International Symposium on Accounting, Auditing and Governance in Asia

Presentation on

Family Ownership, Corporate Governance and Transparency: Evidences from an Emerging Economy

by

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Thesis

- A big-bang economic reforms began in 1991. It was followed by a rising investment-GDP ratio and an accelerating economic growth. Rising export earnings and surging flow of inward remittances appear to be driving this growth acceleration.
- It was also causing a persistent monetary expansion, falling interest rate and soaring private sector credit. Excess liquidity also flew into asset markets; price spiraling followed. Stock markets experienced two crises in this period. In both the crises, a large number of external shareholders and creditors were expropriated by *insiders*.
- In an environment of weak enforceability of laws and where family control is dominant, separation of ownership from management becomes blurred. A agency conflict arises whereby controlling shareholders influence management to adopt a disclosure regime biased against external shareholders and creditors.
- Findings show that accrual earnings are smoothened by corporate management and it is done by accumulating operating accruals. Cases of bloated balance sheets are common.
- Findings further indicate that controlling for factors such as age, size, profitability and financial leverage, ownership concentration reduces corporate disclosure and worsens information problem. An outcome is that insiders trade in information and expropriate external shareholders in an environment where legal protection of the latter is weak.

Outline of Presentation

- An overview macroeconomic growth, monetary growth, development and stock market performance in Bangladesh.
- An evaluation of corporate governance mechanism in Bangladesh and its relation with family ownership, ownership concentration and other corporate attributes.
- Corporate transparency and cases of discretionary disclosure in annual reports.
- Estimating divergence between accrual earnings and free cash flows (FCFs) and earnings management by firms.
- Pattern of ownership concentration and control-ownership wedge and estimation methods.
- Reporting key findings and their interpretation.
- Implications for public policy in areas of accounting, auditing, and corporate governance in Bangladesh.
- Scope for further research.

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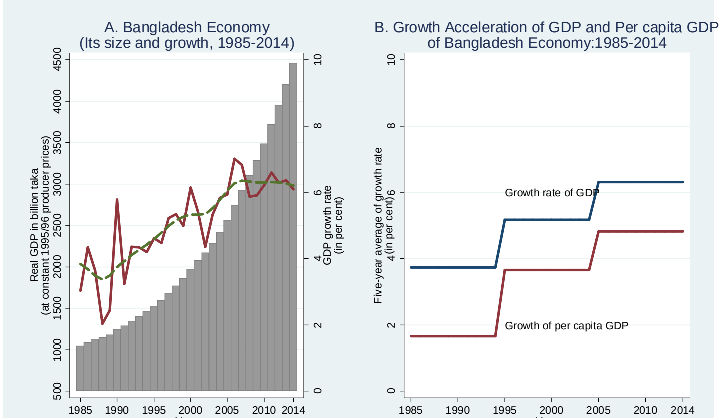
Bangladesh Economy
Its Size and Pattern of Growth Acceleration



Panel-A shows GDP of Bangladesh economy (at 1995/96 prices) in billion BDT and growth rate of GDP, both actual and Hodrick-Prescott smoothed series, over the 1985-2013 period. Panel-B shows growth acceleration in both GDP and per capita GDP. A 5-year averaging of annual growth rates is done for identifying growth acceleration between periods.
Source: Author's estimates from National Income Accounts Statistics of Bangladesh Bureau of Statistics (2000, 2005, 2014).

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Sectoral Contribution to Growth Acceleration

between 1985/1994 and 1995/2014 (In 1995/96 producer prices)

Sector	GDP growth over 1984/85~ 1993/94 (billion taka)	GDP growth over 1994/95~ 2003/04 (billion taka)	GDP growth over 2004/05~ 2013/14 (billion taka)	Incremental GDP (from 1985-94 to 1995-2004) (billion taka)	Sectoral share in incremental GDP in 1995-04 (%)	Incremental GDP (from 1995-2004 to 2005-14) (billion taka)	Sectoral share in incremental GDP in 2005-14 (%)
	1	2	3	4=(2-1)	5	6=(3-2)	7
Agriculture	**71.6**	**159.3**	**255.5**	**87.7**	**17.2**	**96.2**	**8.9**
Crop production	31.6	75.7	119.7	44.1	8.7	44.0	4.1
Fisheries	25.3	49.0	72.7	23.7	4.7	23.7	2.2
Others	14.7	34.6	63.0	19.9	3.9	28.4	2.6
Industry	**154.0**	**331.7**	**797.4**	**177.7**	**34.9**	**465.7**	**43.0**
Manufacturing	94.9	181.1	514.3	86.2	16.9	333.2	30.7
Large & medium	68.0	126.5	380.9	58.5	11.5	254.4	23.5
Small scale	26.8	54.7	133.4	27.9	5.5	78.7	7.3
Construction	38.4	121.0	212.9	82.6	16.2	91.9	8.5
Others	20.7	29.6	70.3	8.9	1.7	40.7	3.8
Services	**222.8**	**465.9**	**987.9**	**243.1**	**47.8**	**522.0**	**48.2**
Total GDP	448.3	956.9	2040.8	508.6	100.0	1083.9	100.0

