CORPORATE GOVERNANCE REPORTING AS A VOLUNTARY DISCLOSURE: A STUDY ON THE ANNUAL REPORTS OF SQUARE GROUP

Md. Habib-uz-Zaman Khan
Department of Business Administration
East West University
Dhaka, Bangladesh

and

Suntu Kumar Ghosh
Department of Management and Business
BRAC University
Dhaka, Bangladesh

and

Md. Shahriar Akter
Depart. of Business Administration
East West University
Dhaka, Bangladesh

ABSTRACT

Corporate governance refers to the manner in which a corporation is directed, and laws and customs affecting that direction. It includes the laws governing the formations of firms, the by-laws established by the firm itself, the structure of the firm. The issue of corporate governance are receiving greater concentration in both developed and developing countries as a result of the increasing recognition that a firm’s corporate governance affects both its economic performance and its ability to access long term, low cost investment capital. The issue has been reinforced in the corporate sectors after the recent accounting scandals for companies like The Enrons, Worldcoms and the other companies. Nevertheless, this issue still remains almost unfamiliar in Bangladesh. The study focuses on a new trend introduced in the annual reports of one of the well-established business groups of Bangladesh. The paper involves empirical study as well as a questionnaire survey. The principal findings are twofold: firstly, we find that SQUARE makes very few disclosures on corporate governance on a voluntary basis. Secondly, we find that SQUARE user groups are in favor of such disclosures. However, the disclosures reported in Bangladesh by Square are not ample in achieving the goals of corporate governance.

Key words: Stakeholder, Corporate governance, SQUARES

INTRODUCTION

Development in corporate governance practices, principles, and procedure have to keep pace with change in economic, social, legal and other environment prevalent in the world. To know the increased importance of corporate governance concept we have to go back the origin of the business. Although business transactions and land sales recording was found by about 3000 B.C. introduction of money as a medium of exchange provided the necessary impetus for the development of large-scale business. Though partnerships and sole trader continued to grow, the industrial revolution led to the growth of large-scale business. More and more corporations came up. The ownership concept shifted from proprietary ownership to shareholder ownership in the case of companies by the management and since ownership was divested from management, the owners become interested to know the level of executing stewardship responsibility. Thus the stewardship reporting comes to evolve.
The concepts of large-scale business developed during the period of industrial revolution in the eighteenth century. Such large-scale business brought significant changes in financing, ownership and management patterns. New technologies were innovated and it required huge investment in the industrial unit. At that time ownership of the business organizations also extended due to advent of Joint Stock Company. People from different sections of the society invested funds. Due to diversification of ownership the management pattern also changed. Some people were engaged by the owners to manage the business known as managers. So the owners who are the residual claimants in net cash flows of the organizations started not taking part decision-making functions regarding the running of the business. Rather, professional management may well be expected to look after its own interest to the detriment of owners’ interest (Jensen and Meckling, 1976).

Because of this divergence between the interests of management, commonly known as Agency problem, there must be some mechanism so that agency problem can be mitigated. Good corporate governance practices and its proper reporting to the owners from time to time can be a way to deal with such agency problem. But even a decade ago the owners of the business were not as much concerned as they are today about corporate governance. It is because that the returns were spectacular and they paid very little attention behind-the-scenes manner in which companies went about their business. (Dubiel, 2001). The goal of corporate governance is to ensure that the goals of the management of the corporation are in line with the goals of the other major’s stakeholders. This is important since by ensuring that goals are aligned through system, other stakeholders are able to make sure that their rights are protected and the corporation is working for maximizing shareholder value and fairness. But recent events, especially those that come to light around major business failures such as Enron, WorldCom and in our country BCCI scandal, and above all the Asian financial crisis has reinforced the appeal for greater corporate governance to other different countries over the business world irrespective of developed, developing, or under developed one. This paper focuses on the voluntary reporting on corporate governance in the annual reports of one of the largest business group of Bangladesh - SQUARE group. Though reporting on corporate governance may include both the financial and non-financial aspects, in this paper only the non-financial portion is included. The SQUARE group recently has started reporting on corporate governance under a separate heading in the annual reports of their listed companies. This is not common practice in Bangladesh and obviously, a go-heading practice performed by any Bangladeshi business concern having a very few predecessor in that respect.

