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Corporate governance reform in a developing country: the case of Bangladesh

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Submitted in fulfilment of the requirements for the degree of PhD in Accounting

The University of Edinburgh Business School

April 2014

DECLARATION

In accordance with the University of Edinburgh Regulations for Research Degrees, I declare that

(1) this thesis has been composed by me,

(2) this is the results of my own original research,

(3) this has not been previously submitted for any other degree or professional qualification,

(4) I have followed relevant ethics procedures and guidelines.

______________________ ________________

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Corporate governance reform in a developing country– the case of Bangladesh

ABSTRACT

Bangladesh reformed its corporate governance by adopting Bangladesh Corporate Governance Guidelines-2006 (the BCGG-2006 hereafter) due to pressures from international financial institutions (IFIs). However, there is huge controversy in prior literature regarding the IFIs' suggested reform initiatives. The thesis asks specific research questions: RQ1. Do institutional investors and bankers in Bangladesh perceive that the level of compliance with the BCGG-2006 by the investee or borrowing company influences the investment and lending decisions respectively? RQ2.1. To what extent is the BCGG-2006 implemented in form rather than in substance? RQ2.2 Is there a relationship between the nature of compliance with the BCGC-2006 and firm performance? RQ3.1. To what extent does reported compliance with the BCGG-2006, as reported in annual reports, overstate underlying compliance with the BCGC-2006? RQ3.2 Does the overstatement of compliance reported in annual reports lead to a different relative ranking of a firm's corporate governance structure? RQ3.3 What factors influence the overstatement of compliance with the BCG-2006 in annual reports?

To investigate RQ1, an inductive approach is taken and data are collected by using semi-structured interviews of investment managers and credit rating analysts. In order to examine the remaining RQs, a deductive approach is taken and data are collected: (1) by using a structured survey questionnaire addressed to company secretaries or CFOs; and (2) from annual reports and stock exchanges.

With respect to RQ1, this study finds (1) strong evidence that institutional investors and bankers perceive limited impact of corporate governance mechanisms recommended by the BCGG-2006 on investment and lending decisions respectively. In order to theorise the above findings, two theories: agency theory and the theory of path dependence are contrasted. Using a grounded theory coding, this study finds that (1) companies are locked in the path of control by sponsor families and sponsor families then impede the implementation of the BCGG-2006 and (2) institutional investors and bankers lock themselves in the path of name-based and relationship-based investment and lending practices which deters consideration of corporate governance mechanisms introduced by the BCGG-2006. Very few interviewees provide an explanation consistent with the agency theory. This evidence thus points more to the theory of path dependence than to agency theory.

In relation to RQ2.1, this study finds that local privately-owned companies and government-owned companies either do not comply or comply in form but not in substance with the BCGG-2006, while subsidiaries of foreign multinational companies comply in form and in substance with the BCGG-2006. The relative strength of path dependence in local privately-owned companies and government-owned companies and subsidiaries of foreign multinational companies explains these

results better than agency theory. The evidence with respect to RQ2.2 provides an indication that the nature of compliance with separation of the chairman and CEO, board independence and audit committee does not have an association with firm performance in case of local privately-owned companies. However, the evidence in relation to RQ2.2 provides an indication that the nature of compliance with the corporate governance mechanisms introduced by the BCGG-2006 makes a difference in firm performance in subsidiaries of foreign multinational companies.

With respect to RQ3.1, it is found that companies overstate compliance with the BCGG-2006 in annual reports. With respect to RQ3.2, this study finds that the rank of a firm's corporate governance is different when comparing compliance with the BCGG-2006 as reported in annual reports with compliance with the BCGG-2006 as stated in the survey. With respect to RQ3.3, it is found that overstatement of compliance is more pronounced with respect to less-observable provisions of the BCGG-2006, is positively associated with control by sponsor families and is negatively associated with control by institutional investors. This evidence is again more consistent with the theory of path dependence and institutional logic than agency theory.

The findings of this thesis suggest that corporate governance researchers in developing countries should consider the role of path dependence rather than agency theory exclusively. This thesis also makes a methodological contribution by investigating overstatement of compliance with the BCGG-2006. The findings of this study may also assist regulators in developing countries and the IFIs in formulating future governance guidelines for developing countries.

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Abbreviations

AC	Audit Committee
ADB	The Asian Development Bank
AGM	Annual General Meeting
ANOVA	Analysis of Variance
BAL	The Bangladesh Awami League
BB	The Bangladesh Bank
BCGG-2006	Bangladesh Corporate Governance Guidelines-2006
BCGG-2012	Bangladesh Corporate Governance Guidelines-2012
BEI	Bangladesh Enterprise Institute
BNP	The Bangladesh Nationalist Party
BRPD	Banking Regulations and Policy Department of Bangladesh Bank
BSEC	The Bangladesh Securities and Exchange Commission
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG	Corporate Governance
CIB	Credit Information Bureau
CRG	Credit Risk Grading
CSE	Chittagong Stock Exchange
DFID	Department for International Development
DSE	Dhaka Stock Exchange
FCA	Fellow of the Institute of Chartered Accountants of Bangladesh
FCMA	Fellow of the Institute of Cost and Management Accountants of Bangladesh
GDP	Gross Domestic Product
HIA	Head of Internal Audit
IASs	International Accounting Standards
ICAB	Institute of Chartered Accountant of Bangladesh

IFC	The International Finance Corporation
IFIs	International financial institutions
IFM	The International Monetary Fund
IFRS	International Financial Reporting Standards
LBOs	Leverage Buyouts
MNCs	Multinational companies
NGOs	Non-governmental organizations
OECD	The Organisation for Economic Co-operation and Development
PhD	Doctor of Philosophy
RJSC	The Registrar of Joint Stock Companies
RMG	Ready-Made Garments
ROA	Return on Assets
ROE	Return on Equity
ROSC	Reports on the Observance of Standards and Codes
RQ	Research Question
SAFA	South Asian Federation of Accountants
TIB	Transparency International Bangladesh
USA	The United States of America
UK	The United Kingdom
UNCTAD	The United Nations Conference on Trade and Development

Chapter One

Introduction

1.1 Motivation

Corporate governance (CG) reforms based on an Anglo-American model have proliferated in developing countries. It has been argued that these reforms are influenced more by legitimacy-based than efficiency-based reasons (Reed, 2002; Siddiqui, 2010). More particularly, developing countries execute CG reforms in response to pressures from international financial institutions (IFIs) namely the World Bank, the International Monetary Fund (IMF), the International Finance Corporation (IFC) and the Asian Development Bank (ADB) (Reed, 2002; Siddiqui, 2010) and in order to attract foreign direct investment (Rwegasira, 2000; Yakasai, 2001; Krambia-Kapardis and Psaros, 2006). The IFIs exert (1) coercive pressures for CG reforms in developing countries by conditioning financial assistance on the adoption of CG reforms (Rosser, 2003; p. 330; Singh et al., 2002) and (2) normative pressures by suggesting poor CG is one of the important reasons that causes financial crisis (Singh et al., 2002; Soederberg 2003) and slows down economic growth (Reed, 2002).

The proponents of CG reforms in developing countries (IFC, 2013; Claessens and Yurtoglu, 2012; Global Corporate Governance Forum, 2005; Iskander and Chamlou, 2000) argue that sound CG is an important precondition for rapid economic growth and sustainable economic development. By sound CG, these proponents indicate CG mechanisms recommended by an Anglo-American model (cf Singh et al., 2002). They argue that sound CG ensures rapid growth and sustainable economic development through (1) greater access to external financing by firms, (2) lower cost of capital and associated higher valuation of firms, (3) better operational performance of firms, and (4) more favourable treatment of all stakeholders (ROSC, 2013; IFC, 2013; Claessens and Yurtoglu, 2012; p. 17; Claessens, 2006; p. 99; Global Corporate Governance Forum, 2005; p. 6). An Anglo-American model of CG helps attain the aforementioned outcomes by ensuring (1) better protection of

shareholder and creditor rights (Claessens, 2006; La Porta et al., 1998), (2) reduced self-dealing and insider trading behaviour (Claessens, 2006; Iskander and Chamlou, 2000); (3) efficient management, better allocation of resources and active participation of stakeholders in performance-enhancing mechanisms (Claessens, 2006; Iskander and Chamlou, 2000); and (4) timely and accurate disclosure and transparency on all matters material to company performance, ownership and CG (Iskander and Chamlou, 2000).

However, there is controversy about the effectiveness of an Anglo-American model of CG in developing countries and the reform initiative of the IFIs. The unique historical background, path of development, political, economic and social institutions of developing countries are distinct from that of Anglo-American countries (Li and Nair, 2009; Singh et al., 2002). Thus, CG models that may have performed effectively in Anglo-American countries may not work in developing countries (Singh et al., 2002; Sam, 2007; Young et al., 2008). Moreover, the test of association between a measure of sound CG (e.g., board independence) and an outcome variable (e.g., firm performance), not to mention systematic causal relationships, provides inconclusive evidence (Vives, 2000; Adams et al., 2010; Hermalin and Weisbach, 2003). Furthermore, IFIs have been accused for endorsing an Anglo-American model because it is better suited to Western investors (Soederberg 2003: 17–18, 23; Soederberg 2004) while giving little consideration to the low government capacity (Grindle, 2004; Rodrik, 2006), the existing power relations among government, controllers and financiers of corporations (Hout, 2012) and the lack of complementary institutions in the developing countries concerned (Uddin and Hopper, 2003; p. 29; Dyball et al., 2006).