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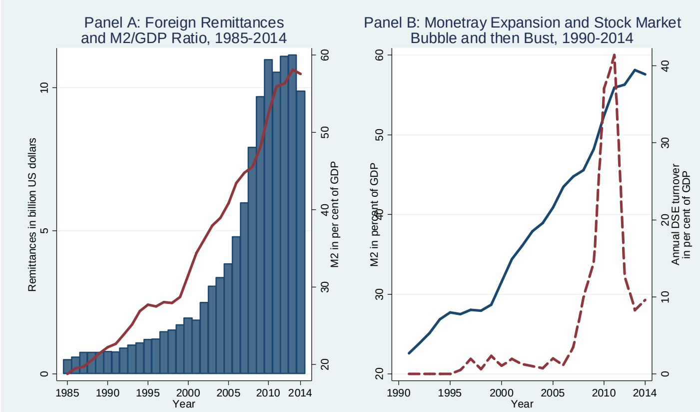
Remittances, Monetary Expansion, and Asset (Stock) Market Bubble & Bust in Bangladesh



Panel A shows remittances and expansion on monetary aggregates in Bangladesh. The vertical bars represent inward foreign emittances in billion US dollars and shall be read on the left scale. The line shows m2 in percent of GDP on the right scale. Panel B depicts an association between cheap money and surge in the stock market turnover in the Dhaka Stock Exchange (DSE), which then followed by a bust in 2011.
Sources: Dhaka Stock Exchange (2014), Bangladesh Bank (2014).

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An Overview of Corporate Governance in Bangladesh

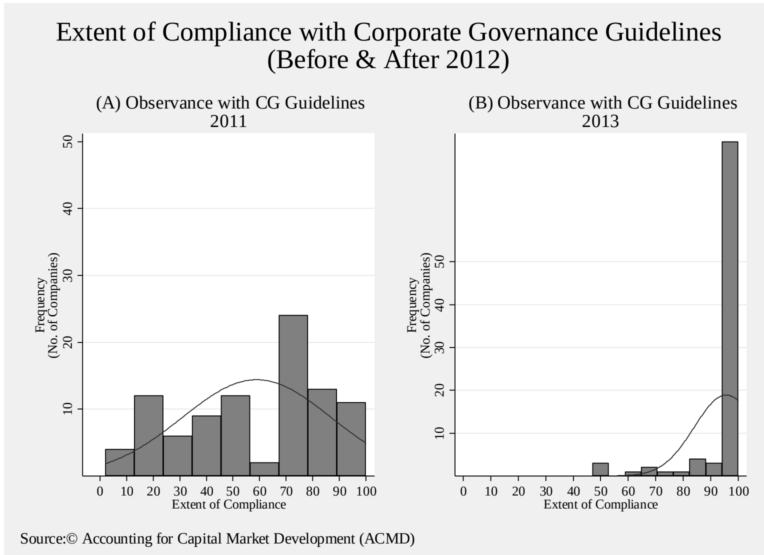
SL#	Governance Attributes		Frequency	Percent
1	Size of the Board of Directors (N=90)	Less than 5	20	22.2
		More than 5 but less than 10	59	65.6
		More than 10	11	12.2
2	Number of Non-executive Director (N=89)	No Independent Director	10	11.2
		One(01) Independent Director	42	47.2
		Two(02) Independent Directors	32	36.0
		Three(03) or more Independent Directors	5	5.6
3	Relationship between CEO and Chairman of the Board of Directors (N=88)	0 if CEO and Chairman are not family members and independent	55	62.5
		1 if CEO and Chairman are family members and not independent	33	37.5
4	Separation of the Board from Management (N=87)	0 if CEO and Chairman is the same person	10	11.5
		1 if CEO and Chairman are separate individuals	77	88.5
5	Chief Financial Officer (CFO) (N=87)	0 if no CFO	17	19.5
		1 if CFO exists	70	80.5
6	Head of Internal Audit (N=82)	0 if no Head of Internal Audit	12	14.6
		1 if Head of Internal Audit exists	70	85.4
7	Company Secretary (N=88)	0 if no CompanySecretary	4	4.6
		1 if CompanySecretary exists	84	95.5
8	Size of the Audit Committee (N=94)	No information on Audit Committee	25	26.6
		Less than or equal to 3	40	42.5
		More than 3	27	28.7
9	Chairman of the Audit Committee (N=75)	0 if not an Independent Director	15	20.0
		1 if an Independent Director	60	80.0

