the issues. It describes why more attention is needed to be paid to CG by the relevant stakeholders. The paper next briefly assesses the contemporary CG landscape in Bangladesh to provide an overview of the weaknesses and regulatory efforts at implementing and enforcing good CG structure in Bangladesh. It explores recent research documenting the degree of corporate governance problems in Bangladesh. After analyzing the Bangladesh landscape, a brief policy outline for the companies has been formulated on the basis of various literatures and information available. Then after, the paper leads to examine the modalities of guidelines to implement good CG practices in Bangladesh based on sector-specific approach. This policy paper identifies four categories of sectors: SOEs, FIs, PSEs and NGOs.² Next part identifies the forces that act as barrier for CG. As a logically coherent outcome of these discussions, the paper concludes by identifying some important policy recommendations and research issues that require further study.

Limitations of the Study:

This policy paper has certain limitations that need to be taken into account when considering the recommendations and its implications. Some of these limitations can be seen as fruitful avenues for future research under the same theme. This study has focused on a phenomenon that is a very extensive and major one, i.e. corporate governance. In this paper, assessment of this complex phenomenon has been studied from a rather narrow empirical perspective. During the literature review, it has been found that not much of research has been conducted on the CG landscape in Bangladesh. Indeed, there are ample of studies available on the methods and principles of CG from Bangladesh's perspectives but there is a substantial lack of sector specific empirical and real-life studies. There is an absence of credible data and relevant

¹ www.cima.org.uk

² Acronyms: State-owned Enterprise (SOE), Financial Institution (FI), Private Sector Enterprise (PSE), Non-Government Organization (NGO)

information on the real CG concerns in Bangladesh. Given the time limitation, comprehensive access to information was a difficult task. A systemic and periodic survey of CG practices in Bangladesh has thus become an important task for the organizations like DCCI, BEI, and SEC.³

Output of the Paper:

This economic policy paper has both academic and policy implications. The findings of this policy paper may contribute to Government, private sector, NGOs, academia and civil society.

Defining Corporate Governance:

Definitions of corporate governance vary widely. They tend to fall into two categories. The first set of definitions concerns itself with a set of behavioral patterns: that is, the actual behavior of corporations, in terms of such measures as performance, efficiency, growth, financial structure, and treatment of shareholders and other stakeholders. The second set concerns itself with the normative framework: that is, the rules under which firms are operating—with the rules coming from such sources as the legal system, the judicial system, financial markets, and factor (labor) markets.⁴

Given the structure of market and liberal economic policies of Bangladesh, the first type of definition is the most logical choice.⁵ It considers such matters as how boards of directors operate the role of executive, compensation in determining firm performance, the relationship between labor policies and firm performance, and the role of multiple shareholders. However, a somewhat broader definition would be to define corporate governance as a set of mechanisms through which a single country or firms within a country operates when ownership is separated from management. Therefore, *corporate governance is the system by which companies are directed and controlled*.⁶

CG has become a top priority for the regulatory bodies with the objective of providing better and effective protection to all stakeholders and also to make the market confident as research reveals a positive correlation between corporate governance and share prices.⁷ The edifice of corporate governance (which includes, among others, board composition, relationship between the Board and the management, internal control mechanisms, independent audit committee) are based on four principles.⁸ These are:

- Compliance with all regulatory requirements;
- Equitable treatment of all stakeholders such as suppliers, employees, consumers, etc.;

³ Acronyms: Dhaka Chamber of Commerce and Industry (DCCI), Bangladesh Enterprise Institute (BEI), Securities and Exchange Commission (SEC)

⁴ Claessens, Stijn. 2003. *Corporate Governance and Development*. Focus 1. Global Corporate Governance Forum. World Bank: Washington.

⁵ The size and realm of companies and corporation in Bangladesh are relatively small. There are about 45,000 private limited companies and over 200 public limited companies were listed in the Dhaka stock Exchange (DSE) and the Chittagong Stock Exchange (CSE). Source: http://nation.ittefaq.com/artman/publish/article_27929.shtml

⁶ Cadbury Committee (Committee on the Financial Aspects of Corporate Governance). 1992. *The Report of the Committee on the Financial Aspects of Corporate Governance*. London: UK.

⁷ Ahmad, J. U. 2004. *Draft Code of Corporate Governance-Bangladesh*. The Bangladesh Accountant. October-December. Quarterly journal of the Institute of Chartered Accountants of Bangladesh.

⁸ Islam, M.A. 2005. *Role of Securities and Exchange Commission (SEC) in Corporate Governance*. Paper presented at the International Conference on Corporate Governance in Bangladesh. Dhaka. July 30-31, 2005.

- Full and fair disclosure of all material information with particular emphasis on accurate, objective presentation of financial information; and
- Respect for norms of business ethics and social responsibility.

Therefore, CG comprises the legal infrastructure organizing business (corporate law, security law, accounting rules), business ethics and the overall business environment. Good CG is highly correlated with better operating performance and market valuation of companies. By preserving and protecting rights of the shareholders – in particular those of minority and foreign shareholders – it encourages innovation and long-term investment in human and physical capital, Foreign Direct Investment (FDI), as well as the creation of intellectual property. By stimulating performance, generating higher returns and profitability of companies, it encourages higher total factor productivity growth; the major source of economic growth. By limiting the abuse of power by corporate insiders, it creates an efficient mechanism for transferring wealth between generations. By monitoring managers of companies in both the financial and ‘real’ sectors and making them accountable for their actions, it protects investors’ interests; in turn, this encourages both domestic and foreign direct as well as portfolio investment.⁹

An Overview of Corporate Governance in Bangladesh:

