



ECONOMIC RESEARCH GROUP

# Analytical Study on Companies Act Reform and Informal Economy

Sajjad Zohir  
Adeeb Choudhury

May 2012

## FINAL REPORT

Submitted to  
The Bangladesh Investment Climate Fund (BICF)

Economic Research Group  
House # 342, Road # 25, Mohakhali DOHS, Dhaka - 1206

## Table of Contents

List of Acronyms .....	2
Analytical Study on Companies Act Reform and Informal Economy .....	3
I. INTRODUCTION .....	3
I.1 Background and Rationale .....	3
I.2 Objectives and Scope.....	3
I.3 Study Method and Sources of Information.....	3
REFERENCE .....	19

### List of Tables

Table 1: Distribution of Sample Entities by Activity Area and Ownership Types .....	9
Table 2: Nature of Ownership Contract .....	10
Table 3: Summary Statistics on Various Correlates of Ownership Contracts.....	10
Table 4: Participation in Trade Associations/Bodies .....	13
Table 5: Importance of being a member of a Trade Association.....	13
Table 6: Factors perceived important for Expanding Business: Responses to a hypothetical question ....	14

### List of Figures

Figure 1: Grouping of Business Entities .....	5
Figure 2: Various Dimensions of Business Engagement.....	6

### ANNEXES

ANNEX 2: LIST OF PERSONS INTERVIEWED.....	23
ANNEX 3: QUESTIONNAIRE .....	1
ANNEX 4: EXPLANATORY NOTES ON TERMS USED .....	29
ANNEX 5: STATISTICAL TABLES AND FIGURES .....	32
ANNEX 6: TRADE LICENSES IN BANGLADESH AND .....	35
SELECTED OBSERVATIONS ON PROVISIONS FOR SOLE PROPRIETORSHIP .....	35

## **LIST OF ACRONYMS**

ADB	- African Development Bank
BB	- Bangladesh Bank
BICF	- Bangladesh Investment Climate Fund
BOI	- Board of Investment
CA	- Companies Act
CC	- Closed Corporation
COI	- Certificate of Incorporation
ERG	- Economic Research Group
GDP	- Gross Domestic Product
IASB	- International Accounting Standard Board
ICAB	- Institute of Chartered Accountants in Bangladesh
IFC	- International Finance Corporation
NBR	- National Board of Revenue
NGO	- Non-Government Organization
OCR	- Optical Character Reader
PPP	- Public-Private Partnership
RIA	- Regulatory Impact Analysis
RJSC	- Registrar of Joint Stock Companies
SA	- South Asian countries
SME	- Small and Medium Enterprise
SPSS	- Statistical Package for the Social Sciences
TIN	- Tax Identification Number
TL	- Trade License
TOR	- Terms of Reference
UN	- United Nations
VAT	- Value Added Tax
WB	- World Bank

# Analytical Study on Companies Act Reform and Informal Economy

## I. INTRODUCTION

### I.1 Background and Rationale

The Government of Bangladesh has initiated a reform of the existing 1994 Companies Act with the goal of drafting a comprehensive set of laws that are expected to capture the majority of the recent developments in the country's private sector<sup>1</sup>. The Bangladesh Investment Climate Fund (BICF), managed by IFC, is supporting the drafting of the new Act by providing both legal and technical experts. In this context, the Economic Research Group (ERG) was approached for undertaking an analytical study on the possible impacts of provisions in the Companies Act on the informal economy. This report, prepared by Sajjad Zohir with substantive contribution from Adeeb Choudhury, is the result of the ERG initiative.

### I.2 Objectives and Scope

The specific aim of the exercise is to understand how some of the provisions in the current Act and their enforcement deter 'informal' enterprises from registering; and what the perceptions of entrepreneurs are about the significance of the Act in expanding the size of the net of registered enterprises. The primary purpose is to provide inputs to the current initiative towards reforming the Companies Act of 1994 so that the provisions in the latter may encourage incorporation by willing actors in the 'informal' economy aspiring to grow and be a part of the 'formal' economy. Upon a better understanding of how the provisions of Companies Act may affect the size of the informal economy and why some businesses choose informality over formality, the exercise aims at recommending changes in the Act that will encourage better business environment and facilitate reduction in the size of 'informal' unrecorded economy.

The 'Act Reform Team' identifies several purposes for reforming the Act<sup>2</sup>, and the agenda covers a large canvass. Since the focus of the current exercise is on the informal sector, it has limited overlap with that agenda. At the inception of the study, such overlap was acknowledged in the broad objective to encourage business enterprises to register, recognizing that the latter is not mandatory. Subsequently, the research team came to know that "single proprietorships" (one-person company) might be included in the revised Act with a view to bring greater number of business entities into the registration rubric of the RJSC. Thus, among other things, the study also looks into the desirability of such inclusion upon assessing possible impacts of the new provision on integrating the current informal-sector enterprises.

Current discourses on informality lack adequate rigor, particularly in the sphere of definitions. One important focus of this paper will therefore be on developing an analytical framework to raise relevant questions and assess merits of alternative provisions from an economic perspective. The purpose is to provide inputs to the restructuring of the Companies Act so that the latter may address incentives for 'informal' businesses to 'formalize', in addition to considering issues regarding business registration and licensing.

### I.3 Study Method and Sources of Information

*Ex ante*, assessment of provisions to be (potentially) included in a revised Companies Act is similar to Regulatory Analysis, which, at times, is narrowly termed Regulatory Impact Assessment (RIA). The analysis would require one to evaluate the benefits and costs of central provisions in the Act as well as of their alternatives. In addition, one would need to identify the expected undesirable side effects and ancillary benefits of proposed provisions and the alternatives. The Act itself however encompasses various

---

<sup>1</sup> A 17-member team has been formed under the helm of the Ministry of Commerce.

<sup>2</sup> It is understood that the core Act-Reform Team will address the following five focus areas/objectives: (i) encourage business enterprises to register recognizing that the latter is not mandatory; (ii) ensure greater transparency by introducing requirements on information that may subsequently help in reducing tax evasion; (iii) ensure greater accountability within enterprises; (iv) attract foreign investment and business; and (v) facilitate capital mobilization through the money market.

dimensions and ‘informal’ sector is possibly the last (if at all) in the list, if not completely absent. The only provision under discussion with potential overlap with the subject of the present study is that of including single (sole) proprietorship in the Companies Act; and therefore, merits assessment akin to regulatory analysis. However, much of the latter as well as other undertakings in this study involve mental exercise and the study involves three tasks to support the analytical work:

- Review literature and documents to flesh out various perspectives and develop a conceptual framework.
- Draw upon secondary data and review information available in existing literature, reports & documents.
- Review stakeholders’ consultation reports and analysis on Bangladesh and interview relevant stakeholders having knowledge and experience with informal economy and on how the latter connects with the formal economy.

Beside the thought process to recast the issues within a meaningful framework, the study will draw upon information collected from enterprises (business units), collectively called the ‘combines’. A questionnaire (see Annex x) was administered during February-March 2012 in major cities, with a greater emphasis on the Dhaka and Chittagong metropolitan areas.<sup>3</sup> As was anticipated, a large majority of the (allegedly informal) combines covered do not have registration with the RJSC. Thus, additional effort was made to identify registered companies and undertake case studies on them.

## II Basic Concepts and Issues

Engaging in the grey area between law and economics, and that also in the sphere of business entangled with practices of accounting and auditing, is an extremely difficult task. It will be foolish to presume a common language of communication across all these disciplines and expect unanimity in perceived definitions of various terms. Given the bias of the authors, the analysis will primarily adhere to economic logic. But the object of study demands venturing into unfamiliar terrain, and those are stated as understood in order to be structured and logical – not necessarily being legalistic. This section highlights key analytical categories used relegating the details to Annex 4. Using those concepts, it also elaborates the analytical framework within which the ‘Companies Act’ and the ‘Informal Economy’ may be linked and understood.

### II. 1 Combines, Business Enterprises and the Regulatory Canvass

At the very onset, we introduce an entity called ‘combine’, a term that showed up in the English translation of the Companies Act of 1994, possibly, while trying to distinguish between companies that included registered and non-registered entities (combines), and the companies that are registered (companies).<sup>4</sup> While such terms as ‘business’, ‘enterprises’, or some other similar terms may be used to represent the collective, ‘combine’ appears to capture the essence of people getting together to undertake an activity with an objective and within an agreed set of rules. The online free dictionary mentions the following meanings of ‘Combine’, which may be relevant for our purpose: (i) to join forces for a common purpose; and (ii) an association of people or groups united for the furtherance of political or commercial interests.<sup>5</sup> In the same

---

<sup>3</sup> The other urban areas covered include Rajshahi, Bogra, Rangpur, Comilla, Joydevpur, Jessore, Khulna and Barisal. No sampling frame was available. The respondents were therefore selected from purposively selected clusters in the urban areas where there were reported/visible concentrations of business/manufacturing activities. Attention was paid to ensure that a large number of locations and varieties of activities within as well as across locations were covered. The study does not generate estimates of population means (or, proportions) and therefore no effort is made to ensure unbiased estimate of such population parameters as ‘proportion of combines not registering’.

<sup>4</sup> One may note that companies are defined in the Act of 1994 as companies (business entities) that are registered. “কোম্পানী” বলিতে এই আইনের অধীনে গঠিত এবং নিবন্ধিত কোন কোম্পানী বা কোন বিদ্যমান কোম্পানীকে বুঝাইবে (1<sup>st</sup> part, 2 Gha). One finds ‘combine’ in the context of ‘Unclaimed dividend and undistributed assets to be paid to Combines Liquidation Account’ (Section 343); ‘Application of Act to Combines formed under former Companies Act’ (Section 351) and while referring to ‘former Combines Act’ (Section 352); and in ‘Exemption of certain Combines from payment of Fees’ (Section 361). The term has a more prominent place in titles of two parts of the Act; Winding up of Unregistered Combines’ (part IX) and ‘Foreign Combines’ Registration, Etc.’ (Part X). Over the course of exchanges during the period of this study, it got revealed that the English translation was not ‘proper’ and the term ‘combine’ was used in place of ‘company’ shown in the Bangla version.

<sup>5</sup> One may draw analogy with the concept of social contract one finds in the literature on political philosophy.

literal spirit, we consider a combine in the economic sphere to be an arrangement/association between two or more individuals defined by either a written or unwritten contract with the objective of engaging in any sort of economic activity. The latter, in broad terms, would include production and/or distribution of goods & services.

One may note that combines involve two or more persons, who may engage in any one sphere or in multiple spheres of activities; and ‘doing business’ (i.e., engaging in economic activities) is only one of many such spheres. Interestingly, an individual may also engage in these spheres of social and economic activities without joining with others. One may also note that there are sub-spheres within ‘doing business’, with overlaps in more than one dimensions. For example, pharmaceuticals which may engage in international trade (i.e., either export its output, imports inputs directly), or, may rely fully on domestic markets. There may be banks, which deal with foreign exchange, and others who do not. Similarly, some business units may rely exclusively on owner’s equity, while others may choose to engage in ‘markets’ of debt instruments (banks, capital market, etc.).

The regulatory canvass pertaining to general business activities in Bangladesh is perceived to include three basic instruments (not phrased in legal terms):

- (i) A general authorization in terms of broad sphere of engagement (such as, commercial, industrial, etc.) through issuing of **Trade Licenses (TL)**. The latter is essentially a certificate/ document granting permission from the relevant local government (City Corporation, Municipalities or Union Parishads) to a legal entity (an individual or an incorporated company) to engage in business. It does not give legal status to the business entity owned by TL-owner; nor do we see any attempt to tag such licenses to specific premises.
- (ii) **(Specialized/Specific) Licenses (SL)** are also issued, which act as certification of compliance with various laws and regulations pertaining to safe and environmentally sound economic activity, to particular profession, trade, calling or business or to deal with (or in) controlled (or dangerous) substances.
- (iii) Certificate of Incorporation (COI), referred to in this report as **Registration**, is issued by RJSC to a new entity (combine) upon “satisfaction that the application conforms to the provisions of the applicable Act and the requisite fees are paid”. The incorporation that turns a combine into a corporation confers *legal personality* to the combine (or, business entity)<sup>6</sup>.

There are many other regulations, either to obtain license or to register, that are specific to individual spheres of businesses, and are not pursued here.<sup>7</sup> Within the simplified context, Figure 1 groups business entities to provide the ground for subsequent discussion on ‘informality’.

**Figure 1: Grouping of Business Entities**



Note: Family business is in both categories. Some registered combines may have only family members amongst shareholders.