II OBJECTIVES

The objectives of this study to examine the extent of corporate governance disclosure by SQUIRE group which is new trend introduced in the annual reports in Bangladesh as well as to find out users attitude regarding this disclosure.

IV. LITERATURE REVIEW

Corporate governance is concerned with methods, laws and policies that direct, control and administer important functions of corporation. In other words, corporate governance is a system by which companies are directed and controlled. Typically it is being managed by principal stakeholders in a corporation- mainly the shareholders, management and the board of directors. It also specifies the relations, and the distribution of rights and responsibilities among these stakeholders. This system spells out the rules and procedures for decision making on corporate affairs, provides structure through which the company objective are set, as well as the means of attaining and monitoring the performance of those objectives.

Different authors view the meaning of corporate governance differently. For example, one School of thought describe Corporate governance as a ‘system’ by which companies are directed and controlled (Cadbury Report, CFACG 1992); to another School view Corporate governance with the “structures and processes for decision making, accountability, control and behavior at the governing body (Public accounts and Estimates Committee, 2002) To others corporate governance is about ‘finding ways’ to ensure effective decision making (pound, 1995). But it must be kept in our mind that the fundamental concern of corporate governance is to ensure the conditions whereby a firm’s directors and managers are held accountable to capital providers for the use of assets.
Organization of Economic Cooperation and Development (OECD) (Rashid, 2003) outlined Corporate governance as

Protecting the rights of shareholders: This includes the right to secure ownership, full disclosures, voting rights, participation in all kind of activities in general shareholder meeting, to be informed on fundamental corporate changes, to have access to efficiency and transparency in markets for corporate control. Bosch committee (1995) suggested that shareholders should see themselves as owners, not just investors.

Equitable treatment of shareholders: Here OECD is concerned to protect the rights of minority shareholders. Corporate governance framework should ensure the fair treatment of all shareholders including minority and foreign shareholders (Rashid, 2003). Insider trading and abusive self-dealing is explicitly prohibited. Members of the board should disclose any material interests in transactions or matters influencing the organization.

Role of stakeholders: OECD recognizes that in addition to shareholders there are other stakeholders such as banks, bond holders, regulatory authorities, suppliers and employees who are very important in the way in which company perform and make decisions. Corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between organizations and stakeholders.

Ensuring disclosure and transparency: The OECD suggests for provision for disclosing and communicating all material facts (financial and non-financial). The corporate governance framework should ensure timely and accurate disclosures on all matters regarding the organization. Annual audits by independent auditors are also required in this context.

Clarifying responsibilities of the board: The OECD is much concerned about a board’s responsibilities for protecting the company, its shareholders and stakeholders. The corporate governance framework should ensure the effective monitoring of management by the board and the boards accountability to the organizations and shareholders.

Vittal (2000) states that corporate governance calls for three factors:
One: Transparency in decision-making
Second: Accountability, which follows from transparency because responsibilities could be fixed easily for actions taken or not taken, and
Third: The accountability is for the safeguarding the interests of the stakeholders and the investors in the organization.

Corporate governance can also play a very important role in the economic development of any country like Bangladesh. Oman (2001) identified a number of socio-cultural and legal factors present in developing countries that call for higher degree of corporate governance.
- The importance of productivity growth
- Relationship-based vs. Rules-based Regimes
- Agency and Expropriation costs
- Vested interests

III. METHODOLOGY

For the purpose of the study, annual reports of 11 companies of the SQUARE group, which are listed with the Dhaka stock exchange, have been considered. The related manual and other published information regarding the SQUARE group have acted as secondary source of information. At the end of the paper, a limited scale empirical study has also been conducted to investigate the level of users’ understanding of SQUARE group’s corporate governance disclosers. For this purpose, questionnaires were sent to 50 users of SQUARE’s annual reports. The instrument has been designed under 5 point likert scale where ‘1’ refers to ‘strongly disagree’ and ‘5’ refers to ‘strongly agree’. We have collected data through survey method with a focus on mall intercept interview (Malhotra, 2004). Finally data have analyzed under parametric research procedures.