Bangladesh corporate sectors are still in its initial stage. Most of the companies depend on the banks as their major source of financing. Capital market in Bangladesh is still at an emerging stage with market capitalization amounting to only 6.5% of GDP with low investor confidence on corporate governance and financial disclosure practices in many companies listed in the stock exchanges.¹⁰ The neighboring countries are well ahead vis-à-vis Bangladesh in terms of depth of capital market. For example, in India, Pakistan and Sri Lanka, the market capitalization is 56%, 30% and 18% of their GDP respectively. However, Awareness of the importance of corporate governance in Bangladesh is growing. Securities and Exchange Commission of Bangladesh issued a notification on Corporate Governance Guidelines (CG Guidelines) for the publicly listed companies of Bangladesh under the power vested on the Commission by Section 2CC of the Securities and Exchange Ordinance, 1969. The CG Guidelines were issued on a ‘comply or explain’ basis, providing some ‘breathing space’ for the companies to implement on the basis of their capabilities. Nevertheless, the overall framework for investor protection and CG has a number of important weaknesses that have hindered the capital market development.

CG practices in Bangladesh are gradually being introduced in most companies and organizations. 66.7 percent of the companies have adopted CG and 43.3 percent have compliance policy with national or international benchmarks. A considerable percentage of the top management does not fully understand the concept of CG.¹¹ However, Bangladesh has lagged behind its neighbors and the global economy in CG.¹² One reason for this slow progress in adopting CG is that most companies are family oriented.¹³ Such concentrated ownership structures affects the effectiveness of

⁹ Saidi, Nasser. 2004. *Corporate Governance and Business Ethics*. Launching Ceremony of RDCL ‘Code of Business Ethics’. Beirut: Lebanon. 28 April 2004.

¹⁰ Du, Hua. 2006. *Roundtable Discussion on Corporate Governance Guidelines of SEC and its implementation practices in Bangladesh*. Asian Development Bank. 23 September 2006.

¹¹ *Ibid*

¹² Gillibrand, M. 2004. Corporate management essential for industrialization. *The Bangladesh Observer*, April 17, 2004.

¹³ Most of the companies claim that they maintain a fair recruitment procedure where only merit and efficiency prevail rather than kinship or prejudice. Although a study conducted by CPD found that only 32.3 percent of the companies have formal policies on recruitment and promotion.

corporate governance mechanisms, which weaknesses cannot be rectified by laws and regulations.

Motivation to disclose information and improve governance practices by companies is also felt negatively. There is neither any value judgment nor any consequences for CG practices. The current system in Bangladesh does not provide sufficient legal, institutional and economic motivation for stakeholders to encourage and enforce CG practices. Ahmed and Yusuf (2005) argue that there has been failure in most of the elements of CG.¹⁴ Some of these individual elements can be portrayed with a view to seeing their weaknesses in implementing CG:

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. Such practice hinders the level of fairness, accountability and transparency.¹⁵

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.¹⁶

Lack of initiatives to drive for CG from the International Investor Community: Most companies in Bangladesh have a pessimist approach in attracting foreign investment. As a result, there is a lack of drive from the international investor community for better corporate governance. Level of penetration of Bangladeshi companies in the foreign stock exchanges is also very low. Lately though, BEXIMCO Pharmaceutical Company has been given with the clearance by SEC for listing with the London Stock Exchange.

Accounting standards, audit and disclosure: The scenario of internal audit; accounting standards and disclosure and its impacts on CG and management practices in Bangladesh are mixed. There are now elements of both positive scopes and new challenges and risk for the corporations in these areas. Following the tradition of English law, Bangladesh accounting standards are not based on codified law, but rely on Generally Accepted Accounting Principles (GAAP) developed by accounting profession. These principles are primarily shareholder oriented and are independent of tax considerations. In Bangladesh the companies have to make disclosure of information required by law. Disclosure requirements for Initial Public Offerings are defined by the Companies Act and the orders under the Securities and Exchange Ordinance, 1969.

¹⁴ Ahmed, Mamtaz Uddin, and, Yusuf, Muhammad Abu. 2005. Corporate Governance: Bangladesh Perspective. *The Cost and Management*. Vol. 33. No. 6. November-December 2005. pp. 18-26.

¹⁵ It is revealed that in Bangladesh 72.5% of the outstanding shares are owned by households/ sponsors and individuals. Insignificant concentration is observed by bank and financial institutions i.e., 3.1 % and foreigners held 16% and Government / financial institutions held only 16% of the outstanding shares in 2000. It is also reported that even when the company is listed on the stock exchange, few shares are available for trading, as majority remain held by the original sponsors. The original sponsors often buy additional shares from the market to raise their holdings to as high as 70 percent or 80 percent though shares are floated in the primary market on 50:50 basis. Chowdhury, AA Mahboob Uddin. 2006. Role of corporate governance for the development of Bangladesh capital market. Editorial Page. *The New Nation*. 17 May 2006. http://nation.ittefaq.com/artman/publish/article_27929.shtml

¹⁶ Hossain, M. 2005. Why shareholders' activism is still an illusion in Bangladesh. *The Financial Express*, Dhaka (1-8-2005).