<sup>6</sup> The process of ‘incorporation’ confers a separate legal status (or ‘personality’ as it is increasingly referred to) on a group, which generally would imply that the liability of the individuals is limited and the group can commit legal undertakings, such as entering into contracts. In practice, the grey area between finite liability and unlimited liability is large and often remain unexplained.

<sup>7</sup> For example, those under the Securities & Exchange Commission, Bank Companies Act, Insurance Companies Act, Financial Institutions Act, Income Tax Ordinance, Value Added Tax Act, Customs Act, University Grants Commission Ordinance, Stamp Act, Societies Registration Act, Co-operative Societies Act, Bangladesh Labor Code, Bangladesh Labor Law 2006, Business Laws: contract Act and Partnership Act, BEPZA, Waqf Laws, Housing and real estate laws, Foreign Private Investment (Promotion and Protection) Act, 1980; Foreign Exchange Regulation Act, Microcredit Regulatory Authority Act.

The above perspective upholds a view that suggests:

- Individually-owned businesses and those with multiple owners (combines) are subsets of the whole called the business entities; and
- Current practices allow combines to incorporate, assuming certain pre-requisites are fulfilled.

One may however note that individually owned business may induct family members to posture as a combine and get incorporated. When it comes to regulatory canvass, as narrowly defined in Figure 1, there are several questions one may pose:

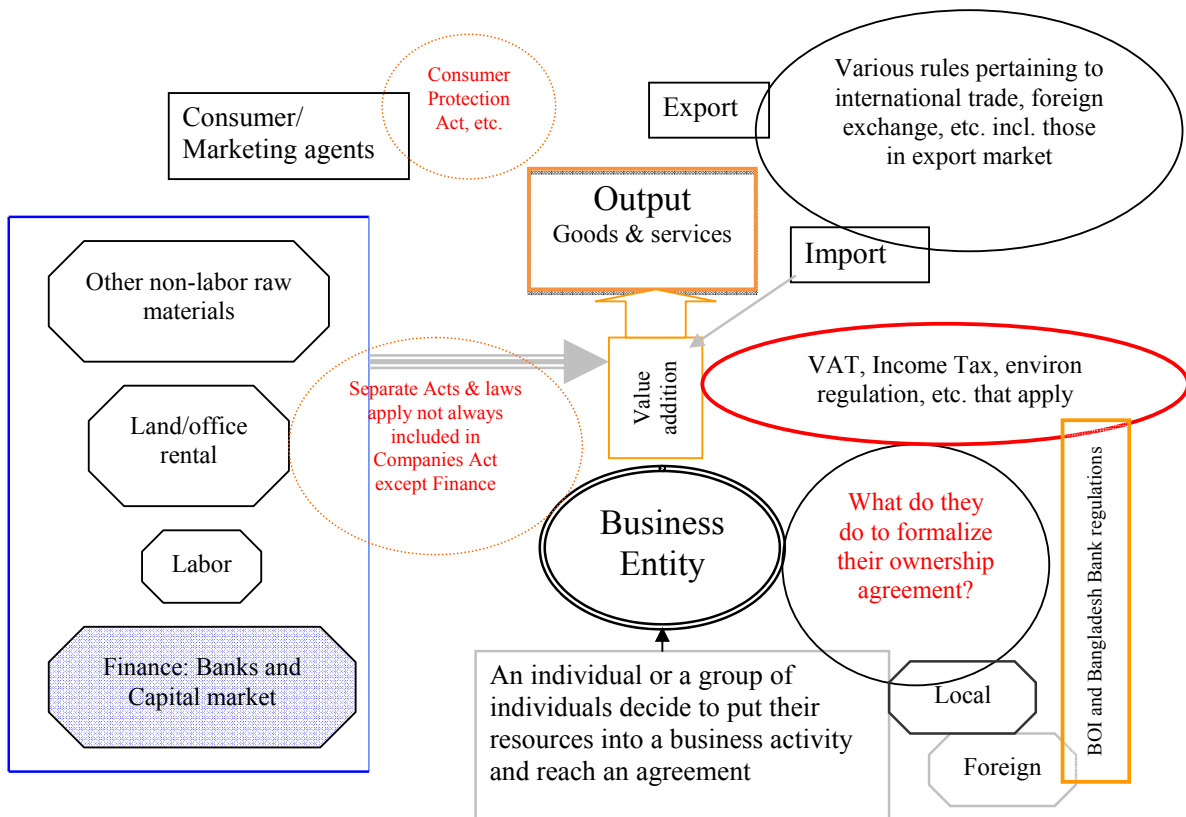
- Should the rule of engagement in a given sphere vary across business entities with different ownership status?
- Should those vary across combines that are incorporated and those that are not?
- Do we really have codes of conduct for general business applicable to all those who undertake businesses? Do trade licenses serve the latter purpose?

Not all of the above will be answered in this exercise, but these are pertinent to form a perspective on the issue at hand. In order to further that, the following section proposes a framework to define the various dimensions of business engagements, which had helped us to structure the field surveys and case studies.

## II. 2 Proposed Analytical Framework with Business at the Center

Figure 2 describes the various dimensions – people of local and foreign origins engaging in ownership contract (if combines) to define a business entity; having contracts with other entities on the input side as well as on output side; and expected to fulfill various regulatory obligations. One may note that a business entity engages in several contracts, the very first of which is (if applicable) amongst owners of a combine

**Figure 2: Various Dimensions of Business Engagement**



themselves, but registration with RJSC and the Companies Act go beyond dealing with registering ownership deeds. Both classification of companies and a significant portion of the provisions in the CA94 (which is a common practice across the globe) deal with the business entity's engagements in the financial market. One possible justification may be sought in the presumption that small shareholders in public limited companies are not 'lenders' but 'owners' of the entity. But that subtlety has, over the decades, increasingly biased the content of a Companies Act. We recognize the presence of cross-cutting purposes in a conventional Companies Act (both CA94 and in the drafting exercise) that mix up policies with regulations; and potentially open up avenues for wrong-doings in resource transfer and rent-seeking. However, given the limited scope of the study, subsequent focus will be on informality and on what provisions may or may not be included to improve business environment in Bangladesh.

## II. 3 Informality – an alternative perspective

Many define the informal sector to include economic entities that are not 'registered'. There is however circularity in such definitions and one ideally needs to find independent definitions, particularly when one looks for reasons of 'non-registration' among combines in the 'informal' sector. A second perspective is to consider 'informal' as opposite to 'formal', where the latter implies something regular, usual or in established form. Thus, one could define 'informal' as something not according to official, conventional, prescribed, or customary forms or rules. It is therefore a common practice among scholars and in governments and banks to define the informal sector or the informal economy as the part of an economy that is not taxed and/or monitored by any government agency. Along the same line of reasoning, one could also consider businesses with trade licenses part of the *formal economy* since some degree of oversight is implicit in it. This view, often spiced with our notions of legality, appears to dominate our perception of informal.<sup>8</sup>

It is important to acknowledge that the 'informal economy', as defined under the second perspective, is not a deviation of the formal economy, if only because all economic activities started informal and those formed the basis from which the formal economy sprang, with firms and annual accounts, taxes, chambers of commerce, etc. We therefore resort to a wider concept of formal and informal that is independent of registration – more in the spirit of exploring alternative concepts. Following the second perspective, one may consider two approaches, not necessarily mutually exclusive. The first relates to book-keeping practices, particularly related to the financial transactions of a combine. The Government's focus on integrating the 'informal' economy with the 'formal' sector in India emphasizes this aspect of business.

A second approach to differentiate between the formal and the informal is in terms of the nature of contract. It is perceived that there are potentially four different sets of relations a combine may have to engage in, over and above its relations with government and regulatory agencies. These include (see Figure 2), (i) two or more individuals (be they from the same family or having no kinship relation) come to an understanding among them to undertake a joint business initiative and form and run a combine (multiple owners); (ii) the owners and/or their representative management make arrangements with laborers to produce goods and services; (iii) the combine negotiates with suppliers of non-labor inputs (including goods for wholesaling or retailing); and (iv) arrangements that a combine engages in with clients, distributors, etc. in the marketing of output and services the combines produces/ delivers. In all those cases, some form of contracts, formal or informal, are negotiated (see Annex 4 for a discussion on contracts) and the threshold between formal and informal may be defined by the scale of the five types of 'contracts'/arrangements described earlier. With contracts and informality defined in this manner, one may find combines (business entities) with multiple identities – formal in some dealings while informal in others. Our focus in the current study will remain confined to arrangements reached among owners and the combine's relations with the government agencies, though information will be sought in other dimensions as well.

---

<sup>8</sup> There is however lack of unanimity in setting the demarcation line and many, especially in national tiers within the government, would hesitate to accept all trade license owners as part of 'formal' It is also important to note that legality is not at issue at all; it is rather the presence of an entity within the purview of relevant government agency that is emphasized in the stated view.



## II. 4 Review of Stakeholders' Consultations

The 17-member committee on drafting a new Companies Act had consulted several business chambers and associations of chartered accountants (ICAB and others). Representatives of businesses and professionals directly linked with accounting and auditing activities of companies during incorporation and in sustaining that status, are more familiar with the substance of the Act. During the course of the study, it was also realized that very few outside the professionals in companies law and chartered accountants are familiar with the substance in the Companies Act.<sup>9</sup> The transcriptions from the consultation meeting retained by BICF were reviewed and are summarized in Box 1 below. In general, there was no reference to the informal economy. However, some of the tangentially related themes raised by some participants included: purposes of reform, issue of single proprietorship and the need for upholding 'interest of the nation' that is not biased by narrow interests of specific stakeholders. Separate consultations and case studies by the authors are taken up later.

### Box 1: Stakeholders' Consultations – Selected observations

1. There is unanimity in recognizing that the drafting is taking cue from acts and laws existing in other countries and the current Act of 1994. There is however indication of inadequate knowledge on practices in other countries and some stakeholders made strong observations on the validity of various evidences, particularly, on UK. Provision of natural person and that an object clause was still in place in UK were noted.
2. On one-person company: Some have endorsed the proposal without digging deep and presuming that such provision would open ways for many family firms and single owner business to incorporate, which will subsequently help business to grow. There were however opinions expressed against one man company: it should be a minimum of two or more to be a viable company (Ali Ahmed). Even some raised concerns with regards to misuse of laws by businesses having family members act as directors and their personal expenses shown as company's expenses.
3. Concerns were raised on companies getting entangled with litigation and suggestion was made to reduce the probability of such happenings.
4. Mr. Syed Toufique Ali, former Vice President, Dhaka Chamber, was very critical of the Act and noted that there was nothing in the Act for the small business. He also mentioned that it were the small businesses which paid tax and not the family-run big companies.
5. The same person also raised an important perspective missing from the exchanges – "They all spoke for their petty interests mentioning this is cumbersome, that is bad, etc, but nobody has spoken about what can be done for the nation. (Yet) We are talking about national policy."
6. Another pertinent methodological issue raised – without reviewing the experiences gained with the old Act, and without identifying deficiencies, we may be doing injustice in rushing towards drafting a new Act. As Mr. Ali noted: "We should keep it in mind that we have worked under this Companies Act for 50 years and we have prospered. Today, our national exchequer has 14 billion dollars! So, nothing is bad. If we can tolerate the worst, we can always improve it slowly."
7. A different but pertinent perspective upheld by Advocate Lubna Yasmin: "The new Act should benefit the new generation. We should think about the next 50 years."
8. The Registrar (of RJSC) noted that the single proprietorship in other counties is addressed by Business Registration Act, which is absent in Bangladesh. He opined that "It would be better if we could form such an Act. But, ... there is little scope to discuss that point in this forum." He however noted, without explanation, that "proprietorship will not be discouraged in single-man company system".
9. Mr. Manzoor Ahmed of FBCCI also echoed similar concerns by suggesting the need for a business establishment Act. As put by him: "It will describe businesses in all forms of business corporate level, whether in publicly owned, privately owned or joint venture or foreign direct investment or PPP format. ... should be addressed under the new companies law, the *Byabosha Prothistan Ain* (Business Organization Act) or *Banijjik Protishthan Ain* (Commercial Organization Act)."

Source: Transcriptions retained by BICF.

<sup>9</sup> Winding up (involving judiciary and legal profession) covers 234 to 346, part V extending over 210 to 271 out of 299 pages, which is more than 20% of the content. Note also the content in chapters VII to IX., which demand active roles of auditors and accountants.

### III Comprehending the ‘Informal’ Business – empirics and beyond

This section draws upon survey findings, insights from case studies and interviews, and draws lessons from review of practices<sup>10</sup> in other countries. Summary and recommendations are left for the concluding section.