The high level of poverty and aid dependency of Bangladesh makes it a major test case for IFI-led CG reform (Kochanek, 2000). In response to the stock market crash of 1996, the government of Bangladesh initiated a project titled *Capital Market Development Programme in Bangladesh* costing $80.00 million in collaboration with the ADB in 1997. The main objective of this programme is to restore investor confidence (ADB, 2005; p iv; Uddin and Choudhury, 2008). This programme consists of seven types of technical assistance. One objective of this programme is to draft a comprehensive CG manual for public limited companies and security issuers.

This programme was executed by the ADB with the help of The Aries Group, Ltd. a consultant from USA. The consultant formulated CG guidelines in line with the OECD's Principles of CG. The Bangladesh Securities and Exchange Commission (BSEC) adopted the guidelines in 2006 (SEC order No. SEC/CMRRCD/2006-158/Admin/02-08, dated 20 February 2006).

The Bangladesh Corporate Governance Guidelines-2006 (hereafter 'the BCGG-2006') is based on a 'comply or explain' principle and it supplements the Companies Act 1994 in respect of administration of publicly listed companies. It has also been included in the listing rules of the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE). The main recommendations of the BCGG-2006 are detailed in chapter three, Section 3.6.2.

Some researchers question the applicability and effectiveness of the BCGG-2006. Siddiqui (2010) argues that the BCGG-2006 is not suitable for Bangladesh given its institutional characteristics and claims that the adoption of the BCGG-2006 is prompted by 'exposure to legitimacy threats rather than efficiency reasons' (p.253). This is consistent with Uddin and Chowdhury (2008) who find that the traditional culture and values of Bangladesh are in conflict with the rationality implicit in an Anglo-American model of CG. On the other hand, the World Bank (2009) finds that the average level of compliance with the BCGG-2006 is 82 per cent and claims that an improvement in the Bangladesh CG framework has ensued since 2006. There is no study that investigates whether the level of compliance with the BCGG-2006 indicates attainment of any objective of CG reform in Bangladesh as advocated by the IFIs. This study, thus, intends to investigate whether the BCGG-2006 accomplishes a number of its intended objectives.

Section 1.2 presents research questions. Section 1.3 contains research methods to be used in the study. Section 1.4 outlines expected contributions of the study and Section 1.5 sets out the structure of this thesis.

1.2 Research questions

This thesis addresses one 'motivating research question' asking whether the BCGG-2006 accomplishes a number of its intended objectives in Bangladesh as a developing country. The main objective of CG reform in Bangladesh is to ''foster investors' confidence and facilitate savings and investment'' (ADB, 2000[1]; p. 1). The underlying argument is that better CG will foster investors' confidence by (1) ensuring better protection of investors' rights, (2) clearly and appropriately defining the responsibilities of the board of directors and management of public limited companies and (3) timely and adequate disclosure of information to the public and shareholders (ADB, 2000; p. 3).

The purpose of fostering investors' confidence is to ensure (1) greater access to external financing by firms and (2) lower cost of capital and associated higher valuation of firms, the two important outcomes of sound CG perceived by proponents (e.g., IFC, 2013; Claessens and Yurtoglu, 2012; Claessens, 2006; Global Corporate Governance Forum, 2005; Iskander and Chamlou, 2000) of CG reform. Hence, this study argues that the first intended objective of the BCGG-2006 is to have a positive influence on the investment and lending decisions of institutional investors and bankers respectively. Hence, the first research question to be addressed in this study is:

RQ1. Do institutional investors and bankers of Bangladesh perceive that the level of compliance with the BCGG-2006 by the investee or borrowing company influences investment and lending decisions respectively?

Another outcome of a CG reform in developing countries as perceived by its advocates (e.g., IFC, 2013; Claessens and Yurtoglu, 2012; Claessens, 2006; Global Corporate Governance Forum, 2005; Iskander and Chamlou, 2000) is to ensure the better operational performance of firms. Hence, this study argues that the second intended objective of the BCGG-2006 is to influence firm performance positively. However, prior CG researchers (e.g., Cohen et al. 2008; Connelly et al. 2012) argue

[1] Although the capital market development programme was approved in 1997, the Technical Assistance report was signed by government in 2000.

that when CG mechanisms are implemented ‘in form but not in substance’; they mainly play a ceremonial role and thus, have no impact on firm performance. Hence, it can be argued that the CG mechanisms introduced by the BCGG-2006 need to be implemented ‘in form and in substance’ rather than ‘in form but not in substance’ in order to have a positive impact on performance. Hence, the second set of research questions to be addressed in this study is:

RQ2.1. To what extent is the BCGG-2006 implemented both ‘in form and in substance’ rather than ‘in form but not in substance?

RQ2.2 Is there a relationship between the nature of compliance with the BCGG-2006 and firm performance?

Sound CG fosters investors’ confidence by ensuring timely and accurate disclosure and transparency on all matters material to company performance, ownership and CG (Iskander and Chamlou, 2000; ADB, 2000; p. 3). This implies that accurate disclosure on compliance with the BCGG-2006 is important for making informed investment and credit decisions. Moreover, accurate disclosure on compliance with the BCGG-2006 is essential for the monitoring of compliance as the BCGG-2006 is based on the ‘comply or explain’ principle. The monitoring of compliance with a CG code based on ‘comply or explain’ principle is left to shareholders (FRC, 2006; p. 4; MacNeil and Li, 2006; pp. 488-499; Arcot et al., 2010; Wymeersch 2006; v. Werder et al., 2005). The results reported in World Bank (2009) and a preliminary analysis of 20 annual reports of Bangladeshi companies reveal that the disclosed level of compliance with the BCGG-2006 is very high. This high level of compliance with the BCGG-2006 as disclosed in annual reports raises suspicion about the accuracy of compliance because companies in Bangladesh are reported as being reluctant to make disclosure on both mandatory (Akhtaruddin, 2005) and voluntary accounting items (Belal and Cooper, 2011). The suspicion is further reinforced by the scepticism of prior researchers about the disclosed level of compliance with adopted CG codes in developed countries (e.g., Arcot et al., 2010; v. Werder et al., 2005; Akkermans et al., 2007). Hence, the third set of research questions to be addressed in this study is:

RQ3.1. To what extent does reported compliance with the BCGG-2006, as reported in annual reports, overstate underlying compliance with the BCGG-2006?

RQ3.2 Does the overstatement of compliance reported in annual reports lead to a different relative ranking of a firms' corporate governance?

RQ3.3 What factors influence the overstatement of compliance with the BCGG-2006 in annual reports?

In this study, 'underlying compliance with the BCGG-2006' indicates compliance with the BCGG-2006 as stated in a confidential survey.

1.3 Research methodology and methods

The research questions determine the research methodology and methods (Punch, 2005; Mason, 2002; Abernethy et al., 1999). With respect to RQ1, this study employs an 'inductive approach' while with regard to RQ2 and RQ3 it employs a 'deductive approach'.

With respect to RQ1, an inductive approach is appropriate because (1) previous archival studies mainly conducted in the USA and UK provides inconsistent evidence (c.f. Bansal, 2013), (2) survey-based research provides contrasting evidence depending on the context of the survey (c.f. Bansal, 2013) and (3) there is little academic research that directly investigates the impact of CG on investment and lending decisions in both developed and developing countries (c.f. Barker and Imam, 2008). Consistent with an inductive approach, a semi-structured interview method is used to collect the data needed to investigate RQ1.

A deductive approach is appropriate when using prior theoretical and empirical literature propositions and when hypotheses can be developed (Dubois and Gadde, 2002; Bryman, 2008). Section 2.2 discusses theories that are used in prior corporate governance research. This section also argues that agency theory and neo-institutional theory with an emphasis on path dependence can be explored to study RQ2 and RQ3. Using these two theories and prior literature, propositions and hypotheses with respect to RQ2 and RQ3 are formulated in chapter 4. Consistent with the deductive approach, structured survey questionnaires and other publicly available data such as annual reports are used to investigate RQ2 and RQ3.

This thesis as a whole employs mixed methods. Semi-structured interviews provide evidence relating to RQ1. A survey based on a structured questionnaire and annual reports provide data required for answering RQ2. The responses from this survey are compared with disclosures in annual reports to answer RQ3.

1.4 Findings and contribution of the study

From the interviews, this study finds that CG mechanisms suggested by the BCGG-2006 have a limited impact on the investment and lending decisions of institutional investors and bankers respectively. This is because companies subject to the BCGG-2006 are reluctant to implement it in form and in substance while institutional investors and bankers persist with name-based and relationship-based investment and lending practices respectively, which deter consideration of the recommended CG mechanisms. This evidence is in contrast to prior empirical evidence in developed countries that use archival and survey methods and find that institutional investors and bankers prefer better governed firms.

