Centre on Regulation and Competition

WORKING PAPER SERIES

Paper No. 127

POLITICAL ECONOMY OF CORPORATE GOVERNANCE IN BANGLADESH

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September, 2006

ISBN: 978-1-905381-26-3

Further details: Centre Secretary
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1. INTRODUCTION

Recent empirical studies on the political economy of corporate governance have challenged the well-established law-and-economics tradition[1] based on the legal origin and the quality of corporate laws (QCL), by advancing the idea of 'politics school' in corporate governance (Gourevitch 2003). Several recent studies (Pagano and Volpin 2005; Pagano and Volpin 2005b; Bebchuk and Neeman 2005; Pound 1992, quoted in Turnbull 1997) depart from the structural explanations of the 'law and finance' literatures on corporate governance[2], and forward a political economy model to explain the country-level variations in investors' protection.

López-de-Silanes (2002) relates politics with the legal reform and argues that legal reform associated with international corporate governance initiatives should take into account the local political and judicial realities,. While Bebchuk and Neeman (2005) recognise the positive impact of investor protection on stock market development as well as economic growth (La Porta, Lopez-de-Silanes, Shleifer and Vishny, hereafter LLSV 1998, LLS 1999; Gugler et al., 2001), they argue that the causation may run from the opposite direction e.g. countries with more developed economies and more accountable political systems tend to adopt higher levels of investor protection. In response to the economic interests of the different stakeholders of the society, political process creates or changes laws (Pagano and Volpin 2005; Bebchuk and Neeman 2005), and thus acts as a link between legal rules and economic outcomes (Pagano and Volpin 2005). Turnbull (1997) regards the finance model as a sub-section of the political model that emphasises the importance of macro framework including political, legal or regulatory system, within which the allocation of corporate power, privileges and profits among owners, managers, and other stakeholders takes place at a micro level.

[1] Roe (2003) cited in Gourevitch (2003) not only claims the superior explanatory power of political factors over the legal rules, but also charges QCL of neglecting the degree of economic competition.

[2] According to the 'law and finance' model of corporate governance, legal origins (common law tradition vs. civil law tradition) having significant influence on country-level variations in investors' protection.

The issue of corporate governance in financial and non-financial firms has received considerable attention and recognition as one of the most critical developmental issues in Bangladesh. Several studies (e.g. Nenova 2004; Oman and Blume 2005; Iskander and Chamlou 2000) also regard the development of appropriate corporate governance system as one of the greatest challenges of low-income countries in achieving sustainable financial sector development and economic growth. In this paper we draw on two of the recently proposed political economy models to explain the corporate governance realities in Bangladesh. The 'voting model' and the 'interest group politics model' are tested using survey data as well as interviews to determine whether the macro-level assumptions of these models can explain firm level governance dynamism[3]. The paper is organized as follows. Section 2 describes the methodology of the study, followed by a summery of the survey results. Section 4 analyses the findings from the perspective of the voting and interest group politics models, while section 5 concludes the paper.

2. CONCEPTUAL FRAMEWORK

Our analysis is based on two recent political economy models of corporate governance namely, the voting model and the interest group politics model. The former regards the voting process as the prime determinant of investor and employee protection, whereas the latter stress the role put forward the notion of power and influence of powerful interest groups in shaping corporate laws of investors' protection and transparency.

2.1 Voting Model

Pagano and Volpin (2005) propose a political economy model of corporate governance based on cross-country data on political determinants of investor and employment protection. It is argued that the political economy model determines the motives as well as timing of the changes in corporate laws by formalizing the behaviour of voters. The model assumes that the voting process plays a crucial role in aggregating the conflicting preferences of the voters or agents of the economy e.g. maximising private benefit for the entrepreneurs, strong investor protection for the minority shareholders, and protection against dismissal of workers. Using cross-section and panel estimation techniques, the model predicts that the homogeneous political preferences of the former tend to influence the political parties in the proportional voting system (e.g. Continental European countries and Japan, where winning a majority of the votes is crucial) to design a policy agenda that

[3] The present paper does not consider the influence of the legal and regulatory framework on corporate governance.

produce weak shareholder protection and strong employment protection[4]. On the contrary, the political outcomes of the Anglo-Saxon countries (whose political systems tend to be majoritarian i.e. winning a majority of districts ensures victory), tend to produce strong shareholder protection and weak employment protection. It is further stated that the static legal-origin approach seem to have little explanatory power for the changing nature of corporate governance or labour related regulations.

Other researchers have also referred to politics as significant determinant of corporate governance, and favour the voting model, where political majority tends to determine the corporate governance as well as financial and labour regulations in a democratic society (Roe, 2003, etc.). It is important to note that the convergence of interests between entrepreneurs (or managers) and employees can take place non only in the macro political arena (Pagano and Volpin 2005) but also at the firm-level, where the management use generous employment contracts (e.g. long-term employment contract, high wages, lax monitoring) to advantage employees at the expense of non-controlling shareholders (Pagano and Volpin 2005b).

2.2. Interest Group Politics Model

Gourevitch (2003) extends Roes' (2003) version of political economy model by analysing alternative preferences of the interest groups with reference to class-based or left-versus-right divisions, and sector-based or cross-class coalitions. Gourevitch also mentions the institutional issues of consensus versus majoritarian political systems such as, combine electoral laws, the number of political parties, and legislative-executive relations etc. Bebchuk and Neeman (2005) propose a similar political economy model that analyzes how the political game of the three different interest groups (e.g. corporate insiders, institutional shareholders, and entrepreneurs) affects the level of investor protection or private benefits of control. In this model, all three interest groups compete for influence over the politicians, who generally determine the level of investor protection. Several factors seem to influence equilibrium level of investor protection including, the ability of corporate insiders to use the corporate assets they control to influence politicians (Bebchuk and Roe, 1999, cited in Bebchuk and Neeman 2005), the divergence of interests between institutional investors and outside shareholders, and the politicians' perception of social welfare. Since lax investor protection helps insiders enjoy the full private benefits of control at the cost of the firm (or

[4] Weak shareholder protection is favourable to entrepreneurs since the latter can extract high private benefits of control at the expense of residual groups or minority shareholders, while strong worker protection enables low-productivity workers to retain well-paid jobs (Pagano and Volpin 2005).

other shareholders), the former tend to spend more firm resources than the value of their extra private benefits. The possibility of overlapping interests between the insiders and entrepreneurs, especially in the areas of planning to raise equity capital for the existing public firms or new firms, appears to moderate their bias of extracting private benefits but does not eliminate it. The model also assumes that the lack of activism[5] of the institutional investors in the lobbying game, coupled with the exclusion of dispersed and uninformed outside investors from the interest group politics leads to further distortion of investor protection.

Bebchuk and Roe (1999) also suggest that lobbying has an effect on the allocation of rents from the capital of the public firms. Busch and Muthoo (2003) argue that the bargaining power of some powerful agents have significant adverse effect on the development of political as well as economic and social institutions, with the inequality in bargaining power being positively associated with the persistence of inefficient institutions. Bongini et al., (2001) also reveal that the financial institutions' 'connection' with industrial groups or influential families appears to have increased the likelihood of distress and closure during East Asian Financial Crisis, suggesting that supervisors had granted selective prior forbearance from prudential regulations.