#### III.1 Revisiting Informality – survey of business entities in urban Bangladesh

##### *Selected observations on the Business Entities Surveyed*

The survey, undertaken during February-April 2012, covered business entities in several cities and towns in Bangladesh. As mentioned in Section 1, there is no sampling frame to choose an appropriate sample of business entities for this study. RJSC has information on registered companies which provide indication of spatial distribution of business in the country (see Table A.5.1 in Annex 5). Dhaka accounts for almost 73% and Chittagong another 11% of registered entities – thus, a larger proportion of our sample was chosen from these two cities.<sup>11</sup> Around 43% of the surveyed entities were located in market places, 36% in part of buildings and 20.5% stood alone. While almost all (97.2%) the premises had floor and wall materials made of bricks & plasters, 20.7% had roofs made of tin/CI sheets. Table 1 provides basic information on ownership, by type of activities, while Figure A.5.1 (Annex 5) shows distribution by year of establishment.

**Table 1: Distribution of Sample Entities by Activity Area and Ownership Types**  
(row percentages)

	Family business: ownership			Partnership	
	Single	Multiple	Undefined	immediate kins	with outside
Agriculture goods/grocery	66.67	18.75	6.25	6.25	2.08
Agr machinery/automobile	77.50	15.00	2.50	2.50	2.50
Jewellery/personal care	78.26	13.04	0.00	8.70	0.00
Food manuf/restaurant	50.00	25.00	10.00	12.50	2.50
Home furniture	69.86	20.55	5.48	1.37	2.74
Home appliance/electronics	75.00	20.00	5.00	0.00	0.00
Machinery/hardware	79.31	17.24	1.72	0.00	1.72
Consumer products	78.63	11.97	4.27	0.85	4.27
Medicine/pharmacy	70.83	16.67	0.00	8.33	4.17
Light engineering	88.89				11.11
All groups	73.18	16.77	4.14	3.16	2.56
Average number of owners	1.00	2.02	1.48	2.19	2.54

Source: ERG Survey 2012.

That family businesses dominate business in most countries is well documented - the most conservative estimates (as reported in Islam *et al* 2010) suggest that the worldwide percentage of business that are family owned ranges from 65% to 80%. Since the survey had covered small business units with a view to include the perceived ‘informal’ sector activities, 94% of the entities in the survey are found to be family run business. Of the family businesses, 73% are owned by single person and in at least 17% cases, ownership extends to two or more family members.<sup>12</sup>

<sup>10</sup> We hesitate to say ‘best practices’ because adequate information to make that judgment is not available, nor are the authors competent to make comprehensive comparisons accounting or the multi-disciplinary nature of the issue with expressed biases towards law and accountancy.

<sup>11</sup> Respect Information at sub-sector level is unspecified for 72.24% of entities, 30 and 18.5 percents of the sample business entities are from Dhaka and Chittagong cities. Rest (51.5%) were drawn from six other cities.

<sup>12</sup> Islam *et al* (2010) found 73% of family firms to be sole proprietorship and 22% were in partnership.

Following the discussion in Section II, we sought information on how agreements amongst owners and between owners and other agents are recorded (or, not recorded). Generally, ‘formal’ is defined to include written and registered contract only; ‘quasi-formal’ includes agreements written on stamp papers or on plain papers signed on revenue stamps; and ‘informal’ includes agreements based on trust, or written on letterhead/plain paper. Table 2 records the distribution of contract types across family businesses (with multiple members) and partnerships between persons from different families. Clearly, relative incidence of formal agreements increase as ownerships extend beyond families (see also Table A.5.2 in Annex 5).<sup>13</sup>

**Table 2: Nature of Ownership Contract**

Type of understanding/contract	(column percentages)	
	Family, Multiple	Partnership
Written and Registered	3.37	25.00
Written on stamp paper	10.11	21.43
On plain paper with signature on revenue stamps	1.12	0.00
Written on paper with no stamp	4.49	3.57
Unwritten, trust based understanding, informal	80.90	50.00

Note: Family business run by single owner is not included since no ownership contract is involved.

Information on several Correlates of degree of formality in ownership contracts are summarized in Table 3. More formal the ownership contract is, more likely it is that the rental contract will be formal. All cases of formal ownership contract had either formal or quasi-formal rental contract. The opposite is not true, i.e., all formal rental contracts did not lead to high formal contract on ownership (see also Table A.5.3 in Annex 5). One may note that the degree of formality in ownership contract, as defined in this paper, has bearings on forms of contracts (and degree of ‘formality’) in other spheres as well: more firms with formal ownership contracts maintain proper accounts<sup>14</sup>; issue cashmemos to customers; have trade licenses and have TINs. Interestingly, in two specific areas the owners of business entities with formal agreements falter: in dealing with their suppliers (of inputs) and in enforcing VAT – the reasons for which could not be probed into in this study. While one observes insignificant difference in obtaining trade license across ownership contracts, there is no significant variation across sub-sectors within business. However, higher percentages of wholesale business and light engineering obtain TLs (83-85%) while only 63-66% of business units in retail and service sectors obtain TLs.

**Table 3: Summary Statistics on Various Correlates of Ownership Contracts**

Percentages of respondents (in each contract type):	Contract type, Combines			Single owner	All
	Formal	quasi-formal	informal		
with formal or quasi-formal rental contract	100.00	92.86	91.03	94.08	93.56
not maintaining any accounts	0.00	6.25	14.29	15.63	14.74
with formal/quasi-formal contract with input suppliers	0.00	0.00	4.81	1.91	2.42
charging sales tax/VAT	0.00	12.50	10.48	9.46	9.58
Issue cashmemo/receipt without being asked for	90.00	68.75	52.38	59.46	58.88
issue cashmemo/receipt with or without being asked for	90.00	93.75	83.81	88.11	87.43
with trade license	100.00	93.75	95.24	97.01	96.59
with TIN (Tax Identification Number)	90.00	87.50	74.04	74.03	74.75

Source: ERG Survey 2012.

<sup>13</sup> Three-fourth of family businesses are singularly owned and about 17% have equal partnership. Those with formal ownership arrangement are graduates at the least, while the minimum is HSC for those under quasi-formal.

<sup>14</sup> Of the four items on which information on record keeping was sought – deliveries received on credit, inventory, cost & expenses and sales – maximum record-keeping of some sort was observed in case of sales. Percentages reporting some form of record-keeping were respectively, 71%, 51%, 81% and 85%.

Beyond degree of formality in ownership contract, following observations may be made on formality or informality in general:

- Trade Licenses: Nearly all of the firms surveyed have trade licenses. Across the board it was noted that acquiring trade licenses were relatively painless in terms of bureaucratic delays and the need to pay bribes for service. It seems easy to get and renew.
- VAT Registration and TIN certificates: the survey results for these (considered mandatory for most businesses) are more ambiguous. The most common response is that the respondent is unaware that these are required for business. The other responses were mainly that it was mandatory and the business had it and that it was optional and they do not have it. Given the fact that even the bodies responsible for issuing the licenses are rather uncertain about when they are required it perfectly justified that confusion exists in the general public.
- Trade Licenses and other licenses are more strictly enforced and more rigorously renewed outside of Dhaka. In fact, almost all of the businesses that do not have trade licenses are situated in Dhaka metropolitan city. This could be because Dhaka itself is densely populated and is thus understandably hard to police whereas areas with a lower density of businesses are more easily policed.
- There does not appear to be any clear (or any really) pattern between getting trade licenses and firm characteristics. This could be because this form of formalization has too low an “activation energy” to be a proper metric<sup>15</sup>. To explain, trade licenses have a “low activation energy” because they are easy to procure and their benefits are simply in terms of compliance to the law (and hence escaping problems) and not other benefits. Company Registration has a “high activation energy” because the costs of RJSC Registration are very high and the benefits are nebulous and poorly defined at best. In essence, using T.L.s and C.R.s as metrics of formalization might be too extreme; they will have no links to the characteristics of a firm of a particular scale.
- Record Keeping practices do not seem to have any link to firm or owner characteristics either. The different dimensions (discussed at the start of this section) do not seem to have any link to (surprisingly) to owner’s age and education either. However, record keeping practices do seem to indicate that though standard account practices are not followed, there is some daily ledger kept for transactions, though it is important to note that these are usually for major transactions (as reported by the field enumerators who conducted the survey)

#### *Market-based Links with spheres of ‘Formality’*

No unique definition of ‘informality’ has so far been adopted, though ownership of a business entity is emphasized and the nature of agreement reached between owners is categorized into three on a perceived scale of formality (informality). The latter however raises a problem of placing single ownership since no separate agreement among owners is called for. In the context of the Companies Act 1994, one could confine to combines and stick to the strict version of formality and probe into why some of those register and others do not. However, common perception of informality is lot loose, expecting the formal sector to adhere to certain norms and practices within the purview of regular monitoring of the regulatory authorities. Two potential instruments of general nature for the regulatory authorities to connect with the economy with a view to ‘formalize’ are incorporation/registration with RJSC and trade licenses. Most business entities covered by the ERG survey have TL and almost all have not incorporated. From the perspective of the local authorities, businesses (or, rather business persons) having TLs are legal (doing businesses legally) as long as they renew their licenses annually. But others, including the people in Ministry of Commerce, is likely to consider them ‘informal’ unless (possibly) they are paying taxes, and abiding by all the regulations applicable – a canvass on which there may be multiple perceptions! Thus, drawing a line between ‘formal’ and ‘informal’ will depend on one’s purpose of inquiry. If we take the extreme version of ‘non-registration with RJSC’ as equivalent to ‘informality’, the ERG sample provides a basis to assess how the business entities link with the ‘formal’ part of the economy if they at all do so.

---

<sup>15</sup> A concept of “activation energy” from chemistry and define as the minimum cost required to change “state” from “informal” to “formal” what we will refer to is engaging in some forms of formalization where the cost of formalization is very low compared to the potential punishments (monetary or otherwise) that would be accrue if the business did not formalize.

A pertinent question that the regulators may consider: what is the best way to bring the various business entities within a network so that policies may be effective and regulations may be enforced in cost-effective ways. A comprehensive understanding of the issues is beyond the scope of this study. But, recognizing the need to understand current linkages, the current exercise looked into few sub-sectors and had addressed related questions in the survey. Two important areas/routes of linkages are identified below: sub-contracting/ out-sourcing activities of the entities that are in the ‘formal’ segment; and trade bodies and/or owners’ associations that hold potential for playing mediatory roles. These are further discussed below.

Out-sourcing and sub-contracting are commonly recognized as effective ways to do business. These also permit labor market flexibility, that is discussed in literature on economic fields. For the purpose of illustration, we provide three examples. First is the case of a real estate developer/construction firm. As a business entity, it is visible and is (most likely) registered as a company, maintains ledger books, pays taxes (with or without evasion), may (or may not) have VAT registration. Such an entity engages different groups of labor and contractors to do their job; and these groups never surface as business entities (hence truly, ‘informal’ in all senses of the term); except when they grow big enough to rent a premise and therefore obtain a trade license.<sup>16</sup>

A second case, we encountered during our field visits in old parts of Dhaka city, relates to another ‘unseen segment’ of the formal entities. There are, apparently, some units formally tied to a principal business entity; but the latter would not formally acknowledge it. In the absence of centralized data on premise use and full disclosure of information by a formal entity, it is difficult to bring those under the purview of regulatory bodies. Similar instances are reported to often arise in cases of dyeing of RMG output. The principal entity may find it convenient to disown the dyeing unit if so needed; though effective ownership and line management are with them.

The third case is illustrated by a case study we undertook on ship-breaking industry that is situated between Nw Patenga to North Sonaichori. Reportedly, one may obtain more than 101 items from an old ship. Most of these are used locally though some of these are (re)exported (e.g., propeller, copper, marine parts, generator, compressor, ss pipe, etc)<sup>17</sup>. Old ship items also used in some ship-building industries in Narayongonj. The ship-breaking firm is essentially an organizer and coordinator of multiple activities and agencies that include global agents as well. As in other cases of bulk imports, there may be pre-import arrangement between various parties mediated and/or post-import auctioning of various parts of the ship. In general, each buyer is expected to negotiate with available labor and for equipments to get their purchases out of the yard. It is important to note that many of the actors remain invisible from the scanners of regulatory authorities; and it is only through the visible part can one think of ensuring compliance.