Periodic disclosure requirements are mentioned in the Securities and Exchange Rules, 1987.¹⁷

*Inconsistency between Companies Act, BAS and SEC Requirements:*¹⁸ The companies Act, 1994 provides, among others, provisions regarding preparation and publication of financial statements, disclosures and auditing. However, in many cases, the Act lacks clarity with regard to statutory requirements on disclosures in the financial statements of listed companies. Moreover some accounting requirements mentioned in the Act are incompatible with International Accounting Standards (IAS) which is required by the SEC. For example, contrary to IAS, the Companies Act requires capitalization of gains and losses arising from changes in foreign exchange rates under all circumstances. Another inconsistency is that the Companies Act does not require a consolidated balance sheet for a holding company but it is required under the IAS. Inconsistencies between IAS and the Companies Act need to be eliminated.¹⁹

Limited or No Disclosure regarding Related Party Transactions: Related party transactions are not disclosed properly in the financial statements. It is an impediment towards achieving good CG in Bangladesh.²⁰

Weak Regulatory System: Bangladesh still follows the hybrid system of legal system inherited from the British administration. Currently, the Companies Act of 1994 is the law that governs the incorporated domestic corporations and institutions. The 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. Therefore, weak regulatory system along with board interference with the management retards the improvement of CG in the country.²¹

Capital Market Role: Capital market facilitates good governance through information production and monitoring.²² The capital market of Bangladesh consists of two stock exchanges: Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). Bangladesh does not have depth in its equity market. The capital market of Bangladesh is still a weak link in the movement towards strengthening CG. The overall performance measures of its stock market show low trading volume, intermittent bumps, not many new offerings and unsteady valuations more on the declining side than otherwise.²³ The stock market scandals in 1996 have seriously eroded investor confidence in the stock market.²⁴ One vital aspect is that capital market in Bangladesh does not react

¹⁷ Chowdhury, AA Mahboob Uddin. 2006. Role of corporate governance for the development of Bangladesh capital market. Editorial Page. The New Nation. 17 May 2006. http://nation.ittefaq.com/artman/publish/article_27929.shtml

¹⁸ Ahmed, Mamtaz Uddin, and, Yusuf, Muhammad Abu. 2005. Corporate Governance: Bangladesh Perspective. *The Cost and Management*. Vol. 33. No. 6. November-December 2005. pp. 18-26.

¹⁹ World Bank. 2003. *Report on the observance of standards and codes (ROSC) Bangladesh Accounting and Auditing*. The World Bank Report. www.worldbank.org/ifa/roscc_aa_bgd.pdf

²⁰ *Ibid.*

²¹ Chowdhury, AA Mahboob Uddin. 2006. Role of corporate governance for the development of Bangladesh capital market. Editorial Page. The New Nation. 17 May 2006. http://nation.ittefaq.com/artman/publish/article_27929.shtml

²² Tadesse, S. 2004. The Allocation and Monitoring Role of Capital Markets: Theory and International Evidence. *Journal of Financial and Quantitative Analysis*. December. Vol. 39. No. 4.

²³ Hossain, M. 2005. Why shareholders' activism is still an illusion in Bangladesh. *The Financial Express*. Dhaka. 01 August 2005.

²⁴ Bangladesh Enterprise Institute. 2003. *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh*. Dhaka: BEI.

significantly to corporate performance in terms of higher stock valuation for accurate disclosure and poor stock price for failure of accurate and full disclosure. There is little incentive in becoming a public company and listing on the stock exchange in Bangladesh. Companies with good reputations can get bank financing relatively easily than through share issue. Moreover, there are no bonds, fixed income or debt instruments in the capital market. This means there are no pressure groups²⁵ for enforcing CG principles.²⁶ 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.²⁷

General Meeting Scenario: General meetings of a company, in particular the Annual General Meeting (AGM) are the primary platform where shareholders can raise their concerns and make their influence felt over the management towards attaining good governance. Although a good number of provisions in the Act provided sufficient leverage to allow shareholders a voice in companies, most companies in Bangladesh, are closely held. Small groups of shareholders own or control the majority of shares, and by using that majority, control the decision making processes of the companies.²⁸ In number of studies it has been found that there is a negative correlation exists between good CG and defaulting in holding annual general meetings in due time.

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.²⁹ 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.³⁰

The Boards of Directors: The Companies Act, 1994 provides for many stringent rules in respect of any negligence, default, breach of duty or trust on the part of director, manager or officer of a company. However, experience suggests that these are more honored in the breach than observance. In an overwhelming majority of the non-bank listed companies, the board is heavily dominated by sponsor shareholders who generally belong to a single family. The boards are 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

²⁵ If there are debt markets, investors in bonds and other debt instruments may emerge as an important pressure group for encouraging good corporate governance.

²⁶ Bangladesh Enterprise Institute. 2003. *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh*. Dhaka: BEI.

²⁷ Ahmed, Mamtaz Uddin, and, Yusuf, Muhammad Abu. 2005. Corporate Governance: Bangladesh Perspective. *The Cost and Management*. Vol. 33. No. 6. November-December 2005. pp. 18-26.

²⁸ *Ibid*.

²⁹ Lambe, A. 2005. Audit Committees step into the limelight. *Accountancy Ireland*. February. Vol. 37 No. 1. Pp. 48-51.

³⁰ Bangladesh Enterprise Institute. 2003. *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh*. Dhaka: BEI.

previous favors. In the context of Bangladesh, independent directors do not act as an advocate for minority shareholders or as a source of innovative ideas.³¹

Lack of Shareholder Activism: Shareholder rights are today recognized in countries across the globe as relevant to efforts for improving and strengthening CG. The average non-controlling or minority shareholders do not possess significant level of education, understanding and sophistication required to exert pressure on a company to change behavior. The number of shareholders with sufficient knowledge and skills to understand company operations and to hold management and the board of directors accountable is very low. Moreover, general shareholders do not pay attention on issues of performance, business strategy, future business plans, disclosures and processes that could give them a greater voice in the policy decisions of a company. In fact, there is very little awareness about shareholders' rights and responsibilities. Shareholders' activism is still an illusion in Bangladesh.³²

No Market for Corporate Control: A market for corporate control plays an important monitoring function in CG, as poorly managed companies will become takeover targets.³³ In Bangladesh, there seems to have no market for corporate control.