A New Corporate Governance Regulations-2012

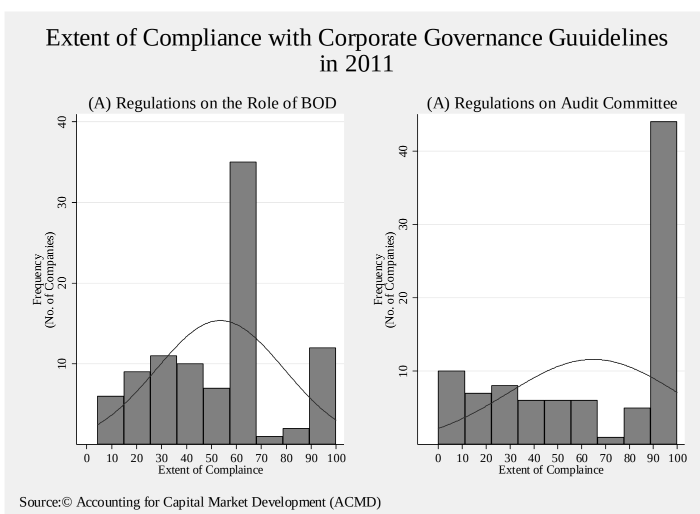
A de jure surge in governance compliance

Distribution of Corporate Governance Regulations	N	Mean	Percentiles				
(Year-2011)			1%	25%	50%	75%	99%
Board of Directors (46 items)	93	0.54	0.04	0.35	0.61	0.63	1.00
Chief Financial Officer, Head of Internal Audit and Company Secretary (02 items)	93	0.76	0.00	0.50	1.00	1.00	1.00
Audit Committee (28 items)	93	0.65	0.00	0.33	0.82	0.96	1.00
External/Statutory Auditors (08 items)	93	0.74	0.00	0.38	1.00	1.00	1.00
Parent/Subsidiary Company Relations (05 items)	57	0.33	0.00	0.00	0.13	0.63	1.00
Duties of CEO and CFO (03 items)	56	0.37	0.00	0.00	0.00	1.00	1.00
Reporting of Compliance with Corporate Governance Regulations (02 items)	92	0.63	0.00	0.50	0.50	1.00	1.00
All Corporate Governance Regulations (94 items)	93	0.59	0.02	0.36	0.74	0.79	1.00
Distribution of Corporate Governance Regulations	**N**	**Mean**	**Percentiles**				
(Year-2013)			1%	25%	50%	75%	99%
Board of Directors (46 items)	93	0.96	0.39	1.00	1.00	1.00	1.00
Chief Financial Officer, Head of Internal Audit and Company Secretary (02 items)	93	0.98	0.00	1.00	1.00	1.00	1.00
Audit Committee (28 items)	93	0.95	0.00	1.00	1.00	1.00	1.00
External/Statutory Auditors (08 items)	91	0.98	0.13	1.00	1.00	1.00	1.00
Parent/Subsidiary Company Relations (05 items)	91	0.92	0.00	1.00	1.00	1.00	1.00
Duties of CEO and CFO (03 items)	92	0.94	0.00	1.00	1.00	1.00	1.00
Reporting of Compliance with Corporate Governance Regulations (02 items)	93	0.95	0.00	1.00	1.00	1.00	1.00
All Corporate Governance Regulations (94 items)	93	0.96	0.47	0.99	1.00	1.00	1.00

An Instance of *de jure* Compliance



Non-observance with Corporate Good Governance (1)



Case of Weak Observance with CG Guidelines (w.r.t. the Role of Board of Directions)

Independent director should have knowledge about financial, regulatory & corporate laws	0.207
Independent director should be Business Leader/Corporate Leader/ Bureaucrat/ University Teacher with 12 years of corporate management/ professional experiences.	0.207
Independent director post cannot be vacant for more than 90days	0.196
Independent director is not a partner of company's statutory audit firm	0.185
Independent director is not a defaulter to a bank/NBFI	0.185
Independent director is not convicted for any criminal offense	0.174
Independent director is not a stock exchange member or intermediary of capital market	0.163
Independent director is not independent director of more than 3 listed companies	0.163
The code of conduct of all board memebers should be announced & recorded	0.163
Independent director is not a member / director of any stock exchange	0.141
In special cases qualification requirement may be relaxed	0.095

Case of Weak Observance with CG Guidelines (w.r.t. the Role of Audit Committee)

Audit Committee review adequacy of internal audit function	0.620
Audit Committee review Management Letters/Letter of Internal Control weakness issued by statutory auditor	0.567
Audit report is disclosed in the annual report, signed by the Chairman of the committee	0.565
Audit committee reports immediately on suspected or presumed fraud or irregularity	0.525
When term of a audit member is expired, another member is appointed immediately or within one month	0.519
Audit committee reports immediately on conflicts of interests	0.476
Audit committee reports immediately on suspected infringement of laws	0.476
Company shall disclose to Audit Committee fund utilization which are raised by IPO, RPO/Right Issue on quarterly & annual basis	0.476
Audit committee reports to the SEC, if repeatedly ignored any rectification by the Board	0.462
Audit committee reports immediately on any other matter it thinks necessary	0.460
The quorum of the Audit Committee shall not constitute without atleast 1 (one) independent director	0.374