#### *Non-Market Links with spheres of ‘Formality’*

While undertaking pre-testing of questionnaires, we realized that many business entities would not open up till they received green signals from the executives of specific trade bodies (or, association of owners). Subsequently, some such agencies were looked into in order to assess if they provided links to the formal economy or with the regulatory agencies. The ERG survey reveals that almost 70% of all entities (surveyed) are associated with one or the other form of organized body – be those shop-owners’ association at market places, association of such specialized trade groups as light engineering, or national associations and chambers. Other than a larger representation in national trade bodies from the ‘formal’ ownership category, there is not much difference across groups of all non-registered business entities.

---

<sup>16</sup> The real estate business involves another interesting case also – when several individuals put their money in procuring land through the established entity based on trust and (possibly) an agreement on judicial stamps. This association of temporary owners, as also the case of mill-level stock build-ups, are not lenders, but their gains are tied to resale value of the property (or produce).

<sup>17</sup> See Figure A.5.2 in the Annex.

**Table 4: Participation in Trade Associations/Bodies**

(row percentages)

Type of business entities	shoppers in market place	specilaized trade bodies	National trade bodies	Is not a member of any
Formal	30.00	20.00	20.00	30.00
Quasi-formal	31.25	31.25	12.50	25.00
Informal	38.46	24.18	2.20	35.16
Single owner	40.41	24.78	5.60	29.20
All	39.47	24.78	5.48	30.26

Source: ERG Survey 2012.

The discussion in Section 2 suggested that one prime reason for provisions of registration was to facilitate formalization of title of ownership; and in cases of combines, it addresses the agreement reached between multiple owners regarding various aspects of running and profiting from a business (Figure 2). Abstracting from the issue of incorporation that bestows ‘legal personality’ to businesses, having an ownership deed registered to secure rights of all owners as well as for resolving conflicts with other business entities, are considered important factors. ERG survey shows that respondents who are members of trade associations consider the role of such associations to be extremely important in dispute resolution (Table 5). Interestingly, interviews with stakeholders suggest that combines with fewer players and small size find mutually agreed private arbitration of conflicts more effective than relying on government agency or registration.

**Table 5: Importance of being a member of a Trade Association**

(row percentages)

Reason for participation evaluated	Not important	Important	Very Important	Mandator y
Pre-requisite for doing business	60.49	10.49	4.32	24.69
Substitute for trade license	99.07	0.62	0.31	
Efficacy in business operation	55.56	11.73	16.67	16.05
Dispute resolution	8.92	9.54	47.69	33.85

Source: ERG Survey 2012.

### III. 2 Why would Combines aspire to Register

Across the board, the level and quality of knowledge of the RJSC and company registration are, to put it mildly, poor to completely non-existent. Few businesses (surveyed) have even heard of the RJSC or know what its functions are. Only 9.6% of the surveyed firms knew of RJSC. But only one-eighth of them had incorporated their business. Did they feel that it was worth registering? Responses were equally divided between three: yes, no and ‘yet to be revealed’. Of those who did not register but knew of RJSC (49 respondents), only 3 felt that they could benefit if they had registered – 2 by getting access to adequate finance and 1 by avoiding ownership dispute. Those who knew of RJSC but did not incorporate were asked if they wanted to register. Almost four-fifth of them did not want to register – they perceive it as something for the “big companies”, less than 10% expressed willingness to register, and the rest upheld conditional willingness.

For the kind business entities we have considered and which are perceived to be in the ‘informal sector’ no matter what definition we assign to the latter, ownerships issues are most likely to be settled out of court with complete private arbitration. The same applies for all other disputes – with employees or with other agencies one engages with while doing business (see Table A.5.5). Thus, contrary to prior expectation, business is unlikely to register with the RJSC for the purpose of protecting ownership – possibly, the freedom of choosing partners and non-transferability of person-specific endowments sustaining many small

businesses provide enough protection to ownership (unlike real assets) and involvement of government agencies is perceived an unnecessary hassle<sup>18</sup>.

The most common response to why the firms do not “register to become private companies” is that they are too small. Interestingly, though almost all the respondents have expressed the desire to expand their business, they seem not to have any clear plan on how to do so. Questions on hypothetical needs for expansion often cite access to finance as a major constraint (Table 6). The fact that expansion of business and company registration may be complementary is not properly understood. This is an area of public knowledge building that can be explored.

**Table 6: Factors perceived important for Expanding Business:  
Responses to a hypothetical question**

(row percentages)

Access to	Not important	Important	Very Important	Most important
Finance	1.98	1.59	2.18	94.25
Law enforcement authority	57.14	32.74	7.14	2.98
Electricity/Power	16.63	25.15	25.94	32.28
Telecommunication	24.16	25.94	16.83	33.07
Computer/internet	79.60	9.90	3.76	6.73
Training	69.12	14.14	6.77	9.96
Premise/Space	26.71	12.82	11.97	48.50
Trade License	80.30	2.78	1.93	14.99

Source: ERG Survey 2012.

Several case studies were undertaken to understand why some of the combines chose to incorporate and others did not. Drawing upon several such interviews, the following observations may be made:

- Among our case studies, the most cited reason for company registration was “efficacy of doing business with foreign firms” and the advantage appears to be the perceived “access to the big leagues”. When a combine registers, the act itself seems to confer a sense of seriousness and stability (in terms of succession) that makes it more likely for other registered firms to deal with them on a long term basis. RJSC registration serves as a credibility certification; a sort of reputation guarantee for international firms wanting to do business with local firms. The signal received by other firms is that the incumbent is not only around for an extended period of time, but it also subscribes to a particular set of practices and rules that ensure a degree of accountability and transparency within a legal framework. Apparently this is especially important when dealing with foreign firms; the idea is that registering (with RJSC) means the firm has been vetted. In that sense, the RJSC is a guarantee of “reputation” shaped by preferences of the global business entities.
- In terms of the practices themselves; the fact that other firms also follow (or should follow) the same set of rules means that the parties are in level-playing fields when it comes to accounting, corporate governance, etc. However excessive standardization have limitations as well, as the context sensitive needs of each firm may not be best served with a one size fit all solution.
- Ownership: the usual benefits of having the option of having recourse to the law in case of disputes; makes it less likely for owners to renege on contracts if these contracts are “official”. There is also a system in place for effectively mediating ownership disputes. However, this factor appears to have very little appeal in the context of Bangladesh, especially for small so called informal businesses.
- Continuity of business: Since incorporation allows a business entity to be a ‘legal personality’, it may continue to exist beyond the death (or, non-functionality) of its founder. There are

<sup>18</sup> Mel, McKenzie and Woodruff (2012) treated formalization as equivalent to incorporation in Sri Lanka and found that most firms are rationally refraining from formalizing, since they see few benefits from doing so. Only a few did however make substantial profits, though no significant effect of formalizing was found on relationships with the financial sector – applying for business or personal loans or having a business bank account; or on relationships with the government – having an electricity connection in the business name, applying for a government contract, making sales to the government, participating in any government SME program. Firms which formalize were found more likely to use receipt books and to do more advertising. They also reported that they feel their businesses are more legitimate, and trust in local government increased.

apprehensions that there is now a sufficiently large segment of business entities, large in their operations and assets, where the progenies are keen on engaging actively.<sup>19</sup>

- Registration to avail benefits out of differential tax and incentive structure in place. For example, a group of companies may show profit in (say) its associate corporation in agriculture sector where (say) no tax is imposed without undertaking any effective activity for that sector; and this is possible with accounts transfers in many different ways.
- Access to legal benefits and facilities availed from the ‘formal’ sectors, such as the bank finance and raising investment fund from capital market, are facilitated by having the business entity turned into a legal personality. Moreover, “limited companies” reduce the risk of undertaking by those who own or run the companies.

The very last observation relating finance is possibly the most important reason why some persons in business want to incorporate their undertakings – though very little of it is raised in open exchanges. Our assertion is based on several observations: (i) revealed biases in the formulation of a companies act with issues on finance, audit and liquidation largely arise due to checks and balance one ought to put to guard ‘public’ interest threatened by misuse of the provisions on limited liability; (ii) while one would presume the importance of registration providing protection to ‘title of ownership to a business’, in reality, most people seek private arbitration to resolve conflicts in business ownership as well as in other disputes arising in business – thus, in majority cases, urge to register is not driven by that factor; (iii) in the various spheres a business entity has to engage in (see Figure 2), there are separate laws and acts to govern contracts – labor, banking, foreign exchange, rent of premise, etc. – companies acts (generally and of 1994 in particular) do not put effort on compliance in other areas of engagements by a company (such as, labor, environment, etc.), but focus on the financial details, from statements to audit, and even to the management issues of appointing (accountant) secretaries!

#### **IV Inclusion of Single Proprietorship: review of issues and practices in other countries<sup>20</sup>**

##### *Companies Act Reform: brief discussion on the Proposal of Including Single Proprietorships*

The inclusion of Single Proprietorships (hence forth abbreviated to SPs) in the Companies Act Reform has been tabled and appears to appeal to many. Our intention in this section is not to argue for or against its inclusion, but to briefly outline the characteristics of SP Companies and what alternatives exist. Particularly, the current practices in Singapore are reviewed as their model breaks away from the traditional mold and introduces a number of innovations that can be adapted to great effect here in Bangladesh:

Implications of introducing SP Companies are perceived as follows:

- Separate Legal Status: SP will be liable for lawsuits as well as be able to own other businesses and companies. This also means that SP attain perpetuity, i.e. they do not cease to exist if the original owner of the firm dies; it can be inherited or sold.
- Limited Liability: will reduce the risk from “act of god” crises leading to personal (private) bankruptcy of the owners of the company, i.e. the owner’s debt liability will be limited. The exact nature of this is still undefined (as of the writing of this report)
- As a registered company with the RJSC, business laws will be applicable to the SP; hence there will be (at the very least) improved contract enforcement

---

<sup>19</sup> Islam et al (2010) found that 73% of firms in the northwest Bangladesh lack succession planning, another 25% firms have succession planning but not in written form, and only 2% have a succession plan which is in written form. The proportion of the third category in Dhaka city and among better-of family businesses is likely to be lot higher. Islam *et al* also reports that the most important factor that motivates the owners of family firms to develop succession plans is to keep the business within the family, followed by the urge to avoid unexpected transition. The survival of the business over generation comes only in the third place in order of priority.

<sup>20</sup> This section touches the issues briefly and is supplemented by discussion on trade licenses and business registration in Annex 5. It is necessary to read the Annex to get the full picture on the practices in Bangladesh and elsewhere.



- The SP will likely fall under a different tax structure (bracket) than businesses with a trade license. If the SP is just taxed at the normal rates for companies (as high as 47% in some cases) then the owner may have little incentive to go for RJSC registration. (Trade License holders are taxed at 25% flat)
- The SP will still require a trade license
- Given bureaucratic delays and other problems, setting up at will likely be very expensive; unless large scale automation activities are undertaken.
- Will most probably require yearly audits
- If there is heavy regulation regarding the AOA's and the MOUs, then the SP might be too inflexible to be highly competitive.

### *Alternatives: Looking at Singapore*

The issues of automation and modular licenses are a matter of process and efficiency that have significant impacts in the cost of doing business. Singapore's ACRA, being the sole agency in overseeing both business and company registration means that not only can they conduct centralized data collation (leading to modular forms), it also makes them more agile and flexible when it comes to offering those services.

Singapore has also introduced two new forms of companies, Limited Liability Partnerships (LLP) and Limited Partnerships (LP) that serve as a mid-point between businesses and companies (though the LLPs are technically known as companies)

**Separate Legal Status:** LLPs have a separate legal status and combines the operational flexibility of a partnership with the limited liability features of a company; each partner bears limited liability for the debts and obligations of the LLP

**Risk Reduction:** a LP does not have a legal personality separate from its partners, (i.e. it cannot sue or be sued and does not have the right to own property in its own name), however its general partner bears unlimited liability while each limited partner bears limited liability for the debts and obligations of the LP. As we briefly detailed above, LLPs and LPs have different strengths and are governed by different sets of regulations; however their implementation makes for a much more flexible business environment where entrepreneurs can pick and chose what type of company that fits them best and not have to just stick to a one size fit all solution.

It is entirely possible for the Companies Act Reform to include provisions for different sorts of companies following similar structures as outline above. It might even be possible to structure the SP requirements in such a manner as to include the Trade License as a part of a modular form or make provisions for a "Trade License Plus" that has a different mix of benefits (such as separate legal status with no limited liability, some degree of limited liability, etc ). **The latter however may require a new Business Registration Act** that is not tied to the municipality authority even though their services may be tied in at an operational level.

