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**Corporate Governance Reform in an Emerging Economy:  
Organisational Change or Window Dressing of Compliance**

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## **Abstract**

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This paper examines organisational change partly as window dressing or compliance when corporate governance reforms were introduced to varying listed companies in a developing country. Specifically, we examine whether the listed companies transformed their roles including those of board members; what the nature of the changes were; what factors hindered governance related development initiatives and how the companies and their members reacted to the reforms. By using content analysis between 2007 and 2017, this study observed that the listed companies of Bangladesh tended to overstate compliance statements to manage their impressions to their stakeholders. After the reform in 2012, requiring more independent directors into the board and external certification of compliance statements, however, it was found that the extent of window dressing in compliance statements declined considerably. Government firms were found to make more proportionate overstatements compared to family, non-family and foreign companies. In fine, we found that the companies' developmental efforts were challenged by the existing formal legal environment and regulatory pressures.

**Keywords:** Organisational Change, Window Dressing, Corporate Governance, Impression Management, Overstatement, Emerging Economy

## 1. Introduction

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Companies around the globe embrace the Anglo-American model of corporate governance (*hereafter*, CG) either on the logic of efficiency (in terms of attracting foreign investment) or on the legitimacy justifications (Zattoni and Cuomo, 2008). Developing and emerging economies with an intent to gain an access to the international markets and to partner foreign donors in the development projects, incorporate the prescribed standards into their rules and regulations irrespective of the policy implications that contradicts with the their institutional settings. Moreover, increasing global pressures originating from the ascendancy of market integration forces have led the governments of developing countries to adopt the western-stylised models (Cuomo et al., 2016; Hansmann and Kraakman, 2001; Khanna et al., 2004). However, institutional scholars (for example, Bebchuk and Roe, 1999; North, 1990) show their disagreement on the universal ascendancy of this model as the competing institutional rationality may inhibit such wholesale espousal and question the effectiveness of the codes.

Bangladesh also adopted the Anglo-American model since 2006 to demonstrate its legitimacy to the international financial organisations like World, ADB and IMF (Siddiqui, 2010), paying no attention to the prevalent economic and social conditions (Uddin and Choudhury, 2008). It is argued that the legitimacy notion is more justifiable in the context of developing countries (Reed, 2002; Siddiqui, 2010) than the rationale of efficiency. In view of distinct nature of cultural and institutional characteristics, Wanyama et al (2009) observes that the implementation of these westernised CG codes can be challenging. As the codes are developed on the foundations of standard regulative arrangements, there exists an incompatible institutional practices for which a dissimilarity between the reported compliance and actual compliance arises (Jamali, 2010), which could be termed as window dressing or overstatements of compliance. In this vein, Oliver (1991) argues that companies tend to avail the practice of overstatements in compliance statements to ensure their legitimacy with the regulations, which Yoshikawa et al (2007) points out as an indication of an active response to align organisational practices with the codes of CG. As long as there is no alteration in the internal organisational practices and cultural settings, the level of compliance fundamentally become merely a symbolic compliance (Ahmed and Uddin, 2018) that challenges the effectiveness of the Anglo-American model in the context of emerging markets (Ees and Witteloostuijn, 2007). Therefore, for the companies with the passage of adoption, institutional logics may provide alternatives like rejecting or modifying compliance than only to abide by the codes. With respect to global CG practices, a growing body of research (Ananchotikul et al., 2010; Krenn, 2015; Tagesson and Collin, 2016) have shown their concern that the level of implementation of CG regulations is in letter but not in spirit. Pursuant to this, Weber et al. (2009) points out, “it is also clear that practices resulting from coercive pressures are more likely to reflect ceremonial compliance because motivations, skills and resources for making the practices thrive do not become distributed in a local setting” (p.1327).

Previous studies (for example, Arcot et al., 2010; Bozec, 2007; Hooghiemstra and van Ees, 2011; Talaulicar and von Werder, 2008; Seidl et al, 2013; von Werder et al, 2005) have also documented the extent of CG compliance in different countries and explained about the quality of explanations that the companies provided in case of nonconformity to the codes. Explanations with respect to CG regulations of Bangladesh also saw some form of formal demonstrations, but was far from what was perceived by the market. Bangladesh Securities and Exchange Commission (BSEC), the regulatory body of capital market, adopted the soft

law based voluntary approach in the first instance, by issuing an order back in 2006. It was observed that companies, if not all, inclined to present the explanations on defiance of the conditions by putting some meagre and brief declarations at the compliance statements, rather than explaining in detail. In majority of the instances, companies just preferred a 'box-checking' approach, or wrote 'not complied' as the worst case of explanations, indicating that they did not adhere with conformance in the instances of noncompliance. On the 'true' implementation of CG practices of the companies in terms of maiden guidelines, Uddin and Choudhury (2008) show their confusion over the factual representation of compliance in annual reports. But the true picture were unveiled in an empirical study conducted by Sobhan (2016) on 91 non-financial companies of Bangladesh for the year 2010, on the basis of the maiden guidelines issued in 2006. He compared the reported level of compliance in annual reports with the results revealed from questionnaire survey, and it was reported that there exists "significant overstatement of compliance in annual reports" (p.599). In another study, Nurrunnabi et al (2016) compared the status of falsification that the companies make in compliance statements for two political regimes, unelected caretaker government and elected democratic government in 2007 and 2011 respectively, and they found that annual reports demonstrate unchanged and substantial amount of overstatements irrespective of changing political regimes. This indicates that a number of listed companies in Bangladesh used to overstate their compliance statements that manifest their impressions positively to the stakeholders while showing acquiescence with the current regulations.