From the survey, this study finds that local privately-owned and government-owned companies either do not comply or comply-in form but not in substance, while subsidiaries of foreign MNCs comply in form and in substance with the BCGG-2006. Moreover, this study finds that CG mechanisms recommended by an Anglo-American model do not make a difference in performance among local-privately owned companies even when a company complies in form and in substance.

From comparing the survey with disclosures in annual reports, this study provides evidence that companies overstate compliance with the BCGG-2006 in annual reports due to institutional pressures; this overstatement leads to different ranking of firms and is more pronounced with respect to non-observable provisions of BCGG-2006. The evidence of this study, thus, supports the suspicion of prior researchers that compliance with CG guidelines as reported in annual reports may not present underlying compliance. This study also finds that overstatement of compliance is positively related with control by families and is not related with control by institutional investors.

All three chapters point towards the theory of path dependence, which in turn contributes to an understanding of why an agency-based code of corporate governance is unlikely to be effective in a developing country such as Bangladesh.

Although the evidence of this study is specific to Bangladesh, the results are perhaps generalizable to other developing countries with similar corporate and institutional characteristics such as family controlled companies, weak shareholders rights and rampant corruption. In that case, the insights revealed by the findings of this study should be of particular interest to advocates of CG reform in all developing countries such as the IFIs and domestic regulatory agencies.

1.5 Structure of the thesis

This thesis is structured into nine chapters including this introduction chapter. A brief outline of the following chapters is detailed below:

Chapter Two presents a review of existing literature on CG. Section 2.2 presents a discussion and a critical analysis of a number of CG theories and argues that agency theory and the theory of path dependence are appropriate to study CG reform in developing countries. Section 2.3 presents a brief discussion of different CG models while providing a greater attention to the Anglo-American model as the BCGG-2006 is based on the Anglo-American model. In order to understand the difference between Anglo-American countries and developing countries, institutional characteristics of both kinds of countries relevant to CG are discussed in Section 2.4. Section 2.5 reviews prior literature on the impact of CG on the investment and lending decisions of institutional investors and bankers respectively and justifies RQ1. Section 2.6 discusses the corporate governance problems in developing countries, the reasons for the adoption of CG codes based on an Anglo-American model in developing countries, the influence of institutional characteristics of developing countries on the effectiveness of an Anglo-American model of CG, reviews prior research on five CG mechanisms recommended by the BCGG-2006 and justifies RQ2. Finally, prior literature on compliance with the CG code is reviewed and RQ3 is justified in Section 2.7. Section 2.8 concludes the chapter.

Chapter Three discusses several institutional characteristics of Bangladesh which are relevant to this thesis. Section 3.2 presents an overview of the economic

condition of Bangladesh. Section 3.3 describes the political regimes in Bangladesh since independence with an emphasis on industrial policies and their impact on the development of the corporate sector. This section gives an indication that the collusion between political leaders and business entrepreneurs lead to the development of family capitalism in Bangladesh. Section 3.4 describes the present characteristics of the corporate sector and the relevant institutional characteristics of Bangladesh. Section 3.5 describes important general institutional characteristics (e.g., culture) of Bangladesh. The emergence of CG and the content of BCGG-2006 are outlined in Section 3.6. Section 3.7 presents the characteristics of banks and credit rating agencies in Bangladesh. Section 3.8 summarises the chapter.

Chapter Four develops sub-questions related to RQ1 (Section 4.2), propositions related to RQ2.1 and RQ2.2 (Section 4.3) and hypotheses related to RQ3.1, RQ3.2 and RQ3.3 (Section 4.4). With respect to RQ1, neither a theoretical framework nor an association between level of compliance with the BCGG-2006 and investment and lending decisions is outlined following the logic of induction. With respect to RQ2.1 and RQ2.2, propositions are developed using agency theory and the theory of path dependence. Finally, using agency theory, the theory of path dependence of corporate governance and neo-institutional theory, I develop hypotheses related to RQ3.1, RQ3.2 and RQ3.3. Section 4.5 summarises the chapter.

Chapter Five addresses the methodological issues of this thesis. A detailed analysis on semi-structured interviews (Section 5.3) and self-explanatory structured questionnaire survey (Section 5.4) is conducted. The measurement of variables for testing propositions related to RQ2 (Section 5.6) and hypotheses related to RQ3 (Section 5.7) is discussed. Statistical techniques for testing propositions related to RQ2.2 (Section 5.8) and hypotheses related to RQ3 (Section 5.9) are also outlined. Section 5.10 provides a summary.

Chapter Six presents the results for RQ1. Using semi-structured interview data, results are presented with respect to two questions and a theoretical framework is generated from the data. The results provide strong support that the CG mechanisms introduced by the BCGG-2006 have limited or no direct and indirect impact on the investment and lending decisions of institutional investors and bankers respectively. This is because the investee or borrowing company does not implement

the CG mechanisms introduced by the BCGG-2006 due to rent-protection and low-relative efficiency of the BCGG-2006. Moreover, the investment and lending decisions are strongly influenced by the name of the key person in the investee or borrowing company. The past relationship with that key person is also influencial.

Chapter Seven presents results for RQ2.1 and RQ2.2. With respect to RQ2.1, the results show that CG mechanisms introduced by the BCGG-2006 are implemented 'in form rather than in substance' in privately-owned and government-owned companies and 'in form and in substance' in subsidiaries of MNCs. However, the results related RQ2.2 indicates that the association between nature of compliance with the BCGG-2006 and firm performance depends on the selected performance measure. However, the difference in performance based on nature of compliance with the BCGG-2006 does not hold with respect to privately-owned companies in the case of the separation of chairman and CEO, board independence and audit committee.

Chapter Eight presents results for R3.1 to RQ3.3. The results show that there is an overstatement of compliance with the provisions of the BCGG-2006 in annual reports. Moreover, this overstatement leads to different ranking of firms' governance. Furthermore, this overstatement is more pronounced with respect to less observable provisions. Finally, overstatement of compliance in annual reports is positively related with control by family and not related with control by institutional investors.

Chapter Nine presents a summary of the key findings and the contributions of this thesis. This chapter also describes limitations of this thesis and provides suggestions for future research.

Chapter Two

Literature Review

2.1 Introduction

The aim of this chapter is to provide a review of the literature on CG which is relevant to the main research question of this thesis: *Does a CG reform based on an Anglo-American model of CG accomplish its intended objectives in a developing country?* and related sub-questions: *RQ1. Do institutional investors and bankers in Bangladesh perceive that the level of compliance with the BCGG-2006 by the investee or borrowing company influences the investment and lending decisions, respectively? RQ2.1. To what extent is the BCGG-2006 implemented in form rather than in substance? RQ2.2 Is there a relationship between the nature of compliance and firm performance? RQ3.1. To what extent does reported compliance with the BCGG-2006, as reported in annual reports, overstate underlying compliance with the BCGG-2006? RQ3.2 Does the overstatement of compliance reported in annual reports lead to a different relative ranking of a firm's corporate governance? RQ3.3 What factors influence the overstatement of compliance with the BCGG-2006 in annual reports?*

This chapter will help to identify gaps in prior literature on CG, particularly in developing countries and thus, provide justification for the abovementioned research questions. It will further help to formulate propositions and hypotheses and to discuss the findings of this study in later chapters. More specifically, this chapter seeks to achieve the following objectives.

Section 2.2 discusses a number of theories that have been used in prior literature on CG and thus, identifies one or more theories appropriate for studying CG reform in a developing country, Bangladesh. Section 2.3 discusses different models of CG with a special emphasis on the Anglo-American model. Section 2.4 focuses on institutional differences between Anglo-American countries and developing countries. Section 2.5 discusses prior literature on the impact of CG on the investment and lending decisions of institutional investors and bankers respectively and identifies the gap in this literature. Section 2.6 discusses corporate

governance problems in developing countries, the reasons for the adoption of Anglo-American-based CG codes by developing countries, the influence of institutional characteristics of developing countries on the efficient implementation of a CG code based on the Anglo-American model and prior literature on CG in developing countries. This section also identifies a gap in the CG literature in developing countries to justify RQ2. Section 2.7 discusses existing literature on compliance with an adopted CG code and identifies a gap in this stream of literature. Section 2.8 concludes.

2.2 Theories and definition of corporate governance

At present, CG literature is relatively mature and highly interdisciplinary. Prior researchers employ a number of theories to investigate CG in accounting and finance. Some of these theories define CG and suggest respective CG models while other theories explain compliance with an adopted CG code. There are different definitions of CG under different theories and the term CG has no agreed upon meaning among scholars in accounting and finance (Brickley and Zimmerman, 2010). This section discusses a number of theories of CG. A definition of CG is also provided with respect to a particular theory if the proponents of the theory define CG. Otherwise, the theory only is explained. The models of CG relevant to the theories are discussed in Section 2.3.

2.2.1 Agency theory and corporate governance

Agency theory is the most frequently used theoretical framework in CG literature (Sheilfer and Vishney, 1997, p. 738; Aguilera et al, 2008). Although Jensen and Meckling (1976) formally model agency theory and discuss its implications for publicly listed companies with dispersed ownership, the concept of agency conflict was developed as early as 1776 when Adam Smith in his *the Wealth of Nations* declared that managers might not exercise a similar level of care over shareholders money as shareholders did because managers dealt with other people’s money instead of their own (cited in Denis, 2001, p. 192). In between, Berle and Means (1932) also make a seminal contribution to the development of agency theory.