## **V. Issues and Recommendation**

### *Summary*

No unique definition of 'informal' may be identified. One may take an administrative view and draw a cut-off, say, formal being defined as active businesses that are (i) incorporated (registered with the RJSC), (ii) have trade licenses renewed annually, or (iii) paying taxes and abiding by other compliances. While the study considered the first two aspects into active consideration, attempt was made to assess and quantify the relative incidence of various **forms of** agreements that owners of a business engage with different groups while undertaking their businesses. This was derived from an analytical framework explained in Section II.

The study draws upon a survey of business entities in urban areas of Bangladesh, carried put an extensive review of literature and web postings to document the various practices with regards to incorporations and

business registration, and consulted with a diverse group of stakeholders. Drawing upon those, the report has hinted at (raised) some broad observations on the state of the informal economy, provisions of companies act and on general governance of the business (particularly, small) sector in Bangladesh. These are briefly listed below:

- Owners of most business entities in major cities of Bangladesh have trade licenses. However, these licenses neither serve the purpose of ‘premise licenses’, nor that of ‘business registration’. Essentially, it allows local authority to raise revenue.
- If formality (informality) is defined in terms of having (or not having) TLs, then most businesses in the cities are formal. Other dimensions of government requirements to distinguish between formal and informal have not been adequately probed into. If one consider having TIN in addition to TLs, a large segment would (three-fourth or more) would be considered as formal as well. However, the fact that we do not consider most of those as parts of ‘formal’ sector clearly suggests failure of policymakers and regulatory authorities in using the license issuing process and the information generated in the process for bringing the license-holders in line with certain basics that are perceived to characterize formal sector.
- If one proceeds from current practices, one finds limited prevalence of registering ownership agreements among combines. However, comparing formal, quasi-formal and informal in the form of ownership agreement, one finds relatively more ‘formal’ practices in other dealings in business to be associated with greater degree of formal agreements in ownership of business. Thus, greater degree of formality may be realized by facilitating formalization of agreements on ownership.
- There is an increasing urge to ensure continuity of business beyond one generation. Clearly, TLs are not appropriate instrument to realize that objective. In addition, there are aggregate-level risks associated with introducing single proprietor company.
- Majority of business-owners, with TLs but otherwise aggregated with small and informal activities, are unaware about the presence of RJSC and what it is meant to do. Most of those who know of it consider it to be an affair of big business. For them, private arbitration is perceived to be the best choice to seek dispute resolution. Moreover, TLs allow them to avail bank finance; and the requirements for availing term finance with incorporation are perceived to be beyond their means. Thus, even though there is urge to expand and demand for finance, it should ideally be an issue to be addressed outside the scope of the Companies Act. Yet, the study observes, the association is too vivid across globe.
- Those listed above characterize the perceived informal segment with TLs, mostly drawn from survey findings. There is however a minority group of better-off and/or more dynamic and ambitious segment in the business community who may aspire for incorporation. Such aspirations may be grouped into: client-driven, finance-driven, ownership-driven, and for paying heed to perception of the society on what is credible and what is not.
- Incorporations are often perceived as means to access cheap funds. Under Bangladeshi law it is possible and simply too easy for a company Director to evade financial liability if she/he depletes corporate account by ‘honest but negligent’ business maneuvers. Incorporation is also perceived to allow one to make untaxed (‘black’) money white as well. This is possible when the funds are coming (re-remitted) from abroad. Furthermore, the study noted the possibility of tax evasion when a single supra entity controls companies in multiple sectors facing differential tax incentives/rates.
- The study illustrated several cases of informal-formal links, such as, through sub-contracting or outsourcing, and those mediated via traders’ associations/trade bodies. Specialized traders’ associations play important roles as quasi-registrar.
- The study made extensive review of practices elsewhere. It is found that some form of business registration is present in most countries, which is independent of incorporation. While the South African experiment with CCs is alluring, recent changes in their Act to stop further registration under CC Act and possible lapses leading to such change raise concerns on allowing closed business to evade the risk of their undertakings (and possible misuse of funds) under the cover of incorporation. Singapore case has been presented as well. The latter’s experiment with limited liability partnership (with unlimited liability for one) and the practice of a single agency looking after both business registration and incorporation are worth looking into for localized adoption in Bangladesh.

## *Recommendations*

It is presumed that the Government intends to realize a number of objectives through formulation of/reforming the Companies Act 1994, which include, (i) better record-keeping and information compilation which will allow better planning; (ii) widen the tax net; (iii) assist local business to grow into viable institutions; (iv) business entities comply to the requirements in each sphere of their engagements; and (v) take the society towards greater civility for betterment of all the citizens. With that presumption, a number of recommendations are tabled for consideration. Given the limited scope of this study, the focus has confined to the first four objectives.

- Trade associations and trade bodies be given legal status in the Act to bridge between formal and informal practices;
- Current practice with trade licenses (TL) should be reviewed. It is proposed that eventually TL be given the status of 'premise license' and appropriate amendments be made to introduce trade (modular) license plus (say, through a business registration act, or having a separate chapter on it in the Companies Act as an interim step) and remove any potential conflicts with TL with a view to accommodate single proprietorship. In this context, the Reform Committee may like to assess why South Africa retreated from CCs; and may find revisiting the Singapore experience worth replicating after accounting for our limitations on institutional capacity.
- Certain obligations be introduced on incorporated (as well as those under business registration, if introduced) business entities in the 'formal' economy to formalize their contracts with other entities they do business with. This will reduce the load on central government in reaching out to all corners of the business canvass.
- It is important to recognize that the agency responsible for registration is not providing any legal service, but is a storekeeper of information on which the system of arbitration and conflict resolution relies. Since such services hold potential for rent-seeking, it is important to find ways to make the agency accountable for distorting information it is trusted with. Some such provisions in the Act will increase confidence in registration and attract business to register.
- If smoothing access to finance is a primary objective of the Companies Act, let it be stated in clear terms so that appropriate checks and balances may introduced to ensure that the negative fallouts from 'Limited liability' option.
- Companies Act is not meant to reflect on tax structure and incentives; yet, NBR needs to be consulted to ensure that there is consistency in government policies and attempts to enhance the net of registration is not thwarted by adverse tax policies.
- Public Awareness Campaigns that increase the quantity and quality of public knowledge of RJSC (or any other agency assigned to do the job) and its benefits.
- The potential for enhancing the relative size of the 'formal' economy may be realized if institutional reforms are enforced involving RJSC, Local government (and any other deemed relevant) preceding Acts (but following major policy reforms) by recognizing service-delivery nature of the functions and ensuring that the agency remains accountable to those to whom services are extended.

## REFERENCE

- Bangladesh. Bangladesh Bureau of Statistics. The Industry and Labour Wing. *The Annual Establishment & Institution Survey (AEIS) 2002-2003*.
- Becker, K. F. "The Informal Economy." *SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY Fact Finding Study* (2004).
- Charmes, Jacques. "Estimation and Survey Methods for the Informal Sector."
- Farid, M. "Measuring the Non-observed Economy." *ADB Workshop on Assessing and Improving Statistical Quality* (2004).
- Feige, Edgar L. "Defining and Estimating Underground and Informal Economies: the New Institutional Economics Approach", *World Development* 18.7 (1990).
- Gajigo, Hallward-Driemeier, *Transitioning In and Out of Formal Status: A look at the Determinants of Informality among New Enterprises*, World Bank 2011.
- Gajigo, Ousman, and Mary Hallward-Driemeier. "Transitioning In an Out of Formal Status: A Look at the Determinants of Informality among New Enterprises." (2011).
- Ihrig, Jane, and Karine S. Moe. "Lurking in the Shadows: The Informal Government Policy."
- Ingram, Michael, Vijaya Ramachandran, and Vyjayanti Desai. "Why Do Firms Choose to Be Informal? Evidence from Enterprise Surveys in Africa." (2007).
- Islam, Shariful et al (2010). "Existence and importance of succession plan in family owned firms: A study in Bangladesh", Working Paper under SGP, Economic Research Group, November.
- Jan Breman "A Dualistic Labour System? A Critique of the 'Informal Sector' Concept: I: The Informal Sector, *Economic and Political Weekly* Vol. 11, No. 48 (Nov. 27, 1976), pp. 1870-1876.
- Joshi, Kaushal, Rana Hasan, and Glenita Amoranto. "Surveys of Informal Sector Enterprises— Some Measurement Issues." *ADB Economics Working Paper Series* 183 (2009). Print.
- Leino, Jessica. "Formal and Informal Microenterprises." *Enterprise Surveys Enterprise Note Series*, Enterprise Note No. 5 (2009).
- Malik, Shahdeen, and Fazle Hasan Abed. "Legal Mechanisms to Empower Informal Business – Bangladesh Perspective", mimeo., 2007.
- Quasem, M. A., Mondal, A. H., & Mahmud, S. (1998). *A study of the informal sector in Bangladesh*. Dhaka, Bangladesh: Bangladesh Institute of Development Studies.
- S.V. Sethuraman, *Urban Poverty and the Informal Sector: A Critical Assessment of Current Strategies*, Development Policies Department, International Labour Office, Geneva
- Seibel, Hans Dieter, and Uben Parhusip. "Financial Innovations for Microenterprises – Linking Formal and Informal Financial Institutions." *Small Enterprise Development* 1.2 (1990): 14-26. Print.

Suresh de Mel, David McKenzie and Christopher Woodruff. "Do informal firms want to formalize and does it help them if they do?", *Finance and PSD Impact*, March 2012.

Swaminathan, Madhura. "Understanding the "Informal Sector": a Survey", *WIDER Working Papers* (1991). Print.

Westergaard, K., Hossain, A., & Centret for udviklingsforskning (Denmark). (1996). The green revolution and the growth of the informal sector in Bangladesh. Copenhagen: Centre for Development Research.

World Bank (2011). *Bangladesh - Enterprise Survey 2007*.

## **ANNEX 1: TERMS OF REFERENCE**

### **Companies Act reform and informal economy**

#### **About the IFC**

The International Finance Corporation (IFC), a member of the World Bank Group, promotes sustainable private sector investment in developing countries as a way to reduce poverty and improve people's lives.

#### **About IFC BICF**

The IFC has established an advisory facility known as the Bangladesh Investment Climate Fund (BICF). The mission of the BICF is to assist the Government of Bangladesh (GoB) to promote pro – poor economic growth, i.e. increased income and employment for the poor, through improving the investment climate. Consistent with the Government's strategic vision for private sector development within its overall poverty reduction strategy, the Government and the BICF will jointly design and implement programs to institute more business friendly policies, laws and regulations, and strengthen the institutions and civil servants who implement them. This is a highly significant and innovative initiative, with IFC playing a lead role in what is a major long – term private sector reform effort.

#### **Background on Companies Act Reform**

The Government of Bangladesh has initiated a major reform of the existing 1994 Companies Act with the goal of drafting a comprehensive set of laws that will capture the majority of recent developments in the country's vibrant private sector.

The Bangladesh Companies Act was last amended in 1994; since then, the country's private sector has undergone major changes that are reflected in the current dynamic business community. A number of laws and regulations covered in the existing Act fails to reflect these important developments and to some extent impedes private sector growth. Therefore several of the laws in the Act need to be amended and furthermore new provisions need to be included in order to simplify business processes in a manner that will lower operating costs and boost efficiency. Thus a new and modern Companies Act, properly implemented, will create a more conducive business environment by eliminating difficult compliances for businesses.

The Bangladesh Investment Climate Fund (BICF), managed by IFC, has agreed to support the drafting of the new Act by providing both legal and technical experts to draft the Act and by engaging in a dynamic conversation with stakeholders during and after the drafting period will incorporate the most vital stakeholders' views and perceptions into the Act.

As a part of this support, BICF will select a firm to conduct an analytical study on possible impacts of provisions in the Companies Act on the informal economy. The specific aim is to understand how some of the provisions in the current Act and their practices deter informal enterprises from registering; and what the perceptions of entrepreneurs are with regards to the significance of the Act in expanding the size of the net of registered enterprises (formal economy).

#### **Purpose and scope**

The analytical study will focus on linkages between the informal and the formal sector while assessing/analysing the impact of the proposed reforms in the new Companies Act on the informal economy itself. The purpose is to provide inputs to the restructuring of the Companies Act so that the latter may address incentives for informal firm units to formalize in addition to considering issues regarding business registration and licensing. Furthermore, the study will also consider a range of informal business practices and drivers that contribute to the informal sector, such as informal employment, trade, premises, and the failure to pay tax.

Beside inputs to the formulation of the Companies Act, the paper is expected to provide guiding principles and advice to development agencies, and their programme partners on how to encourage enterprises in the informal economy to regularize their enterprises.