To improve the compliance, the state of compliance of the listed companies of Bangladesh, BSEC reformed the CG guidelines in 2012, transforming it from a 'comply or explain' principle' to a 'comply' one. As the guidelines issued in 2012 was based on 'comply' basis and thus, there was no scope as such for the companies to provide explanations of non-conformance of CG compliance but to follow the hard rules. Therefore, Bangladesh saw two contrasting laws (soft vs hard) in the past era, which makes the country an interesting piece of study. With the increased number of outside independent directors (*hereafter*, IDs) in the board (earlier it was 10 percent while after the reform it was made 20 percent of the board size) and requirements to submit the certificate of compliance issued by a professional auditor make this case even more appealing for this research. It was found that a negligible portion of the companies continued to put explanations against any failure to comply any of the conditions. More importantly, after the issuance of BSEC Corporate Governance Guidelines (BCGG) 2012, the rate of overstatements plummeted significantly in all the three areas of observable items in terms of appointing required proportion of IDs in the boards, CEO non-duality and forming an audit committee (*hereafter*, AC). However, the rate of overstatements made by the family- and state-owned companies remained somewhat stable while the number of companies with these ownership structures have sharply decreased.

To the best of our knowledge, this research is the first of its kind not only in the perspective of a developing country but also in a global context that deals with a longitudinal study on overstatements while identify the effect of reforms in CG guidelines. Having said that, this study advances the research of overstated compliance by contributing in two key areas. Firstly, this study deals with overstatements on agential perspectives over a period of 10 years. In so doing, this study investigates the level of window dressing of compliance over two CG guidelines regime – one that issued in 2006 and another in 2012. Therefore, the research rigorously examined the impact of CG reforms on organizational change and the extent of impression management using overstatement of compliance. Secondly, this study attempts to identify the overstating tendency of family, state-owned and other firms over two reform

horizons to get an insights on the influence of firms' ownership pattern on the window dress culture of CG compliance.

The study is structured as follows: section 2 reviews of the literatures related to impression management that overstatement of compliance; section 3 and 4 presents an account of the institutional idiosyncrasies of Bangladesh as an emerging economy and an account of background of the CG reforms that took place respectively; section 5 outlines the sample characteristics and discusses the methodology used in conducting the study; section 6 discusses results of the trend analysis, and, section 7 presents the overall findings followed by concluding remarks.

## **2. Literature Review**

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One of the key objectives for overstating or window dressing of compliance is to provide signal to the investors and the regulators that the companies are abiding by the normative rules and regulations. The reason is, it helps to create positive impression of the companies towards the wider community. The concept of impression management (IM) (Neu, 1991) stems from social psychology (Merkl-Davies and Brennan, 2011) and is concerned with the manifestation of individuals to the outside world (Goffman, 1959) in a manner that upholds their impression positively to the constituents who have a direct or indirect interest in them. IM, that leads to bias in the company reports, embark more on favourable outcomes while mask on unfavourable instances (Merkl-Davies and Brennan, 2007, 2011; Săndulescu and Albu; 2018) and thus, can contribute to the reputation of companies (Hooghiemstra, 2000). Generally, companies use affirmative tones in annual reports to send a signal of superior performance or outcomes to a third party (Krische, 2005). Like earnings management in company financials, managers may attempt to manage the other statements in annual reports (Clatworthy and Jones, 2001), such as environmental reporting, statement on risk management, and CG compliance statements.

From the economics point of view, agency theory is believed to be the predominant perspective in the development of an understanding on IM (Merkl-Davies and Brennan, 2007). The Agency theory posits that managers, being an economic agent, have an inner intent to maximise self-benefit (Yekini et al., 2016) since the decisions are made on the basis of the complete set of company information that they have (Zarri, 2009). However, it is not only the private economic rationality that leads the management to IM. The survival of managers largely depends on organisational performance, whereby "management has economic incentives to disclose messages that convey good performance more clearly than those conveying bad performance" (Rutherford, 2003, 189). Merkl-Davies and Brennan (2011) argues that depending on instrumental rationality, management can anticipate the impact of information on the audience. Therefore, management takes a strategic position to forestall unfavourable impact of organisational outcomes while showing conformity with the formal governance practices (Renders and Gaeremynck, 2012) for the sake of their career progression. It is even more crucial when the key managerial position is held by a controlling shareholders (preferably from a family) that provides immense opportunity to mask their internal organisational practices.

Following the framework of Merkl-Davies (2011), impression management in terms of symbolic management in the company narratives is determined by the perspectives of institutional settings, stakeholders' demand and organisational legitimacy. Social customs and rules have influence on how the managers respond as the decisions are made on the basis of a social context (Merkl-Davies and Brennan, 2011). A wide array of elements (like stakeholders) who have direct or indirect relationship with organisation and are considered as constituents of

society may, in turn, instigate the managers to the symbolic presentation of company documents. Therefore, the rationalities behind the masking of company documents originates from the social substance, whereby the management try to provide a signal to the external constituents that the social norms and rules are fulfilled (Coffee, 2001; Estrin and Prevezer, 2011), which can be termed as symbolic management of company documents.