Weak Pressure Groups: Shareholders, investor associations, institutional investors and the financial press can play significant role in ensuring better CG. Each of these potential pressure groups is weak in Bangladesh. The numbers of journalists who possess knowledge on financial reporting are limited and there are lacks of investigative reports. Similarly public shareholders are not organized under a common platform (such as shareholder associations) to demand better corporate governance. Unlike institutional investors in most capital markets across the globe, the few State-owned Enterprises (SOEs) lack performance spirit and motivation to force companies to improve CG as well as performance.³⁴

Lack of Auditor Independence: Auditors in Bangladesh are not considered independent or sufficiently qualified to attest to the validity of the financial statements of corporate entities.³⁵ A study shows that 64.4 percent of the companies conduct regular audit for effective implementation of the core labor policies. Of the companies which audit the implementation of core labor policies, 91.1 percent meet their labor policy objectives. Only 2.2 percent of the companies confessed that they make unfair dismissals and 4.4 percent of the companies confessed that they violated labor laws in last 5 years. Around 67 percent of companies have a formal policy to ensure clean, healthy and safe working conditions. Procedures to implement policy and specific assignment to senior management for implementation are found only in 26.7 percent of the companies.³⁶

Poor Audit Report: Audited financial reports are rarely reliable and free from the control of the owners. Despite irregularities (in respect of non compliance with the applicable

³¹ *Ibid.*

³² Hossain, M. 2005. Why shareholders' activism is still an illusion in Bangladesh. *The Financial Express*, Dhaka. 01 August 2005.

³³ Morrison, J. 2004. Legislating for Good Corporate Governance: Do We Expect Too Much? *The Journal of Corporate Citizenship*. Autumn. Issue 15. Pp. 121-133.

³⁴ Ahmed, Mamtaz Uddin, Yusuf, Muhammad Abu. 2005. Corporate Governance: Bangladesh Perspective. *The Cost and Management*. Vol. 33. No. 6. November-December 2005. pp. 18-26.

³⁵ Bangladesh Enterprise Institute. 2003. *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh*. Dhaka: BEI.

³⁶ Raihan, Ananya. 2003. *Corporate Responsibility in Bangladesh: Where Do We Stand?* Report No. 54. Centre for Policy Dialogue: Dhaka. www.cpd-bangladesh.org

IASs) in the audit report, the auditors issue unqualified audit report on the financial statements.³⁷

A need for corporate governance is urgent:

Above scenarios suggest that for effective CG in Bangladesh; it requires a clear understanding of the respective roles of the board and of senior management and their relationships with others in the corporate structure. Removing these weaknesses requires appropriate reform and implementation thereof are highly necessary in Bangladesh.³⁸ Following policy is intended to clarify these relationships and responsibilities and to promote effective CG:

The Board of Directors:

The Board of Directors has the important role of overseeing management performance on behalf of stockholders. The board exercises its oversight responsibilities and authority by:

- Delegating authority and responsibility for managing the everyday affairs of the corporation to the CEO and senior management while monitoring and overseeing management's execution of these responsibilities and performance;
- Planning for management succession;
- Understanding, reviewing, and monitoring implementation of the corporation's strategic plans;
- Understanding and reviewing annual operating plans and budgets;
- Taking reasonable steps, through its audit committee, to become comfortable that the corporation's financial statements and other related disclosures fairly and accurately present the corporation's financial condition and results of operations;
- Reviewing internal controls;
- Selecting, overseeing and compensating (through its compensation committee), a well qualified and ethical chief executive officer who, with senior management, runs the Corporation on a daily basis;
- Reviewing and approving significant corporate actions;
- Through its nominating/CG committee, nominating directors and committee members and overseeing CG; and
- Reviewing and implementing any other actions which, in the discretion of the board or its committees, are necessary to promote the interests of the shareholders and effective CG.

Directors should bring a range of experience and knowledge to the corporation and should not have any interests which, in the reasonable discretion of the board, could reasonably be expected to interfere with the Director's obligation to effectively represent the interests of the shareholders or effectively govern the corporation.³⁹

In performing its oversight function, the board is entitled to reasonably rely on the advice, reports, and opinions of management, counsel, auditors and expert advisors. In this

³⁷ World Bank. 2003. *Report on the observance of standards and codes (ROSC) Bangladesh Accounting and Auditing*. The World Bank Report. www.worldbank.org/ifa/rosc_aa_bgd.pdf

³⁸ Ahmed, Mantaz Uddin, Yusuf, Muhammad Abu. 2005. Corporate Governance: Bangladesh Perspective. *The Cost and Management*. Vol. 33. No. 6. November-December 2005. pp. 18-26.

³⁹ Bangladesh Enterprise Institute. 2003. *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh*. Dhaka: BEL.

reliance, the board should be satisfied with the qualification of the advisor and the processes used by the advisor in reaching decisions and making recommendations.

The Board and Shareholders:

- The board needs to interact effectively with shareholders: transparency and accountability are the watchwords. The most important elements to this are the timely provision of good quality information, thus promoting an informed dialogue and a credible decision-making process;
- In their turn, the shareholders should devote sufficient time and give effective consideration to the information they are provided with and the judgments they need to make in the decision-making process.