According to Jensen and Meckling (1976), an agency relationship arises when the managers (the agents) are entrusted with decision-making rights by the shareholders (the principals). An agency relationship is characterized by two major types of problems: (1) moral hazard problems and (2) adverse selection problems (Eisenhardt, 1989a; Walker, 1989). The problems of moral hazard arise because shareholders cannot directly observe the managers' effort toward the maximisation of shareholder wealth and thus, managers, being self-interest maximising rational people, may shirk on effort or opportunistically maximise their personal interest at the expense of shareholders (Jensen and Meckling, 1976). The problems of adverse selection arise because managers can misrepresent their abilities or skills to shareholders and shareholders cannot completely verify these abilities or skills (Eisenhardt, 1989a).

Jensen and Meckling (1976) recommend the introduction of monitoring and bonding mechanisms to limit the opportunistic behaviour of management. The analysis of agency theory by subsequent researchers indicates that they use these monitoring and bonding mechanisms as a synonym of CG (e.g., Eisenhardt, 1989a). Hence, according to agency theorists, the main objective of CG is to reduce the problems of moral hazard and adverse selection (Lubatkin et al. 2007; Letza et al., 2004; Vives, 2000; Eisenhardt, 1989a). As such, agency theorists define CG as a set of controlling and monitoring mechanisms that restrain the opportunistic behaviour of management and reduce information asymmetries between managers and shareholders (e.g. Jensen and Meckling, 1976; Fama and Jensen, 1983; Gillian, 2006; Eisenhardt, 1989a).

Agency theory is used as a basis for the Anglo-American model of CG. This model recommends the separation of the roles of chairman of the board and CEO, the appointment of a greater number of non-executive and independent directors on the board, the appointment of board committees (nomination, remuneration and audit committee) fully composed of non-executive independent directors and the establishment of a formal board evaluation procedures (Lorsch and MacIver, 1989; Demb and Neubauer, 1992). The Anglo-American model of CG is further discussed in Section 2.3.

As the main objective of CG, according to agency theory, is to restrain the opportunistic behaviour of management (Fama and Jensen, 1983; Lubatkin et al., 2007), supporters of agency theory believe that the introduction of CG mechanisms positively affect firm performance and accounting reporting quality (Eisenhadrt, 1989a; Fama, 1980; Fama and Jensen, 1983). A large body of prior empirical literature that investigates the aforementioned assertion, however, provides inconclusive evidence (Daily et al., 2003; Dalton et al., 2003, 1998, 1999; Adams et al., 2010; Hermalin and Weisbach, 2003).

Agency theory is critiqued by stewardship, stakeholder and institutional theorists on a number of grounds (Cuevas-Rodríguez et al., 2012; Huse, 2007; Aguilera and Jackson, 2003). Stewardship theorists criticise agency theory for its pessimistic assumptions about human behaviour (Donaldson & Davis, 1994; Davis et al., 1997) while institutional theorists criticise agency theory for its failure to recognise the influence of social context on the behaviour of principals and agents (Wiseman et al., 2012; Filatotchev and Allcock, 2010; Aguilera et al., 2008). Institutional theorists equally criticise prior agency theory-based studies (Doucouliagos, 1994; Hirsch et al., 1987; Aguilera et al., 2008). For example, Aguilera et al. (2008, p. 475) regard agency theory-based studies as '*closed system*' approaches and argue that this approach fails to pay adequate attention to the unique circumstances in which firms are operating.

In addition, several recent researchers argue that the main assumption of agency theory, the separation between shareholders and managers, does not hold in developing countries (e.g., Young et al., 2008; Jackling and Johl, 2009). This is because in developing countries, corporate ownership is concentrated in controlling shareholders and controlling shareholders generally hold key management positions in companies (Wiwattanakantang, 2002; Joh, 2003; Yeh et al., 2001; Claessens et al., 2000). The issue of agency problems in developing countries is further discussed in Section 2.6.1.

2.2.2 Stewardship theory and corporate governance

In contrast to agency theory, stewardship theory assumes that managers are honest (Hernandez, 2008), motivated more by intrinsic rewards than extrinsic

rewards (Sundaramurthy and Lewis, 2003) and self-motivated to maximise collective interests (Nicholson and Kiel, 2007; Wasserman, 2006; Davis et al., 2000; Davis et al., 1997; Muth and Donaldson, 1998). Stewardship theorists, thus, argue that monitoring can be counterproductive because monitoring activities negatively affect the motivation of managers to perform pro-actively (Hernandez, 2012).

Under stewardship theory, the role of CG is to maintain structures that facilitate efficient and effective decision making by managers (Davis et al., 1997). Consistent with this view, stewardship theorists recommend the appointment of a dual CEO (Donaldson and Davis, 1991) and a majority of inside directors on the board (Kiel and Nicholson, 2003; Sundaramurthy and Lewis, 2003). A number of studies argue that a stewardship theory-based board of directors is more applicable if ownership is concentrated and the major owners represent the firm's management (Chin et al., 2004; Eisenberg et al., 1998; Huse, 2000)

However, the meaning of stewardship (O'Connell, 2007) and the impact of intrinsic versus extrinsic rewards on managers' motivation (Huang et al., 2003) varies across countries. This theory, like agency theory, provides an under contextualised view of the manager-shareholder interaction (Bruce et al., 2005; Shapiro, 2005; Lubatkin, 2005).

2.2.3 Stakeholder theory and corporate governance

Stakeholder theory assumes that the corporation is a nexus of both implicit and explicit contracts among a broad range of stakeholders (Hill and Jones, 1992). These stakeholders include 'any group or individual who can affect or is affected by the achievement of the organization's objectives' (Freeman, 1994, p. 46). Donaldson and Preston (1995) further refine the concept of stakeholders and state that stakeholders include all persons or groups who have legitimate interests in a firm. Waddock et al. (2002) following Clarkson (1995) classify these stakeholders into two groups: primary and secondary stakeholders. They identify owners, employees, customers, and suppliers as primary stakeholders and non-governmental organizations (NGOs), activists, communities, and governments as secondary stakeholders. These stakeholders have different interests in firms and thus, there is the possibility of favouring the interests of one group over another (Jones and Wicks,

1999). Hence, stakeholder theory posits that the interest of each group of stakeholders deserves consideration for its direct legitimate interest in a firm and thus, the interest of one group of stakeholders cannot be compromised in favour of that of another (Donaldson and Preston, 1995).

According to stakeholder theory, the role of CG is to recognise the divergent interests of multiple stakeholders (Donaldson and Preston, 1995) and reduce conflicts of interests among stakeholders (Hill and Jones, 1992). A comprehensive definition of CG from the perspective of stakeholder theory is given by Tricker (1994). According to him, 'corporate governance addresses the problems facing the board of directors, such as the interaction with top management, and the relationship with the owners and others interested in the affairs of the company, including creditors, debt financiers, analysts, auditors and corporate regulators.'

Under stakeholder theory, the objective of a company is to serve the divergent interests of multiple stakeholders (Donaldson and Preston, 1995). In contrast, under agency theory the objective of a firm is to maximise the wealth of shareholders only. Consequently, agency theorists argue that stakeholder theory creates an excuse for managerial opportunism as it lacks a single objective function (Jensen, 2001; Marcoux, 2000; Sternberg, 2000). However, Wheeler et al. (2003), using prior research that evidenced a positive association of corporate environmental and social responsibilities with economic performance, argue that the time has come to harmonise agency theory and stakeholder theory within a single paradigm.

2.2.4 Resource dependence theory and corporate governance

Resource dependence theory posits that corporations depend on the environment and other organizations for required resources (Pfeffer and Salancik 1978; Pugh and Hickson, 1997). Similarly, other organizations depend on corporations for resources (Pfeffer, 1987). As the success of corporations is constrained by a network of independencies, corporations need to manage this network of interdependencies (Pfeffer, 1987).

According to this theory, CG is a set of mechanisms that ensure efficient management of the network of interdependencies and access to scarce resources and their management (Boyd 1990; Zahra and Pearce, 1989). Resource dependence

theorists propose the appointment of board members with relevant experience and knowledge so that the board of directors can: (1) provide advice and counsel managers in setting effective policies and strategies for the firm, (2) ensure access to scarce resources, (3) ensure access to channels of information between the firm and its environmental contingencies and (4) increase legitimacy (Cohen et al., 2008; Nicholson and Kiel, 2007; Williamson, 1999; Aldrich and Pfeffer 1976; Boyd 1990; Pfeffer and Salancik 1978; Zahra and Pearce, 1989). This view is supported by a recent stream of empirical evidence that organisations consider environmental contingencies while appointing their board of directors (Kor and Misangyi, 2008; Hillman et al., 2008; Hillman et al., 2007).