Review of Literature and Hypothesis

- Shleifer and Vishny (1997) → Ownership concentration is a natural response to poor legal protection of minority shareholders from expropriation by managers.
- La Porta et al. (1999) → In the developing world, it is family which constitutes controlling shareholders with majority voting rights. Controlling shareholders influence corporate management to adopt a disclosure regime biased against external shareholders and creditors. Jiang et al. (2011) → control-ownership wedge allows controlling shareholders to exercise nearly full control …, while maintaining low cash flow rights relative to voting rights.
- Singhvi and Desai (1971) , Watts and Zimmerman (1978), Verrecchia (1983), and King et al. (1990) → Relationship b/w size and disclosure.
- Verrecchia (1983, 1990) , (Penman, 1980; and Lev and Penman, 1990), Diamond (1985) → On the association b/w return variables and disclosure.
- Lang and Lundholm (1993) → Relation b/w disclosure quality and performnace variables, structural variables, and offer variables.
- De Angelo (1981) and Owusu-Ansah (1998) → Audit quality vs. disclosure.

Research Methods: Measuring Disclosure Adequacy & Observance with CGG Rules

- The principal task is to prepare a usable disclosure checklist for the non-financial companies.
- In order to do it, we first reviewed detailed disclosure regulations as they are included in the Companies Act, 1994; the Securities and Exchange Rules, 1987; Listing Regulations of the Stock Exchanges, SEC Corporate Governance Guidelines, 2006; the International Accounting Standards (IASs) that are adopted by the ICAB and observance with which is now mandated by the BSEC; and other relevant pronouncements.
- The review ended up with a list of more than 500 disclosure items.
- We then reviewed several studies on user information needs and disclosure practice at home and abroad and carried out a number workshops to elicit perception of stock market regulators, corporate executives, practicing chartered accountants, and academics.
- Previous literature and users' perception are then combined and corroborated to define a usable checklist for the sample of non-financial companies.
- The survey used a checklist of 190 items for measuring compliance with disclosure rules and another checklist of 94 items for assessing observance with BSEC governance rules.

Research Methods: Disclosure Index

- A disclosure index for a company i is defined below:

$$I_i = \frac{\sum_{j=1}^{m} \bar{d}_{ij}}{\sum_{j=1}^{n} d_{ij}} \qquad (1)$$

- Here d_{ij} represents a mandatory disclosure requirement j for company i and it is an indicator variable taking 9 if the item is judged to be irrelevant, 1 if the disclosure is made and 0 if the relevant disclosure is not made. Thus the numerator $\sum_{i=1}^{m} \bar{d}_{ij}$ represents the number of actual disclosure and the denominator $\sum_{j=1}^{n} d_{ij}$ represents the number of relevant disclosure requirements for the company. Since $m \leq n$, $0 \leq I_i \leq 1.0$ implying that the disclosure score has the lower bound of zero and the upper bound of unity.
- The same approach is followed to measure disclosure levels across various parts of annual reports and major financial elements disclosed in the annual reports.
- A weighting scheme is developed and weights for specific disclosure items represents frequency of actual disclosure compared with the frequency by which the item of judged relevant to be disclosed. Weights thus represent implicit importance attached to an item by management.
- The same approach is followed for measuring observance with CG rules.

Research Methods: Disclosure Probability and Precision

- Disclosure probability of a major financial element represents likelihood of the element to be disclosed by the sample firms. For each financial element, it is measured by a ratio between (i) the cumulative frequency of actual disclosure of the element over the sample firms and (ii) the cumulative frequency by which the element was judged *relevant to be disclosed* over the sample firms.
- The probability measures indicate observed likelihood of management to make required disclosure in corporate annual reports.
- Disclosure precision is the reciprocal of disclosure variance.

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$$P_j = \frac{\sum_i^N \sum_{k=1}^K \overline{d}_{ijk}}{\sum_i^N \sum_{k=1}^K d_{ijk}} \qquad (3)$$

- The probability measures indicate observed likelihood of management to make required disclosure in corporate annual reports.
- Disclosure precision is the reciprocal of disclosure variance.

