



**BRITISH AMERICAN
TOBACCO**



Internship Report on:
Relationship between Corporate Governance and Cost of Capital of
British American Tobacco Bangladesh

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30th April, 2019

Mr. Saif Hossain

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Subject: Submission of Internship Report

Dear Sir,

It is my pleasure to present the internship report based on “**Relationship between Corporate Governance and Cost of Capital of British American Tobacco Bangladesh**”. This has been given to me as a requirement for the completion of Bachelors of Business Administration Degree.

Working in an organization like British American Tobacco Bangladesh (BATB) has been a great experience. I have got the opportunity to work in BATB under Operations department and gain in depth knowledge on how tobacco industry operates and how accounts related information are dealt with. Furthermore, the project has allowed both academic and practical exposures.

I am grateful for your guidance and kind cooperation in polishing this report. I shall be highly obliged if you receive this report and provide your advice on the effort.

Sincerely Yours,

Mahathir Alam

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Executive Summary

Corporate Governance is currently one of the most discussed matters around the economies by both corporates and academicians. This report focused on the relationship between corporate governance and cost of capital of a renowned multi-national company- British American Tobacco Bangladesh. The first part of the report discussed about the organization. Additionally, the duties and responsibilities are also discussed in the next phase, as I have been an intern at BATB since February and for successful completion of the report, my major duties and responsibilities in the organization are discussed. Then it focused on the base terms and made an introduction of the topics i.e. Corporate Governance, Cost of Capital. Previous studies on the topic had also been focused afterwards. After that, there is a brief description of how the analysis had been done. Finally, in the finding part, the relationship that is retrieved from the analysis is discussed and appropriate recommendations are put to conclude the report.

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Organizational Overview

British American Tobacco Bangladesh (BATB) is one of the largest multinational corporations in Bangladesh. The mother organization of this company is British American Tobacco. The company is listed in both Dhaka Stock Exchange (DSE) and Chattogram Stock Exchange (CSE). It has been operating its business in this region for more than a century. It was founded in Bangladesh on 1910. After the partition of India in 1947, Pakistan Tobacco Company was established in 1949. The first factory in Bangladesh (the then East Pakistan) was setup in 1949 at Fauzdarhat in Chattogram. In 1965, the second factory of Pakistan Tobacco Company went into production in Mohakhali, Dhaka. Thereafter it became Bangladesh Tobacco Company Limited in 1972 immediately after Bangladesh's independence. In 1998, the Company changed its name and identity to British American Tobacco Bangladesh (BAT Bangladesh) aligning the corporate identity with other operating companies in the British American Tobacco Group.

BATB make high quality tobacco products for the diverse preferences of consumers, spanning the business from crop to consumer and they are committed to embedding the principles of corporate social responsibility Group wide.

British American Tobacco Bangladesh's motto is "success and responsibility go together". Shehzad Munim is the current Managing Director of BATB. He is serving as the first ever Bangladeshi MD in the history of BATB.

Source: British American Tobacco website. (British American Tobacco Bangladesh, n.d.)

Shareholders

BATB was among the first companies to be listed on the Dhaka and Chattogram Stock Exchanges and currently ranked amongst the top 10 companies in terms of market capitalization. British American Tobacco Group holds 72.91% of their shares; 12.86% is owned by Investment Corporation of Bangladesh; Shadharan Bima Corporation, Bangladesh Development Bank Limited, Government of People's Republic of Bangladesh and a further 14.23% is owned by other shareholders.

They continue to contribute approximately two-thirds of the revenue derived from the cigarette industry, wherein 2013-14 fiscal year BAT Bangladesh contributed over BDT 8,436 crore as taxes to the National Exchequer. The company will continue to support Government proposals that

establish a sustainable level of tax contribution to the national exchequer while ensuring a sustainable growth for the industry.

My Duties and Responsibilities

About the Job:

My internship at British American Tobacco Bangladesh had started on 15th February, 2019 for three months period. I was assigned to the Engineering and Site Services (ESS) team under Operations Department. The team consists of three groups, which are: Utilities, Facilities and Project. I had been assigned specifically to the Utilities Manager. However, as BATB is an organization where collaboration and synergy are believed to be core responsibilities among the employees and stakeholders at large, I had the opportunity to work with three of the groups under ESS team of Operations Department.

