

Panel Presentation
on
Corporate Governance and Privatization
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Chapter 1: Introduction

Background

Bangladesh inherited a private sector dominated economy at the time of independence in 1971. At this time, the economy was devastated with much of the infrastructure destroyed and a large number of industrial enterprises and commercial establishments damaged and abandoned by their former non-local owners and managers. The Government took over the management of all abandoned factories and commercial establishments to provide entrepreneurial support and to get the economy moving; this was followed by large-scale nationalization schemes of key large and medium industries, banks and financial institutions. The nationalization program led not only to the transfer of ownership of the abandoned private enterprises of the Pakistani period, but to significant enlargement of the government ownership in the industrial sector.¹

However, the performance of the public sector enterprises has been a topic of much discussion over the years, with particular reference made to the losses suffered by the SOEs. One study by Satter (1997), reports that the persistent losses by the SOEs were costing the national exchequer nearly one per cent of GDP. A reversal of the policy of state ownership and control of industries began as early as 1974 and the size of the public sector declined significantly thereafter. Despite the gradual decline in the size of the public sector, losses suffered by the SOEs are still substantial. The SOEs are likely to continue, for the time being, to feature prominently within the economy and therefore the regulators and policy makers will need to look at ways and means of making the SOEs more efficient, profitable, and professionally managed.

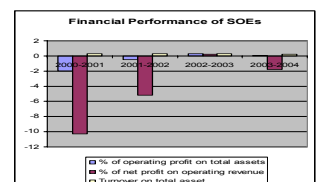
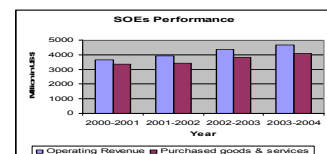
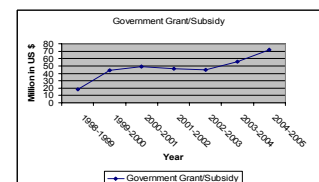
Objective

The objective of the paper is to discuss how good corporate governance practices helps to improve the State Owned sectors and facilitate the privatization of the enterprises efficiently in Bangladesh.

Chapter 2: SOEs in Bangladesh

SOEs in Bangladesh and its Performance over the Past Years

SOEs contribute 2% to the GDP. There are 44 State Owned Corporations and about 200 subsidiary enterprises owned by 19 Ministries. SOEs can be grouped into nine sectors: Industry, Power, Gas and Water, Transport and Communication, Trade, Agriculture, Services, Construction, Banks and Financial Institutions. There is an absence of a central authority controlling the SOEs – Ministry of Finance is responsible for approving their budgets, the Ministry of Establishment is responsible for appointing the CEOs and Directors, Ministry of Labor is responsible for working conditions in the factories and the pay scales of workers, the Ministry of Commerce is responsible for compliance with Company Law and Insurance regulations.



¹ Ahmed, Momtaz Uddin. 2000. "Privatization in Bangladesh"

The above charts show that although the performance of the SOEs as a whole has improved considerably since 2002, the amount of government grant or subsidy is also on the rise.

Board Composition and Government Structure of the SOEs in Bang^{[Source: Monitoring Cell, Ministry of Finance.}

The role of a dynamic, performing Board is the key to achieving coordination between the enterprise and the Ministries that control them. The governance structure of SOEs is complex; accountability of the SOEs rests with the holding corporation, the Board, the administrative Ministry, and the relevant Parliamentary Committee. At a roundtable discussion organized by BEI in 2006, it was pointed out that there are no specific rules or policy guidelines for nomination of directors on Boards of SOEs.² In many government owned corporations or where the government is the major shareholder, often the government nominated Board members are not equipped with the right knowledge, skills and ability to understand the problems facing the enterprises. They are also often not clear about their role and responsibilities; therefore, their performance at the Board meeting, generally speaking, leaves much to be desired. There is also at present no clear cut government policy regarding criteria for serving on Boards.

There is an absence of written TOR or job description for the Directors and they often do not have a clear understanding about their roles, responsibilities, deliverables and commitments. The established practice has been that in many cases the post held by a senior government official determines membership on certain Boards. Thus the Secretary Ministry of Industries automatically becomes the Chairman of KAFCO, the Executive Chairman BOI, sits on the KAFCO Board as a Director, etc. No consideration is given to whether the person has the time or inclination to serve on the particular board and less so to his or her experience and qualifications.