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Disclosure Quality and Detecting Earnings Management Exercises

Accrual Accounting Relations (AAR):

$$(c\text{-}i) + i + Operating\ Accruals\ = ox \qquad Eq.(1)$$

$$(F - D) + financial\ accruals = nfe \qquad Eq.(2)$$

$$ox - nfe = x \qquad Eq.(3)$$

Net Operating Assets Relation (OAR):

$$noa_t = noa_{t-1} + i + \text{operating accruals} = noa_{t-1} + \text{ox-(c-i)} \qquad Eq.(4)$$

Net Financial Obligations Relation (FOR):

$$\begin{aligned} nfo_t &= nfo_{t-1} - D + \text{financial accruals} \\ &= nfo_{t-1} + nfe - F = nfo_{t-1} + nfe - (c - i) + d \qquad Eq.(5) \end{aligned}$$

Clean Surplus Relation (CSR):

Since $B_t = noa_t - nfo_t$,

$$\Delta B_t = \Delta noa_t - \Delta nfo_t$$

$$\begin{aligned} B_t &= B_{t-1} + [ox_t - (c_t - i_t)] - [nfe_t - (c_t - i_t) + d_t] \\ &= B_{t-1} + x_t - d_t \qquad Eq.(6) \end{aligned}$$

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Research Methods: Model Estimations

- In order to estimate effects of corporate attributes including ownership concentration on disclosure levels and a set of measures of disclosure quality of published annual reports, we estimate both OLS and VWLS models of the specification with/without constant term.
- The general form of the specification:

$$y_i = \boldsymbol{\beta}'\mathbf{X_i} + \boldsymbol{\gamma}'\mathbf{Z_i} + u_i, \quad i = 1, \cdots, N \qquad (4)$$

$\mathbf{X_i}$=[age$_i$ size$_i$ profit$_i$ flev$_i$ sci$_i$]′, and $\mathbf{Z_i}$=[inv$_i$ parent$_i$ foreign$_i$ audit$_i$]′

- The covariates included the following:
  Size of company is measured by the log of turnover or total operating assets, age represents number of years since incorporation, profitability represents return on common equity, return on net operating assets or profit margin, financial leverage represents NFO/CSE, ownership concentration represents mean fraction of voting right owned by controlling shareholders, audit firm type, and other controls.
- Variance-covariance estimator is robust and/or bootstrapped and intra-industry correlation, if any, is controlled by clustering standard errors by industry types. Robust standard errors are reported.

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Defining Ownership Concentration and Control-Ownership Wedge

- (Owusu-Ansah, 1998; Chau and Gray, 2002)→ proportion of voting rights owned directly and/or indirectly by corporate insiders that included corporate management and/or board members.
- La Porta et al. (1999))→ used a 20 percent rule to define ownership pattern in a firm. The rule states that a corporation has a controlling shareholder (ultimate owner) if this shareholder's direct and indirect voting right in the firm exceeds 20 percent. Otherwise the firm is assumed to be widely held. Hope (2003) defined ownership concentration as the mean fraction of a firm's voting rights owned by the controlling shareholders.
- Makhija and Patton (2004)→ Herfindahl Index, which is the sum of the squares of fractions of ownership across different types of owners, to indicate the extent of ownership concentration.
- In the context of Bangladesh, legal codes do not have specific disclosure requirement to this end. A BSEC guideline requires disclosure on "comply or explain" basis.
- To overcome this difficulty, the present study obtained CDBL (Central Depository Bangladesh Limited) records on shareholdings by the top 20 shareholders as of the last trading date of the concerned financial year.
- An operational definition of insider include sponsors/directors, chief executive officer, company secretary, chief financial officer, head of internal audit, the top five-salaried employees, their spouses and children.
- We then define voting right of insiders as represented by their combined shareholding in the paid up capital of a company. Ownership by institutions is also included into this combined shareholding. Excepting for the state-owned corporations, ultimate control over institutional investors in Bangladesh generally lies with insiders via cross-shareholdings and other means.
- Ownership concentration index is then measured as the mean fraction of the firm's voting right owned by the controlling shareholders.

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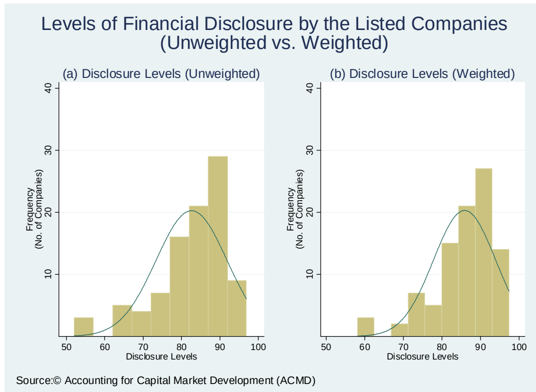
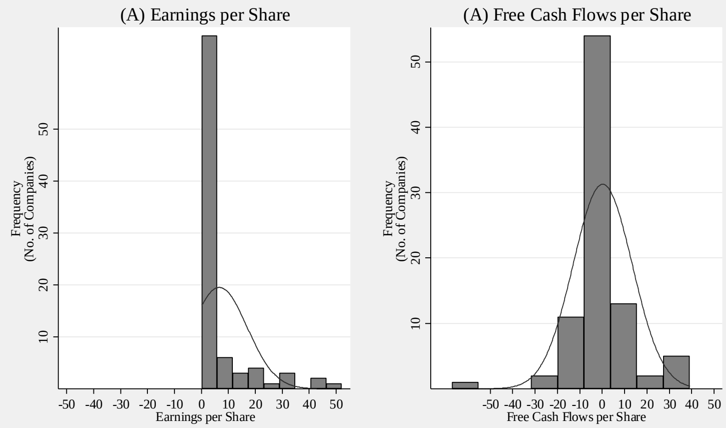