## **Specific Study Objectives**

The paper will address the following questions:

- 1 How does the provisions of companies act affects the business environment, consequently, how does this in turn affect the size of the informal economy?
- 2 Given that the Companies Act reform can affect the size of the informal economy, which areas of the companies act requires significant changes with a view to reducing the size of the informal economy
- 3 Why do some businesses choose informality over formality? What are the benefits of being a formal business? What can be done to provide greater access to the benefits of formality so as to encourage conversion to formality?
- 4 What are the likely implications of the provisions in the companies act focused on the informal economy for the functioning of the formal economy?

## **Methods**

The study will be based on secondary data and review of information available in existing literature, reports and documents. Review of stakeholder consultation reports and analysis on Bangladesh conducted by both local and international company law experts will also be addressed. In addition, the research team will interview relevant stakeholders with extended experience in areas where the economies are impacted by the presence of a persistent informal economy.

## **Deliverable**

- An inception report with (i) research plan and research methodology to be used for conducting the study, and (ii) a list of the relevant stakeholder groups from whom primary information will be sought.
- A draft report of approximately 4,500-6,000 words (about 15-20 pages) in size.
- A consultation workshop to be organized by ERG and funded by BICF that will facilitate a dynamic exchange between academics and policy makers
- A final paper addressing responses to the draft paper and suggestions made at the workshop.

## **Required Qualifications**

- Experienced researchers who have conducted similar analytical studies involving both macro and micro environment
- Experience in extrapolating relevant information from various reports and from
- Knowledge of the Companies Act reform and recommendations produced by several stakeholders

## **Management and Duration of Assignment**

The assignment will be for a period of 2.5 months. The firm will report to Jisha Sarwar, PSD Officer, IFC/BICF.

## **ANNEX 2: LIST OF PERSONS INTERVIEWED**

Mr. Tanjib-ul Alam, Barrister  
Mr. Ahmedur Rahim, Registrar, RJSC  
Mr. Monzurul Haque, Chairman, AIMS and Org-Quest  
Mr. Kamrul Islam, Partex Group of Industries  
Mr. Ghulam Hussain, Secretaary, Ministry of Commerce  
Mr. Majedur Rahman, Managing Director, Premier Bank  
Mr. Sarwar, Managing Director, Trust Bank  
Mr. Sajjad Hayat, Unity Tea Brokers, Agrabad C/A, Chittagong  
Mr. Redwan, Barrister, Companies Law  
Mr. Wasimul Haque, Advocate, Cmpanies Law  
Mr. Aftabul Islam, President, AmCham and former Chairman, SME Foundation  
Mr. Syed Ershad Ahmed, President, Foreign Investors' Chamber of Commerce & Industries (FICCI),  
Mr. Asif Ibrahim, President, Dhaka Chamber of Commerce & Industries  
Mr. Md. Rezwanul Kabir, Managing Director, SME Foundation  
Mr. Masrur Reaz, Program Manager, Regulatory Simplification, IFC Advisory Services in South Asia  
Ms. Jisha Sarwar, Private Sector Development Officer, IFC-Advisory Services in South Asia  
Mr. Abdul Awal, Credit & Development Forum  
Mr. A.K. Enamul Haque, Executive Director, Economic Research Group  
Mr. Shawkat Ali Waresi, Joint Secretary, Ministry of Commerce



**ANNEX 3**

**Economic Research Group**  
 1<sup>st</sup> Floor, House # 342, Road # 25, DOHS Mohakhali, Dhaka - 1206.  
 Phone Number: 02-9135966  
**Analytical Study on Companies Act Reform and Informal Economy**  
 Survey of Urban Combines

**Serial Number**

Initials of Interviewer: \_\_\_\_\_

Date: \_\_\_\_\_ / \_\_\_\_\_ / 201

General Information			
1. Name of firm			
2. Address			
3. Information on Respondent (and owner if absent)	3a. Name:		
	3b. Designation/ Role in firm:		
	3c. Phone:	3d. Email:	
4. Type of economic activity	(1) Retail (2) Wholesale (3) Light manufacturing (4) Service, (5) Other Describe: .....		
5. Type of goods & services provided	.....		
6a. Year of first engagement of operation			6b. Year of starting regular operations

General Characteristics of the Premise			
7a. Physical status	7a. (1) stand alone; (2) part of a building; (3) temporary sidewalk, (4) market		
7b. Construction materials:	Codes: (1) brick with plaster; (2) brick without proper finishing; (3) tin/CI sheet; (4) fine wood; (5) temporary/low quality materials	Wall	
		Floor	
		Roof	
7c. Ownership of premise?	(1) firm owner's; (2) possession bought/leased from private owners; (3) possession bought/leased from City Corporation or other government agency; (4) rented from private on government land; (5) rented from government agency; (6) Other (describe)		
Type of Rental agreement (if applicable)	(1) Written and Registered; (2) Written on stamp paper; (3) Written on letterhead or plain paper etc.; (4) Tacit (Unwritten, trust based understanding, informal etc)		

Ownership (of Firm) Status			
8. Type of ownership	8a. (1) Family - Single, (2) Family – multiple, (3) Family – undefined, (4) Partnership among immediate kin, (5) Partnership with outside members, (6) Private Ltd, (7) Public Ltd., (8) Others (Explain) .....		
	8b. How many Owners? Legal/dejure: ..... Defacto: .....		
9. Type of contract / understanding between different owners	(1) Written and Registered; (2) Written on stamped paper; (3) Written on paper with signature on revenue stamps, (4) written on paper with no stamp, (5) Tacit (unwritten, trust based understanding, informal, etc), (6) Other; (8) not appl.		
10. Who decides on	10a. Investments and major business plans?		
	(1) major owner; (2) Family elder; (3) Manager/Executive; (4) Owner 10b. Day-to-day business operation?		
11. Conflicts and resolution	11a. Was there ever any dispute between owners? (1) Yes, (2) No, (8) not app.		
	11b. If yes, or if disputes ever arise, how was it/will it be resolved? (1) Recourse to law/courts; (2) Private arbitration (with the aid of lawyers, other external agencies); (3) Completely private arbitration; (4) Decisions dominated by one person or group; (8) not applicable		
	11c. Did the owner have to sell or buy/transfer ownership rights (shares) in this or any other business? (1) Yes; (2) No.		
	11d. If yes, how was it realized? (use codes in 11b)		
12. Percentage held by the largest share-holder: or equal:	13. Is the current owner/majority shareholder also the founder? (1) Yes (2) No		

Information on Owner/Majority Shareholder			
14. Name:	Education: (1) below primary; (2) primary; (3) secondary; (4) Higher secondary; (5) graduate; (6) Masters		
15. Age in year:	16. Sex: (1) Male (2) Female		
17. Work experience  17a. Total number of years of experience in either family business or remunerative work? .....	17b. Did she/he ever work before current engagement: (1) Never; (2) Salaried/waged private company; (3) Salaried/waged in government sector; (4) self-employed/family business; (5) Others (describe)		
	17c. How long (years) involved in current activity?		
18. Reason for undertaking this activity	(1) No other employment available; (4) Initial Capital was within means (2) Worked in similar sector before; (5) Profitable/Ease of Entry (3) Family Business		
19. Contact information	19a. Phone:	19b. Mobile:	
	19c. Email :		

Information on Firm			
20. Is it a seasonal affair?	(1) Yes (2) No		If Yes: Months:
21. How important were these factors in choice of location? (1) Not important (2) Important (3) Very Important (4) Most important	Easy access to clients		easy access to suppliers
	Hassle from musclemen		Not many competitors
	Hassle from law-enforcing agencies		Other reasons (mention)
22. Labor and Non Labor Inputs: Supplier information			
22a. Number of workers:	Regular		Temporary/Casual
22b. Number of suppliers (per type of product): (1) <= 5; (2) 6 to <= 20 (3) > 20			
Types of goods or services received:			
22c. Size of average suppliers: (1) Small; (2) Medium; (3) Large			
22d. Does the supplier charge VAT : (1) Yes; (2) No; (3) Not sure			
22e. Does the supplier give receipts? (1) Yes; (2) No; (3) On demand			
22f. Does the supplier give credit? (1) Yes; (2) No; (3) On demand			
Type of contract with supplier (1) Written and Registered; (2) Written on stamp paper; (3) Written on letterhead paper etc. (4) Tacit (Unwritten, trust based understanding, informal etc)			
Inventory turnover/volume of inventory/raw materials: (1) Low (stock purchased every few weeks); (2) Medium (stock purchased once to twice weekly); (3) High (stock purchased daily)			

23. Process Related: Type of record keeping	
23a. For Deliveries received on credit (1) Ledger(hand written) Following Standard Accounting (2) Ledger (hand written) - Not following Standard Accounting (3) Electronic – Accounting Software (4) Electronic – Just Worksheets (5) None	
23b. For Inventory (1) Ledger(hand written) Following Standard Accounting (2) Ledger(hand written) Not following Standard Accounting (3) Electronic – Accounting Software (4) Electronic – Just Worksheets (5) None	
23c. For Costs and Expenses (1) Ledger(hand written) Following Standard Accounting (2) Ledger(hand written) Not following Standard Accounting (3) Electronic – Accounting Software (4) Electronic – Just Worksheets (5) None	
23d. For Sales (1) Ledger(hand written) Following Standard Accounting (2) Ledger(hand written) Not following Standard Accounting (3) Electronic – Accounting Software (4) Electronic – Just Worksheets (5) None	

24. Output	
Does the firm have franchises (1) Yes (2) No	Number of franchise branches
Average Economic status or income Level of Customers: (1) Low; (2) Medium; (3) High; (4) All types	
Does the enterprise charge (customers) VAT: (1) Yes; (2) No; (3) if cash memo demanded	
Do Customers get receipts/cash memos etc ? (1) Yes; (2) No; (3) On demand	
Do you provide customer credit? (1) Yes (if the customer is reliable); (2) No	

25. Type of competition faced in that specific general market (neighborhood) :	Number of sellers: (1) None; (2) 1 to 2; (3) Few ; (4) Many	
	Number of buyers: (1) One; (2) Few; (3) Many	
	Barriers to entry/exit: (1) Low; (2) Medium; (3) High; (7) None	
	Goods: (1) Substitutes; (2) Heavily differentiated	
	Prices: (1) Standardized (i.e. sellers are price takers); (2) Large variations (i.e. buyers are price takers)	

26. How Far is your nearest competitor?	(1) <= 5 min walk; (2) >5 - 30 min walk; (3) > 30 min walk			
27. What is the access to: (1) Poor; (2) Fair; (3) average; (4) good; (5) excellent; (6) not relevant	Finance		Law/Courts	Electricity/ power
	Telecommunication		Computers/int ernet	Training
28. What would be most important to combine/agent in terms of hypothetical expansion?: (1) Not important; (2) Important; (3) Very Important; (4) Most Important	Finance		Law/Courts	Electricity/ power
	Telecommunication		Computers/int ernet	Training
	Space		Trade license	Other
29. Do you want to expand your business? (1)Yes (2)No				

On Trade License	
30a. Do you have a trade license?	(1) Yes; (2) No; (3) Do not know what it is
30b. If yes, what type?	Type: (1) Commercial; (2) Manufacturing; (8) Not applicable
30c. From where did you get it?	(1) City Corporation; (2) Municipality/Paurasava; (3) union Parishad

30d. When did you get it (year)?		30e. When did you last renew it (year)?	
31. Degree of problems faced in getting a trade license? (1) None (4) High (2) Low (5) Prohibitively High (3) Average		Bribery	Bureaucratic delays
		Others (describe)	
32. Other types of licenses needed to run a business you do (1) Do not Know (2) Not Required (3) Optional – do not have (4) Mandatory – do not have (5) Optional – have (6) Mandatory – have	Acid License	Approval of Factory Plan	
	Bonded Warehouse License	Certificate of Incorporation,	
	Environmental Clearance Certificate	Explosives Licenses	
	Export Registration Certificate (ERC)	Fire License	
	Import Registration Certificate (IRC)	Production & Processing License of Narcotics Drug	
	Registration of Foreign Investment /Joint Venture	Registration of Local Investment Projects	
	Tax Holiday Certificate	Tax Identification Number (TIN)	
	Trade License for a Commercial Firm	Trade License for a Manufacturing Firm	
	Trade Marks Registration	VAT Registration	
	Others:		
33. What sort of problems do firms of your type face in acquiring those licenses (1) None (4) High (2) Low (5) Prohibitively High (3) Average (6) Not Applicable		Bribery	Bureaucratic delays
		Others	
34. What sort of advantages are there in having those licenses (1) Not important (2) Important (3) Very Important (4) Most/extremely Important		Legal Protection	Supplier Contracts
		Loans (Bank, NGO etc.)	Others -
		Bank clearance	
35. What sort of disadvantages are there in having those licenses			

35. Membership in Associations

35a. Is the owner of the enterprise a member of any Trade Association on account of this business?