Specific Responsibilities:

1. Assisting my line manager in keeping record of Daily DDS and providing sufficient data for daily DDS meeting. Here, DDS is a measurement of performance of the factory facilities.
2. Assisting the Admin Officer in making and posting Purchase Orders and necessary documentation.
3. Necessary documentation of Risk Assessments and Standard Operation Procedures (SOPs) for Environment, Health and Safety (EHS) audit.
4. Conducting literary activities for the factory workers for acknowledgement of safety issues while working in the factory.
5. Regular maintenance check up in the areas under Utilities department.
6. Making regular schedule for the EHS Safety Inspectors in the factory.
7. Checking and taking actions accordingly for proper documents posted on the factories about the safe guards for workers.

Introduction

Corporate Governance at a glance:

In recent years, the term “Corporate Governance” has emerged as one of the most discussed topics among the economies. One of the most famous websites, being run for financial literacy, Investopedia, defined Corporate Governance as the primary regulations for corporations to be maintained for balancing the interests of the stakeholders. It also says that, Corporate Governance is the facilitator of instating proper Transparency, Accountability and Controlling authority by the corporations (Chen, 2019). After the capital market collapses in the beginning of the 21st century of the developed economies, Corporate Governance had been made an essential matter of consideration by the authorities of the developed economies. However, if we look on the emerging economies, like, Bangladesh, Corporate Governance has not emerged as of those in the developed economies (Rashid, Zoysa, & Rudkin, 2019). According to Corina and Roxana (2011), to fight against scams by the firms, to entice potential investors, and to finally establish a firm in a competitive position, governance must be present among the firms, especially in the developing economies. (Roxana & Corina, 2011). So, it has already been determined that Corporate Governance in the developing economies has become a crucial matter of discussion, research and modification accordingly.

Cost of Capital:

Most companies usually fund their businesses or projects with capital investments or incurring debt or a combination of both. For these funding they must incur a cost, i.e. dividends are paid to shareholders who basically made their investments in the firms (capital) and interest must be paid on the debts. Combination of these costs are averaged responding to the portion of total investment which is called Weighted Average Cost of Capital (WACC) (Kenton, 2019). Harvard Business Review quoted Joe Knight’s definition of Cost of Capital on their article which says it is basically the return demanded by the providers of capital which includes both equity and debt (Gallo, Harvard Business review, 2015). Pratt (2002) in his book chapter- “Defining Cost of Capital”, defined cost of capital as the required rate of return which is driven by the market and the market is obliged to provide that return for investments at large. The author also found Cost of Capital as forward looking and so it is named “Expected Rate of Return” (Pratt, 2002)

The following chapters will facilitate a study in finding the relationship between Corporate Governance and Cost of Capital of British American Tobacco Bangladesh.

Literature Review

“Corporate Governance Theorising: Limits, Critics and Alternatives”- an article published on International Journal of Law and Management, the authors focused on the argument of two articles published under the same organization (Letza, Kirkbride, Sun, & Smallman, 2008). The argument was how corporate governance can be applied on an organization. Sundaram and Inkpen (2004) suggested that corporate governance should serve the purpose of value maximization of the shareholders, while Freeman (2004) suggested corporate governance should be implied to fulfill the terms of value maximization of the stakeholders. However, the similarity between these two points of views is “Value Maximization”. The authors later proposed a new model of Corporate Governance, which will not differentiate between shareholders and stakeholders, by equal distribution of agenda for saving their interests from the organizations.

In the context of Bangladesh, there has not been any literature published, which builds a relationship between corporate governance and the cost of capital of a firm. Nevertheless, literatures have been made on this topic in the developed countries, as corporate governance became an essential topic to be raised by the authorities of developed economies after the global crisis caused for corporate scandals by companies like Enron and WorldCom (Pham, Suchard, & Zein, 2007). Pham, Suchard and Zein (2007) on their research built a relationship between corporate governance and cost of capital and performance of the Australian firms. They considered institutional ownership, smaller board size, independent board and insider ownership as their mechanisms to define the corporate governance quality of the organization and their effects on the cost of debt and equity and the performance at large (Pham, Suchard, & Zein, 2007).