Category of	Un-weighted Disclosure Levels		Weighted Disclosure Levels	
Disclosure levels	Frequency	Cumul. Freq.	Frequency	Cumul. Freq.
Less than 60 percent	3	3.2	1	1.1
60~70 percent	9	12.8	3	4.3
70~80 percent	20	34.0	13	18.1
80~90 percent	43	79.8	40	60.6
More than 90 percent	19	100.0	37	100.0
Sample Size	94		94	

Disclosure of Key Financial Elements in Annual Reports Descriptive Statistics

	Key Financial Elements (specific items are nested)	N	Average disclosure	Variance of disclosure	Disclosure precision	Disclosure probability
1	Accounting policy	14	0.670	0.041	24.4	0.642
2	Audit report	02	0.947	0.024	41.6	0.938
3	Cash flow from financing activities	11	0.847	0.038	26.5	0.852
4	Cash flow from investing activities	07	0.917	0.018	56.5	0.915
5	Cash flow from operating activities	07	0.927	0.014	71.6	0.929
6	Corporate information	09	0.807	0.021	47.4	0.808
7	Cost of Goods Sold	02	0.861	0.090	11.1	0.864
8	Dividend and Earnings	15	0.874	0.024	41.1	0.864
9	Financial Assets	16	0.885	0.018	54.6	0.861
10	Financial Obligations and cost	07	0.762	0.069	14.4	0.744
11	Intangibles	07	0.547	0.186	5.4	0.587
12	Operating Assets	11	0.866	0.019	53.3	0.853
13	Operating Expenses	16	0.715	0.053	18.8	0.675
14	Operating Liabilities	03	0.874	0.058	17.3	0.880
15	Presentation of financial statements	07	0.950	0.006	157.6	0.947
16	Property, plant and equipment	17	0.867	0.022	44.5	0.855
17	Provisions	09	0.586	0.039	25.6	0.596
18	Revenue	05	0.866	0.027	36.5	0.855
19	Shareholders' equity	11	0.849	0.018	56.2	0.836
20	Tax expense	03	0.764	0.082	12.2	0.733
	Total Disclosure Items	**190**				

Accrual Earnings vs. Free Cash Flows (FCFs) per Share (2009-2013 Average)



Source:© Accounting for Capital Market Development (ACMD)

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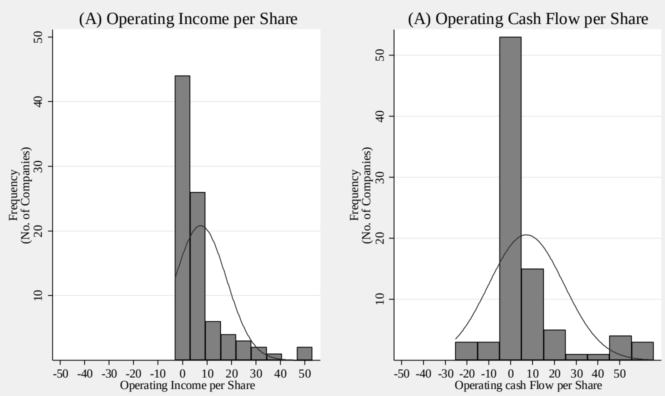
Operating Earnings vs. Operating Cash Flows (FCFs) per Share (2009-2013 Average)



Source:© Accounting for Capital Market Development (ACMD)

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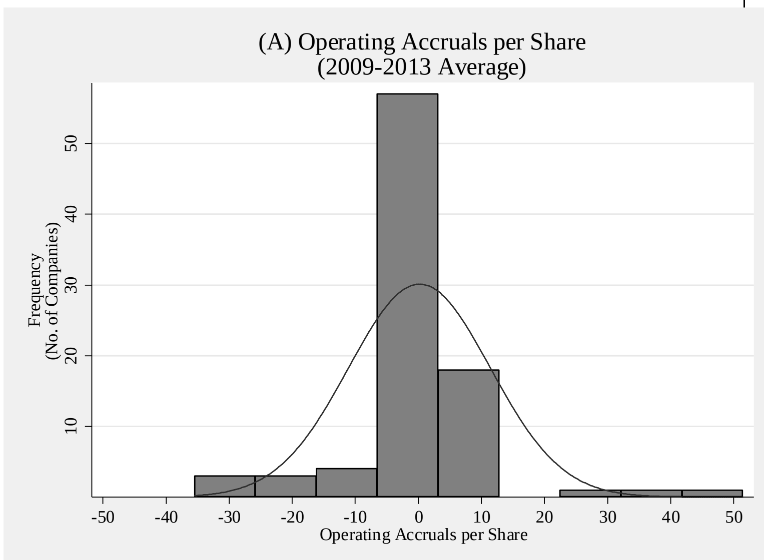