IV. CASE ANALYSIS

SQUARE’s point of view on corporate governance:

Today, the SQUARE group is one of the largest private sector industrial groups of Bangladesh and is more than just an organization. The industrial concerns of SQUARE include textiles, toiletries, garments, information technology, pharmaceuticals and health products, food products, hospital. The SQUARE group currently consists of 12
companies. These 12 companies are: SQUARE Textile Ltd., SQUARE Knit Fabrics Ltd., SQUARE Toiletries Ltd., SQUARE Pharmaceuticals Ltd., SQUARE Spinning Ltd., SQUARE Fashion Ltd., SQUARE Consumer Product Ltd, SQUARE Informatics Ltd, SQUARE Agro Ltd, SQUARE Hospitals Ltd, SQUARE Herbal and Ayurvedics Ltd, and Health product Ltd. Among these 12 companies, the annual report of 2 companies (SQUARE Pharmaceuticals Ltd and SQUARE Textile Ltd), which are listed in Dhaka Stock exchange (DSE), have been considered in this paper. The annual reports of 2004-2005 of these companies were collected and analyzed. The focal point of this paper is absolutely on the contents of the page title as ‘corporate Governance’ in these annual reports.

In the annual reports of these 2 companies of the SQUARE group, almost same wording were used. The introductory words of these reports summarize their thoughts on the issue of ‘corporate Governance’ in these annual reports.

SQUARE believes that corporate governance is key to its sustenance and maintenance of effective corporate governance should be a key priority for the organization. That’s why they strive for practicing good- governance in every spare of activities covering inter alia, not being limited to, disclosure and reporting to the shareholders holding AGM in time, distribution of dividends and other benefits to shareholders, reporting /dissemination of price sensitive information, acquisition of shares by insiders, recruitment and promotion of staff, procurement and supplies etc. all that directly and indirectly affect the interest of the stakeholder groups.

SQUARE’S reporting on Corporate Governance:

The annual reports of the corporate of the SQUARE group covered important issues like the shareholders, the board and the committees, management, internal control and audit and but no assurance on behalf of the companies that the companies will be able to run their businesses for a foreseeable future, i.e., Going concern. meaning SQUARE group reporting covers all the main participants of corporate governance except shareholder related information. This section of this paper at first present a general discussion on these issues and then it focuses on the report practicing of the SQUARE group.

Shareholders

According to Cadbury Report, 1992. ‘Shareholders have an important role in corporate governance. Although the shareholders own the firm, day to day control is in the hands of the managers (this situation being referred to as the divorce of ownership and control) and they are in an ideal position to follow their own objective at the expense of other parties. Again shareholder can replace the management of company by voting out the directors at the AGM and thus they perform a significant role in corporate governance.

Practices

In most of the annual reports of the SQUARE group companies, in the page titled ‘corporate governance’, they have mentioned In fact, nothing about control rights of shareholders and relations with shareholders. But they conveyed that the board of directors is being reappointed every year by the shareholders through retirement/ reelection/ election of one third of its member regarding the control rights of shareholder in the annual report of SQUARE Textile LTD.

The Board and the committees

The board of directors are essentially the policy makers and they mostly oversight whether the corporate objectives are being fulfilled in an efficient way or not. The board or the governing body is an important element of an organization as it gives direction and exercise judgment in setting the objectives and observing their implementation. But it should be clearly stated here that the board is not liable for performing the day-to-day activities of an organization but it rely on management to manage the corporation.

Practices

The discussions about the ‘board’ covered in the annual reports are mainly focused on its composition and its functioning process. If all these annual report are summarized, the following important focuses can be found out:
The Board, the Top Management tier, is the highest level of authority in the organizational framework. The Board is responsible for overall control and supervision of the entire affairs of company, strategic development of the company, primarily through strategic planning and budgetary mechanisms. To this end, the board of Directors hold periodic meeting to resolve of policies and strategies, recoding of minutes/ decisions for implementation by Executive management. Members of the Board of Directors often travel abroad to bring into focus, the Company’s image and acquire technological gains. The board of directors is reconstituted every year by the shareholders through retirement/ reelection/ election of one third of its members.

The discussion on the ‘Board’ in the pages titled ‘corporate governance’ in the annual reports indicated that in every annual report there appears the name of the directors. But they did not mention anything about the non-executive directors in the board.

In order to perform the tasks of the board in a proper way, the powers can be delegated to several board sub-committees. Establishing these sub-committees enhances the effectiveness of the non-executive directors. Some of the SQUARE group companies maintain a ‘Remuneration committee’.