Katisart and Arsasri (2018) discussed the relationship between corporate governance and cost of capital based on the listed companies in Thailand. The authors showed two detailed connectivity to determine the relationship- first, the connectivity and effect of aptitude of independent directors and gross borrowing cost (cost of debt) and the other one is how remuneration of board members affects the dividend payout ratio (cost of equity). The research showed that firms with higher propensity of independent directors in the Board of Directors (BOD) had less interest expense as well as there were a fall in dividend payout ratio for the shareholders as firms were paying higher amount of honorary to its board members (Katisart & Arsasri, 2018). So the mechanism here for measuring corporate governance are portion of independent directors in BOD and remuneration of the board members.

Opperman (2009) in his research report, focused on the mechanisms set by Rating Agencies. The author firstly conducted a quantitative research to determine the governance score. Then he built relationship between the score and Cost of Debt and Cost of Equity. Furthermore, he built another relationship between the mechanisms and the cost of capital. There was not any significant relationship between governance score and cost of capital found. Among the mechanisms only Internal Audit was proven having significant relationship with cost of debt. The other mechanisms used were: Corporate Governance disclosure, remunerations of the board members, code of ethics, risk management (Opperman, 2009).

Objectives

The object of the report is as follows:

1. Finding out the mechanisms applicable for determining Corporate Governance.
2. Finding out the relationship between Corporate Governance and Cost of Capital of BATB.

Methodology

According to a recent article published in “Dhaka Tribune”, among the top ten listed companies in terms of Earning per Share (EPS) in Dhaka Stock Exchange (DSE), seven companies are MNCs. The report also says that BATB is topped on the list (Ovi & Mahmud, 2019). Based on the previous studies and the guidelines provided by Securities and Exchange Commission for Corporate Governance, the mechanisms used for corporate governance in this paper are: remuneration of board members, proportion of independent directors, duality of managing director and director’s report. For cost of capital, Dividend Payout Ratio has been considered as a mechanism for cost of equity and gross borrowing cost is considered as cost of debt.

Multiple regression analysis has been conducted to determine the relationship between the corporate governance mechanisms and cost of capital mechanisms (separate regression analysis for cost of equity and cost of capital). From the year 2012 to 2016 data are considered for the preparing the paper for avoiding the abnormal values created by the depression in the capital market.

Limitations

The limitations for conducting the study are:

1. Lack of previous studies regarding the relationship between corporate governance and cost of capital in the context of Bangladesh or similar economies and so the determination of mechanisms are not proven adequate.
2. Absence of corporate governance index or a corporate governance score has made it tough to determine the quality of corporate governance.

Findings

Data Analysis:

The regression analysis had been conducted in Stata, a software where multiple linear regressions are run. Among the systems Stata is considered more accurate for the analysis. For convenience of interpreting, Cost of Debt variable and Cost of Equity variable are labeled as Y, and governance mechanisms are labeled as x1, x2, x3, and x4. The analysis are discussed below:

Cost of Debt:

<pre>. reg Y X1 X2 X3 X4 note: X3 omitted because of collinearity note: X4 omitted because of collinearity</pre>						
Source	SS	df	MS	Number of obs = 5		
Model	.000074721	2	.000037361	F(2, 2) =	1.33	
Residual	.000056215	2	.000028108	Prob > F =	0.4293	
				R-squared =	0.5707	
				Adj R-squared =	0.1413	
				Root MSE =	.0053	
Total	.000130937	4	.000032734			
Y	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
X1	9.24e-07	6.08e-07	1.52	0.268	-1.69e-06	3.54e-06
X2	-.1481794	.0925295	-1.60	0.250	-.5463016	.2499427
X3	0	(omitted)				
X4	0	(omitted)				
_cons	.0073965	.0156169	0.47	0.682	-.0597976	.0745906

The results show that both x3 and x4 variables are collinear, which means Duality of MD's role and Publication of Director's Report were not considered in the analysis. That is because, both the variables were same throughout the 5 years of consideration. Both the variables were dummy variables (yes= 1, no= 0). For all 5 years Director's Report had been published and MD has never been played the role of Chairperson throughout the five years of consideration. So, these variables could not affect cost of debt. The other variables i.e. Remuneration of the Directors and Proportion of Independent Directors in BOD, have a R- square of 0.5707, which means 57% of the times, cost of debt is affected by these variables. Moreover, Proportion of Independent Directors has an

negative relationship with cost of debt and MD's Remuneration has a positive relationship with cost of debt.