Management:

It is the responsibility of the Chief Executive Officer (CEO) and the senior management to operate the corporation in an effective and ethical manner. As part of this operations responsibility, the CEO and senior management are charged with:

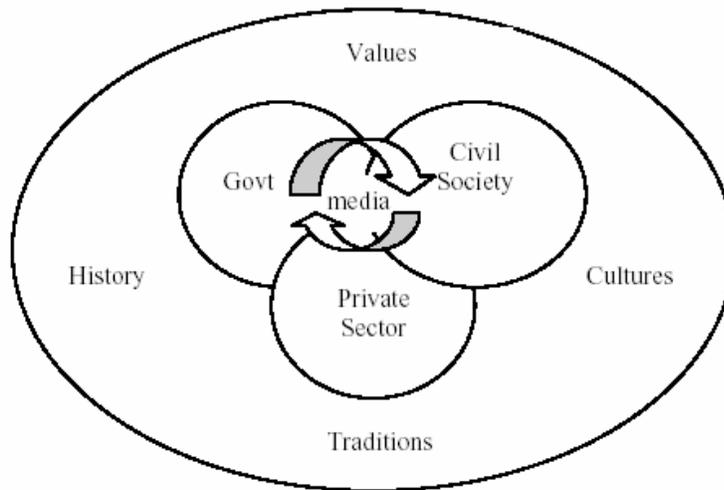
- Operating the business of the corporation in a manner which is reasonably calculated to maximize the long term value of the corporation;
- Establishing and implementing a strategic plan for the corporation;
- Establishing and implementing annual operating plans and budgets;
- Selecting qualified management and establishing an effective organizational structure;
- Identifying and managing risks;
- Establishing internal controls and a financial reporting system which are reasonably calculated to produce financial reports that accurately and fairly present the corporation's financial condition;
- Setting a strong ethical tone for the corporation and establishing and implementing a code of conduct which is reasonably calculated to discourage and detect misconduct;
- Effectively and candidly communicating with shareholders on a timely basis;
- Treating employees fairly and equitably;
- Establishing the corporation as a good corporate citizen within the community;
- Implementing other goals and programs established by the board or its committees.

This policy is intended to provide a broad and flexible framework for defining the roles of, and relationships between, the board and management for effective governance of the corporation. In accordance with this policy, it is this corporation's goal that the relationships of the board and management:

- with shareholders be characterized by candor and good faith;
- with employees be characterized by fairness;
- with the communities in which the corporation operates by good citizenship; and
- with the government by commitment to compliance.

Corporate Governance Practice for Sector-specific Firms:

Above scenario stresses the need for a comprehensive framework for implementation of CG in Bangladesh. The following graphic describes functionality of CG at the national level by depicting the different entities, or players, that occupy the social and economic landscape.



There are no firm boundaries between the players in the graphic (and in fact they often overlap) because the borders of these sectors are permeable (e.g. state-owned organizations may have a foot in both government and the private sector; donor-funded NGOs also straddle two camps). However, modest differences in the approach of CG of different sectors could be identified keeping the basic CG principles in center.

State-owned Enterprises (SOEs):

In spite of privatization over the last three decades, state-owned enterprises (SOEs) are still a mainstay in Bangladesh economy. Like Bangladesh, China, India, Russia and South Africa are just a few countries where wholly or partly government-owned SOEs remain productive and influential. Good CG is crucial for SOEs in Bangladesh, because they face even more governance challenges than private companies do. Unlike a widely-held private company, an SOE usually cannot have its board or management changed via a takeover or proxy contest, and they usually cannot go bankrupt. In addition, they may have “free” equity and a very low cost of subsidized loans.⁴⁰ Thus, the incentives for board members and managers to maximize the value of the company and keep costs in check are reduced. Accountability and performance may also be hindered by political interference, poorly defined non-commercial objectives, and an absence of transparency. Strong internal controls, good disclosure, independent boards of directors, and other CG tools can help state-owned enterprises perform well and act in the best interests of citizens and other shareholders. To help make state-owned enterprises more competitive, efficient and transparent, OECD has introduced following guidelines⁴¹:

Ensure a level-playing field for state-owned enterprises competing with the private sector by

- Clearly separating the state’s ownership role from its regulatory role

⁴⁰ World Bank. 2006. *Held by the Visible Hand: The Challenge of SOE Corporate Governance for Emerging Markets*. World Bank: Washington.

<http://rru.worldbank.org/Documents/Other/CorpGovSOEs.pdf>

⁴¹ OECD. 2004. *OECD Guidelines on Corporate Governance of the State-owned Enterprises*. OECD: Paris.

- Allowing more flexibility in capital structures while making sure that state-owned enterprises face competitive access to finance

Become more informed and active shareholders by

- Simplifying the chain of accountability through centralizing or more effectively coordinating shareholding responsibilities within the state administration
- Reducing political interference in day-to-day management
- Introducing a transparent nomination process for boards, based on competence and skills

Empower boards by

- Clarifying their mandates and respecting their independence
- Separating the role of Chairman and CEO and giving boards the power to appoint CEOs
- Systematically monitoring the board's performance

Improve transparency by

- Strengthening internal controls
- Carrying out independent, external audits based on international standards
- Disclosing any financial assistance from the state
- Producing aggregate performance reports

Corporate Governance in the Private Sector Enterprises (PSEs):

The basic principles of good CG for the PSs are identified as involving⁴²:

- Appropriate disclosure
- The development of codes of conduct for company directors, and the
- Development of internal structures which provide for independent review of processes and decision making within a company.

Ensuring the basis for an effective corporate governance framework: The CG framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

The rights of shareholders and key ownership functions: The CG framework should protect and facilitate the exercise of shareholders' rights.

The equitable treatment of shareholders: The CG framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

The role of stakeholders in corporate governance: The CG framework should ensure behavior and the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

Disclosure and transparency: The CG framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

The responsibilities of the board: The CG framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

⁴² *Ibid.*

Corporate Governance in the Financial Institutions (FIs):

The need for a competent financial sector is important to stimulate and support economic growth through efficient resource allocation. Good CG practices are essential to the effectiveness, competitiveness and safety and soundness of financial institutions.

*Streamlining the Guidelines with the Code of Corporate Governance*⁴³: A Code of CG has been published by BEI can be streamlined to reduce duplication and resources to comply with CG requirements for the FIs.