Anglo-American CG codes (e.g., UK Corporate Governance Code, 2012) recommended the appointment of a board of directors which has sufficient independence and expertise. The recommendation in relation to the expertise of directors is consistent with the views of the resource dependence theorists. Hence, a board of directors which has sufficient expertise is a resource. However, appointment of a board of directors based on expertise only may not ensure compliance with Anglo-American CG codes if the appointed board lacks recommended independence. (The relevance of resource dependence theory for this thesis is discussed in section 2.2.8).

In CG literature in accounting and finance, the impact of the expertise and experience of the board of directors and audit committees on firm performance and accounting reporting quality has long been studied. The evidence provided by this literature is, however, mixed (see Adams et al., 2010 for a review on board of directors, and Bédard and Gendron, 2010 for a review on audit committee expertise and accounting reporting quality). In spite of this mixed evidence, Christopher (2010) argues that the prescriptions of resource dependence theory need to be acknowledged in prescribing board size and composition, and selecting the senior managers of corporations in order to augment the effectiveness of CG.

2.2.5 Managerial hegemony theory and corporate governance

Managerial hegemony theory describes the powerlessness of the board of directors as a mechanism to control managerial opportunism (e.g., Galbraith, 1967;

Kosnik, 1987). This is because of three reasons: (1) biases in the nomination and selection process of outside board of directors (Patton and Baker, 1987); (2) constraints on the monitoring and controlling ability of outside directors (Wolfson, 1984); and (3) weak incentives for outside directors to monitor management (Patton and Baker, 1987).

Firstly, the hegemony of CEOs makes the board of directors ineffective because CEOs play a substantial role in the nomination and selection of outside directors despite the presence of a nomination committee (Mace, 1979; Lorsch and MacIver, 1989 cited in Shivdasani and Yermack, 1999; Monks and Minow, 1991; Patton and Baker, 1987), the tenure of the outside directors depends on the CEO (Monks and Minow, 1991) and the board positions, promotions and salaries of inside directors depend on the CEO (Jensen, 1993).

Secondly, a number of constraints limit the monitoring and controlling ability of outside directors such as limited participation in setting the agenda of board meetings (Jensen, 1993), limited access to insight information of the firms (Bacon and Brown, 1975; Nowak and McCabe, 2003), a lack of adequate expertise and time to properly analyse business proposals by the management (Estes, 1980; Patton and Baker, 1987) and 'polite' boardroom culture (Lorsch and MacIver, 1989 cited in Clarke, 1998). Finally, meeting fees and the stock compensations of outside directors are not adequate (Patton and Baker, 1987).

Shivdasani and Yearmack (1999) provide detailed archival evidence that CEO's involvement [proxied by the presence of the CEO on nomination committee or the absence of nomination committee] reduces the appointment of independent directors and the consequent controlling and monitoring role of the board. Furthermore, a number of researchers who find no significant association between board independence and their outcome variable state that their results are consistent with managerial hegemony theory (e.g., Mallette and Fowler, 1992; Kalyta, 2009).

2.2.6 Market myopic theory and corporate governance

Market myopia theory posits that the share price is not a reliable measure of long-term shareholder wealth because the stock market, being short-term oriented, undervalues long-term investments (Keasey et al., 1997). Consequently, market

myopia theorists emphasise the maximisation of long-term shareholder wealth instead of the maximisation of share price (Keasey et al., 1997; Charkham, 1994; Sykes, 1994).They perceive that CG practices in Anglo-American countries (e.g., UK and USA) suffer from four main weaknesses: (1) shareholders are reluctant and unable to exercise ownership roles; (2) institutional investors and managers are highly concerned about short-term return on investment and corporate performance, respectively; (3) high remuneration of management relative to corporate performance and (4) excessive threats of takeover (Sykes, 1994, p. 190; Charkham, 1994).

In order to overcome the weaknesses of the Anglo-American model, the proponents of market myopia theory suggest that institutional investors commit 'relationship investing' over the long-term, play a strong monitoring role either by sitting on the board or by appointing independent directors if institutional investors cannot sit on the board due to legal reasons (Sykes, 1994). Further suggestions include a reduction in takeover threats, restrictions on the voting rights of short-term shareholders, and the empowerment of long-term stakeholders such as employees and suppliers (Keasey et al., 1997).

2.2.7 Neo-institutional theory and corporate governance

Neo-institutional theory has been developed by neo-institutional economists (e.g., North, 1991; Aoki, 1994) and neo-institutional sociologists (e.g. Berger and Luckmann 1967; DiMaggio and Powell 1983; Dobbin 1994; Giddens 1984; Granovetter 1985; Whitley 1992). According to neo-institutional theorists, national institutions dictate human and organisational interactions in a society (North, 1991) and act as constraints as well as expediters of organisational change (Hall and Thelen, 2009). Institutions are defined as a set of 'cognitive, normative and regulative structures and activities that provide stability and meaning to social behaviour. Institutions are transported by various carriers – cultures, structures and routines – and they operate at multiple levels of jurisdiction (Scott, 1995, p. 33)'.

Neo-institutional theory differs from 'old' institutional theory in terms of its relative focus on sources of organisational resistance to change (DiMaggio and Powell, 1991). Neo-institutional theory views that external environmental factors are more important sources of organisational inertia than the internalised values, norms

and commitments of old institutional theory (Hirsch and Lounsbury, 1997). Neo-institutional theory is extensively used in studying persistence and changes in accounting (Lounsbury, 2008) and CG practices (e.g., Okhmatovskiy and David, 2012; Yoshikawa et al. 2007; Henrekson and Jakobsson, 2012).

2.2.7.1 Institutional path dependence and corporate governance

A group of institutional theorists view organisational arrangements as relatively stable and use institutional theory to explain organisational inertia rather than change (Tolbert, 1985; Tolbert and Zucker, 1983). The notion is that organisational change is a 'path dependent' process (Libecap, 1989*).* According to this group of institutional theorists, path dependence occurs because (1) initial organisational arrangements, often happen by chance, offers self-reinforcing positive feedback and this positive feedback may 'lock-in' organisational agents into a particular trajectory (Burns and Scapens, 2000; Greener, 2005; Kay, 2005); (2) this initial organisational arrangement creates vested interest groups who constrain organisational change in order to safeguard their interests (North, 1991) unless the beneficiaries of organisational change commit to compensating the loss that the vested interest groups suffer (Ostrom, 2005); and, (3) emerging alternative trajectories are not compatible with existing institutions and structures and thus, changing to an alternative trajectory may result in inefficiency (Greener, 2005; Wilsford, 1994).

Bebchuk and Roe (1999) pioneer institutional path dependence in CG by proposing the theory of path dependence of corporate governance. While proposing this theory, they refer to the persistence of corporate ownership structures and CG practices in USA, Western Europe, and Japan. They argue that in spite of enormous pressures exerted by global products and capital markets, divergence in corporate ownership structures and CG practices among these countries persists because of path dependence. They argue that resistance to new CG practices is legitimate on the grounds of the lower '*relative efficiency*' of new CG practices compared to existing CG practices and is opportunistic on the grounds of '*rent-protection*' on the part of existing controllers of companies (Bebchuk and Roe, 1999). On '*relative efficiency*' grounds, Bebchuk and Roe (1999, p. 139) argue that new CG practices may not be

efficient relative to long-established CG practices due to '*sunk adaptive costs, network externalities, complementarities, endowment effects and multiple optima'*.

Sunk adaptive costs suggest that the implementation of new CG practices may be less efficient because firms might have adapted to existing CG practices by developing related mechanisms such as authority relations or incentive compensation schemes (Gedajlovic et al., 2004; Khanna et al., 2006; Yoshikawa and Rasheed, 2009). *Network externalities* suggest that the CG structure of a particular firm in a country depends on the CG structures of peer firms and thus, a firm cannot switch to a different structure of CG due to high switching costs (Khanna et al., 2006; Yoshikawa and Rasheed, 2009). Central to the idea of efficiency-based path dependence is *complementarities* (Schmidt and Spindler, 2002; Bratton and McCahery, 1999; Aoki, 1994). *Complementarities* imply that a CG framework is embedded in the institutions, legal rules and practices of a country and thus, imposing new CG practices may hamper the efficiency of the overall system (Khanna et al., 2006; Schmidt and Spindler, 2004). *Endowment effects* mean that individuals having control under the existing CG structure affect the total value of the alternative CG structure due to their existing control (Bebchuk and Roe, 1999). Finally, *multiple optima* implies that every system of CG has pros and cons (Aguilera et al., 2008) and a country may choose different bundles of practices that yield equivalent long-run performance (Bebchuk and Roe, 1999; Khanna et al., 2006). The concept of '*relative efficiency*' of the Anglo-American model of CG is acknowledged by the majority of regulatory authorities around the world (Coombes and Wong 2004) and thus, they recommend 'comply or explain' basis codes (Wymeersch 2006).

On the grounds of '*rent protection'*, Bebchuk and Roe (1999) argue that the initial CG structure provides '*private benefits of control*' to certain controllers. They argue that these controllers may resist the implementation of new CG practices to protect their '*private benefits of control*' despite the fact that new CG practices are more efficient than initial CG practices. The different types of '*private benefits of control'* are discussed in Section 2.6.1.