Rosser (1999) puts forward the idea of political economy (i.e. the issues of power and interest) of accounting system based on the dependency approach[6] that regards accounting reform in developing countries as the result of a colonial heritage and continued neo-colonial domination[7] rather than rational choices by wise policy-makers. He argues that the developing countries tend to respond to the particular interests of the dominant political and social coalitions in these countries, consisting of the strata of politico-bureaucrats that occupy the state apparatus and the dominant fractions of capital and other resources. However, the developing countries need to make concessions (through reforming economic

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[5] The institutional investors (e.g. mutual fund managers) are likely to exert less effort and money in the lobbying game for a variety of reasons such as, getting a fraction of benefits from improved investor protection, and the possibility of receiving side payments from the controlling insiders.

[6] This "dependency" approach improves on the neoclassical/modernization theory approach because it brings issues of power and interest into the analysis. Scholars operating from a neoclassical/modernization perspective, for instance, have suggested that developing countries will shift away from traditional accounting practices and towards Western ones as the former become incompatible with an increasingly complex and competitive business environment (Chow et al 1995 and Han 1994, cited in Rosser (1999).

[7] Rosser (1999) mentions that accounting policies in developing countries have largely been imposed by developed countries initially through colonialism and then through the influence of transnational corporations, foreign aid donors, and professional accounting institutes. It is argued that the developing countries seem to have little choice but to adopt western accounting policies instead of developing their own primarily because of the interests of the developed countries and multilateral corporations.

policy in general and accounting policy in particular) to other fractions of capital or organisations such as the World Bank and IMF because of the formers' reliance on the latter in many aspects including capital (Robison 1986; Rueschmeyer and Evans 1985; Robison et al 1993; Rosser 1998).

Nevertheless, Rosser (1999) argues that the dominant section of 'politico-bureaucrats' of the developing country, with the access and authority to allocate resources, oppose or slowdown the accounting reform measures because of their fear that increased transparency and accountability could limit their rent-seeking opportunities from the SOEs as well as private domestic conglomerates with which they are connected. The reform process is also being inhibited by the inefficiency and corruption in the judiciary coupled with the power of the politico-bureaucrats and conglomerates to control judicial outcome, and flawed auditing practices. Fung et al., (2002) also opine that reform initiatives seem to be constrained by unlikely difficulty in reaching a compromise between the interests of powerful politicians[8] (e.g. reputation, markets or political influence) and other societal values such as, protecting public safety and proprietary information, guarding personal privacy, or limiting regulatory burdens. Rosser (1999) and Fung et al., (2002) therefore, suggest that fundamental political change is needed to neutralise such multiple political and social interests in order for entrepreneurial politicians to consider the real interest of the users[9] in the disclosure and associated policy frameworks such as, effective enforcement, regulatory synergies, and complementing market interactions.

2.3. Methodology and Data

In the absence of structured data on the firm-level corporate governance issues in Bangladesh, we conducted a questionnaire survey as well as semi-structured and unstructured interviews. The structured self-explanatory questionnaire was designed to obtain corporate governance information for the listed companies. A number of governance areas were included: ownership pattern, shareholder rights, board and management diversity, disclosures and auditing, and responsibility toward the stakeholder. Apart from the questionnaire-based responses, most of the respondents have been interviewed in an unstructured format in order to get further insights of the governance

[8] The political entrepreneurs, who are primarily responsible for the disclosures and associated costs, are politically better organized than the potential users in shaping or obstructing the policy agenda in accordance with the formers' interest.

[9] The beneficiaries of sustainable transparency policies include consumers, investors, employees, political activists, voters, residents, or government officials (Fung et al., 2002).

dynamics of the sample firms. Besides this, several semi-structured or unstructured interviews have been carried out with various stakeholders.

All of the 234[10] financial and non-financial listed companies of the Dhaka Stock Exchange (DSE) have been approached for the questionnaire survey carried out between August 2004 and January 2005. The study follows several researchers (for example, Black et al., 2003; Grosfeld and Hashi 2003; Ong et al., 2003; LLS 1999; and Claessens et al., 2000), who incorporate financial and non-financial institutions in their studies. A total of 140 firms comprising more than 80 per cent of the financial institutions and around 54 per cent non-financial companies have responded to the survey, with the response rate being 60 per cent. The sample firms capture nearly 83 percent of the total market capitalisation (MC) of the DSE, with the dominance of manufacturing companies (SIC: 2000-3900) with more than half of the total MC of the sample firms compared with 33 percent for banking sector (SIC: 6000), although the latter appears to control roughly four-fifth of the total assets of the sample firms[11]. In order to facilitate comparison, the 4-digit SIC code is used to categorise the sample firms, which are then presented in broad industrial categories such as, manufacturing, banking, non-bank financial institutions (NBFIs) comprising the insurance and leasing companies, and other service firms, coupled with financial versus non-financial, and foreign-controlled versus locally-controlled firms.

3. CORPORATE GOVERNANCE IN BANGLADESH: SURVEY RESULTS

This section presents a summary of the questionnaire survey as well as the interviews with reference to concentrated sponsors' shareholding, family-dominated board, family-aligned management, minority shareholders' rights, and auditing and disclosures. While we regard the concentrated ownership as well as family-aligned board and management as the determinants of firm-level politics, which in turn shape macro-level political preferences, we argue that poor shareholders' and depositors' rights and weak auditing and disclosure practices are the consequences of micro or macro level political behaviour.

Concentrated Ownership and Sponsors' Control

The survey reveals that most of the companies in Bangladesh do not come to the capital market to meet their financing needs partly because of the controlling owners' fear of losing

[10] Following Ong et al., (2003), 12 mutual or investment funds are excluded from the survey because of their different business practices and financial practices.

[11] Source: The authors' estimations based on the data published in the DSE Monthly Review, December 2004 (Year End Special Edition).

control and meeting increased disclosure requirements. Even though a small portion of those companies are listed in the stock exchanges, the founding family or the sponsors of those companies seem to ensure that they have direct control over the company. It is revealed that the largest shareholder of the sample firm owns around a quarter of the firms' equity, even though the average shareholdings of the largest five and ten shareholders are 50 per cent and 60 per cent, respectively. According to the sector-wise distribution of ownership, concentration in manufacturing sector is relatively high compared with banks and insurance companies.