Continuity on the Boards of SOEs is also an issue that needs to be addressed and resolved. Since so many Board memberships in the case of government directors is linked to the post which he or she currently occupies, it means that the moment the officer is transferred to another post he gives up his position on the Board(s) of all the SOEs, companies or financial institutions that he or she was serving on as a Board member. He or she will be replaced automatically on the Board by his or her successor. The experience in Bangladesh has been frequent postings and transfers, some times due to promotions on other occasions at the whim of politicians. Thus by the time a Board member learns the function of the SOE Board he or she is serving on, he or she is transferred and the proper functioning of the Board is disrupted.

Limitations of SOE in Bangladesh

The legal instruments for SOEs in Bangladesh are many and multi faceted. The legal and regulatory framework governing the boards of SOEs includes the following:

- Relevant Statutory Acts Rules/Regulations for State-Owned Sector Corporation
- General Government Orders/Instructions
- Company's Act 1994
- Bangladesh Bank Order 1972
- Bank Companies Act 1991
- Financial Institutions Act 1993

² "Roundtable on the OECD Guidelines on CG of SOEs", 2006

- Securities and Exchange Commission Act 1993
- Bankruptcy Act 1997

The nomination process of the Boards of SOEs suffers from numerous limitations. The Boards of many of the SOEs such as the corporations, the members serve in the capacity of ex-officio. In many of the SOEs the Chairman is usually on a political appointment, and the Board members are nominated by the government either from civil service or on political consideration such as retired civil servant, academicians etc. The MD/CEO is at times appointed by promotion and company secretary selected from within the enterprise.

Corporate governance practice in the SOEs is essential for the functioning of the Boards and the performance of the sector.

Chapter 3: Corporate Governance and State-Owned Enterprises (SOEs)

Corporate Governance concerns a company's structure of ownership and control. Ownership rights also entail the rights to a company's profits. Control rights are the rights to determine what the company does, or more specifically, what it does when a contingency arises that has not been covered in the corporate charter or any other contract. Too wide a separation between ownership and control rights can lead to poor company performance. A large separation between ownership and control characterizes a state-owned enterprise. In a state-owned enterprise, government bureaucrats typically have significant control rights. They may, for example, determine the pricing of products or services; they may propose, review, or block new investments; or they may determine company employment policy. In contrast, ownership rights are public property, and company profits accrue to the government budget. Wide dispersal of shareholding in a private company can also produce a large separation between ownership and effective control. A small shareholder has little incentive to expend personal resources to exercise control of a company, since any returns from improvements in the company accrue to all shareholders.

Legal protection for investors is also an important part of effective corporate governance. Without rules against managerial self-dealing and affirmative requirements of managerial responsibility to owners, managers have a stronger incentive to pursue their own interests rather than investors' interests. Under such conditions a company will have difficulty raising capital from rational investors. Moreover, effective corporate governance also requires protection for minority investors. Without such rules, a major shareholder has a greater incentive to take action to appropriate the value of minority investors' investment. Potential minority investors facing such a hazard are less likely to invest.

Effective legal protection for investors benefits from a clear understanding of responsibilities and objectives. State owned enterprises typically impose a wide variety of objectives on managers and bureaucrats with control rights. These objectives could include regional development, employment generation, industrial policy, and political patronage, among others. Since these objectives often conflict and change, and often are never explicitly described, managers and bureaucrats of state enterprises have considerable discretion in the objectives that they pursue. In contrast, the fiduciary responsibility of the manager of a private company is clearer: maximize the return to shareholders through actions consistent with the law and widely accepted social norms

and values. Thus it tends to be easier to establish effective legal standards of responsibility for managers of private companies than for public sector managers. The need to improve corporate governance in State Owned Enterprises (SOEs) has gained increased attention globally. The OECD has developed Guidelines on Corporate Governance for State Owned Enterprises in 2005. The Guidelines are as follows:

1. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises (SOEs)

The legal and regulatory framework for SOEs should ensure a level-playing field in markets where the SOEs and private sector companies compete in order to avoid market distortions.