A growing body of scholars (for example, Shi and Connelly, 2018; Wade et al., 1997; Westphal and Zajac, 1994; 1995; 1998; 2001) illustrate the symbolic management mechanisms that the companies use while espousing governance practices with an intent to satisfy the external pressures from shareholders and to escape from undesirable controls. One of the approaches to this kind of symbolic management is “decoupling”, which can be defined as the unorthodoxy in organisational practices between the actual and the prescriptive or standardized processes (Bromley and Powell, 2012; Meyer and Rowan, 1977). Decoupling arises as the company nonliterally adapt an operational change, so far it does not require a company to change or modify fundamental practices (Westphal and Zajac, 2001) while shows its symbolic compliance to the outside pressure groups (Fiss and Zajac, 2006; Markoczy et al., 2013; Shi and Connelly, 2018). For example, Westphal and Zajac (1994) in their commendable empirical work on decoupling shows that the companies adopt long-term incentive programmes for CEOs to ensure improving governance quality, however, the mechanism was originally intended to condense the proportion of IDs in the boards. Westphal and Zajac (2001), in another study demonstrates, how the companies decouple the stock repurchase programmes to show conformity to the external authority. Cohen et al (2012) demonstrate how the appointment of the outside IDs are stage-managed, whereby the IDs are appointed on the basis of relationship with the management rather than how well they can serve the organisation.

Yoshikawa et al (2007, 3), in delineating about the precursors to decoupling practices and how it aligns with an organisational framework states, “on encountering external pressure for change, organisations may import foreign models but decouple them from their original institutional context and modify them to fit their own institutional contexts”. As long as there exists a divergence of institutional practices between the firm-level dynamics and new-fashioned practices, the firms are under more compulsion of bringing some changes to organisational level of adoption (Fiss et al., 2012) and to overstate compliance on legitimacy ground (Oliver, 1991; Sobhan, 2016).

The reform initiatives in the context of adoption of CG regulations in Bangladesh are chiefly originated from Anglo-American region (Belal et al., 2017; Siddiqui and Ferdous, 2014; Sobhan, 2016; Sobhan and Werner, 2003; Uddin and Chaudhury, 2008). To make the companies legally responsible in terms of CG mechanisms, BSEC issued the first CG guidelines back in 2006 on a ‘comply or explain’ basis to show its legitimacy to the foreign donors. Later, it was observed that the companies did not incorporate the spirit of the guidelines into their board structures, while putting tick marks in the CS, meaning that they adhered to the guidelines. To streamline the governance structure of companies’ top management, BSEC reformed the CG guidelines in 2012 on a ‘comply’ basis in which there was no scope for explaining against any kind of non-compliance. The key to the CG reform in Bangladesh was a shift from a ‘comply-or-explain’ CG practices to ‘comply’ form of governance. Krenn (2014), in a study on soft law, observes that the companies tend to adopt the code provisions in paper but not in practice. One of the plausible reasons for deficiency in case of ‘comply or explain’ provisions on the level of compliance may be, its less restrictive nature. Eventually, the impression management practices through overstating CS was also prevalent for the listed

companies of Bangladesh that question the ‘true’ changes in organisational and board structures. Pursuant to this, Cuomo et al (2016) argues, “codes cannot improve the governance practices of all companies as they leave them free to comply” (p.224).

However, hard laws can work as an effective instrument in forcing the companies to follow the standard practices. Supplementary documents like verification of compliance practices by a third-party professional, as in the case of Bangladesh after enactment of BCGG, can also work as a coaxing tool that narrows opportunities for companies to deviate from CG norms. Although the costs for the espousal of mandatory codes could be higher for the firms that are performing below par (Leuz et al., 2008) and small-scale companies (Engel et al., 2007), companies have limited scope for noncompliance, at least by using mere explanations. Reform initiatives like appointing more IDs into the boards are also expected to be more active in uncovering the corporate deceits as long as their eminence is involved with the identification of those malpractices (Bhagat et al., 1987), which may in turn, work as a catalyst to minimize window dressing of statements. Beasley (1996), in a study on a developed country context, shows that more corporate frauds takes place in the firms where the insider directors are appointed and the extent of frauds lessen significantly as the proportion of IDs are appointed. Virk (2017), in another study on the illicit practices made by the Indian companies, finds that more IDs into the boards ensure more adherence to the CG codes and is more effective in minimising the level of CG violations.

### **Institutional Background of Bangladesh**

Bangladesh, once upon a constituency of British colony until 1947 and later a part of East Pakistan, got its independence from Pakistan in 1971 followed by a nine-month long liberation war. From the very beginning of its sovereignty, Bangladesh tried to incorporate ‘socialism’ in every spheres of economy, and consequently all the manufacturing units were nationalised (Jahan, 1973). Soon after the assassination of father of the nation, Bangabandhu Sheikh Mujibur Rahman on 15 August 1975, the socialist culture of the country came to an end. Afterwards, international donor agencies such as World Bank and IMF insisted the subsequent governments to follow a policy of denationalisation that emphasised privatisation of corporations (Boughton, 2001; Belal et al., 2017) that gave birth to a major shift towards market economy. On certain instances, the IFOs had profound effect on government policy making (Sobhan and Werner, 2003) as they provided development funds in various sectors like trade liberalisation, development of capital market and even in the reforms of CG practices. Nevertheless, growth of the capitalist economy were curbed different times due to the traditionalist culture that prevail in the country like colonialism, injustice, family dominance, economic polarisation (Belal et al., 2017; Uddin and Choudhury, 2008; Uddin and Hopper, 2001) and political instability.