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Ownership structure of 94 non-financial companies listed in Dhaka Stock Exchange (DSE)

Distribution of corporate ownership	N	Mean	Percentiles				
Pattern of ownership			p1	p25	p50	p75	p99
Ownership by controlling shareholders/insiders	94	0.605	0.190	0.523	0.577	0.688	0.936
Direct ownership by sponsors/directors	94	0.452	0.030	0.310	0.485	0.540	0.900
Public ownership	94	0.396	0.060	0.310	0.425	0.480	0.810
Ownership concentration index	94	0.144	0.001	0.026	0.062	0.147	0.830
Control-ownership wedge	94	1.862	0.995	1.046	1.272	1.686	16.867

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Descriptive Statistics of Corporate Attributes and Disclosure Levels

	n	Mean	Percentiles				
			1%	25%	50%	75%	99%
Unweighted disclosure levels	94	0.826	0.521	0.779	0.848	0.891	0.969
Weighted disclosure levels	94	0.858	0.581	0.819	0.879	0.914	0.974
Accounting policy disclosure	94	0.67	0.2	0.57	0.67	0.8	1
Age (Years since incorporation)	94	25.01	2	15	22	33	56
Listing status (No. of years)	94	15.1	0.0	4.0	15.0	24.0	36.0
Size (Turnover)	94	4621.4	0.0	271.5	862.7	3066.2	89059.6
Size (Operating assets)	94	5252.3	33.2	456.4	1240.2	4031.4	100668.2
Profitability(ROCE)	94	0.112	-3.394	0.046	0.093	0.186	1.45
Profitability(RNOA)	94	0.097	-3.56	0.053	0.102	0.179	0.676
Profitability (PM)	92	0.072	-2.37	0.031	0.073	0.162	0.614
Financial leverage (NFO/CSE)	94	0.895	-28.32	0.102	0.352	0.875	33.81
Mean voting right (CS)	94	0.144	0.001	0.026	0.062	0.147	0.83
Total assets	94	5951.2	33.3	552.5	1453.8	4455.2	108904.0

Determinants of Financial Disclosure

(Dependent Variable: Un-weighted Disclosure Levels)

Independent Variables	*1*	*2*	*3*	*4*	*5*
Age	0.115***	0.111***	0.116***	0.114***	0.117***
	(0.019)	(0.018)	(0.018)	(0.018)	(0.017)
Size [ln(turnover)]	0.050***		0.047***		0.043***
	(0.010)		(0.009)		(0.009)
Size [ln(operating assets)]		0.053***		0.049***	
		(0.009)		(0.009)	
Return on Common Equity	0.025	0.053			
	(0.105)	(0.098)			
Profit margin					0.437*
					(0.250)
Return on net operating assets			0.362***	0.212**	
			(0.098)	(0.103)	
Financial Leverage	-0.001	0.005	0.016	0.018	0.005
	(0.018)	(0.015)	(0.013)	(0.012)	(0.013)
Shareholding Concentration Index	-0.051***	-0.040***	-0.043***	-0.037***	-0.052***
	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)
Investment in Associates	-0.013	-0.003	-0.021	-0.005	-0.023
	(0.031)	(0.027)	(0.026)	(0.025)	(0.030)
Parent Company Status	-0.119***	-0.138***	-0.138***	-0.146***	-0.119***
	(0.044)	(0.040)	(0.039)	(0.038)	(0.044)
Foreign Affiliation	-0.119***	-0.085**	-0.095***	-0.064**	-0.136***
	(0.040)	(0.037)	(0.031)	(0.031)	(0.037)
Audit Firm	0.064*	0.044	0.041	0.039	0.072**
	(0.038)	(0.036)	(0.036)	(0.036)	(0.035)
Number of Observations	87	88	87	87	87
R-Squared	0.981	0.983	0.984	0.984	0.982

Robust standard errors are reported and they are adjusted for intragroup correlation. Significance test: *** p<0.01, ** p<0.05, * p<0.1, ‡p<0.15.