2. The State Acting as an Owner

The State should act as an informed and active owner and establish a clear and consistent ownership policy.

3. Equitable Treatment of Shareholders

The State and state-owned enterprises should recognize the rights of all shareholders and ensure their equitable treatment and equal access to corporate information.

4. Relations with Stakeholders

The State ownership policy should fully recognize the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.

5. Transparency and Disclosure

State-owned enterprises should observe high standards of transparency

6. The Responsibilities of the Boards of State Owned Enterprises

The Boards of SOEs should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

According to **OECD's survey (2008)**, significant progress has been made recently regarding transparency and accountability of SOEs in most of the countries in Asia. Almost all countries surveyed report that substantial progress has been made recently in terms of transparency and accountability. The progress made so far covers the most important aspects or elements of the reporting system, including maintenance of websites, financial disclosure on basis of internationally recognized standards, external audit, and effective parliamentary oversight. To drive this progress further, some countries have set up special workgroups to strengthen transparency and accountability regimes (in Brazil) and develop new codes which put emphasis on transparency and accountability issues (in Egypt, India, Morocco, Pakistan). Remaining challenges in the area of transparency and accountability include the quality of reporting and disclosure on non-financial objectives. However, functioning of the boards remains the main challenge in SOE reform. It is the functioning of the Board which is reported to be the main weak point. The sticking points in terms of the functioning of the Boards are related to the expertise and professional qualifications of the Board members, their selection and training. The survey has reported that Board members elected by the employees act as Union leaders rather than Board members. There is a lack of clarity about the roles and

responsibilities of the Board members as their accountability is complex and system-based and not results-oriented. On the other hand, management accountability to the board is weakened due to the lack of separation between Chairman and CEO. In few instances, the ownership entities take all the decisions related to the functioning of the SOEs by disregarding the Boards completely.

Consequently, priority for further reform in half of the countries surveyed is in the area of Board functioning, i.e. strengthening SOEs Boards as main tools for communication between the government and the SOEs, delegating more responsibilities to the BoDs, training current and future directors, listing of SOEs on the stock markets which would bring in independent directors. Other priorities include empowering the regulator, changes in the legal status of the SOEs, strengthening the government's monitoring and oversight through setting up of proper performance assessment systems, better coordination between relevant sectoral Ministries and better exchange of performance data between the SOEs and the ownership entities. In addition, developing and implementing better practices of corporate governance is being given precedence and to this end several countries have recently introduced or are planning to introduce new codes of Corporate Governance for SOEs (Brazil, Egypt, India, Morocco, Mozambique, Pakistan, and Thailand). Lastly, implementing internationally recognized accounting principles and standards is another area of primacy for many countries.

Many countries, such as our neighbour, India, have already developed a Code of Corporate Governance for SOEs. In India the Code is mandatory for all State Owned Enterprises at the federal level. The Institute of Company Secretaries of India in collaboration with Prime Database has developed a website consisting of a list of qualified independent directors to enable the companies to select efficient independent directors on their Boards. The Government of Kerela has also initiated an e-governance project by which key performance indicators for the SOEs are identified and the performance of the Board and senior management is monitored using a centralized data system. This has helped to turn around the loss making SOEs in Kerela into profitable enterprises.

Chapter 4: Privatization in Bangladesh

Background

Privatization programs in Bangladesh accelerated during the 1980s when a large number of the jute and cotton textile mills were returned to their owners under the New Industrial Policy (NIP). The NIP was probably the most significant move in the privatization process which was announced in 1982. The Government announced the Revised Industrial Policy (RIP) in 1986 with a view to further expanding, relaxing, and strengthening the measures required providing impetus to the privatization process through a deliberate denationalization program.

The programs gained momentum when the government drafted a liberal Industrial Policy in 1991, where 42 enterprises were identified for privatization. In 1993, the Privatization Board was established, to formulate the modalities for transferring SOEs to the private sector. In order to further strengthen the role of the private sector by accelerating the privatization process, the Government adopted a comprehensive privatization policy aimed at relieving the financial and administrative burden of the Government, improving efficiency and productivity, facilitating economic growth, reducing the size of the public

sector in the economy and help meeting the national economic goals. The Privatization Board was converted into a Commission in 2000, with stronger administrative and financial authority to intensify the privatization drive. The Commission is constituted with six member's of Parliament (currently vacant), two full time members, four Secretaries to the Government (Ex-officio), Chairman, Securities & Exchange Commission (Ex-officio), Chairman, FBCCI (Ex-officio) and one representative from professional organization. The Commission is headed by the Chairman of the Privatization Commission.