This theory has subsequently been used as a theoretical framework by a number of comparative studies that investigate the non-convergence of CG practices

around the world (e.g., Gilson, 2001; Coffee, 2002; Khanna et al., 2006). The theory is also used in a number of country-specific studies that evidence the persistence of national CG systems (e.g., Lubinski, 2011 in Germany; Henrekson and Jakobsson, 2012 in Sweden).

The theory of path dependence of corporate governance (Bebchuk and Roe, 1999) explains the persistence of initial CG practices. However, it sheds limited light on (1) why other interest groups such as financial market participants and banks do not negatively react to this persistence especially when the initial CG practices are inefficient and thus, influence change toward new CG practices and (2) how companies subject to new CG practices tackle significant institutional pressure for compliance with new CG practices. A probable reason for limited or no negative reaction to the persistence of initial CG practices by financial market participants and banks could be that path dependence occurs on the part of incumbent financiers (Rajan and Zingales, 2003; Black and Coffee, 1994). Rajan and Zingales (2003) argue that development in financial systems is hindered by incumbent financiers because they also protect their rent and do not want to let their existing skills become redundant. This is consistent with Black and Coffee (1994) who argue that institutional investors play a passive role in changing CG practices because they want to protect their corporate business and being specialised organisations, cannot easily change their behaviour. Section 2.2.7.2 explains how companies which are subject to new CG practices tackle the enormous institutional pressures for compliance.

2.2.7.2 Institutional change and corporate governance

As mentioned in Section 2.2.7.1, institutional path dependence provides limited focus on how organisations respond to maintain legitimacy under institutional pressures. Institutional theorists vary among themselves in understanding these organisational responses. One group argue that all organisations will inevitably comply with new practices due to institutional pressures today or tomorrow (e.g., Scot, 2001; p.170) leading to homogenous organisational practices. DiMaggio and Powell (1983) explain the process of homogenisation with the help of Hawley's (1968) concept of 'isomorphism'. DiMaggio and Powell (1983) identify

three kinds of institutional isomorphism: 1) coercive isomorphism occurs when organisations change their existing practices due to both formal and informal pressures from government and non-government organisations; 2) mimetic isomorphism occurs when organizations implement industry best practices without assessing the appropriateness of the practices in order to regain decaying legitimacy resulting from poor performance and environmental uncertainty; and 3) normative isomorphism occurs when organizations implement new practices due to pressures from professional associations.

Prior CG scholars argue that isomorphic processes are working at country (Aguilera and Cuervo-Cazurra, 2004; Zattoni and Cuomo, 2008; Enrione et al., 2006; Reed, 2002; Siddiqie, 2010) and firm (Hooghiemstra and van Ees, 2011; Seidl, 2007; Seidl et al., 2013) level to make CG practices more similar. At an international level, isomorphic pressures often come from international capital, product and labour markets (Aguilera and Cuervo-Cazurra, 2004; Zattoni and Cuomo, 2008) and from IFIs (Reed, 2002; Siddiqie, 2010). At a firm level, coercive isomorphism stems from the issue of CG codes by regulatory authorities or from the inclusion of CG codes in the listing requirements of stock exchanges (Burton, 2000; Aguilera and Cuervo-Cazurra, 2004). Moreover, compliance with CG code by peer firms exerts normative isomorphism on other firms (Talaulicar and v. Werder, 2008). One possible consequence of isomorphic pressures is that firms may adopt CG practices only symbolically (e.g., Spira, 1999; Zattoni and Minichilli, 2009). For example, Spira (1999) finds that many audit committees in the United Kingdom are playing ceremonial roles rather than becoming an instrument of monitoring against corporate misconduct. The concept of isomorphism is also used to explain the high level of compliance with an adopted CG code and the mimicking explanation for non-compliance with CG code provided by companies (Hooghiemstra and van Ees, 2011; Seidl, 2007; Seidl et al., 2013)

Although the studies that evidence institutional isomorphism as an impetus for organisational change contributed a lot to understanding institutional dynamics, these studies have been criticised for paying inadequate attention to the role of active agency and power dynamics (Dillard et al., 2004; Covaleski and Dirsmith, 1988) and thus, ignore a range of potential organisational responses to institutional pressures

(Lounsbury, 2008). Several recent institutional theorists, thus, conceptualise that organisational responses to external institutional pressures vary because different organizations face institutional pressures of different strengths (Guerreiro et al., 2012; Lounsburry, 2008; 2001; Greenwood and Hinings, 1996; Oliver, 1991).

Oliver (1991) developed such a conceptual framework to predict organisational varying responses to institutional pressures. She contends that an organization's response to institutional pressures varies from passive conformity to active resistance: 'acquiescence, compromise, avoidance, defiance, and manipulation' depending on five predictive institutional factors. These include: cause (legitimacy and efficiency), constituents (multiplicity of and dependence on those who exert pressure), content (consistency between organizational actors and external constituents in terms of goals and organizational discretion in terms of compliance), control (legal coercion and diffusion of practices) and context (uncertainty about outcome and interconnectedness among organisations).

Oliver's framework has recently been used in studying the organisational response to changes in accounting standards (Guerreiro et al., 2012; Albu et al., 2013) and the adoption of CG codes (Okhmatovskiy and David, 2012).

2.2.8 Summary

The analysis in this section indicates that prior literature on CG uses a number of theories. This is because scholars from different disciplines take different perspectives while dealing with the issue of CG. This creates a lack of unifying theory to study CG. Tricker (2009) pointed out this issue and state: 'Corporate governance, as yet, does not have a single widely accepted theoretical base nor a commonly accepted paradigm...the subject lacks a conceptual framework that adequately reflects the reality of corporate governance'. As all theories suffer from several limitations, none of the theories in isolation can provide a complete understanding of CG (Daily et al., 2003; Lynall et al., 2003; Nicholson and Kiel, 2004; 2007; Jackling and Johl, 2009). Hence, researchers recently have been asking for the use of multiple theories to study CG (Huse, 2007; van Ees et al., 2009).

Among the theories discussed, agency theory is extensively used in the accounting and finance literature mainly to study the impact of CG on outcome

variables. However, as indicated in Section 2.2.1, agency theory is less applicable in developing countries. Moreover, agency theory is less applicable to study compliance or non-compliance with a CG code because this theory takes a narrow view that due to pressure from shareholders, managers themselves effectively implement a CG code[2]. Prior research, however, argues that the level of compliance with an adopted CG code by a firm is influenced by a large number of internal and external factors (Aguilera et al., 2008; Filatotchev, 2007). However, it is not worthwhile to abandon agency theory completely because the Anglo-American model of CG is based on agency theory and the Anglo-American model of CG is extensively adopted in developing countries as part of CG reform. Furthermore, it is often claimed that the purposes of CG reform in developing countries is to reduce agency problems (Liew, 2007). The issue is again discussed in Section 2.6.1.

Like agency theory, resource dependency theory is also less applicable in developing countries because the board of directors in developing countries is mainly dominated by a controlling family (Wiwattanakantang, 2002; Joh, 2003; Yeh et al., 2001; Claessens et al., 2000). Moreover, a controlling family often selects non-family members for appointment to the board of directors, based on personal relationships. The family places limited weight on the experience and expertise of prospective non-family board members.

Stewardship theory is applicable in developing countries because the honesty of managers is not beyond question and lower level needs are not fully satisfied yet. Stakeholder theory is less applicable in the sense that prior research shows that managers in developing countries are less concerned about the interest of employees and about the environment (Belal and Cooper, 2011). Managerial hegemony is also less applicable because professional managers rarely run the company as CEOs in developing countries (e.g., Wiwattanakantang, 2002). Market myopia theory is less applicable because institutional investors in developing countries do not play an effective role (Sarkar and Sarkar, 2000; World Bank, 2009) and thus, it is difficult to promote accountability by empowering institutional investors as suggested by the theory.

[2] This argument is based on the logic of bonding mechanisms as proposed by Jensen and Meckling (1976).

Neo-institutional theory is the most applicable theory for the study of CG reform in a developing country such as Bangladesh for the following reasons. Firstly, within neo-institutional theory, the concept of path dependence can explain how present controller of companies (Bebchuk and Roe, 1999), country-level institutional characteristics (e.g., Henrekson and Jakobsson, 2012 in Sweden) and incumbent financiers (Rajan and Zingales, 2003) resist change in CG practices (Section 2.2.7.1). In my view, the consideration of both the role of existing institutional characteristics, the active role of the present controller of companies and incumbent financiers on the implementation of new CG code is a more appropriate approach to study CG reform and its impact in developing countries.

Secondly, neo-institutional theory, especially the concept of isomorphism (Section 2.2.7.2), is used to explain the adoption of CG code based on an Anglo-American model in developing countries (Reed, 2002; Siddiqie, 2010), the consequences of isomorphic pressure on level of compliance with CG codes reported in annual reports (Seidl, 2007; Seidl et al., 2013) and observed symbolic practices of a CG mechanism (e.g, audit committees in the UK by Spira, 1999). I think that the interplay between path dependence and isomorphic pressure can better explain compliance with the BCGG-2006 as reported in annual reports. I will discuss in Chapter 3 Section 3.6 how firms in Bangladesh are subject to isomorphic pressures to comply with the BCGG-2006.