Determinants of Financial Disclosure

(Dependent Variable: Un-weighted Disclosure Levels)

Independent Variables	6	7	*8*	*9*	10
Age	0.110***	0.111***	0.106***	0.108***	0.107***
	(0.017)	(0.016)	(0.012)	(0.012)	(0.012)
Size [ln(turnover)]			0.053***	0.049***	0.047***
			(0.006)	(0.006)	(0.007)
Size [ln(operating assets)]	0.048***	0.048***			
	(0.008)	(0.008)			
Return on Common Equity			0.011		
			(0.081)		
Profit margin	0.496**	0.508**			0.356**
	(0.228)	(0.230)			(0.155)
Return on net operating assets				0.338***	
				(0.076)	
Financial Leverage	0.012		0.003	0.018‡	0.008
	(0.012)		(0.013)	(0.012)	(0.012)
Shareholding Concentration Index	-0.040***	-0.040***	-0.050***	-0.044***	-0.051***
	(0.008)	(0.008)	(0.006)	(0.006)	(0.006)
Investment in Associates	-0.015	-0.015	-0.027	-0.034‡	-0.037*
	(0.026)	(0.026)	(0.021)	(0.021)	(0.022)
Parent Company Status	-0.140***	-0.141***	-0.121***	-0.142***	-0.122***
	(0.038)	(0.039)	(0.027)	(0.027)	(0.027)
Foreign Affiliation	-0.107***	-0.109***	-0.103***	-0.087***	-0.118***
	(0.034)	(0.033)	(0.030)	(0.028)	(0.028)
Audit Firm	0.049‡	0.049‡	0.071***	0.048*	0.077***
	(0.033)	(0.034)	(0.026)	(0.027)	(0.026)
Number of Observations	88	88	87	87	87
R-Squared	0.984	0.984	.	.	.

Robust standard errors are reported and they are adjusted for intragroup correlation. Significance test: *** p<0.01, ** p<0.05, * p<0.1, ‡p<0.15.

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Findings and Interpretation (1)

- The extent of compliance with mandatory disclosure requirements is varying between 52.1 percent and 96.9 percent. 34 percent of the companies failed to disclose a minimum 20 percent of the disclosure requirements.
- Mean disclosure scores, disclosure precisions and observed probability are low for some key financial elements. They include (i) intangibles, (ii) provisions, (iii) accounting policy, (iv) tax expense, (v) financial obligations and finance costs, (vi) operating assets (vi) operating liabilities, (vii) operating expenses.
- A pattern of non-observance emerges that management resorts to the use of accruals to overstate earnings and/or understate debt-to-equity ratio and it is disguised by non-disclosure.
- *De facto* observance with corporate governance guidelines is poor. Separation between ownership and management is often absent. BSEC or exchanges do not monitor internal control practices of the listed companies.
- Earnings after taxes are smoothened. Build-up of accruals is persistent and overstatement of assets and equity is a common phenomenon. A pattern of information problem operates in Bangladesh. Controlling shareholders and management are insiders and trade in information at the cost of external shareholders.

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Regression Results and Interpretation

- A relatively older, larger and more profitable firm disclose more information. It validates a political cost hypothesis of Watts and Zimmerman that disclosure choice would depend on the likelihood of adverse political actions and so the expected costs to mitigate them. A transaction cost hypothesis is also valid that more disclosure is intended to reduce cost of external financing and that incentives for private information acquisition are greater for larger and more profitable firms.
- A significant and large estimate of the coefficient of ownership concentration implies corporate management adopts a disclosure regime biased against external shareholders and it is increasing as ownership concentration deepens.
- The extent of financial leverage is found not significant. A tradition of bank-based borrowing, intricate cross-shareholdings, and default culture is perhaps an explanation of this.
- The quality of audit firm matters for both transparency and quality of annual reports.
- A finding contrary to common perception is that foreign affiliation dummy and parent company dummy are negatively associated with disclosure levels. Two possible explanations. One is fear of loosing competitive position and the other is the differential regulatory requirements.

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Policy Implications

- Disclosure choice is discretionary as disclosure rules are poorly enforceable. Pervasive non-compliance with reporting regulations is causing non-disclosure of ***useful information*** for investment and credit decisions. Decision relevance of published annual reports is thus poor. Overpricing of IPOs and right shares is related to this poor quality of financial disclosure.
- Controlling shareholders and management constitute insiders and disclosure regime is biased for insiders and against outside shareholders. An outcome is pervasive insider trading and other market manipulations. Related party relationships are poorly defined. Regulators should continually monitor transactions in shares by *insiders*. Reforms are needed to prosecute insider trading.
- Given that non-compliance with ***disclosure rules*** is common, audit opinion goes unsubstantiated and auditors are perceived not independent. Stronger regulation of audit market is long overdue.
- Regulators including the stock exchanges require both physical and human capital to (a) validate offer price of new issues, (b) ensure compliance with full disclosure requirements; and (c) assess quality of audit opinion and financial disclosure.
- Will the proposed Financial Reporting Council improve corporate governance of firms controlled by family members? What will be the auditor oversight system?