Table 1: Sector-wise distribution of average percentage of shareholding by different types of ownership

Types of Ownership	*Manufg.*	*Banks*	*NBFIs*	*Oth. Serv.*	*Financial*	*Non-Fin*	*Foreign*	*Local*	*Total*
	%	%	%	%	%	%	%	%	%
Largest	31.5	10.1	15.7	28.3	13.0	31.2	56.3	23.3	26.1
Top 5	57.0	28.9	37.1	51.8	33.1	56.6	80.2	47.2	50.0
Top 10	65.4	41.8	51.6	63.1	46.8	65.2	86.5	57.6	60.1
Public(Dispersed)	29.4	29.7	29.1	35.0	29.4	29.8	12.6	31.3	29.7
Insiders (MD,ED, other executives)	17.6	-	0.2	27.2	0.1	18.4	5.1	14.0	13.3
Sponsors	48.2	55.1	50.7	46.9	52.8	48.1	68.7	47.6	49.4
Family	32.6	11.4	14.7	40.9	13.1	33.2	6.2	29.6	27.6
Financial Cos.	21.2	11.1	21.3	11.9	16.3	20.5	20.2	19.2	19.3
Foreign	9.5	7.9	7.1	6.3	7.5	9.3	65.7	3.4	8.8
Government	5.6	2.4			1.2	5.2	0.4	4.4	4.1
n	93	19	20	8	39	101	12	128	140

Source: Primary Survey Data, 2004-05.

It is further evidenced that the controlling family does have direct control over the sample firm by owning around 28 per cent shares, with the financial institutions having fairly low family ownership of 13 per cent against 33 per cent in non-financial companies. The lower family shareholding in financial sector is primarily resulted from the regulatory initiatives to restrict family or individual ownership[12], even though such compliance is questionable to many quarters[13]. In addition to direct control, the controlling family tends to exert indirect control over the activities of the sample firms through the sponsors[14] who own around half of the sample firms' equity in all industrial categories. The higher sponsor shareholdings (at least 55 per cent) in both banks and insurance are particularly interesting in the sense that the regulatory initiatives to control ownership concentration do not seem to bring any positive outcome[15]. It is worth mentioning that the non-financial companies[16] have an average of 18 per cent insider shareholding[17] that mainly reflects the holdings of the CEOs and/or other executive directors, who are basically sponsors, and are from the controlling family. This pattern of shareholding clearly portrays a highly concentrated pattern of ownership of the listed companies in Bangladesh.

Family-dominated Board

The study (table-2) envisages that the average board size of the listed companies of Bangladesh is nine, with the proportion of non-executive directors (non-ED) being fairly high in financial institutions (more than 90 per cent) against non-financial firms (64 per cent). In spite of having relatively low average shareholding, the controlling family comes out to be the most dominant force on the board with roughly half of the board members being family representative, although this ratio is reasonably lower in financial companies[18] (around one-fifth) than that of non-financial firms (62 per cent). Even though nearly two-fifth of the

[12] The separate regulatory provisions enacted by the Bangladesh Bank and the Controller of Insurance of the Ministry of Commerce require that no individual or family can own more than 10 per cent shares in the banks and insurance companies. However, leasing companies are excluded from such compliance.

[13] It is observed that the controlling owners or families appear to comply with the provision of ceiling of ownership, while transferring their shares into the names of other family members or close relatives or allies since there is no legal bar in this regard. It is revealed that complying regulatory provisions is basically paperwork done as face saving measure, but the real ownership of this transferred shares remains with the controlling individuals or families.

[14] Sponsors are the controlling shareholder group composed of the controlling family along with its relatives and close business associates. Gutiérrez and Tribó (2004) regard this group as multiple large shareholders.

[15] While the largest (or top5/top10) shareholder(s) of banks and insurance companies appears to partially comply with the provisions maximum individual or family shareholding, the substantial sponsors' shareholding of these financial institutions likely to undermine the regulatory efforts unless there are appropriate measures to limit sponsors' shareholding.

[16] The financial sector companies (banks, leasing companies and insurance companies) have virtually no insider shareholding, primarily because of the regulatory obligations for having professional executive management who are not entitled to own company shares.

[17] It may be mentioned here that insider shareholding does not normally involve insiders' (mainly CEO and Executive Directors) remuneration in the form of stock options, which is largely absent in listed companies in Bangladesh.

[18] Although the Bangladesh Bank and the Controller of Insurance have recently enacted separate regulatory provisions requiring banks and insurance companies not to have more than one board member from the same family, the founding families or sponsors of many banks and insurance companies tend to actualise the loopholes of regulatory provisions. The most apparent techniques of maintaining the family control include, transferring shares to close relatives to enable the latter to be board member, using close ties with other powerful sponsors to ensure the dominance of few controlling families, and getting court order against the regulatory provisions.

sample firms have at least one institutional representative[19], the proportion of institutional directors in financial and non-financial firms is fairly low (roughly one-tenth), with foreign firms having the highest institutional representation (42 per cent). Being the major sources of funds for the listed companies, banks or creditors do not have noticeable presence on the board of their loan recipients.

Table 2: Average board size (number) and composition of different director categories as a proportion of the total board members (%)

Board size and composition	*Man -ufg.*	*Bank*	*NBFI*	*Oth. Serv.*	*Finan cial*	*Non-Fin*	*Foreign Firm*	*Local Firm*	*Total*
Avg. Board Size	6.3	12.3	22.1	6.9	17.3	6.3	7.6	9.6	9.4
Ex. Director	36.0	9.0	7.0	28.2	8.2	35.1	27.4	27.4	27.4
Non-Ex. Director	64.0	91.0	93.0	71.8	91.8	64.9	72.6	72.6	72.6
Family Rep.	60.4	20.0	17.4	76.3	18.7	61.7	6.3	53.8	49.7
Institutional Rep.	10.9	7.7	14.1	2.1	11.0	10.2	41.8	7.5	10.4
Independent Rep.	6.2	2.3			1.1	5.7	8.1	4.1	4.4
Director Serving other firms as Director	71.4	69.2	56.7	61.7	62.8	70.7	47.7	70.4	68.5
n	93	19	20	8	39	101	12	128	140

Source: Primary Survey Data, 2004-05.

The controlling family influence is also evidenced (table-3) by the dual role of the family-aligned CEO, with roughly two-fifth of the non-financial firms including a quarter of the foreign firms having the CEO, who is also the board chairperson, while financial companies do not have CEO duality primarily because of the regulatory compliance of having professional top executive. Although around 70 per cent sample firms do not have CEO duality, only eight per cent local companies have independent chairman and only one-tenth of the local firms[20] hold independent board members. The critical issue of board independence is also constrained by high level of board interlocking[21] (table-2), with more or less 70 per cent of the board members of the financial and non-financial firms serve other family-controlled listed or non-listed firms as director. While the central bank regulations

[19] Institutions include both local financial institutions (banks, insurance companies, mutual funds, leasing companies or merchant banks) and foreign financial or non-financial institutions.
[20] In spite of having regulatory obligation, only one-tenth of the banks have independent non-ED on the board.
[21] Board interlocking is defined as the number of directors sitting other firms as board members.

seem to show partial success in restricting the directors' tenure[22], the controlling family-aligned directors or CEOs of non-financial companies face no legal restrictions to hold their post for a longer period of time, which might have adverse effect on the issue of transparency and accountability of the firm.

Family-aligned Executive Management

The controlling family influence is commonly prevalent in the executive management of almost all financial and non-financial companies with the exception to the foreign and government-controlled firms. The survey (table-3) shows that roughly 85 per cent of the sample firms have the chairman and/or MD and/or one of the top-three executives, who represent the controlling family. Moreover, eighty-five per cent non-financial companies against one-fifth of the financial companies have family-associated executive management e.g. the MD and/or one of the top3 executives are from the controlling family.