Protection of depositors: Given the special nature of banking institutions, a broad view of CG where regulation of banking activities is required to protect depositors. In developed economies, protection of depositors in a deregulated environment is typically provided by a system of prudential regulation, but in developing economies such protection is undermined by the lack of well-trained supervisors, inadequate disclosure requirements, the cost of raising bank capital and the presence of distributional cartels.⁴⁴

Improvements in prudential regulation: Liberalization policies need to be gradual, and should be dependent upon improvements in prudential regulation. Bangladesh needs to expend resources enhancing the quality of their financial reporting systems, as well as the quantity and quality of bank supervisors.⁴⁵ Given that bank capital plays such an important role in prudential regulatory systems, it is necessary to improve investor protection laws, increase financial disclosure and impose fiduciary duties upon bank directors so that banks can raise the equity capital required for regulatory purposes. A further reason as to why this policy needs implemented is the growing recognition that the CG of banks has an important role to play in assisting supervisory institutions to perform their tasks, allowing supervisors to have a working relationship with bank management, rather than adversarial one.⁴⁶

*Political determinants of Corporate Governance*⁴⁷: CG of financial institutions, particularly banking sector, in Bangladesh is severely affected by political considerations. Given the trend towards privatization of government-owned banks in Bangladesh, there is a need for the managers of such banks to be granted autonomy and be gradually introduced to the CG practices of the private sector prior to divestment.

Role of the shareholders: Where there has only been partial divestment and governments have not relinquished any control to other shareholders, it may prove very difficult to divest further ownership stakes unless CG is strengthened.⁴⁸

Governance in the NGOs⁴⁹:

The orientations of NGOs are defined, updated and widely communicated: Like other non-profit organizations, NGOs cannot escape from the need and requirement to explain and make known their major orientations and the strategic framework of their action

⁴³ Bangladesh Enterprise Institute. 2004. *Code of Corporate Governance for Bangladesh*. Dhaka: BEI. www.bei-bd.org

⁴⁴ Arun TG. 2003. *Corporate Governance of Banks in the Developing Economies: Concepts and Issues*. Development Economics and Public Policy Working Paper No. 02. IDPM: Manchester.

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

⁴⁷ Roe, Mark, J. 2003. *Political Determinants of Corporate Governance: Political Context, Corporate Impact*. *John M. Olin Center for Law, Economics and Law*. Working Paper No. 451. Harvard: Massachusetts.

⁴⁸ *Ibid.*

⁴⁹ For closer exposition see Khan, Safi Rahman. 2006. *NGO Governance Principles*. Bangladesh Enterprise Institute. www.bei-bd.org

regularly. This 'communicational activity' is found in all the principles. It implies the defining and appropriateness of what is going to be communicated. Good governance verifies that this is true at each level of the NGO's aims and projects.

Relationship with the stakeholders: Good governance devotes itself to federating the internal stakeholders and to managing the interfaces with the external stakeholders. This is how it builds its legitimacy, its image and its representativeness. Good governance also strengthens the support that its stakeholders give it.

The **internal stakeholders** are: the members, trustees, volunteer help, expatriate staff, employees, local non-profit organization partners and national staff (in the country of intervention).

The **external stakeholders** are: the beneficiaries, financial backers, private donors (including sponsors), public sector of the country of the NGO, public opinion in the country of intervention, public opinion in the country of intervention, suppliers, partners in the field, other non-profit organizations and NGOs, and non-profit organization collectives, etc.

Information is sincere, reliable and available: Each person receives all the information appropriate for his or her position, in an appropriate form. The quality of the information is checked, and its circulation is adapted to the use that must be made of it.

The NGO's financial management is impartial. The notion of the NGO's impartial management must be subject to internal discussion, because it can be interpreted in different ways. *Synergie Qualité* defines it as follows: 'The people who manage and administer the NGO, by themselves or by people who intervene for them, have no direct or indirect advantage from the financial results of the operations'.⁵⁰ The balance between administrative and organizational costs and the resources allocated to the operational projects is to be examined regularly, out of concern for efficiency. Good governance, for example, has a cost, but it contributes to improving the interventions to the beneficiary's advantage. The building up of reserves, investments, loans, guarantees and deposits is governed by the required rules of exactness and carefulness.

The representative bodies: The representative bodies of the internal stakeholders can be consulted before a significant expenditure is made (purchase of buildings, for example). The members of a Board of Trustees of an NGO must be volunteers.

Forces Against and For Corporate Governance

Resistance comes from vested interests (oligopolists, relationship-based investors) who wants to retain status quo.⁵¹ In Bangladesh there is a tendency to make large investments in highly-capital intensive enterprises --- with an eye to price incentives through relationship. This leads to wastage of scarce capital resources. Many firms now need foreign capital to finance expenses ----- that again can lead to demand for better CG. Political turmoil and vested interests are the key factors to hinder the process of good CG framework in Bangladesh. Thus, policy makers have to focus not only on regular / accurate financial accounts & transparency, but they have to address issues

⁵⁰ Guide Synergie Qualité. 2004. *Proposal for Quality Humanitarian Actions*. <http://216.239.59.104/search?q=cache:kKr9whH-irIJ:www.politika.lv/index.php%3Ff%3D431+NGO+governance+principle&hl=bn&ct=clnk&cd=3&gl=bd&client=firefox-a>

⁵¹ Afzal, Mueen. 2007. *Role and Responsibilities of Independent Directors*. Key note paper. Roundtable discussion on the Role and Responsibilities of Independent Directors. Bangladesh Enterprise Institute. March 18 2007.

like whether a large business group should also be allowed to own a bank. In brief, following are the issues that hinder the enforcement of CG in Bangladesh.⁵²

The Boards of Directors:

- Inadequate examples of role in formulating vision and strategy
- Lack of independent representation
- Lack of power held by CEO
- Absence of accountability structure of management to the board/shareholders
- When the Board Chairman is also a Cabinet Minister there may be a tendency to treat the SOE as a Government department

Commercial focus:

- Procedures are set and not easy to deviate from
- Price controls are not market driven
- Sometimes face unfair competition from the private sector

Accountability and Monitoring

- Access to accurate information is difficult
- Ample of evidence of management collusion with trade unions
- Control Audits of Internal Audit, Government Commercial Audit, and External Audit
- Commercial Audits results are doubtful and not transparent

Employee incentives

- No genuine incentive for better performance
- Quality people not attracted to SOEs
- Pressure from trade unions

⁵² Rahman, Lopa. 2006. *Corporate Governance for SOEs: The Bangladesh Context*. Bangladesh Enterprise Institute: Dhaka.