The institutional environment of Bangladesh is quite different from the developed economies, while resembles to emerging economies having weak rule of law (La Porta et al., 1999); poor financial transparency and government intervention in business activities (Fan et al., 2011); weak investor protection (La Porta et al., 2000) with endemic corruption and dearth of accountability, weak rule of law<sup>1</sup> and transparency in society (Khan, 2003). Quite surprisingly, with feeble institutional arrangements and high corruption index<sup>2</sup> (TIB, 2017), the growth of

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<sup>1</sup> According to Rule of Law Index of World Justice Project (2017-2018), score of Bangladesh was so poor that it positioned 102 out of 113 countries across the globe.

<sup>2</sup> In 2017, Bangladesh stood at 143 out of 180 countries in terms of Corruption Perceptions Index constructed by Transparency International Bangladesh.



Bangladeshi economy has been outstanding for more than a decade. The average GDP growth rate has been more than 6 percent per annum for last 10 years, hitting the peak at 7.28 percent in 2017 (World Bank, 2017). Consequently, the country has upgraded to a low-middle-income country in 2015 (World Bank 2015) and the current government is eyeing on achieving higher-middle-income status by 2021 to mark its 50<sup>th</sup> anniversary.

The corporate sector of Bangladesh also suffers from absence of market for corporate control (Ferdous, 2013), weak monitoring regulations (Khan et al., 2015), absence of second-order institutions (like experienced lawyer and accounting forums, investment bankers and security analyst) (Siddiqui, 2010) and weak protection of minority shareholders (Solaiman, 2006). The employees who can act as ‘whistleblowers’, have meagre legal protection that hinders outsiders to acquire corporate information (World Bank, 2009). Moreover, relationship with the dominant clans in Bangladesh works as a deciding factor for the career progression of the employees rather than their professional intelligence and judgement (Uddin and Choudhury, 2008). Analogous to the other developing nations, family business in listed firms are also common phenomena in Bangladesh (Farooque et al, 2007; Khan et al, 2011; Sobhan and Werner, 2003; Siddiqui, 2010; Uddin and Choudhury, 2008). For Bangladesh, Kochanek (1996) reports that family dominance is prevalent even before the country got its independence in 1971. After the independence, major business entities were made state-owned, however, reinstated to family ownership with the passage of incorporating market-based economy from its socialist structure after 1975 (Belal and Cooper, 2011). However, family firms with their long standing and deep rooted bonding with the companies they own (Stein, 1988), are very cautious in controlling the information that may negatively signals company prospects and questions their managerial capabilities. Consequently, it may induce the management, led by controlling shareholders and/or families, to decouple different reporting narrative documents like CG compliance statements.

The expropriation of controlling shareholders are also warrant in the context of government owned companies in Bangladesh. In these organisations, the selection process is principally determined by the justifications of political affiliations (Khatun, 2013), rather than individual’s qualifications to serve its social and political purposes. These individuals with limited skills of operation and lack of incentives for better company performance (Su et al., 2007), often involves with the decisions that hampers firm value. These companies are less competent with respect to incorporating standard disclosure practices compared to the private companies (Haque et al., 2006) due to lack of oversight from the related government organ. Moreover, according to BEI (2004), there exists a dearth of representation of the outside independent directors in the state-owned companies and the situation worsen when the chairperson of a government company is a standing cabinet minister cabinet, which may trigger that individual to assume the firm as a government organ. Due to limited presence of outside directors in the board, the government nominated directors may well be motivated to window dress company financials and narrative documents like CS to manage companies’ impression to the outsiders.

### **CG Reforms in Bangladesh**

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In 2002, a private think-tank named Bangladesh Enterprise Institute (BEI), with funding support from Department for International Development of the British Government, in association with the Global Corporate Governance Forum of the World Bank and the OECD, and the Commonwealth Secretariat, conducted a research on the state of CG in Bangladesh and outlined a prescription on the standard CG practices (Sobhan and Werner, 2003). Later, in April 2004, ‘The Code of Corporate Governance for Bangladesh’ was published by BEI. However,

as the code was voluntary in nature, BEI is a private organization did not possess the power to enforce companies for adopting CG guidelines (World Bank, 2009). Therefore, it proposed BSEC to adopt the code on a ‘comply or explain’ basis (BEI, 2004). On legitimacy grounds to the IFOs (Siddiqui, 2010) and hence to institutionalize the authoritative codes (Siddiqui and Ferdous, 2014), BSEC issued a Notification of Corporate Governance Guidelines (*hereafter*, NCGG) on 20 February 2006, following voluntary or soft approach as it was ‘comply or explain’ in nature<sup>3</sup>. Reviewing the compliance status of CG practices in Bangladesh in 2007, World Bank (2009) in a report of ROSC found that only 33 percent of the companies declared full-compliance, while 60 percent declared partial compliance to the first guidelines. The report found that, among many, minimal presence of outside IDs in the boards and lack of well-defined directors’ responsibilities were key to lack of adherence to the standard CG practices. Although Biswas (2012) claims that the level of compliance is increasing in terms of what companies declare in their compliance statements, studies (like Ferdous, 2013; Sobhan, 2016) argue that actual compliance is much less than what the companies provide in annual reports. It indicates, window dressing of compliance was taking place in the regime of NCGG. World Bank (2009), in this report, urged for a reform in the existing CG regulations in course of minimal presence of outside IDs and lack of well-defined directors’ responsibilities. Taken together, BSEC on legitimacy grounds find their way to reform NCGG while transforming the guidelines from voluntary to a compulsory one. Later, on 3 July 2012, a review took place to reinforce the BSEC CG guidelines (*hereafter*, BCGG), updating the principles to ‘comply’ basis from the strand of ‘comply or explain’<sup>4</sup>.