Thirdly, neo-institutional theory can be applied to explain diverse responses of companies to a CG code (Section 2.2.7.2). I expect that in spite of the role of path dependence, the dynamics of external institutional pressures and organizational internal interest motivate several firms to behave differently than others in Bangladesh. Finally, neo-institutional theory takes an 'open systems' (Aguilera et al., 2008; Filatotchev, 2007) logic rather than an 'under-contextualised' and a 'closed systems' approach.

2.3 Corporate governance models

The purpose of this section is to provide an overview of CG models in light of the theories discussed in Section 2.2 and to detail the Anglo-American model of CG. A number of studies review CG models (Blair, 1995; Keasey et al., 1997; Letza

et al., 2004). Letza et al. (2004) base their analysis on Blair (1995) and Keasey et al. (1997). Blair (1995) and Keasey et al. (1997) identify four models of CG, namely (1) principal-agent or finance model, (2) the myopic market model, (3) the abuse of executive power model, and (4) the stakeholder model. A summary of these four models is presented in Appendix 2.1.

The principal-agent or finance model rests on the assumptions of agency theory (section 2.2.1). According to this model, the objective of a company is to maximise shareholder wealth and CG is needed to restrain the self-interest maximising behaviour of managers (Letza et al., 2004). The proponents of this model believe that markets: particularly the markets for capital, labour and corporate control, provide the most effective means to reconcile the divergence of interests between shareholders and managers (Keasey, 1997). They suggest minimum interference in the operation of market (Fama, 1980). The myopic market model rests on the assumption of myopic market theory (section 2.2.6). Consequently, the proponents of this model emphasise the maximisation of shareholders wealth (Letza et al., 2004). However, it does not consider the markets: particularly the markets for capital, labour and corporate control as constraints on managerial discretion (Keasey, 1997). This model, thus, views CG as a set of rules that encourage the long-term performance maximisation behaviour of both shareholders and managers (Keasey et al., 1997). The abuse of executive power model rests on the assumptions of managerial hegemony theory (section 2.2.5). Thus, the proponents of this model call for statutory changes in CG practices such as independent nominations and greater powers of non-executive directors (Keasey et al., 1997). Finally, the stakeholder model is based on assumptions of stakeholder theory (section 2.2.2). Consequently, proponents of this model call for designing a CG system that acknowledges interest of multiple stakeholders.

Letza et al. (2004) labelled the first two models collectively as the shareholder model because these two models rest on the assumption that the purpose of a corporation is to maximise shareholder wealth. According to several researchers (e.g., Becht and Röell, 1999; La Porta et al., 1997), the shareholder model is synonymous with the Anglo-American model. However, the arguments of Turnbull (1997, pp.188-189) indicate that the principal-agent or finance model is synonymous

with the Anglo-American model. Given the context of this thesis, I discuss the Anglo-American model of CG in detail below.

Turnbull (1997, p. 188) labelled the CG practices in UK, USA, Canada and Australia as the Anglo-American model of CG (Turnbull, 1997). According to this model, one important internal mechanism of CG is board of directors composed of a majority of non-executive independent directors (Lorsch and MacIver, 1989). Shareholders using their residual voting rights elect this board of directors for monitoring managers as shareholders cannot directly observe the actions of managers (Letza et al., 2004).

The actual level of voting power shareholders can exercise in electing the board of directors, however, is limited (Easterbrook and Fischel, 1996) indicating that the success of an Anglo-American model largely depends on the existence of efficient markets, namely the markets for capital, labour and corporate control (Letza et al., 2004). Hence, proponents of an Anglo-American model advocate no or minimum government interference in markets (Fama, 1980). However, they approve the introduction of voluntary CG codes because voluntary codes impose minimum costs or obligations upon firms (Keasey et al., 1997). Consequently, an important principle embodied in the Anglo-American model is the 'comply or explain' principle (Salterio et al., 2013).

The 'comply or explain' principle indicates that non-compliance with a particular provision of CG codes is not a violation of the code as long as an explanation for non-compliance is provided in annual reports (Hooghiemstra, 2012; Arcot et al., 2010). This principle recognizes that a 'one size fits all' approach is not justified for CG and thus, permits firms to non-comply with a specific provision of the code if firms cannot comply with it cost-effectively (Coombes and Wong 2004; Seidl, 2007). Furthermore, shareholders are made responsible for appraising the appropriateness of compliance with the CG code (e.g. MacNeil and Li, 2006; Seidl, 2007; Arcot et al., 2010). Shareholders can either sell their shares or voice their discontent if they are dissatisfied with the level of compliance with or explanation provided for deviation from the 'comply or explain' basis CG code (Seidl, 2007; Hooghiemstra, 2012).

A representative CG code under the Anglo-American model of CG is OECD Principles of Corporate Governance-2004. These principles have been regarded as the international benchmark for CG and used as the basis for CG reform by both the public and private sectors in both developed and developing countries around the world (Krambia-Kapardis and Pasros, 2006). The IFIs use the OECD Principles of Corporate Governance-2004 as a benchmark for assessing the quality of corporate CG in developing countries (Soederberg, 2003; ROSC, 2013). The main principles of OECD Principles of Corporate Governance-2004 are summarised in Appendix 2.2.

The effectiveness of an Anglo-American model of CG in developing countries is discussed in Section 2.6.3.

2.4 Institutional characteristics of Anglo-American and developing countries

A large body of recent literature argues that the CG framework is embedded in a country's economic, legal, political and social structure (e.g., Doidge et al., 2007; Khanna et al., 2006; Wanyama et al., 2009; Aguilera et al., 2008; Aguilera and Jackson, 2003; 2010). According to Khanna et al., (2006; p 71) the CG practices of a country are the result of a 'system of complementary institutions, legal rules and practices'. This evidence implies that the effectiveness of a CG code depends on the existence of its complementary elements. Hence, this section discusses the institutional characteristics of Anglo-American countries and developing countries.

2.4.1 Institutional characteristics of Anglo-American countries

The main institutional characteristics of Anglo-American countries, perceived as the complementarities of an Anglo-American model (e.g., Paredes, 2004; Clerk, 2007; Gordon and Roe, 2004), include the following.

Firstly, the ownership of a company is dispersed among a large number of individuals and institutional investors, and the management of the company is separate from shareholders (Aguilera and Jackson, 2003). Institutional investors have a significant percentage of ownership (Sykes, 1994) and thus, have the motivation and ability to play a monitoring role (e.g., Gillian and Starks, 2003; Donnelly and

Mulcahy, 2008). The monitoring role of institutional investors is also mandated by law (e.g, Stewardship Code 2010 in the UK).

Secondly, the rights of shareholders are strongly protected by a legal framework (Franks and Mayer, 1990; La Porta et al., 1997; Weimer and Pape, 1999). To ensure equal voting rights, the 'one share, one vote' principle is generally maintained (Weimer and Pape, 1999). Moreover, an efficient court system plays an important role in upholding the spirit of laws protecting shareholder rights (Paredes, 2004).

Thirdly, stock markets are efficient, deep, and liquid in Anglo-American countries (La Porta et al., 1997). A large number of sophisticated market participants (Paredes, 2004) continuously determine the share price of a company based on the strength of CG and also the financial position of the company. Consequently, the movement of the stock price disciplines managers and motivates them to maintain a good CG system (Aguilera and Jackson, 2003; Manne, 1965).

Fourthly, companies in Anglo-American countries are subject to high disclosure standards and enforcement action for non-compliance with those standards (Paredes, 2004). Moreover, accountants and auditors in Anglo-American countries are sophisticated and ethical. The maintenance and dissemination of quality accounting information is triggered by both internal and external demands.

Fifthly, the managerial labour market is efficient with respect to penalising poorly performing managers (Paredes, 2004). Moreover, managerial incentives are strongly linked with accounting-based and market-based performance measures (Abowd and Bognanno, 1995). These, in turn, motivate managers toward maximisation of shareholder wealth (Aguilera and Jackson, 2003). The efficiency of labour markets increases the mobility of managers across firms (Aoki, 1990) and thus, reduces the exploitation of managers and employees by dominant shareholders, if any.

Sixthly, hostile takeovers play a significant role in disciplining managers because incumbent managers likely suffer from the loss of their jobs and subsequent loss of power, prestige and value of 'firm specific' human capital (Humphery-Jenner and Powell, 2011; Krug and Hegarty, 1997; Walsh, 1989; Jensen and Ruback, 1983; Manne, 1965).

Finally, other institutions of Anglo-American countries such as investment bankers, securities analysts, accounting firms, lawyers, credit-rating agencies, broker-dealers, shareholder watchdog groups, shareholder service firms, proxy solicitation firms and financial media are skilled and experienced. These institutions ensure the effective working of the rest of the CG mechanisms (Paredes, 2004).

2.4.2 Institutional characteristics of developing countries

The main institutional characteristics of developing countries relevant to CG include the following.