Table 3: Proportion of sample firms with different director categories and MD duality and family representation

Description	*Man-ufg.*	*Bank*	*NBFI*	*Oth. Serv.*	*Financial*	*Non-Fin*	*Foreign Firm*	*Local Firm*	*Total*
	%	%	%	%	%	%	%	%	%
Instl. Director Exist	35	42	55	12	49	34	92	33	38
Bank Nominee Exist	13		20		10	12	8	12	11
Independent Dir. Exist	16	10			5	15	33	10	12
Foreign Nom. Exist	14	10	10		10	13	100	4	12
MD & Chair are same	38			50		39	25	28	28
Chair is Ind. Non-Ex.	13	5	5		5	12	33	8	10
MD or 1 of Top3 from Controlling Family	84	5	30	100	18	85	25	70	66
MD, Chair or Top3 from Controlling Fam.	82	95	85	100	90	83	17	91	85
n	93	19	20	8	39	101	12	128	140

Source: Primary Survey Data, 2004-05.

[22] The central bank regulatory orders restrict individual board member from serving more than two successive terms (6 years) but they can continue their directorship after an interval of 3 years. There is also provision of maximum tenure of 3 years for bank CEOs.

Given the evidence of significant family-representation, the absence of ED evaluation system and executive management accountability of the non-financial firms is understandable, since the family-aligned CEOs and/or other EDs are unlikely to be held responsible for their opportunistic behaviours. However, the absence of similar system in financial firms suggests that the sponsor directors are disinclined to make the professional CEOs accountable, since many of the latter's actions are for serving the formers' interests. It is however, worth mentioning that taking disciplinary measures against the top-level management other than the EDs is fairly a common practice in Bangladesh. Although some disciplinary measures are based purely on the issues of mismanagement, executives are often discharged by the sponsor directors for the latter's own interest[23].

Minority Shareholders' and Depositors' Rights

The concept of corporate governance in general and minority shareholders' rights in particular, is generally unfamiliar to the general investors in Bangladesh. A significant proportion of the minority shareholders are either unaware of their basic rights or lack appropriate motivation and/or power to exercise their rights. While general shareholders own around 30 per cent equity in the sample firm, only 16 firms (comprising less than half of the banks, a quarter of the insurance companies and two other foreign firms) have public nominee on the board[24]. Regardless of some banks and insurance companies' assertion of having minority or public board representative, it is revealed that the controlling family and/or sponsors generally choose public board members with whom they have family or business relationships.

It is interesting to note that at least half of the locally-controlled firms (both banks and non-financial firms) coupled with a quarter of the insurance companies come out to have one or more events of controversy with reference to financial or other irregularities in favour of majority shareholders at the expense of the interest of the company in general, and minority shareholders or depositors in particular[25]. It is evidenced that many ill-motivated sponsors

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[23] The evidence of a recent IPO scam of a leading private bank and subsequent removal of the MD or other top executives coupled with other lending irregularities in several private banks of Bangladesh suggests that the management is often made scapegoat as face the saving measures if any improper incident in unveiled, while letting the main players unidentified and unpunished.

[24] Unlike non-financial and leasing companies, banks and insurance companies are supposed to comply with the legal provisions of having at least one (one-third for insurance companies) public shareholder on the board.

[25] Even though it is difficult to uncover the confidential issues such as, the number and extent of controversy (e.g. transferring company fund or huge loan for family other purposes, irregularities in holding AGM or giving dividends, undue involvement in share trading, or other issues of transparency that have become public) associated with the interests of the board or majority shareholders, informal discussion with one or more individuals of the sample firm have been enormously helpful in this regard.

seem to take advantage of the persistent loopholes of the country's ailing legal system by raising funds through the capital market and wilfully making their companies defaulted through transferring company assets to other family-owned businesses, while embezzling the investments of numerous general investors.

Nevertheless, a recent trend is for banks and other financial institutions to raise money through the capital market, but unethical business practices of the sponsor directors of banks has been a long-standing phenomenon. It is also imperative to mention that the responsibilities of the bank directors lie beyond recognising and protecting the interests of the general shareholders because of the unique nature of doing business with the depositors' money. Hence, the impact of the controlling shareholders' expropriation in banks is more severe and painful as has been the case in banking sector of Bangladesh. The most common form of malpractices or violation of the depositors' rights appears to be the misuse of depositors' money in making risky investment decisions and/or loan contracts with dishonest individuals or institutions. It is also revealed that this group of borrowers, often directly or indirectly associated with the controlling family and their allies, generally turns out to be defaulter leaving the interests of the depositors and shareholders unprotected. It is worth mentioning that all of these incidences are some of the various forms of expropriations in the country's corporate sector. The failure of the regulatory bodies in detecting the real motives of such irregularities combined with identifying and bringing those responsible appears to show another major loophole of the structure of corporate governance in Bangladesh.

Disclosures and Auditing

The study reveals that nearly two-third of the sample firm tends to have organised internal audit department, even though the latter hardly uncovers the financial irregularities made by the controlling owners and other management failures. Since there is no legal provisions for the internal audit department to act quite independently and to report the regulatory authority other than the CEO or board, it is not possible for the outsiders to be informed about the real form of anomalies. While around 30 per cent the sample firms have audit committee, there is no visible representation of independent non-ED in any of the audit committees of the sample firms, and almost all of the audit committee members of local non-financial firms are executive directors. Therefore, the core issue of transparency and accountability of the executive management through proper representation of (independent) non-ED with appropriate expertise in audit related matters is not at all prevalent in the corporate sector of Bangladesh.

The in-depth interviews reveal that the controlling sponsors and management of many financial and non-financial firms seem to take full advantage of the country's ailing legal and regulatory structures through various forms of manipulation in accounting practices including, (i) getting IPO permission based on the prospectus that provides bright financial pictures and prospects of the company proving through overvaluation of company's assets, or concealing important facts about the sponsors; (ii) fabricating the annual and half-yearly financial statements[26]; (iii) presenting net loss of the company as an asset in the balance sheet, and thus mislead investors with no or little knowledge in accounting[27] etc. Even though the central bank activism and subsequent regulations appear to show some improvement in disclosure practices of banks and leasing companies, various forms of irregularities still be in place with reference to related party transactions, insider lending, classified loans, capital shortfalls and other important information involving financial risks of the banks[28]. The anomalies seem to be a very common practice in both private and public firms in all industrial categories, out of which some are listed in the capital market. While some foreign as well as local firms appear to comply with the existing standards, such efforts are overshadowed by majority of the firms' unwillingness to be transparent and accountable to their shareholders and depositors.