Apart from making the codes mandatory, the key amendment to the latter lies in the increased proportion of IDs. Earlier it was one tenth of total number of directors while the ratio is reformed to one fifth so that the general investors other than the inside directors could also be heard with more outsiders in the board. As per the new guidelines, the qualifications of outside directors were made more specified and standardized by specifying ‘*who*’ can work as an ID. Moreover, the new guidelines require companies to attest the CG compliance statement that they before attaching it to the annual report. With this inclusion, the BSEC ensures CG monitoring more comprehensive as the certification of the compliance status should come from an external auditor which is not designated for auditing the financials of companies. Although it may increase the level of cost for the companies, especially for small ones (Biswas, 2012), this may work as an initial line of defense against non-compliance and any kind of window dressing of compliance in the CS.

## **Data and Methodology**

The study uses content analysis as the prime method of examining the level of overstatements. Content analysis has been introduced as an extensively used tool in the research domain of financial accounting (Beattie, 2005; Nurrunnabi et al., 2016). Annual reports, as a tool to content analysis, are the key source of information that contains comprehensive quantitative and narrative expressions on the performance and future prospects of a company. Most importantly, the companies have sole control over these documents which gives them the outright benefit to exercise any sense giving mechanisms (Neu et al., 1998). Despite the use of other disclosure instruments in the domain of IM, annual reports have been the most widely studied company documents in this field of study (Conway et al., 2015; Merkl-Davies and Brennan, 2007). Therefore, this study considers annual report to identify the rate of overstatements that companies made in their published documents.

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<sup>3</sup> BSEC notification relating to corporate governance number: SEC/CMRRCD/2006-158/ Admin/02-08

<sup>4</sup> BSEC notification relating to corporate governance number: SEC/CMRRCD/2006-158/129/Admin/43

Table 1: Number of Companies by Year

CG Guidelines	Year	Number of Companies	Missing CS	Sample in Analysis
NCGG 2006	2007	110	4	106
	2008	115	2	113
	2009	120	2	118
	2010	127	2	125
	2011	136	1	135
BCGG 2012	2013	155	1	154
	2014	174	2	172
	2015	183	0	183
	2016	193	0	193
	2017	195	1	194

Table 1 shows an account of number of companies that was considered in the study to identify the level of compliance. The table demonstrates the years in consideration that ranges between 2007 and 2017, annual reports of number of non-financial companies listed on the premier stock exchange, Dhaka Stock Exchange (DSE)<sup>5</sup>, Bangladesh, missing CS and the final number of sample companies studied (after deducting the number of missing CS. that were taken into consideration). A total of 1493 firm-year observations were taken into consideration for the study. The reason for considering this period is, Bangladesh corporate sector saw important reforms – issuance of CG guidelines, one in 2006 (NCGG) and the other in 2012 (BCGG). The years 2006 and 2012 were excluded from the sample as the NCGG and BCGG were issued in those years. Therefore, this study covers data relating to the years from 2007 to 2011 and from 2013 to 2017 to examine the effect of CG guidelines on the extent of ‘true compliance’ and ‘window dressing of compliance’.

In Bangladesh, BSEC is the sole regulatory body that sets out the standard of CG for non-financial companies, while Bangladesh Bank, Insurance Development and Regulatory Authority (IRDA) Bangladesh and Ministry of Finance, apart from BSEC, also governs CG principles for financial firms. Following Arcot et al (2010), financial companies were excluded from the analysis on account of their different regulatory and governance structures, compared to the non-financial ones. Data were collected through the five-month-long field trip made between February and June 2018.

It is well-documented that the Anglo-American model is a manifestation of agency theory. A majority of the CG codes are influenced by agency theory as the theory can best accounts for the problems between the principals and agents that prevails in an organisation (Daily *et al.*, 2003; Morrison, 2004). From the inception of agency theory, codes across the globe are have been prescribing different CG practices to ensure accountability, transparency and effectiveness. Among the guidelines in different regions, increasing number of outside IDs, separating the roles of chairperson and CEO/MD, and forming several board committees (AC, nomination and remuneration committee, environmental committee) are widely pronounced (see Aguilera and Cuervo-Cazurra, 2009; Cuomo et al., 2016; Zattoni and Cuomo, 2008).

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<sup>5</sup> The study only covers the annual reports of non-financial companies that were listed at the time of data collection (February to June 2018). The delisted companies at the time of data collection were excluded from the study due to unavailability of annual reports.

The study examines the level of overstatements in these three key elements of agency theory, proportion of IDs into the boards, CEO duality and formation of an AC, which are considered as ‘observable’ items in compliance statement by Sobhan (2016, 606). Observable items are those which can easily be detected by the external entities as those elements are of more interest to the stakeholders, and are stated in the annual reports. There are some other observable items like number of members (at least three) and appointment of Chair of the AC, whereby as per BCGG, an ID should be the Chair of AC. However, many of the companies were found not to report the names of the members of AC in annual reports. Another observable item is the appointment of Chief Financial Officer (CFO). Like AC, name of the CFO were not mentioned in a number of instances. Consequently, it was not possible to identify whether any window dressing took place. Therefore, this study only considers the key CG variables of which the information in presented in CS were verifiable in other segments of annual reports. As per condition 5 (7) of NCGG 2006 (BCGG 2012), companies required to present their compliance status in the annual reports. First, the study identifies the level of compliance that a firm presents in compliance statement (CS). It was then crosschecked in the other parts of annual reports such as “Directors’ Report”, “Directors’ and Sponsors’ Shareholding Position”, “Audit Committee Report” and Attendance List of the Directors to scrutinise and validate whether the information provided in CS is at par with these sections of annual report or not. If the evidences were mismatched between CS and the information of the other parts of annual report for any of the variables in consideration, it was then marked as window-dressing of compliance.