(1) Yes; (2) No

35b. If yes, which of the following?

(1) Shoppers' Association in market place; (2) Association for specialized trade;

(3) National Trade Bodies (name: \_\_\_\_\_); (4) Others:

35c. How important is such membership for (1 not important/not applicable, 2 important, 3 very important, 4 mandatory)

(i) Prerequisite for conducting business in this location

(ii) Substitute for trade license

(iii) Efficacy for business operations

(iv) Dispute resolution




36. Do you operate any bank accounts, not personal bank account, in the name of your enterprise? (1) Yes (2) No			
37. Reason for not formalizing/acquiring trade license for enterprise of your type (1) Not important (2) Important (3) Very Important (4) Most Important	No knowledge of requirements/laws/regulations	Business too small	
	Bribe avoidance	Regulatory avoidance	
	Avoid unnecessary cost	Business technically not legal	
	Tax avoidance	Others	
	Have you heard of Registrar of Joint Stock Company? 1=Yes; 2=No		

38. Do you have registration with the Registrar of Joint Stock Companies? (1)Yes (2) No		
39. If yes	39a. When did you register (year)?	
39b. Type of registration?	(1) Private Company; (2) Public Company; (3) Trade Organization; (4) Foreign Company; (5) Society; (5) Partnership Firm	
39c. Why did you register?		
39d. Was it worth?	(1) Yes; (2) No; (3) Yet to be revealed	
40. If no	40a. Did you ever face difficulty which could be avoided if you registered? 1=Yes; 2=No	
40b. If yes, what kind of difficulty?	1=Finance; 2=ownership dispute; 3=transfer/sale; 4=social/environmental; 5=grabbing; 8=not applicable	
40c. Do you intend to register?	1=(unconditional) Yes; 2= No; 3= Yes, if (mention)	

41. In case of other kinds of disputes, what actions do you take to resolve?	
41a. Internal: between owners and employees (1) Recourse to law/courts; (2) Private arbitration with the aid of lawyers (3) Private arbitration with the aid other external agencies such as trade unions; (4) Completely private arbitration; (5) Decisions dominated by one person or group	
41b. External: with outside agents and combines (Input Side) (1) Recourse to law/courts; (2) Private arbitration with the aid of lawyers (3) Private arbitration with the aid other external agencies such as trade unions; (4) Completely private arbitration; (5) Decisions dominated by one person or group	
41c. External: with outside agents and combines (Output Side) (1) Recourse to law/courts; (2) Private arbitration with the aid of lawyers (3) Private arbitration with the aid other external agencies such as trade unions; (4) Completely private arbitration; (5) Decisions dominated by one person or group	

42. What are your suggestions on provisions in the Companies Act as well as on other government measures that will reduce the likelihood of ownership-related disputes in private business?

.....  
 .....

43. Average weekly turnover during 2010, 2011 and NOW?

## ANNEX 4: EXPLANATORY NOTES ON TERMS USED

It is felt that several terms ought to be commonly understood in order to address the research questions posed.

**Contract & generic types:** The term “contract” is usually defined as “*a written or spoken agreement, especially one concerning employment, sales, or tenancy, that is intended to be enforceable by law*”<sup>21</sup>. In our formulation of what a contract is we take it to an agreement entered into by two parties or more with the intention of creating an obligation (not necessarily a legal obligation), which may have elements in writing. It relies on the notion of consensual exchange between different groups and expresses a convergence of will between the parties and indicates an intended common line of action. Essentially it defines the type of relationship between the different parties.

The generic types of contracts considered in this study are:

- a) Written and registered contracts: i.e. registered or notarized by a commonly recognized legal regulatory body
- b) Contracts written on stamped paper but not registered: (stamped paper is a method of tax collection for the government and can be considered to be more legal?)
- c) Contracts written on letterheads; invoices, price quotations etc.
- d) Unwritten, oral contracts

**Economic goods and services:** “*a product or service which can command a price when sold.*”<sup>22</sup> The economic goods and services are things that are intended to satisfy some wants or needs of a consumer and thus have economic utility.

**Companies & generic typologies:** According to the CA94 : “*company*” means a company formed and registered under this Act or an existing company. In my view this is not a very helpful definition at all. However, the idea that can be pieced together from the CA94 gives us an impression that what is meant by a company is a voluntary association formed and organized to carry on a business “that has for its objects the acquisition of gain”.

The broad types of companies defined in the CA94 are as follows:

- a) Private Company: (i) restricts the right to transfer its shares, if any; (ii) prohibits any invitation to the public to subscribe for its shares or debenture, if any;(iii) limits the number of its members to fifty not including persons who are in its employment;
- b) Public Company: means a company incorporated under this Act or under any law at any time in force before the commencement of this Act and which is not a private company
- c) Company Limited by shares : the liability of the members is limited, the amount of share capital with which the company proposes to be registered, (divisions thereof into a fixed amount) 1 share at least per subscriber,
- d) Company Limited by guarantee: the liability of the members is limited, that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member of within one year afterwards, for payments of the debts and liabilities of the company contracted before he ceases to be a member, and of the charges and expenses of winding up, and for adjustment of the right of the contributories among themselves, such amount as may be required not exceeding a specified amount
- e) Unlimited Company: not limited in any way.

**License:** Essentially a certificate/document granting permission from the relevant municipal governing body (City Corporation or city council etc) to carry on a particular profession, trade, calling or business or deal with (or in) controlled (or dangerous) substances. Licenses also act as a certification of compliance with

---

<sup>21</sup> <http://oxforddictionaries.com/definition/contract?q=contract>

<sup>22</sup> <http://oxforddictionaries.com/definition/economic%2Bgood?q=economic+good>

various laws and regulations pertaining to safe and environmentally sound economic activity. They do not usually confer ownership of property or permission for any other activity than for which they are issued. They are usually issued exclusively in the name of the licensee (which can be an individual or combine/company) and are not transferable. Effectively they serve as a form of taxation.<sup>23</sup>

**Registration:** In general the term “registration” refers to depositing information pertaining to a contract with a recognized government agency (than can be a regulatory body or just a storekeeper of information) or a public record book. More specifically, it is the act of forming a company in accordance with the rules, laws and regulations set down in the CA94 and regulated by the RJSC. According to the RJSC website **registration** happens is when the “*Promoters of a new entity apply for, and RJSC issues a certificate of incorporation for a new entity upon satisfaction that the application conforms to the provisions of the applicable act and that requisite fees are paid.*”<sup>24</sup>

**Informal:** Economic entities that are not registered. Why are they informal? Because they are not registered. The informal sector or informal economy as defined by governments, scholars, banks, etc. is the part of an economy that is not taxed, monitored by any form of government, or included in any gross national product (GNP), unlike the formal economy. In describing this sector, one should bear in mind that the informal economy is not a deviation of the formal economy, if only because all economic activities started informal and formed the basis from which the formal economy sprang, with firms and annual accounts, taxes, chambers of commerce, etc.

## Legal Terms

Tabling our understanding of two legal terms (i.e. “Laws” and “Acts”) appears to be relevant for the current exercise. To explain: the requirement of a license is a Law and considered mandatory if one chooses to engage in an activity (say, driving a motor vehicle), while an Act, such as the Companies Act 1994, lays out the ground rules of forming combines, but does not mandatorily require a combine to register. Leaving aside the intricate legal definitions, we consider the followings to capture the different meanings:<sup>25</sup>

Act as opposed to Laws: “Law” is a generic term that refers to all rules and regulations passed by the parliament and are meant to guide the conduct of people. Laws also help in protection of the citizens and also in maintaining public order. “Acts” are a type of Laws that pertain to specific situations and circumstances. They are passed by the government to let people know the rules and regulations about specific situations.

**Laws** are considered “binding rules of conduct meant to enforce justice and prescribe duty or obligation, and derived largely from custom or formal enactment by a ruler or legislature. These laws carry with them the power and authority of the enactor, and associated penalties for failure or refusal to obey. Law derives its legitimacy ultimately from universally accepted principles such as the essential justness of the rules, or the sovereign power of a parliament to enact them.”

An **Act** is a piece of legislation enacted by the Parliament. It “generally takes the form of legal instruments of writing that have probative value and executory force. They are usually accepted as self-authenticating demonstrative evidence in court proceedings, though with the precarious status of notaries public and their acts under common law, this is not always so.”

**Sampling unit:** refers to one member of a set of entities being studied

**Sampling frame:** it refers to the list of all those (entities) within a population who can be sampled.

---

<sup>23</sup> [http://www.bangladesh.gov.bd/index.php?option=com\\_content&task=category&sectionid=4&id=30&Itemid=27](http://www.bangladesh.gov.bd/index.php?option=com_content&task=category&sectionid=4&id=30&Itemid=27)

<sup>24</sup> <http://www.roc.gov.bd:7781/Guidlines/faq.html#WhatisRegistration>

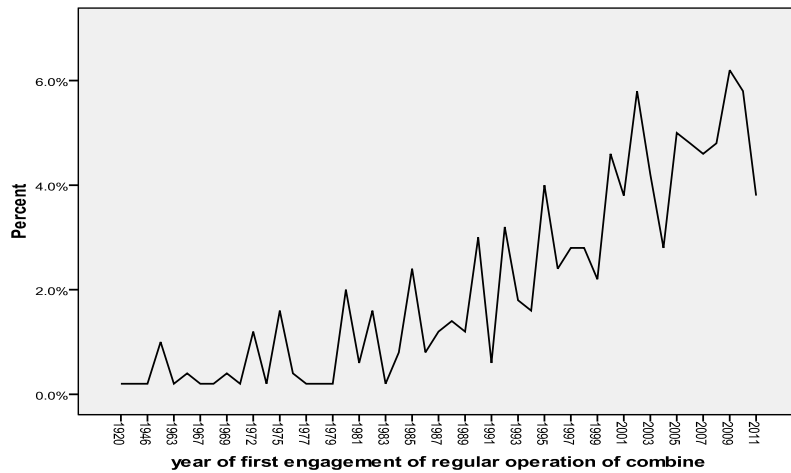
<sup>25</sup> Sources: <http://legal-dictionary.thefreedictionary.com/code>; and [http://en.wikipedia.org/wiki/Act\\_%28document%29](http://en.wikipedia.org/wiki/Act_%28document%29)

**Purposive sampling:** A purposive sample is a sample selected in a deliberative and non-random fashion to achieve a certain goal. It is a form of Nonprobability Sampling and in this case the goal is to capture the diversity of characteristics between different sorts of “informal” combines in the external and internal sense.

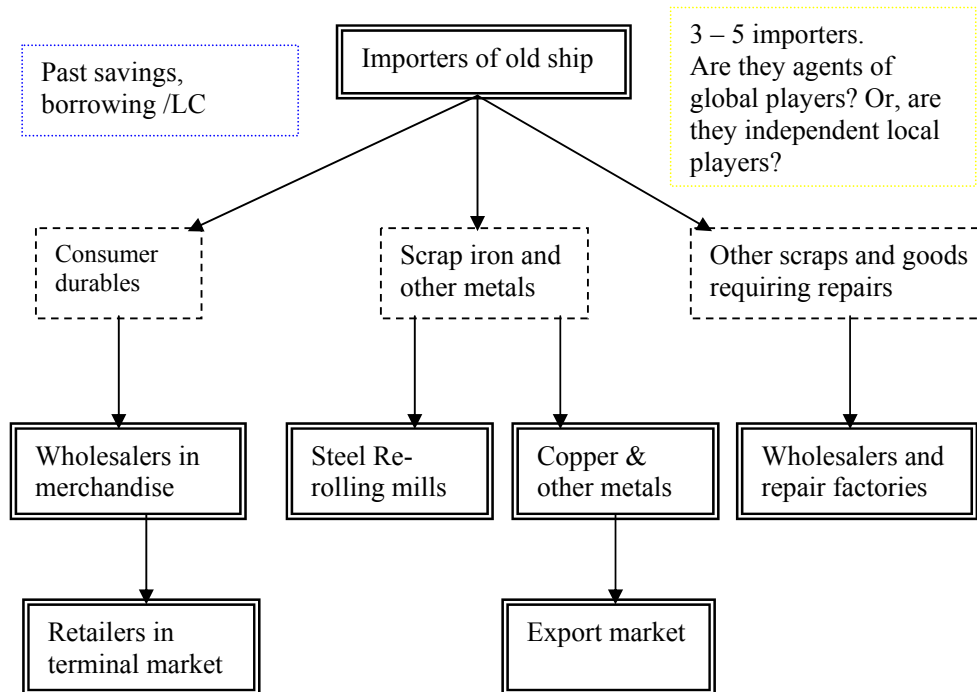


## ANNEX 5: STATISTICAL TABLES AND FIGURES

**Figure A.5.1: Distribution by Year of First Operation (% of all surveyed)**



**Figure A.5.2: Ship-breaking Industry**



Source: Own compilation based on field visits and interviews of stakeholders.