Although the credibility and professional integrity of some audit firms are beyond any doubt, there is substantial evidence of unethical practices by many audit firms in order to enable the ill-motivated sponsors expropriate investors' as well as depositors' interests. Many of the audit firms appear to approve company prospectuses that highlight rosy financial pictures and prospects of the company concerned, or fabricated annual financial accounts[29] with

[26] There are numerous evidences of fabrication of half-yearly un-audited financial statements by giving rosy financial picture to enable the controlling shareholders take advantage of increased share prices for selling large chunk of shares. Conversely, poor financial projections are provided in the half-yearly report to encourage general shareholders sell shares, and be deprived from getting higher dividends in the following AGM.

[27] ADB (2003) also make similar observation.

[28] It is evidenced that sponsors and management of several banks very often rely on rescheduling of loans and writing off of bad debts just to demonstrate banks' ongoing success in lessening the amount of classified loans. Moreover, some banks are reluctant to provide detailed information on insider lending and other related party transactions that might be crucial to the depositors as well as the investors to make careful decision about their deposits or investments.

[29] One of the in-depth interviews reveals massive discrepancies in financial figures such as, default loans and capital shortfalls of different nationalised commercial banks presented in the annual reports and the special audit reports prepared under the instruction of the World Bank and the IMF. It is interesting to note that the local auditors audited the annual reports of the nationalised commercial banks, and the special auditors of the WB reform programme were also local auditors but they came up with different financial pictures of the banks.

declining or no profits to deprive the minority shareholders from getting fair amount of dividends. The poor state of audit quality might also be the result of poor audit fees[30] coupled with the opportunistic behaviour of some audit firms to grasp more audit contracts from other businesses of the controlling sponsors. Moreover, the absence of cost auditing appears to help some manufacturing companies fabricate cost-related items of the financial statements. The transparency and accountability of the firm has also been constrained by the absence of any evaluation system[31] through which external auditors can be held accountable for any unethical practices in auditing. The above discussion is a clear indication of the state of internal as well as external auditing practices in Bangladesh.

4. POLITICAL ECONOMY AND CORPORATE GOVERNANCE IN BANGLADESH

Based on the conceptual framework presented in section 2, our analysis centres on two political economy models of corporate governance namely, the voting and interest group politics model. The evidence in section 3 on concentrated shareholding is used in our analysis of the firm-level proportional majority voting model, while we use family-dominated board as well as management as the prime determinants in the interest group politics model. Based on our analysis, we also propose a political economy model of corporate governance outlining the firm as well as country level determinants, means and political outcomes from the perspective of a developing country.

4.1. Voting Model of Corporate Governance

Although Bangladesh, being founded on the English common-law[32] (LLSV 1998), seem to fall under the Pagano and Volpins' version of majoritarian system (Anglo-Saxon countries), the corporate laws of this country do not comply with the theoretical prediction of strong shareholder rights (Pagano and Volpin 2005) based on the anti-director rights index[33] developed by LLSV (1998, 2002). While the country's corporate laws allow proxy voting,

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[30] A recent survey report of the ICAB under a World Bank funded project (ICAB 2003) and Sobhan and Werner (2003) also regard audit fee as an important deterrent of audit quality.

[31] Although the central bank seems to rank the audit firms into A and B categories based on their performance, the authenticity of the ranking process is questionable to many quarters.

[32] The legal system of Bangladesh is founded on the English common law, with the difference that most of the laws of Bangladesh are statutory laws enacted by the legislature and interpreted by the higher courts. Downloaded from: http://banglapedia.search.com.bd/HT/L_0089.htm, on 10 October 2005.

[33] The shareholder rights or anti-director rights index developed by LLSV (1998, 2002) lies between zero to six, and is estimated by adding 'one' when (i) the shareholders are allowed to mail their proxy vote, (ii) shareholders are not required to deposit their shares before the shareholders' general meeting, (iii) cumulative voting or proportional representation of minority shareholders on the board is permitted, (iv) grievance mechanisms for oppressed minority shareholders such as, class action lawsuit, or appraisal rights for major corporate decisions are in place, (v) existing shareholders have pre-emptive rights at new equity offerings, and it can only be waived by a shareholder' meeting, and (vi) minimum percentage of voting rights needed to call an extra-ordinary shareholder meeting is less than or equal to 10 percent.

there is no legal provision to mail the proxy vote. Our study also reveal that most of the sample firms tend to allow proxy voting, with only existing shareholders rather than the outsiders being allowed for proxy voting, whereas some foreign companies allow proxy voting by mail. The laws also recognise the minority shareholders' rights with respect to take legal actions and call Extra-ordinary General Meeting (EGM)[34] but shareholders with at least 10 per cent stakes are entitled to exercise such rights. While majority of the sample firms recognise (at least in papers e.g. memorandum of association) the shareholders rights to call EGM[35], almost all of the sample firms have never experienced the holding of EGM, with an exception to few financial companies (mainly banks) and two non-financial companies. Nonetheless, in all of those cases, the board rather than the minority shareholders calls the EGM, and in some cases, the board does not seem to comply with the provision of giving notice of at least 21 days. Moreover, the inefficiency and complex judicial systems (ADB 2003) together with the lacking of motivations to accumulate the minimum shareholding do not seem to be financially feasible for the general shareholders to file petitions for their grievances.

The persistence of weak shareholders rights in the corporate laws might be in accordance with the explanation (Pagano and Volpin 2005; Bebchuk and Neeman 2005; López-de-Silanes 2002; Roe 2003, cited in Gourevitch 2003) that politicians can change the corporate laws in response to the economic interests or political ideology of the entrepreneurs or controlling shareholders, who are the dominant force in business as well as politics of Bangladesh. However, the voting model's assumption that politicians' response to homogeneous political preference of entrepreneurs and employees against the minority shareholders and other residual groups does not seem to apply, at least in the macro-level analysis, since legislative (or political) decisions are biased toward the formers' interest of extracting private benefits leaving weak employment rights and protections in the labour laws. Based on the above observation, we argue that neither the legal-origin model (LLSV 1998) nor the macro-level voting model seem to be compatible with the pattern of weak shareholders rights in corporate sector of Bangladesh. Our analysis however, supports the notion that irrespective of formal specification of corporate laws, politics and political forces

[34] Also referred to as 'Requisition Meeting' by many firm.
[35] Although the minimum qualifying share is 20 percent in several financial and non-financial institutions.

are the primary determinants of the degree of shareholding concentration[36] and protection coupled with the relationships among various stakeholders of the firm.

Nevertheless, the political economy model of proportional voting system (Pagano and Volpin 2005) appears to fit into the firm-level analysis, where controlling shareholders tend to use their proportional majority of votes (e.g. shares) to expropriate private benefits at the expense of general shareholders, although the models' prediction of strong employee protections is not recognised by the beneficiaries. Before explaining the political platform of voting e.g. AGM, it is worth analysing the pattern of proportional shareholding and control. Even though several researchers (Shleifer and Vishny 1997; LLS 1999; Morck *et al.,* 1988; Claessens *et al.,* 2000) opine that controlling shareholders can exert their control (or voting) rights through direct shareholding and indirect control via pyramidal and/or cross-sectional ownership[37], we argue that the latter form indirect control seem to be is largely absent in the corporate sector of Bangladesh, with the exception to several foreign firms and two family owned conglomerates. It is previously stated that the controlling family tend to exert indirect control through the shareholding of sponsors with whom the former has personal, business or political affiliations, and together they control roughly half of the sharers. Our analysis is also in accordance with the observation of Gutiérrez and Tribó (2004) that multiple large shareholders (e.g. controlling bank sponsors in our case) use shared control (voting) to extract private benefits.