Privatization process in Bangladesh

The dominant prevailing methods include divestiture of government economic activities, private sale of shares, public offering of shares, lease and management contract, management/employee buy-out etc.

The privatization process starts when the Government finalizes the SOEs list identified for sale through the Sub-Committee of the Cabinet. According to the stipulations of the privatization policy, a chartered accountant or a consulting chartered accountant firm is appointed by the Privatization Commission to make valuations of the assets and liabilities of the SOEs. After careful review and examination of the chartered accountant firm's report, Privatization Commission, may hire another firm for re-valuation if considered necessary. The valuation report is then sent to the Finance Division of the Ministry of Finance for comments and approval.

Tender is invited after finalization of the valuation report quoting the "reserved price" (ie minimum price below which the unit will not be sold) calculated by the consultant and agreed by the MoF. The prospective buyers are allowed access to the valuation report and other relevant papers, such as three year's performance report of the enterprise prior to submission of the tender. The buyers submit quotations according to the terms and conditions of the tender. The tenders are evaluated by the Privatization Commission and the MoF and the Letter of Intent (LOI) handed over to the successful buyer.

The short term liabilities, such as claims of the workers and income taxes, are borne and written off by the Government. However, if the value of the assets exceeds bank loans, the buyer has to pay the excess amount either in cash in a single installment or within one year of purchase along with a simple interest of 10 percent. It is thus important that the long-term and the short-terms liabilities should be clearly defined, demarcated and the distinction established and upheld. There should be no scope for reinterpreting the terms and conditions of privatization after sale, because scope for reinterpretation provides opportunities for rent seeking and provides unequal advantages to the privatized units over other units in the same sector. To avoid such complications, it is necessary to undertake restructuring of the capital of SOEs usually by writing off loans, scrapping of obsolete assets, laying off surplus workers, and improving overall financial efficiency etc for preparing the SOEs for speedy and effective sale. The counter argument put forward by the leaders of the business community against these conditions is that the entrepreneurs buying the unit should be left free to decide the courses of action after the

hand over of the enterprise, because as he takes up the liabilities, there should be no strings attached to the SOEs handed over³.

Limitation in privatizing the SOEs

While Bangladesh is considered a fore-runner in carrying out privatization, there seems to be a common belief that the overall achievement has not been all that impressive. An analysis of the privatization process by AIMs of Bangladesh Limited, found that individual privatization transactions are lengthy and that tenders are often repeated seeking satisfactory results. Sales are also bogged down in litigation concerning title to assets, title to land, and claims by the relevant Ministry after acceptance of a tender offer. The report by AIMs identified a number of reasons for delays in the privatization process. First, there are significant conflicts of interest by the Ministries that would like to retain control of the SOEs and Ministries often interfere in the privatization process. Second, repeated tenders by the Privatization Commission seeking a higher price leads to delays. Third, the Privatization Commission does not carry out proper analysis of an enterprise to prepare it for sale and valuation reports are not adequate for a realistic, independent business assessment. Fourth, several companies have liabilities that exceed asset values and cannot be sold without debt write-off or restructuring. Fifth, the Privatization Commission addresses issues of valuation, debt restructuring and identification of privatization candidates in an ad-hoc case-by-case manner. The Commission needs a strategic plan for the privatization process, which will create policies for dealing with these common problems. Sixth, as is the case with many government agencies, the political parties have used the commission to their own advantage and the staff lacks motivation and sometimes the necessary skill and experience for the task.⁴

The valuation of the SOEs also gives rise to significant delays in the privatization process; although the delays may occur because of difficulties in the valuation process but also because of conflicts of interests by the Ministries that own the SOEs. Also the valuation must be entirely “independent” in spirit and not only in form. The title to assets and land or the deed is at times not available to the new owner. The absence of the deed makes it difficult for the privatized enterprise to seek the much required financing for the growth and expansion of the privatized entity. Availability of relevant data and information from the SOEs has been a major challenge as identified by the Privatization Commission. Some of the SOEs are reluctant to provide financial statements such as income statement and balance sheet of the last 5 years.