Implementation of Corporate Governance in Bangladesh:

This policy paper has reviewed the problems and existing CG practices in Bangladesh. Findings are presented as a matrix in the following box which also highlights the scopes for policy intervention in this regard:

Matrix: an overview of Corporate Governance Mechanisms in Bangladesh⁵³

Corporate Governance Mechanism	Importance in Bangladesh	Scope for policy intervention
Large block-holders	Likely to be an important governance mechanism in Bangladesh	Strengthen rules protecting minority shareholders
Market for Corporate Control	Market does not exist in Bangladesh. Unlikely to be important in a concentrated ownership structure. Can still take place through debt contracts, but requires adequate bankruptcy laws	Strengthen the bankruptcy laws
Proxy votes	Unlikely to be important in a concentrated ownership structure	AGMs needs to be effective and SEC may oversee the outcomes of AGMs
Board activity	Non-transparent recruiting system of the board members are widely practiced, and lack of separation of ownership and management	Implement Code of CG and introduce guidelines for Best Practices, training of directors, transparent recruitment of the Board members
Executive compensation	Less important when owner can hire and fire and has private benefits	SEC or Bangladesh Bank can introduce codes for Executive compensation, transparent compensation policy
Bank monitoring and regulatory environment	Critically important for Bangladesh	Strengthen banking regulation and institutions; encourage accumulation of information on credit histories, develop supporting credit bureaus and other information intermediaries
Employee monitoring	Potentially very important for SMEs with highly skilled human capital threat of leaving is very high	Proper incentive practice on human capital should be institutionalized
Litigation	Depends on quality of general enforcement environment, however it sometimes work in Bangladesh	Facilitate communications among the shareholders
Media and social control	Potentially important in Bangladesh as competition and independence of media is rising	Encourage competition and diversification of media, active public campaigns can empower public
Reputation and self-enforcement	Important at general enforcement is relatively weak	Encourage competition in factor markets by enabling competition policy
Arbitration and auditors	Potentially important, often the origin of public law, but the enforcement is a	Facilitate laws for the third party mechanisms, Auditing

⁵³ Author's compilation

	problem in Bangladesh, audits are often abused	processes needs to be strengthened
Competition	Determines scope for potential mistreatment of factors of production including financing	Proper competition policy can be introduced

To implement reforms in CG, based on the above matrix, with a view to have good corporate governance in Bangladesh, the following proposals/recommendations can be put forward:

Short-term

Code of Corporate Governance and Best Practice Recommendations:

Like other countries⁵⁴, Bangladesh needs to have a “Code of Corporate Governance and Best Practice Recommendations” which can be either rule based or principles based. Bangladesh Enterprise Institute, Corporate Governance Committee of ICAB, and SEC have developed separate Codes for Corporate Governance for Bangladesh. The Government must take initiatives to make these implemented by making necessary changes in the Companies Act.

Implement Competition Policy:

An effective competition policy fosters a flexible, dynamic, and competitive private sector that leads to sustained and widely shared economic development. Bangladesh needs to formulate a Competition Policy which will ensure a culture of good corporate governance to thrive. Competition policy helps bring about efficiency, reduce price distortions, lower the risk of poor investment decisions, promote greater accountability and transparency in business decisions, and lead to better corporate governance.⁵⁵

Medium-term

The legal and regulatory framework should ensure that non-controlling shareholders or minority shareholders are protected from exploitation by insiders and controlling or sponsor shareholders:

Government should introduce measures, or enhance existing measures, to provide non-controlling shareholders with adequate protection from exploitation by controlling shareholders.

These measures may include, among other things: (i) strengthening disclosure requirements (particularly of self-dealing/related-party transactions and insider trading);⁵⁶ (ii) ensuring that regulators have the capacity to monitor companies for compliance with these requirements and to impose substantial sanctions for wrongdoing; (iii) clarifying and strengthening the fiduciary duty of directors to act in the interest of the company and all of its shareholders; (iv) prohibiting indemnification of directors by companies for breaches of fiduciary duty; and (v) providing shareholders who suffer financial losses with private and collective rights of action against controlling shareholders and directors.

⁵⁴ For example, Australian Corporate Governance Council has adopted “The Principles of Good Corporate Governance and Best Practice Recommendations” for Australian corporate entities.

⁵⁵ Organizations like Bangladesh Enterprise Institute have already undertaken comprehensive project on Competition Policy.

⁵⁶ Disclosure should be in line with IASs/IFRSs.