Cost of Equity:

<pre>. reg Y X1 X2 X3 X4 note: X3 omitted because of collinearity note: X4 omitted because of collinearity</pre>						
Source	SS	df	MS	Number of obs = 5		
Model	.029576483	2	.014788242	F(2, 2) =	32.96	
Residual	.000897257	2	.000448629	Prob > F =	0.0294	
				R-squared =	0.9706	
				Adj R-squared =	0.9411	
Total	.03047374	4	.007618435	Root MSE =	.02118	
Y	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
X1	5.73e-06	2.43e-06	2.36	0.142	-4.72e-06	.0000162
X2	-2.259898	.3696681	-6.11	0.026	-3.850451	-.6693445
X3	0	(omitted)				
X4	0	(omitted)				
_cons	.8628926	.0623917	13.83	0.005	.594443	1.131342

In this analysis, the x3 and x4 variables again were not considered and so these are collinear for the same reason as before. Both the variables have been same for all the years of consideration. The other variables i.e. Remuneration of Directors and Proportion of Independent Directors have an R- square of .9706, which means 97% of the time the cost of equity are affected by Remuneration of Directors and Proportion of Independent Directors. In addition, Proportion of Independent Directors has a negative relationship with cost of debt and MD's Remuneration has a positive relationship with cost of equity.

Recommendation

Throughout the report I have made an attempt to build a relationship between Corporate Governance and Cost of Capital of one of the largest MNCs of Bangladesh- British American Tobacco Bangladesh. I have considered four mechanisms for quantifying Corporate Governance to relate it with Cost of Capital (Cost of Debt and Cost of Equity). But the overall analysis is not enough to reach to a conclusion. For conducting a better analysis, the mechanisms must be updated which can be used in the context of Bangladesh. Further study for this analysis is needed. Moreover, other MNCs as well as local companies should be analyzed or evaluated similarly, with better mechanisms taken under consideration. In terms of, compliance with the Corporate Governance Code, presented by Securities Exchange Commission, BATB is successful in every aspect, but that should not be the only measurement to qualify and quantify Corporate Governance. Because, most companies meet the requirements of the above-mentioned codes, and they all have almost similar scores according to the report published by Securities and Exchange Commission. However, not all companies maintain similar quality of Corporate Governance. Therefore, a proper corporate governance framework should be built and thus companies should be evaluated accordingly in terms of Corporate Governance. And it will facilitate further discussion and research on the relationship between corporate governance and the mechanisms of performance and achievements (cost of capital, EPS, Profit Margins etc.). Lastly, a corporate governance index should be made in order to accumulate all the mechanisms for getting a brief understanding about the corporate governance of a particular company just by knowing the index score. Moreover, the score can be used for comparison between organizations as well as a meaningful relationship can be made with other variables as well.

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Appendix

Dividend Payout Ratio					
Year	2012	2013	2014	2015	2016
Details					
Dividend Per Share	40	40	45	40	50
Earnings Per Share	66	81.14	104.7	97.43	126.37
Dividend Payout Ratio	61%	49%	43%	41%	40%

Gross Borrowing Cost					
Year	2012	2013	2014	2015	2016
Details					
Interest Expense	119,878	11,215.00	157,346.00	122,828.00	36,468.00
Total Liabilities	8,001,553	9,562,208.00	15,611,508	14,981,312	16,465,001
Gross Borrowing Cost	1.50%	0.12%	1.01%	0.82%	0.22%

Year	Cost of Equity	Corporate Governance Mechanisms			
	Dividend Payout Ratio	Remuneration of Board Members	Proportion of Independent Directors	Is the MD and Cairperson same person? (Yes= 1, No= 0)	Is Director's Report Published in the Annual Report? (Yes= 1, No= 0)
2012	61%	42,555	22%	0	1
2013	49%	35,034	25%	0	1
2014	43%	54,290	33%	0	1
2015	41%	49,824	33%	0	1
2016	40%	53,917	33%	0	1

Year	Cost of Debt	Corporate Governance Mechanisms			
	Gross Borrowing Cost	Remuneration of Board Members	Proportion of Independent Directors	Is the MD and Cairperson same person? (Yes= 1, No= 0)	Is Director's Report Published in the Annual Report? (Yes= 1, No= 0)
2012	1.50%	42,555	22%	0	1
2013	0.12%	35,034	25%	0	1
2014	1.01%	54,290	33%	0	1
2015	0.82%	49,824	33%	0	1
2016	0.22%	53,917	33%	0	1