Remuneration Committee: This committee should consist solely of the non-executive directors. Non-Executive directors are non-employees who can bring some independent perspective to the board and they can bring independent view to the board’s deliberation. This independent view can lead to a continuing effective leadership. (Arif et al, 2004) The purpose of this committee is to evaluate the terms and conditions of the employment of the senior management. This committee also reviews the pattern of several employee incentive schemes. This committee works for the shareholders in the sense that it works for the association of the interest of management with the interest of the shareholders through designing appropriate remuneration structure.

Practices

In the reports of the companies of the SQUARE group the existence of remuneration committee was found. They call this committee as 'Employment relations committee’ and under this committee there are three sub committee namely Remuneration committee, Work environment committee and Employees welfare and Recreation committee. But in the annual report of the SQUARE nothing has stated regarding how many members are in these committee and they works in setting annual increment, promotion, and emolument of all level of management:

From these general discussions on each topic and findings from the annual reports we can end that, the disclosure about the existence and participation of non-executive directors in the sub-committee is not mentioned and with regard to employment relation committee is quite in sufficient.

Management

Every business corporation objective is achieved through the help of well-defined management team. These teams generally cooperate with directors for successful attainment of corporate objective and perform the responsibility of implementing the direction of the board of directors. That’s why every company should have a well-defined management structure

Practices

The annual reports of the SQUARE Group companies indicated the following issues in respect of ‘management’:

Management structure: the companies stated that they have a sound management structure. In the annual report of SQUARE Textiles LTD. For the year 2005, it has been mentioned: ‘The Managing Director, the CEO, is the head of the Executive Management Team which comprises senior members of the Management Apparatus. Within the limits of delegated authority and responsibility by the Board of Directors, Executive Management operates through further delegation of authority at every echelon of the line management. The Executive Management is responsible for preparation of segment plans / sub segment
plans for every profit centers with budgetary targets for every item of goods and services are held accountable for deficiencies, with appreciation for outstanding and exceptional performances. The executive management through series of committee, sub committee, adhoc committee and standing committee continuously carries out these operations.”

Asset management: The reports didn’t highlight anything that the companies have policies for asset management and nothing is disclosed policy regarding capital expenditure.

Director’s Responsibility for preparation of Financial Statements:

In many developed countries, a sub-committee of the governing body consisting of non-executive directors supervises director’s responsibility for preparation and presentation of financial statement. This committee is called audit committee. This sub-committee of the board represents owners and not management. The main purpose of this committee is to oversee the financial reporting and the auditing process. The major dealings between the auditors and the governing body are done through this committee. This independent committee can modernize the ability of the governing body to fulfill its legal liabilities and it can prohibit un-ethical, questionable or illegal activities. It can add credibility and objectivity of financial reports. This committee is a very good assurance for corporate governance in an organization as it works for greater transparency and for the rights of shareholders. Many companies of the developed countries report on their audit committee on a voluntary basis and this reporting help them to state the director’s responsibility in the preparation and presentation on financial statements. In Bangladesh, the concept of audit committee is not a very known one. But as annual reports contain a chairman or director’s report, there is no doubt about fact that directors have enough responsibility the in context of preparing and presenting financial statements. (Arif et al, 2004)

Practices

In the annual reports of the companies of the SQUARE group, a disclosure relating to audit committee is found. It includes Internal audit committee, ISO Audit committee, Social / Environmental Committee and performance Evaluation Audit committee But no information was available in details in that respect. Moreover no trace of having following issues was also found.

- Information relating to Companies Acts, and other rules and regulation on the basis of which companies financial reports is prepared.
- Whether they take necessary steps to ‘prevent’ and ‘detect’ fraud and other abnormality and whether the company is able enough to run its business operation for the expected future (Going Concern).

Some other practices:

Though it is a very new concept to report on corporate governance in the annual reports on a voluntary basis, some weaknesses of the reports may be identified. In spite of having the coverage of the main two participate of corporate governance, i.e., the Directors, the Management significant information relating to the Shareholders was totally ignored and no clear picture of corporate governance was found. For example, it cannot be found out from the report the amount of shares the sponsors are holding and the amount of shares that are hold by general public. The ratio of shareholder’s of these two groups signifies the possibilities protecting ‘general shareholder’s rights’ in several necessary cases. If the shareholding of general public is higher than that of the part of the directors may be low. Also the number of board committees and their structures could be clearly described.