Even though the survey reveals that roughly twelve per cent financial as well as non-financial companies do not comply with the Securities and Exchange Commission (SEC) rules of holding the AGM every year, the reality appears to be much worse given the fact that 62 per cent of the Z-category[38] errant companies (comprising 38 per cent of the sample) have not responded to the survey. Some listed companies have also been able to escape holding the AGM because of legal actions for/against them and subsequent court stay orders. It is

[36] It is argued that politics can inhibits diffusion (or encourage concentration) of ownership through strengthening the claims of non-shareholders or instituting unfavourable policies on competition, labour markets, and equality of income distribution.
[37] Claessens et al., (2000) and LLS (1999) define pyramidal structure as owning a majority of the stock of one corporation, which in turn holds a majority of the stock of another, a process that can be repeated a number of times. Cross-holding on the other hand, refers to the situation whereby a company has some shares in another company in the same business group and vice-versa.
[38] The SEC categorizes the listed companies based on profit-loss, status of annual general meeting (AGM) and commercial operational status of the companies. According to this measure, A category companies are those which pay 10 per cent or more dividend, B category companies are those which pay less than 10 per cent dividend and Z category companies are which that fail to pay any dividend, hold AGM, and whose accumulated loss exceeded the issued capital or companies which are not in operation for more than six months. (SEC Annual Report 2003-04).

also revealed that many of the listed companies happen to deprive their shareholders by not holding the AGM or giving dividends for many successive years. It is however, interesting to note that most of the sample companies rarely experience the standard (or proxy) voting practice to resolve the issues of the AGM, since the family or sponsor dominated board tend to make decision before being presented in the AGM and approved either by voice-voting or by raising hand. Moreover, almost all of the interview respondents opine that several good as well as poorly performed companies become visible of holding AGMs just to show their legal compliance, while making the financial and other decisions approved through the unethically managed and well-orchestrated events with the help of hired outsiders. The latter generally attend the AGM to take lead on behalf of the shareholders and to deprive the general shareholders from getting the real picture of their company as well as fair dividend, making constructive comments on major corporate affairs or other malpractices. It is worth mentioning the political or social power of the controlling sponsors coupled with the politicians' unwillingness to strengthen the legal and regulatory institutions (e.g. SEC and DSE) framework is perceived to be undermining the latter's disciplinary measures against such irregularities.

4.2. Interest Group Politics Model of Corporate Governance

Even though the interest group politics of investors' protection can explain many aspects of corporate governance of Bangladesh, the important assumption that the lobbying model affects insiders and outside shareholders rather than entrepreneurs does not seem to be compatible with corporate control politics of this country, which is predominantly controlled by the controlling family or entrepreneurs.

The controlling family's effort to maintain direct or indirect control over all corporate matters seems to be constraining the development of corporate cultures with reference to board independence, professionalism in all levels of management, uniformity in financial reporting and auditing practices, and standardised modes of doing everyday boniness. Since the founding family (or civil servant in government owned firms) constitutes the main component of executive management (CEO and/or chairman and other EDs) in non-financial companies, there is a little room for managerial professionalism[39] with respect to autonomy and power over the duties and responsibilities. Apart from the direct involvement in all major organisational decision-makings, the controlling family's opportunistic behaviour

[39] Nonetheless, the study reveals that most foreign-controlled and several local financial and non-financial companies tend to provide the opportunity and environment for the management to demonstrate high degree of professionalism and independence.

through undue interference is perceived as counter-productive to overall value maximization efforts of the company. The executive management of banks and insurance companies appears to be different from that of non-financial and leasing companies, with the management team of majority financial institutions comprising of professional executives though its' responsibilities and power tend to be confined with the sponsor directors. It may also be noted that the executive management is being properly rewarded through lucrative management contract and/or insider lending for being a part of the irregularities to serve controlling owners' interest often at the interest of the bank.

A group of entrepreneurs appear to have caused enormous damages to the country's banking sector by using their political connections to get bank loans and/or forming syndicate to open banks and insurance companies to enjoy mutual benefits to expansion family conglomerates, whilst ignoring their responsibility to repay bank debt. Until recently, the opportunistic behaviour of the directors as well as the top management of bank in making debt contract with the insiders together with numerous undeserving business entities directly or indirectly associated with relatives and/or associates sponsor directors have been a very common practice[40]. This evidence is supporting the observation of Caprio and Levine (2002) that large creditor is unlikely to be independent if that creditor or bank and non-financial firm are directly or indirectly associated with the controlling family. There is also evidence of irregularities associated with borrowing as well as the investment behaviour of the directors of NBFIs, specially the insurance companies. All of these malpractices have made many banks bear huge burden of default loans leaving the interests of the depositors and the shareholders at stake. It is worth mentioning that the creditors' rights in Bangladesh remain very weak because of incomplete and inconsistent Bankruptcy act coupled with the ineffectiveness of the Bankruptcy court and Money Loan court[41], which in turn are the result of strong political lobbies of business elites.

[40] There has been numerous evidence of irregularity detected by the central bank in connection with the valuation and acceptance of securities in giving loans to different dishonest business organizations. Many nationalised as well as private listed and non-listed commercial banks made loan contract based on products that are either valid or tenure-expired, or not easily saleable. Many corrupt businessmen took loan against fake documents. It is further revealed that some dishonest businessmen have taken bank loans using false documents on lands, incomplete buildings or tin-sheds, or overvalued lands and buildings, or even submitting documents on business entities that do not exist at all. In most the cases, these loans have turned out to be defaulted.

[41] Sobhan and Werner (2003) argue that debt recovery has not been succeeded mainly because of the structural weakness and inefficiency of the Bankruptcy court as well as the Money Loan Court.

Even though the general shareholders and financial institutions[42] have reasonably higher portion shareholding (i.e. 30 percent and 20 percent, respectively) in the sample firm, they appear to be unable to exercise any influence in the boardroom as well as voting politics, primarily because of the lack of institutional investors' (e.g. mutual funds or investment banks) activism, coupled with the divergence of interests among institutional investors, other financial institutions and general shareholders (Bebchuk and Neeman 2005), and limited expertise in corporate governance matters. The above discussion leads us to conclude that the entrepreneurs or controlling shareholders rather than the managers constitute the most powerful interest group in boardroom politics of the country's corporate sector, even though the evidence supports the notion of Pagano and Volpin (2000) and Perrotti and Von-Thadden (2004) that there is a possibility of a coalition between these two interest groups against the outsiders (which include both shareholders and depositors) in order for extracting private benefits.