### Trends of Overstatements

(a) Overall Level of Overstatements on the of basis of Content Analysis

Figure 1 shows the level of overstatements that the listed companies made during the period, starting from 2007 and ends at 2017. NCGG encompass 5 years, 2007 to 2011, while BCGG comprises of another 5 years following 2012. Overall, the overstatements with respect to appointment of IDs, forming an AC, and CEO duality demonstrated a steady fall over 10 years.

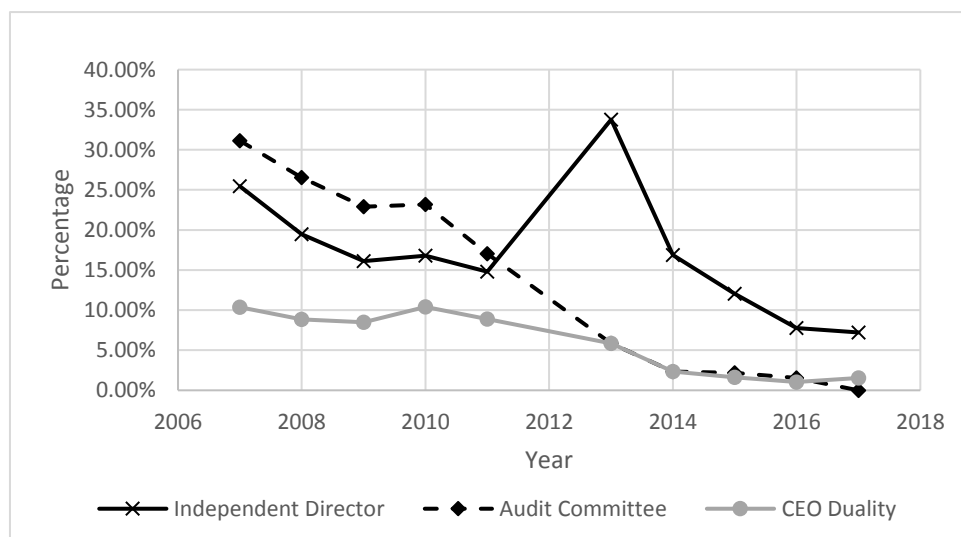


Figure: 1. Trend of Overstatements in appointment of IDs, CEO duality and forming an AC

In 2007, the overstated rates of forming an audit committee was highest among the three at 31.13 percent, followed by appointing IDs (25.47%) and CEO duality (10.38%). Until 2011, the rate of falsification maintained the same pattern i.e. AC was at the highest level, then ID,

and CEO after that. However, 2010 saw a minor rise in all the three cases. This might be assignable to the persistent lack of enforcement by BSEC against any kind of falsification made by the companies in compliance statements that took place over past years. Moreover, stock market of Bangladesh experienced a major crash at the end of 2010. Many of the companies were found to be manipulating financials as well as company operating procedures in the annual reports to attract investors, which possibly be considered as another reason of this upturn in the level of window-dressing at that point of time. However, soon after the crash, BSEC perhaps improved their oversight on the reporting quality, which again forced the proportion of overstatements to a falling trend. Then in 2011, there was a decline in all the three variables, where the rate of AC had a significant decrease. All of the three categories reached to their lowest point at the concluding year of NCGG, in which overstatements relating to ID and CEO reached to 14.81 percent and 8.89 percent respectively and AC (17.04%) with significant decline from previous year maintained its highest position.

Soon after issuing BCGG in 2012, AC formation experienced a significant fall in overstatements that accounted for 5.84 percent, which is around 3 times less than the concluding year of NCGG. At that point of time, CEO duality also continued with a gradual decrease and reached to the identical proportion held by the variable AC. During 2013-2016 both the elements experienced a consistent fall and the rates for both variables were found to be somewhat identical in this period. However, 2017 saw the window-dressing in CEO duality to rise fractionally by 0.51 percent in comparison to previous year with a finishing line of 1.55 percent. At the same time, embellishment in AC reached to 0 percent, the lowest among all the three.

Window-dressing in terms of ID appointment, on the other hand, experienced a substantial growth by approximately 2.5 times (from 14.81 in 2011 to 33.77 to 2013), which is the highest proportion of overstatements for any of the variables within the study period. However, following the first year of BCGG, it experienced a dramatic fall over the years, but continued to surpass the other two variables. As BCGG required more IDs (20%) compared to NCGG (10%) with enhanced qualifications, companies struggled to find competent persons to fill the post from the scratch. Another plausible reason for this upsurge in the window-dressing could be increased level of costs that a company need to incur by appointing increased number of IDs into the board. Pursuant to this view, Krenn (2015) points out, firms choose to window-dress their statements when there is a rise in the level of compliance cost. However, in the following year, with no options for the companies to explain their non-compliance, the overstatement rate of ID appointment attenuated by more than 50 percent i.e. the rate was 33.77 percent in 2013, while the rate for 2014 declined to 16.86 percent. In the subsequent years, the rate in this category fell consistently and reached to 7.22 percent in 2017.