V. THE EMPIRICAL RESULTS

Table-1 shows participants responded positively towards question 1, 4,and 5. In table 2 the detailed break up of response is shown.

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<tr>
<th>Question</th>
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<td>1</td>
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<td>2.8800</td>
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<td>7</td>
<td>25</td>
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Table 1 presents the findings
Questions | > 3 | < 3
---|---|---
1 | 0.2880 | .3920
2 | .7600 | .1150
3 | .8000 | .1150
4 | .3900 | .3550
5 | .1820 | .6100
6 | .04812 | .3316
7 | .28000 | .5650

Table 2 Response Carve up

From the above table 2, it can be seen that almost 40 percent of respondents believed that disclosures regarding corporate governance were helpful in decision-making. However, the participants were very doubtful towards accepting that such disclosures were helpful in maintaining transparency between management and stakeholders, a claim established by SQUARE. 76 percent of the respondents stated that such disclosures are not helpful in achieving this objective, when asked whether these disclosures are helpful in protecting the rights of the shareholders of SQUARE, the respondents tremendously (80 percent) opposed. Moreover, almost 40 percent of the respondents believed that the disclosures would not help them understanding the presence of vested interest groups. However, 61 percent believed that such presentations are useful in understanding the structure of the board. The respondents were found to be pessimistic regarding the contribution of corporate governance disclosures in developing the capital market in Bangladesh. Here, the positive response rate was only 33 percent and negative response rate was 48 percent, leaving almost 21 percent of the respondent who did not have any idea regarding this issue. Finally, more than half of the respondents (56 percent) believed the corporate governance disclosures provided by SQUARE. This is not consistent with responses 2 and 3, and 4 where the respondents overwhelmingly disagreed with SQUARE’s claims.

VI. CONCLUSION AND RECOMMENDATION

No company, public or private, is immune from an Enron-like disaster, a disaster that was driven by greed, ego and a lack of ethics and integrity. Stakeholders are very concerned today with the concept of “Risk” and “No Surprise”. That’s why the organizations must have handle on the risks inherent to business in order to assure stakeholders that no surprises are looming on the horizon. The concern of stakeholders over administration pay and stock losses periodically has led to more frequent call for corporate governance reform. In today’s challenging business environment it is of the essence for a business to manage and maintain solid reputation. This can be achieved by defining a corporate governance function consisting of the documented policies and procedures, adequate employee training and solid systems of internal controls. Without a stellar reputation, maintained via a strong governance function, bad economic times may lead to the final days of business’ life.

From the findings of this study it can be noticed that the companies of the SQUARE group are reporting on the main participants of corporate governance in their annual reports except shareholders related information. However, the extent of disclosures made by SQUARE is not satisfactory in achieving the objectives as identified by Oman (2001). Our findings reveals that the stakeholders are in favor of corporate governance disclosures and they generally tend to believe the disclosures information. However, they do not agree with the claim that such disclosures enhance transparency and ensure better relationship between management and stakeholder groups. This seemingly inconsistent findings could be constructed as the fact that stakeholders of SQUARE group like to have as much information as possible while making an investment decision, but they do not necessarily have the expertise or skill to interpret the information provided through such disclosures (Pany and reckers, 1988).

The corporate environment in Bangladesh is subjugated by resolute ownership; existence of vested interest groups and a switching to rules based regulation. But, the corporate disclosures made by SQUARE do not make sure the accomplishment of objectives of the developing economics as documented by OECD (Rashed 2003). Obviously, this disclosure is a voluntary attempt of this large business group as there is no mandatory requirement for such disclosure. Although in very short content, such as attempt by the SQUARE group is a new practice in the context of Bangladesh and will encourage other corporation to take such kind of initiatives. A research work conducted Arif et al (see Arif, Siddique and Dewan, 2004) revealed that this sort of reporting might encourage other business organizations to do the same thing as such
voluntary disclosure would ameliorate their reporting standards. In fine, we can say SQUARE group current corporate governance reporting practices can never be said as complete and sufficient and should be more adhere to corporate governance reporting practices in particular, incorporating “control right of shareholders” “Management assurance of Going Concern” information in the statement to achieve solid corporate image.

VI. REFERENCE

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