In spite of our disagreement with Bebchuk and Neeman (2005) on who does have the ultimate power to extract private benefits of control, their key argument appears to be a plausible scenario in our macro-level analysis, where controlling shareholders, being the corporate insiders, have the power to use the corporate assets in influencing the politicians in order that the latter's role in formulating or amending corporate laws does not contradict with the formers' interest. Our survey divulges that roughly three-forth of the sample firms in all categories have some involvement in social welfare programme, environment protection programme, promotion of education, and welfare programme for the disabled, although the controlling shareholders of most of these companies seem to use corporate assets in such programmes as part of their political and/or promotional campaign, or gaining direct or indirect political or economic advantage (e.g. tax relief) from the government. Our explanation of the interest group politics goes further as we find the controlling sponsors of more than half of the sample firms either become a part of the political process (e.g. businessmen-cum-politician) or strong political and/or business relationships with the political leaders or financial contributors of major political parties.

The main problem of corporate governance of the insurance sector of Bangladesh is the absence of appropriate legal framework together with weak regulatory and supervisory authority that provides a little obligation for the insurance companies to comply with better

[42] Financial institutions include banks, insurance companies, leasing companies, mutual funds, and merchant banks.

corporate governance practices[43] associated with the issues of transparency and accountability. The political leadership is also lacking appropriate initiatives in materialising the recommendations or demand of various stakeholders including the WB and ADB to amend the corporate laws to bring harmony among the regulations in banking, insurance, securities markets, and taxation (Sobhan and Werner 2003), and to bring the insurance sector under the supervisory oversight of the central bank or the Ministry of Finance rather than the Ministry of Commerce.

The presence of the default culture seems to have enormous impact on the development of the corporate governance of the country in general, and banking sector in particular. Mahmud (2005) argues that the pitiable state of non-performing loans of private banks are rarely of recent vintage, but originated from an earlier era when there is very little accountability for the sponsor directors' activities in taking undue advantage from their banks by misusing the depositors' money. We find that most of the big business groups owned by some powerful families of the country are among the top listed bank loan defaulters of the country, many of whom are the sponsor directors of different banks, while many others use undue political influence on the powerless management (many of whom get personal benefits) of the banks to get the bank loan. It seems rather impossible to get these family conglomerates or other politically-powered businessmen obliged to various rules and regulations enacted by the central bank in making sure that the interests of the depositors and shareholders, and the stability of the country's financial system is maintained. Although the central bank deserves due credit for disciplining both public and private sector banks though proper vigilance on loan contract and default loan recovery, streamlining the borrowing behaviour of the sponsor directors and insiders, dissolving and reconstituting long-serving boards of the bank, and limiting the family's board representation and ownership, many of such efforts appear to have failed because of the inadequacy of laws coupled with Court's stay order, which is very often resulted from the entrepreneurs' legal action against the regulatory orders.

Moreover, the controlling business elites of the listed companies take similar legal shelter in relation to the SEC's various regulatory or disciplinary measures against the errant companies (e.g. the AGM or dividend defaulters) or its sponsors. The judicial inefficiency and

[43] The development partners like the WB and the ADB therefore, suggests the amendment of the existing laws to incorporate internationally accepted corporate governance principles together with the mergers and amalgamations, and to empower the regulatory authority with greater authority to enforce regulatory guidelines (Sobhan and Werner 2003).

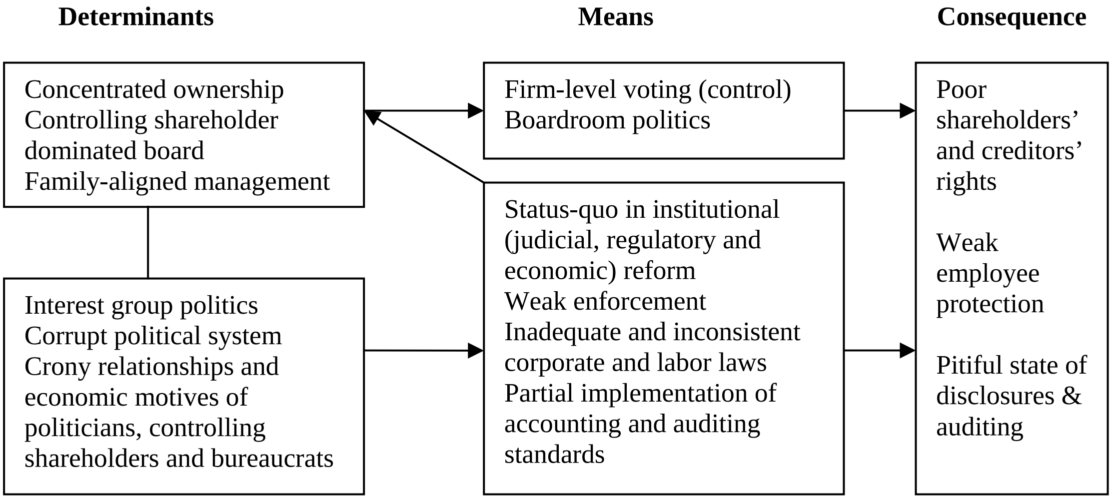
complexities along with numerous inconsistencies[44] among corporate laws and regulations and insufficient manpower with relevant skills and resources seem to be the major deterrents for the regulatory agencies to exercise their monitoring and surveillance authority, which in turn help ill-motivated businessman to materialise the loopholes of the system. Nonetheless, it is the politicians, who are continuously ignoring various stakeholders' demand by not separating the judiciary from the administration, and thus entertain various business irregularities associated with breaching of the banking companies' act, companies' act, securities act, and other related rules and regulations. Against the backdrop of backdated companies' act, the enactment of a time-bound the Companies Act 2004 coupled with the amendment of Bank Company Act 1991 appears be halted by the traditional bureaucratic delays in the Parliament for more than one year following the syndicated efforts of businessmen and politicians of all major parties, who are less likely to come up with an agreement for the betterment of the country other than such personal economic interests. It is worth mentioning that the nature of controlling shareholders' expropriation through dominating boardroom politics and influencing the corrupt political system[45] is somewhat difficult to explain from a particular point of view, rather it is a complex process derived by persistent deterioration of social norms and ethical philosophy, through which a powerful group of political and/or business elites tend to maximize their material well-being often at the expense of the firms' as well as investors' and depositors' interests. In this connection, we support the notion of Bebchuk and Neeman (2005) and a recent study ----- (2004)[46] that country as well as firm level political preferences (e.g. nature and timing of changes) for the investors' protection (or corporate laws) in developing countries is an endogenous variable, and is purely driven by the economic interests of the agents of the society rather than political ideology.

[44] Such inconsistencies have also been addressed in ADB (2003) report.

[45] The magnitude of corruption in country-level governance can partially be imagined through the research of the global anti-corruption watchdog Transparency International that labels Bangladesh along with other one or two countries as the most corrupt states on the planet for the fifth consecutive times based on their Corruption Perceptions Index (The Daily Star, Vol. 5, No. 498, 19 October 2005, http://www.thedailystar.net).

[46] -------- (2004) 'Political Economy of Legal Investor Protection and Financial Development Trap', Downloaded from: http://www.soc.nii.ac.jp/jsme/kinyu/pdf/04f/04f201-murase.pdf, on 13 October 2005.