Improve the capacity of the Boards of directors:

The directors must improve their participation in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders. There is a need for director training, voluntary codes of conduct, expectations for professional behavior and directors' resources and authority *vis-à-vis* management. Also it is required to reduce or eliminate loopholes by tightening standards for director "independence", by making "shadow" directors liable for their actions, by increasing sanctions for violations of duties of loyalty and care and by advocating delineation of a core set of related-party transactions (such as company loans to directors and officers) that should be prohibited outright. It is important to facilitate mechanisms to adequately empower the shareholders to seek redress for violations of their rights and to ensure director accountability. The most vital thing that can ensure good CG is high standards of ethical and personal behavior. This can only be ensured if the value system of society imposes this on their people as the norm in every aspect of life. Good CG must become an unshakable social and moral imperative.⁵⁷

Long-term

Strengthen the Capacity of the Government to Monitor and Enforce the Implementation of Corporate Governance:

The Securities and Exchange Commission (SEC) of Bangladesh need to be strengthened so that it can devise and enforce a code for good CG. The Companies Act has to be amended and updated to have consistency with Bangladesh Accounting Standards (BAS), SEC requirements and the Bank Companies Act. Independent Audit Committee should be made compulsory for all listed companies. Strict implementation of accounting and auditing standards are very important. As the lead regulatory body overseeing corporate accounting and reporting, the SEC has a critical role to ensure that public company boards are properly structured and organized and have the resources to accomplish the objectives of adding value to shareholders, minimize risk of key shareholders and hold management responsible for corporate results. Ruthless monitoring of compliance and severe punishment of transgressors can ensure good CG. But Bangladesh has to wait a lot to ensure enforcement of any corrective measures properly. If the policymakers implement the recommendations suggested above, undoubtedly a good CG environment will prevail in Bangladesh.⁵⁸

Strengthen the Capacity of Public – Private partnership:

Public- and private-sector institutions should continue to raise awareness among companies, directors, shareholders and other interested parties of the value of good CG. Bangladesh has made little progress in raising awareness of the value of good CG. To Achieving the desired CG framework in Bangladesh, requires not only a strong national commitment to CG, but one that is also broad based.

⁵⁷ Chaudhury, A.M. 2004. Corporate Governance – An Industry Perspective. *The Bangladesh Accountant*, October-December, Quarterly journal of the Institute of Chartered Accountants of Bangladesh.

⁵⁸ Ahmed, Mamt az Uddin, Yusuf, Muhammad Abu. 2005. Corporate Governance: Bangladesh Perspective. *The Cost and Management*. Vol. 33. No. 6. November-December 2005. pp. 18-26.

Government should intensify its efforts to improve the regulation and corporate governance of SOEs:

Shortcomings in the governance of SOEs and FIs not only lower returns to the bank's shareholders, but, if widespread, it destabilizes the financial system. To restore confidence to both debt and equity markets, policy-makers and regulators need, in addition to ensuring adequate banking laws and regulations and supervision of banks' operations, to promote sound corporate-governance practices in the banking sector. Ownership and financial relationships should be disclosed. Self-dealing/related-party transactions should be subject to both banking and corporate-governance restrictions. Bank directors should be able to pass "fit and proper" tests for service. These directors should also assume responsibility for bank systems and procedures that ensure sound lending and monitoring practices, as well as the capacity to handle distressed debt. Lastly, local insolvency systems must protect and enforce creditors' rights and provide efficient liquidation of debtors which cannot be expeditiously restructured into commercially viable enterprises.

Introduction of Good Governance Practices in SOEs:

In order to provide a strong demonstration effect, CG reforms in strategic SOEs that handle electricity generation and distribution, gas distribution, telecommunications, and air-transportation can be undertaken. These enterprises are fully owned by the Government.

All jurisdictions should strive for effective implementation and enforcement of corporate-governance laws and regulations:

Over the past several years, most South Asian countries have substantially revamped their laws, regulations and other formal corporate-governance norms. Bangladesh is still lagging behind in this matter. Leadership from the uppermost reaches of government is necessary to promote public confidence in the state's commitment to the rule. In this regard, adoption of international accounting, audit and financial disclosure standards and practices will facilitate transparency, as well as comparability, of information across different jurisdictions. Such features, in turn, strengthen market discipline as a means for improving CG practices.

Institutional Capacity Building:

There is a need for disseminating CG and enterprise restructuring principles and for implementing the related guidelines and standards. Public awareness and development of governance structure i.e., enforceable regulation, ensuring financial transparency, stop financial malpractice and any form of market manipulation are essential for enabling a sound framework for CG. It is, therefore, required to educate the public about their rights as shareholders and about the work of modern corporations through our own specialized publications and through the national and regional mass media.

Improving the quality of Financial Reporting:

In Bangladesh, quality of financial reporting needs to be improved. This requires a robust regulatory regime and effective enforcement of the accounting and auditing standards. True independence of the auditor is at the crux of good CG. Auditors need to be able to function with real independence and without fear or favor. Simultaneously, auditors also need to be monitored through strict enforcement of professional code of ethics of

auditors. In the long run, auditors will become irrelevant if they fail to act independently.⁵⁹ There must be a consolidating financial report for the group of companies.

Role of Dhaka Chamber of Commerce and Industry:

Experience from around the world shows that good CG helps enterprises attract capital, strengthen their operations, and reduce conflicts between shareholders and management. Implementing and enforcing sound CG systems and practices is essential for Bangladesh in order to build confidence, strive to revitalize production, and further market reforms. To strengthen the overall environment for CG in Bangladesh, following issues are required to be undertaken:

- Implement the policy recommendations/interventions asserted in this economic policy paper and assist the government on improving CG regulations, including the development and adoption of national CG codes.
- Work with the NGOs, such as institutes of directors, banking associations, civil society think tanks to increase their ability to advocate for further CG reforms.
- Develop and deliver CG course materials to potential researchers, business schools to ensure that future managers and lawyers understand the importance of good CG and have the skills to practice it.
- Training for the managers, board members and executives should be undertaken on regular basis in consultation with various stakeholders.
- Adopt a long-term strategy to educate the relevant stakeholders about the issues CG through conducting seminars, workshops and by conducting regular surveys of CG practices.

⁵⁹ Chaudhury, A.M. 2004. Corporate Governance – An Industry Perspective. *The Bangladesh Accountant*, October-December, Quarterly journal of the Institute of Chartered Accountants of Bangladesh.