#### *(b) Overstatements on the basis of Number of Companies*

Figure 2 shows the number of listed companies that overstated compliance statements during the period, between 2007 and 2017. Window-dressing in terms of number of companies were fluctuating over the regime of NCGG (2007 to 2011). In NCGG regime, it is evident that the number of companies was 53 out of 106 in 2007, which accounts for a massive 50 percent of the sample size in the initial year, while this figure ended up with 47 out of 135 companies in 2011 that accounts for 34.81 percent of the sample size that year. After issuance of BCGG, the number of firms that were involved in overstating saw a rise, from 47 companies to 57 companies in 2013 that accounts for 37.01 percent of the number of companies in that year. This rise in the number of window-dressed firms is certainly due to the overstatements made in the level of IDs as all the other two categories saw a decline from 2011 to 2013. It is evident

from the previous discussions, as per new regulations the companies had to appoint increased number of IDs with more specified qualifications. Perhaps, it was challenging for the companies to appoint more IDs who meet sophisticated qualifications criteria. More conceivably, companies were perplexed about the cost-benefit analysis of appointing more IDs. However, increased monitoring and pressure from the BSEC possibly have made the companies comply with the new code. The companies, as a result, had no options but to maintain the required proportions of IDs into the board, which reduced the level of overstatements in the subsequent years. Since 2014 onwards, the number of overstated companies decreased in each of the years. The overstated number of companies (percentage) was 34 (19.77), 27 (14.75), 18 (9.33) and 17 (8.76) in the following years until 2017. While the proportion of window dressing of companies was 34.81 at the end of NCGG tenure, it saw a sharp fall to only 8.76 percent in 2017.

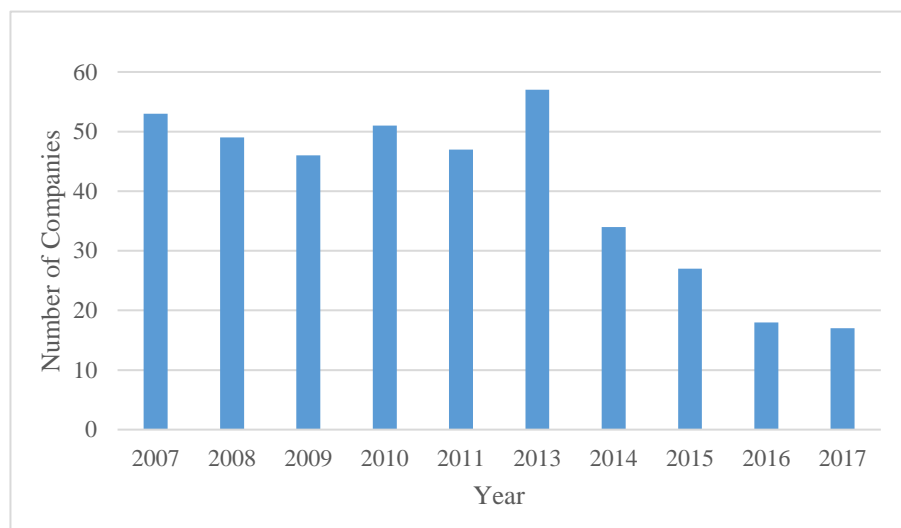


Figure: 2. Number of Companies with Overstatements

*(c) Overstatements on the basis of Ownership Structure*

Overstatements of companies in terms of ownership pattern is shown in figure 3. All of the firms were grouped into three categories on the basis of ownership: family, government, and others (non-family and foreign firms). Both in terms of number of overstated companies as well as the share of window-dressing made by the three ownership selections like family firms, state-owned corporations, and the rest of the companies were somewhat stable in the BCGG regime between 2007 and 2011. In the initial year of NCGG, the number of firms in the cohort of family and government companies increased, while the other firms experienced an insignificant decline. No doubt, this acceleration is triggered by the falsification made by the companies in case of appointing required proportion of IDs into the boardroom. However, all the categories as per the number of overstatements saw a decline in CS window-dressing from 2014 onwards. It was also observed that the family firms led the league of overstatements with its massive share in each of the years throughout the study period irrespective of CG guidelines. It seems that family firms with their major shareholdings had more control over the preparation of annual reports and manipulation of the CG compliance statements. With this symbolic management, family firms show their legitimacy while demonstrating reputation to the stakeholders so that the external parties refrain from raising questions on their leadership capabilities. To catch a clearer picture of how the companies with different ownership pattern are engaged in providing false information in the CS, it requires to find the proportionate overstatements based on the total number of companies in each of the blocks of firms.

Figure 4 shows the rate of overstatements made by the companies in terms of their ownership identity. In other words, it demonstrates the proportion of three categories of companies that window-dress within their group. It was found by the number of companies that overstated CS in a given category in a year (for example, family firms) divided by the total number of companies that were sampled in that year. Until 2009, companies with other ownership identities, although declining, had the highest overstated CS, followed by government and family firms. In the last year of BCGG era, all the three categories were found to be close with 40.79, 37.5 and 42.42 percent of overstatements for family firms, government organisations and the remaining listed companies respectively. From 2013 onwards, from the very beginning of NCGG era, the falsification rate of the government organisations surpassed the family and the other firms till the end of NCGG term. In 2017, government organisations, although declined significantly from 2013 (68.75 percent), recorded 17.65 percent which was more than the other firms (10.52 percent) and family firms (7.02 percent). As government firms are mostly run by line ministries and political directors lead the firms in Bangladesh, the board of directors are less concerned about the quality of governance that are practiced in these organisations. In one hand, BSEC’s failure to take legal actions against these kind of impression management through overstated CS powers the companies to choose these undue practices. On the other hand, state-owned firms have a close connections with the regulatory body as both are government organs, which works as an obstacle to establish legal practices. Therefore, the companies may try to signal positively by managing the compliance statements symbolically. On the one hand, BSEC’s enforcement against any kinds of window-dressing was found to be ineffective. Moreover, the family firms were found to have strong networks with the upper echelons of government (Muttakin et al., 2015) that perhaps, made the regulatory body’s legal actions even more challenging. On the other hand, monitoring the actual compliance from the part of shareholders are very costly (Arcot et al., 2010), which in turn, coaxed the minority shareholders to cast their trust on ‘box-checking’ part of CS.