Figure: A Political Economy Model Outlining the Micro- and Macro-level Determinants, Means and Consequences



One of the critical challenges of corporate governance in Bangladesh is the absence of uniform standards in financial reporting and auditing practices of both listed and non-listed companies. The accountability and auditing structure of the country's corporate sector can be described as the dependency approach of power and interest (Briston 1978; Samuels and Oliga 1982; Johnson 1982; Hove 1986; and Annisette 1997, cited in Rosser 1999) that is determined by the balance of power between the multilateral organisations coupled with the developed nations, and the developing countries because of the latter's dependency in meeting capital inadequacy requirements, which in turn is conditional to various economic and accounting reform agenda. While the Institute of the Chartered Accountants of Bangladesh (ICAB), the professional self-regulatory body to establish accounting and auditing standards of the country, have adopted some of the original versions[47] of IAS and ISA as part of the broader reform initiatives sponsored by the development partners (e.g. the WB, IMF, and ADB), the former has failed to cope with the pace of dynamism by incorporating the subsequent improvements or revisions made by the International Accounting Standards Board (IASB). Several recent studies (for example, Rahman and Zannat 2003; Sobhan and Werner 2003; ADB 2003) regard the existing accounting and auditing standards inadequate and inconsistent in many aspects[48] that help companies

[47] The ICAB has so far adopted 30 out of 40 International Accounting Standards (IASs) as Bangladesh Accounting Standards (BASs), 13 out of 38 International Standards on Auditing (ISA) as Bangladesh Standards on Auditing (BSA), and 0 out of 14 international auditing practice statement (ADB 2003), even though these are original versions and no subsequent revisions have been incorporated.

[48] Some of the important areas of shortcomings include, consolidated financial statements, investment in subsidiaries and associates, deferred tax assets and liabilities, classification rules for leases, foreign currency

avoid many disclosure requirements, which in turn deprive outsiders from being informed about important financial and non-financial details. Mahmud (2005) also emphasises on the structure of incentives for financial reporting and disclosure in order that businesses are rewarded for their arm's-length, objectively verifiable financial disclosure or punitive measures for fraudulent disclosures.

Nevertheless, the compliance of the present standards (e.g. BAS and BSA) has been constrained by the syndicated efforts of the politico-bureaucrats (Rosser 1999) and the powerful entrepreneur groups or the trade associations through delaying the adoption process or partial implementation, and limiting the regulatory and enforcement capacity of both judicial and regulatory institutions. Both groups seem to have the authority and opportunity to extract mutual benefits at the expense of the residual groups (e.g. shareholders and depositors) although the former has greater interest and scope in being involved in rent-seeking activities from private as well as public institutions at the cost of the country's interest. Interestingly, the ICAB, being a powerful professional organ, does not appear to play its due role in making sure that the affiliated auditing firms comply with proactive forward-looking principles of international accounting and auditing through appropriate ethical and legal provisions coupled with professional self-disciplinary measures. The independence and activism of this interest group tend to be questionable because of its' direct association with the accountancy and auditing profession, and indirect business relationships with the powerful entrepreneurs. Even though the government, with the technical and financial assistance of the WB, is planning to establish an independent reporting council[49] to ensure transparency and accountability in private sector, its implementation is far from being reality, given the multiple as well as mutual economic interests of various powerful interest groups.

5. CONCLUSIONS

The significance of better corporate governance in private as well as public sector firms in Bangladesh has recently been emerged as one of the most critical developmental agenda of the country. Based on the firm-level survey data as well as in-depth interviews, our study for

translation and depreciation, classification of revenues and expenses and segment reporting, statement of changes in equity, related party transaction, revaluation of assets, employee benefits, contradictory tax regulations, lack of methodological and ethical guidelines for the auditors, inadequate large audit firms with quality staffs, and reluctance of the auditors to reveal material irregularities etc (Rahman and Zannat 2003; Sobhan and Werner 2003; ADB 2003).

[49] The proposed independent body is aimed at regulating and overseeing the financial statements and auditing practices of the private sector companies, together with strengthening of the existing audit units of the central bank and the Securities and Exchange Commission to ensure quality auditing.

Bangladesh is complementary to the more general literature that adopts political economy of corporate governance. We find that concentrated shareholding in the hands of the controlling family and/or multiple shareholders (e.g. sponsors), coupled with family-aligned board and management is the prime determinant of firm-level voting behaviour and boardroom politics. Moreover, the direct or indirect link of these controlling shareholders with political process, along with the rent-seeking motives of politicians and bureaucrats, is shaping the nature of corporate laws and accounting standards to serve their mutual interests.

Even though Bangladesh is founded on the English common-law (LLSV 1998) and thus fall under the majoritarian system of voting model (Pagano and Volpins 2005), our observation on poor shareholders' rights in corporate laws is contradictory to the theoretical predictions of the legal-origin as well as the macro-level voting model. We argue that these models might work well in the presence of real democracy associated with transparent and stable political environment, but these preconditions are seldom present in developing countries like Bangladesh. Nevertheless, the political economy model of proportional voting system appears to fit into the firm-level analysis, where controlling shareholders or sponsors tend to use their proportional majority of votes (e.g. shares) to expropriate private benefits at the expense of general shareholders, although the model's prediction of strong employee protections is not recognised by the beneficiaries. Our study however, finds little evidence of the widely discussed indirect control (voting) measures through pyramidal and/or cross-sectional ownership.

We also support the notion of the voting, as well as interest group politics, model that argues that irrespective of legal or regulatory structure, it is the politics and political forces that determine the standard of corporate governance in developing countries with respect to outsiders' interests, auditing and disclosures, and that the relationship among various stakeholders, and the political response is purely influenced by the economic interests of the politicians and bureaucrats on the one side and the controlling shareholders or entrepreneurs on the other.

In spite of our disagreement with Bebchuk and Neeman (2005) on who does have the ultimate power to extract private benefits of control, their key argument appears to be a plausible scenario in our macro-level analysis, where controlling shareholders rather than managers have the power to use the corporate assets in influencing the politicians and bureaucrats in formulating or amending corporate laws, or maintaining status-quo in the judicial, regulatory or accounting reform in order that both the policy makers and the entrepreneurs can maximise their mutual interests at the expense of outsiders' as well as country's interest. Nonetheless, our evidence supports the notion of Pagano and Volpin (2000) and Perrotti and Von-Thadden (2004) that there is a possibility of a coalition between controlling insiders and managers against the outsiders in order to extract private benefits, as has been the case in the banking sector Bangladesh. Our explanation of the interest group politics goes further as we find the latter group of business elites either become a part of the political process (e.g. businessmen-cum-politician) or develop strong political and/or business relationships with the political leaders or financial contributors of major political parties. We also find that the crony relationships among politicians, businessman and bureaucrats, and associated overlapping in interests seem to be largely attributable to the lack of political commitment in reforming the judicial, regulatory and other enforcement agencies, and eliminating various adequacies and inconsistencies among different corporate laws as well as accounting and auditing standards that are necessary pre-requisites for a sustainable corporate governance framework.

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