**Table A.5.1: Various Types of Companies/Organizations Registered with the RJSC**

Entity Type	Number	Percent	Entity Type	Number	Percent
Private Company	103892	68.62	Foreign Company	165	0.11
Public Company	1743	1.15	Society	12075	7.98
Trade Organization	859	0.57	Partnership Firm	32672	21.58

Source: RJSC website, not found in recent past. Total number of entities was reported to be 151,406.

**Table A.5.2: Degree of formality in Ownership Contract across Ownership Types**

Ownership type	Type of Ownership Contract			
	formal	quasi-formal	informal	Not applicable
Family - Single	0.00	0.00	0.00	100.00
Family – multiple	3.66	9.76	86.59	0.00
Family – undefined	0.00	10.00	90.00	0.00
Partnership among immediate kin	20.00	20.00	60.00	0.00
Partnership with outside members	23.08	23.08	53.85	0.00
Private Ltd	100.00	0.00	0.00	0.00

Source: ERG Survey 2012.

**Table A.5.3: Rental contract – a case of quasi-formality**

Type of rental arrangement	% distribution by type of contract under each rental arrangement				% of column total
	Written and Registered	Written on Stamp Paper	Written on Letterhead or plain paper	Un-written	
Possession bought/leased from private owners	4.29	88.96	0.31	6.44	81.91
Possession bought/leased from City Corporation or other government agencies	65.38	34.62			6.53
Rented from private on government land	5.88	82.35		11.76	4.27
Rented from government agency	13.79	72.41	3.45	10.34	7.29
All rented premise	9.05	83.92	0.50	6.53	100.00

Source: ERG Survey 2012.

**Table A.5.4 Percentage operating bank accounts and desire for expansion**

Ownership Status	<i>Operate bank a/c</i>	<i>Would like to expand business</i>
<i>Multiple Owner</i>	<i>69.23</i>	<i>89.31</i>
Formal	100.00	70.00
Quasi-formal	87.50	93.75
Informal	63.46	90.48
<i>Single Owner, Family</i>	<i>58.24</i>	<i>94.26</i>
Total Sample	61.13	92.96

Source: ERG Survey 2012

**Table A.5.5: Desired Ways to resolve disputes in business**

Route sought to resolve disputes	In case of (hypothetical) conflicts with		
	employees	External agency – Input side	External agency – Output side
Recourse to law/courts		0.40	0.80
Private arbitration with the aid of lawyers	0.21	0.20	0.20
Private arbitration with other external assistance	3.81	5.04	4.83
Completely private arbitration - internal	82.45	91.13	90.95
Decisions dominated by one person or group	13.53	3.23	3.22

Source: ERG Survey 2012

## ANNEX 6: TRADE LICENSES IN BANGLADESH AND SELECTED OBSERVATIONS ON PROVISIONS FOR SOLE PROPRIETORSHIP

### *Trade licenses in Bangladesh*

Trade licenses in Dhaka were introduced by the “City Corporation Taxation Rules, 1983”, and license fees are considered by many as charges for utility services. In some countries (such as, Singapore and Malaysia), the local municipality’s utility tax function is covered by the concept of the “premise license”. In those countries, there are “business registrations” to separate issues around business from the utility services tagged to premise, even though it may be administered by the same local authority. In Bangladesh, Trade Licenses, in reality, neither serve the purpose of the ‘premise license’, nor do they fit into the category of business registration to facilitate governance. Basic characteristics of a trade license are:

- Needs yearly renewal (the fees are paid to the local municipality, essentially taxation);
- Trade licenses can be obtained for ‘legal personality’ only – i.e., under the individual’s (owner’s) name or in the name of an incorporated business;
- the owner of the business is **completely liable** for all debts (unlimited liability); i.e., the owner of the business is **completely liable** for all law suits and legal actions taken against the business;
- the business **cannot** own another business or company – thus, an individual business person may obtain several trade licenses for doing different businesses;
- the business **does not** have perpetuity - if the person holding the trade license dies, the business effectively ceases to exist.

Practically speaking, businesses may not stop if there are progenies or other family members to take over and continue to run after the initial owner dies. Legally however, when the new owner obtains a trade license, she/he is actually starting a “new” business.

In its current form, holders of Trade Licenses have **no** associated responsibilities in the context of contract enforcement. To explain, there is no **separate** legal mechanism in place that facilitates the enforcement of binding contracts between businesses with trade licensees aside from the recourse to common civil/business law. Hence, aside from being in compliance with the law, there is no extra benefit (in terms lowering costs and risks of doing business) from having a trade license. This is assuming, of course, that good contract enforcement mechanisms (legal ones) lower the risk and hence the cost of doing business.

Business also require TIN Certificates and VAT Registration Certificates (obtained from different agencies), at a minimum, to operate legally. Depending on the nature of the economic activity, the business may be legally required to obtain other licenses as well (e.g. businesses dealing with acids and other similar chemicals need to obtain Acid Licenses etc).

### *Business Registration in Singapore*

As noted earlier, Singapore has ‘premise license’ administered by local authority and is not discussed here. Singapore has one agency, the Accounting and Corporate Regulatory Authority (henceforth the ACRA) that provides both business registration and company registration services. Some of the features are outlined below:

- Fully automated business registration; all forms can be completed online and the certification can be obtained in as little as 15 minutes (according to the website, though it can take up to two weeks in cases referred to outside agencies)
- Modular forms; the simple nature of the business registration form means it can be slotted into the form for company registration, i.e. the completed business registration certificate fits into the requirements for company registration. This means that there are significantly fewer redundant steps and forms to fill out.

- It is explicitly stated that one of the functions of business registration is to facilitate contract enforcement. If a firm with business registration enters into a contract with a firm without business registration, and the later reneges on the contract then the former will *not* have recourse to the courts. Essentially, having business registration allows firms to enter into binding, enforce-able contracts much more easily.
- Though the firms with only business registration need to renew it every year, the process can be completed online, thus saving manpower and time. The initial fees are also relatively low.

### *Brief Observations on Selected Countries*

#### Singapore

- Governed by the “Business Registration Act” (as opposed to the “Companies Act”)
- Registered as a sole proprietorship business with the ACRA
- No limited liability
- No separate legal status
- No perpetuity

#### India

- Not governed by any specific act, not covered in the “Companies Act”
- No obligation to register with any authority; may require local municipality license (trade license) for specific activities
- No limited liability
- No separate legal status
- No perpetuity

#### UK

- No specific act designed to regulate Sole proprietorships. SPs are not obligated to register, but they can with the National Business Register,
- Self-employed people also have to register with the HM Revenue & Customs agency
- No limited liability
- No separate legal status
- No perpetuity

#### South Africa

[Information available in the net on Close Corporations in South Africa and changes in provisions introduced in the country’s Companies Act 2008, enforced in May 2011, tend to suggest that the country’s administrators feel the urge to streamline certain financial anomalies that may have surfaced under the umbrella of CC Act of 1984. The apprehension is speculative to some extent and the authors feel that there is a need to visit the experiences to formulate Bangladesh’s Companies Act.]

Close Corporation or CC was created especially for small businesses in South Africa through an Act in 1984.:

- CCs have corporate status and legal identity that is distinct from their members;
- Its registration is simpler and less expensive than that of a company;
- A CC has a minimum of one and a maximum of 10 owners, requires an accounting officer, and
- Allows its members limited liability provided that sureties (guarantees) have been signed.

When the New Companies Act, 2008 came into force on May 1 2011, it is no more possible to register any new close corporations, nor may companies be converted into close corporations. Existing CCs are allowed to continue indefinitely and are allowed to convert to companies with continuity. Moreover, the CCs will be treated as private companies, and they will be brought into line with legislation on private companies.

The expressed interest is to gradually phase out CCs and/or align the CC Act with the Companies Act.

The amendments brought about by the new Companies Act affect CCs largely in relation to the audit requirements, independent reviews and the financial reporting standards; bringing those to coincide with the equivalent provisions in the Companies Act, 2008. As for the liquidation of CCs, the provisions of the repealed Companies Act, 1973, would continue to apply and new provisions are made which will in future apply to the voluntary winding up of close corporations. The enforcement provisions of the Companies Act, 2008, in relation to investigation of complaints, other investigations and inspections and adjudication of matters by the Companies Tribunal, are made applicable to close corporations. In addition, the offences under the Companies Act, 2008, in respect of breach of confidence, false statements and reckless conduct by members, are also made applicable to close corporations.

#### Box 1

Forms of Business in South Africa (prior to Companies Act 2008, enforced since May 2011)

Sole proprietorship – no limited liability,

Partnership or Joint Venture - two and a maximum of 20 partners, each of whom is expected to contribute money, skill or labour to the business. When forming a partnership, a “partnership agreement” is essential. This agreement deals with formation, profit sharing, salaries, banking arrangements, changes of partners, liquidation and partners’ responsibilities. Like a sole proprietorship, a partnership doesn’t have limited liability; every partner is liable for any debts.

Companies are governed by the Companies Act which lays down the procedures to be followed when forming a public or private company. There are three types of company:

Public companies are big businesses like Woolworths, Mr Price, Discovery and Putco. They’re called “public” companies because they’re owned by shareholders (members of the public) and listed on the stock exchange. There must be at least seven members of a public company, with a minimum of two directors.

Private companies can’t sell shares to the public and can’t list on the stock exchange. Their members are between one and 50. A private company has to prepare audited financial statements but, unlike a public company, is not required to publish them.

Section 21 companies are associations “not for profit”. Most non-governmental organisations are Section 21 companies, as their function is primarily developmental.

Close Corporation or CC was created especially for small businesses. It relieves them from the complicated requirements and formalities of the Companies Act, while still giving them corporate status and a legal identity that is distinct from their members. Its registration is also simpler and less expensive than that of a company. A CC has a minimum of one and a maximum of 10 owners, requires an accounting officer, and allows its members limited liability provided that sureties (guarantees) have been signed.

## Sole proprietorship in India

The sole proprietorship is the oldest, simplest, and most common form of business entity. It is a business owned by a single individual. For tax and legal liability purpose, the owner and the business are one and the same. The proprietorship is not taxed as separate entity. Note that the earnings of the business are taxed at the individual level, whether or not they are actually in cash. There is no vehicle for sheltering income. For liability purposes, the individual and the business are also one and the same. Thus, legal claimants can pursue the personal property of the proprietor and not simply the assets used in the business.

### Advantages of a Sole Proprietorship

Perhaps the greatest advantage of this form of business is its simplicity and low cost. You are not required to register with the government, nor are any legal charter required. The sole proprietorship form of business has other advantages:

- The owner or proprietor is in complete control of business decisions.
- The income generated through operations can be directed into the proprietor's pocket or reinvested as he or she sees fit.
- Profits flow directly to the proprietor's personal tax return; they are not subject to a second level of taxation. In others words, profits from the business will not be taxed at the business level.
- The business can be dissolved as easily and informally as it was begun.

These advantages account for the widespread adoption of the sole proprietorship in the India. Any person who wants to set up shop and begin dealing with customers can get right to it, in most cases without the intervention of government bureaucrats or lawyers.

### Disadvantages of the Sole Proprietorship

This legal form of organization, however, has disadvantages:

- The amount of capital available to the business is limited to the owner's personal funds and whatever funds can be borrowed. This disadvantages limits the potential size of the business, no matter how attractive or popular its product or service
- Sole proprietors have unlimited liability for all debts and legal judgements incurred in the course of business. Thus, a product liability lawsuit by a customer will not be made against the business but rather against the owner.
- The business may not be able to attract high-calibre employees whose goals include a share of business ownership. Sharing the benefits of ownership, other than simple profit-sharing, would require a change in the legal form of the business.
- Some employee benefits, such as owner's life, disability, and medical insurance premiums, may not be deductible, or may be only partially deductible from taxable income.
- The entity has a limited life; it exists only as long as the owner is alive. Upon the owner's death, the assets of the business go to his or her estate.

Source: <http://blog.mukeshraj.com/2008/05/08/what-is-sole-proprietorship-in-india/>