According to a survey by the Bangladesh Institute of Development Studies (BIDS) of privatized firms in Bangladesh conducted under Binayak Sen (1997), out of 205 firms listed in the survey only 112 firms (50%) are presently in operation. Following privatization, a large number of firms have closed down. Among the 83 closed firms, the survey reports 28 firms are engaged in alternative activities (manufacturing, trading, services) and 65 firms are reported to be inactive. Out of the firms providing basic information about current activities 90 (46%) are reported to be making profit or at least breaking even prior to privatization 73 firms (38%) were earning profits or breaking even. This shows that the number of firms making profit has increased. However, there

³ Ahmed, Momtaz Uddin. 2000. “Privatization in Bangladesh”

⁴ AIMs of Bangladesh Information and Marketing Services, March 2002

has also been substantial labor retrenchment following privatization. Nearly 39000 workers have been fired since privatization.

Chapter 5: Conclusion and Recommendations

Corporate governance of the state owned sector has been a major issue for research and discussion. The OECD, among many other agencies, has also given a major thrust in this area, reflected in the OECD's research and advocacy work. In Bangladesh while the governance of SOEs has substantial room for improvement, the privatization process too leaves much to be desired. Among many of the limitations, lack of enough political commitment and determination, absence of sufficient legal framework and institutional capacity, lack of transparency, mistrust among the workers and above all political discord between the party-in-power and the opposition political parties are generally identified as important factors limiting the performance of the SOE sector and also the privatization process.⁵

The basic principles of corporate governance namely; fairness, transparency, accountability and responsibility should prevail at each and every step of the privatization process. The first principle of the *OECD Guidelines on CG of SOEs* is *ensuring an effective legal and regulatory framework*. In the absence of an effective legal and regulatory framework, the process is at times bogged down in litigation – speedy trial courts could be established for the purpose of quick discharge of the litigation and timely handover of the enterprise to the new owner.

The second principle of the *state acting as an owner* needs to be followed by the government and this could be ensured by establishing a clear and consistent ownership policy. The government should identify the objectives and goals of the state owned sector enterprises. This policy would also ensure that the SOEs identified for sale or to be privatized, reflect the government policy to put up the right SOEs for sale. The Industrial Policy of Bangladesh ensures that government will not do business, rather the government's role would be as a facilitator for the private sector. However, when it comes to ensuring availability of essential products (such as fertilizer), to the public at affordable price, providing a social safety net for the poor, government intervention is required. The ownership policy should indicate what the government expects out of each entity and support the SOEs that are losing concerns. The Government should strengthen its support for privatization of poor performing SOE and this could be established by setting up a high powered committee which aims to constantly update and make effective and quick decision on the list of SOEs to be privatized.

The third principle of *equitable treatment of shareholders* stems from the fact that the government should recognize the rights of all shareholders including minority shareholders and ensure equal access to material information about the enterprise.

The forth principle concerning *relationship with stakeholders* again stresses that the state should recognize its responsibilities to the society and should report on the relationship with stakeholders.

⁵ Ahmed, Momtaz Uddin. 2000. "Privatization in Bangladesh"

The fifth principle of *transparency and disclosure* should be established at each step of SOEs operation and privatization process. The SOEs should observe high standards of transparency in ensuring all information is available to the stakeholders. For example, the enterprises should ensure that the information regarding financial performance of the SOEs, disclosure of the annual reports, are available to the Privatization Commission even after privatization.

The sixth principle concerning the *responsibilities of the Boards of the entities* is essential in the context of Bangladesh. As already mentioned in this paper, the role of a functioning Board is key to the turn around of the poor performing SOEs. In addition, it is also essential for the privatized entities to establish a performing Board. In the context of a country like Bangladesh, where most of the businesses remain closely held among family circles, the change of ownership since privatization also strikes an important change. This indicates the emergence, however rudimentary, of a market for corporate control and management. Presumably, new ownership can bring about new management; whereas under public ownership corporate governance needs to be dealt with in a careful manner because the Board and managers are transferred and rotated among enterprises and/or from the bureaucracy to enterprises.