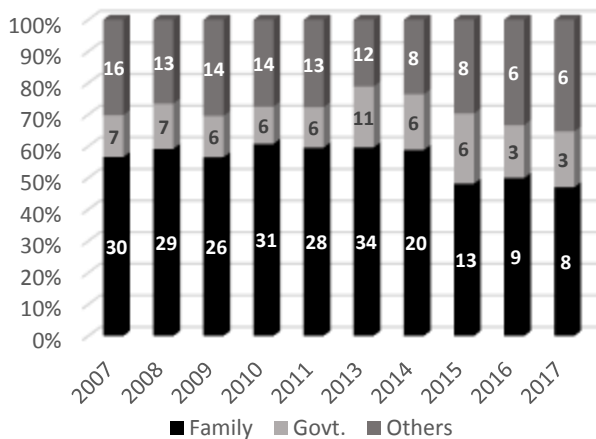


Figure: 3. Overall Overstatements by Ownership Pattern

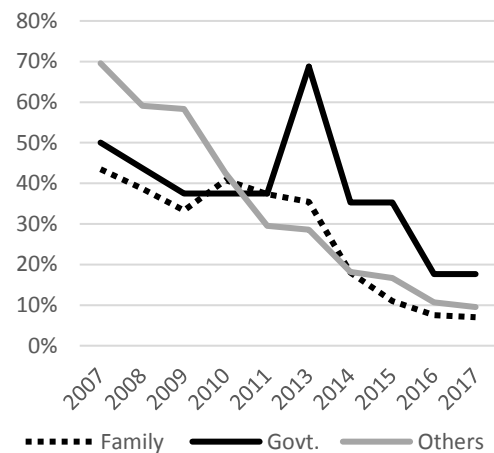


Figure: 4. Trend of Overstatements by Ownership Pattern

## Discussions and Conclusion

This study found that the companies tend to manage their impression towards the external entities through overstated CS in both the regimes of NCGG and BCGG. It was evident that the overstated rates of all the three variables (appointing IDs, separation of CEO-Chair roles and forming an AC) declined in both the regimes. However, BCGG found to have far more

significant impact on minimising the level of overstatements after the reform made in 2012. BCGG has shown more efficacy in minimising the rate of overstated compliance, compared to NCGG as all indicators have considerably improved (window dressing of compliance plummeted). In 2011, at the final year of NCGG, the rates for appointing ID, CEO duality and forming AC were 14.81, 8.89 and 17.04 percent respectively. Nevertheless, at the farthest year of BCGG, all of the three variables saw a substantial fall, reaching to 7.22, 1.55 and 0 percent respectively. Besides, the number of companies using the symbolic management strategy in preparing CG compliance statement also saw a remarkable decline, albeit the controlling shareholders (family and state) maintained their dominance throughout NCGG and BCGG. This indicates, BCGG were more effective with its 'comply' provisions and requirements to appoint increased proportion of independent directors in the board, where the rates for one of the categories have decreased to less than 10 percent and the others are close to zero. Another plausible justification for this noteworthy trend of falling overstatements is, the inclusion of mandatory attestation of CS by a professional accountant. In other words, BSEC, though failed to enforce CG regulations in terms of taking necessary legal actions, was at least able to control the tendency of companies to present deceitful information in the compliance statements by issuance of the codes and reinforcing reforms that brought the 'true' organisational change in terms of governance practices.

It is well documented that there exists dissimilarity in the CG practices among the developed and the developing nations (Uzma, 2018) due to the diversity of countries in the context of legal and cultural profile. Therefore, the findings of this article should be interpreted with caution, even for the developing nations as the institutional settings of each and every country is identical with varying nature of business environments. Contingent to the existing regulatory, social and political horizons, government pressures, country specific governance idiosyncrasies and the position of a country to espouse CG norms affect the development of transformations in CG regulations (Armitage et al., 2017).

In this study, the process of identifying the overstatements in CS was centred on thorough exploration of different segments of annual reports. The information were not cross-validated by a questionnaire survey to investigate whether the companies manages their impressions by using overstated compliances. Therefore, there may have some likelihood that the actual rate of window dressing differs from what was detected through content analysis. Following Sobhan (2016), further quantitative investigations could be conducted to identify the influential factors behind window dressing of CS over pre- and post-BCGG tenure. This could lead to observe how the reform changes the dominant determinants of CS overstatements. Moreover, pursuant to Westphal and Zajak (1998), another future research could be directed by constructing an econometric model that examines the relationship between the rate of overstatements of CS and the market performance of companies. Moreover, this econometric model can also assess the financial and market performance (e.g., return on asset and Tobin's Q) of the companies and can compare the results of performance with respect to pre- and post-reform horizons. It could also help generating knowledge on whether the companies are benefitting from window dressing of CS in case of companies internal profitability or market reactions.



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