Firstly, based on a significant percentage of ownership holding, listed companies in developing countries can be grouped into three types: privately-owned listed companies, government-owned companies and subsidiaries of foreign multinational companies (MNCs) (Cuervo-Cazurra and Dau, 2009). The ownership of privately-owned listed companies is highly concentrated, either directly or indirectly, in the hands of sponsor families (Claessens and Yurtoglu, 2013; Claessens et al., 2000; La Porta et al., 1998; 1999). Government-owned companies are prevalent in several developing countries such as India, Malaysia, Thailand, Singapore and China (Claessens, 2000; Claessens and Fan, 2002; Claessens and Yurtoglu, 2013). The subsidiaries of foreign MNCs are significantly owned by their foreign parents. Consequently, outside individual and institutional investors own a minimum percentage of ownership of corporations (Claessens, 2000; Claessens and Yurtoglu, 2013).

Secondly, developing countries are generally characterised by poor investor protection rights (Claessens and Yurtoglu, 2013; La Porta et al., 2000). For example, Claessens and Yurtoglu (2013) report that the legal protection of minority shareholders in emerging countries is 47.3 per cent as compared with 65 per cent in the USA and 93 per cent in the UK.

Thirdly, stock markets are relatively small and do not play a significant role in the national economies of developing countries. For example, Claessens and Yurtoglu (2013) report that market capitalization as a percentage of Gross Domestic Product (GDP) in emerging economies is 66.8 per cent as compared with 127.1 per cent in the USA and 132.3 per cent in the UK. There are limited numbers of

sophisticated market participants who are powerful enough to often manipulate stock prices and thus, high volatility of stock prices is a norm in developing countries (Singh, 1999).

Fourthly, developing countries are characterised by a relatively opaque information environment (Arun and Turner, 2004; Nam et al., 2001). There are several reasons behind this. Firstly, legal disclosure requirements in developing countries lag behind that of developed countries. For example, Claessens and Yurtoglu (2013) report that disclosure requirement in emerging countries is 58.9 per cent as compared with 100 per cent in the USA and 83 per cent in the UK. Secondly, the institutional characteristics of developing countries (e.g., corruption) reduce the level of compliance with disclosure standards and the reliability of disclosures (Peng and Jiang, 2010; Rajan and Zingales, 2003a).

Fifthly, the market for human capital is far less efficient in developing countries than in Anglo-American countries (Allen, 2005). The low efficiency of the labour market restricts the mobility and autonomy of employees (Khanna and Palepu, 2004). Moreover, the rarity of stock-based compensation (Sun et al., 2010) and pay for performance (Khanna and Palepu, 2004) hampers the alignment of long-term interests of managers with that of shareholders. Furthermore, managerial compensation is influenced by kinship with controlling shareholders (Fagernäs, 2006).

Sixthly, the market for corporate control such as the hostile takeover market is typically inactive in developing countries (Nam et al., 2001). The efficiency of the market for corporate control is hampered by concentrated ownership and control, high use of long-term bank loans (Sing and Zammit, 2006), the prohibition of takeover by corporate laws (Khanna and Palepu, 2004) and the dearth of timely information and high transaction costs (Singh, 1998).

Seventhly, enforcement of laws in developing countries is significantly poor in comparison with developed countries (Pistor et al., 2000). The enforcement of laws is hampered by a lack of formal (e.g., efficient judicial systems) and informal institutions (e.g., cultural traits and customs) (Pardes, 2004; Williamson, 2000), extreme corruption and the politicisation of regulatory agencies (dela Rama 2012; Okike, 2007; Stulz, 2005; Dyer and Mortensen, 2005).

Eighthly, given the limited role of stock markets in developing countries, banks play an important role as financers in these countries. There is a close-relationship between banks and non-financial companies (Singh and Zammit, 2006). Under the institutional environment of developing countries such as thin capital markets, weak legal protection and poor transparency, relationship-based lending strategies work better than arm's length-based lending strategies (Rajan and Zigales, 2003a; p. 144).

Finally, professionals and institutions essential to complementing the Anglo-American model of CG code as investment bankers, securities analysts, accounting firms, lawyers, credit-rating agencies, broker-dealers, shareholder watchdog groups, shareholder service firms, proxy solicitation firms and financial media, either do not exist or are rarely sophisticated in developing countries (Paredes, 2004, p. 1107).

2.4.3 Summary

This section shows that the ownership structure of companies and institutional characteristics of Anglo-American countries are distinct from those of developing countries. First, the ownership structure of companies in Anglo-American countries is dispersed while the ownership structure of companies in developing countries is concentrated in the hands of sponsor families, government and the parents of subsidiaries of foreign MNCs. This difference in ownership structure generates different types of agency problems which are further discussed in Section 2.6.1. Secondly, institutional characteristics of developing countries may influence the efficiency of the implementation of an Anglo-American model of CG. The effect of the institutional characteristics of developing countries on an Anglo-American model of CG as evidenced in prior research is detailed in Section 2.6.3.

2.5 Prior research on the impact of corporate governance on investment and lending decisions

The purpose of this section is to review prior literature on the impact of CG on the investment and lending decisions of institutional investors and bankers respectively and to identify a way to advance this research. To this endeavour, Sections 2.5.1 and 2.5.2 respectively discuss prior research on the impact of CG on

investment decisions and lending decisions. Section 2.5.3 critically analyses the above research and identifies a gap in this research.

2.5.1 Impact of CG on investment decisions of institutional investors

Prior researchers have investigated the impact of an investee's CG on the investment decisions of institutional investors using surveys (World Bank 2005; PricewaterhouseCoopers, 2000; McKinsey and Company 2002; McCahery et al., 2010) and archival methods (Chung and Zhang, 2011; Khurshed et al., 2011; Bushee et al., 2009; Li et al., 2008; Dahlquist et al., 2003; Giannetti and Simonov, 2006; Leuz et al., 2010; Ferreira and Matos, 2008; Aggarwal et al., 2005). A summary of this research is presented in Appendix 2.3.

The results of the survey-based studies, mostly conducted by professional organizations, are inconclusive and indicate that the context of the survey highly influences the outcome of the study (World Bank, 2005; PricewaterhouseCoopers, 2000; McKinsey and Company, 2002; McCahery et al., 2010). To illustrate, World Bank (2005) and PricewaterhouseCoopers (2000) surveyed the impact of an investee's CG on institutional investors' investment decisions in India and Singapore respectively. These studies report that the appointment of independent directors on the board and the formation of an audit committee by an investee company are not considered by the majority of institutional investors while making their investment decisions.

McKinsey and Company (2002) surveys a sample of international institutional investors. The results of this survey, however, indicate that institutional investors put as much weight on CG as financial indicators when making their investment decisions and the majority of them are inclined to pay a premium for companies with strong CG structures.

The results of the above survey studies, more specifically the results of McKinsey and Company (2002), motivated a number of finance academics to investigate whether institutional investors tilt their portfolios towards better governed firms using archival methods (Khurshed et al., 2011; Chung and Zhang, 2011; Bushee et al., 2009; Li et al., 2008; Dahlquist et al., 2003; Giannetti and Simonov,

2006; Leuz et al., 2010; Ferreira and Matos, 2008; Aggarwal et al., 2005). These researchers argue that institutional investors are guided by the 'prudent investment hypothesis' and thus, prefer to invest in firms with 'effective CG' structures (e.g., Chung and Zhang, 2011; Bushee et al., 2009; Dahlquist et al., 2003; Giannetti and Simonov, 2006). Investment in firms with 'effective CG' structures indicates prudent investment decisions because 'effective CG' structures reduce the risks of expropriations and other self-dealings (Chung and Zhang, 2011), reduce the monitoring effort on the part of institutional investors, reduce information asymmetry between management and institutional investors and increase firm performance (Bushee et al., 2009).

The measure of 'effective CG' varies from a single dimension of CG, such as ownership structure (Dahlquist et al., 2003; Giannetti and Simonov, 2006; Ferreira and Matos, 2008; Bushee et al., 2009; Leuz et al., 2009; Khurshed et al., 2011), and board composition (Khurshed et al., 2011) to a comprehensive CG index (e.g., Chung and Zhang, 2011; Bushee et al., 2009). The evidence provided by these studies is not only mixed but also indicates that the association between the percentage of institutional ownership and their measure of 'effective CG' depends on the type of institutional investors, as discussed below.

Dahlquist et al. (2003) and Giannetti and Simonov (2006) provide Swedish evidence on the impact of control to cash flow rights ratio of the principal shareholder on institutional ownership. Giannetti and Simonov (2006) show that while foreign institutional shareholders dislike firms with high control to cash flow rights ratio of the principal shareholder, domestic large shareholders prefer such firms. This finding is not consistent with Dahlquist et al. (2003). Dahlquist et al. (2003) find no association between foreign institutional ownership and control to cash flow rights ratio of the principal shareholder. Giannetti and Simonov (2006) justify their contrary findings with two arguments. Firstly, institutional investors dislike firms with high control to cash flow rights ratio of the principal shareholder because such firms are highly subject to the extraction of private benefits by insiders (Giannetti and Simonov, 2006). Secondly, large domestic individual shareholders prefer firms with high control to cash flow rights ratio of the principal shareholder

because domestic large individual investors may share private benefits of control with controlling shareholders (Giannetti and Simonov, 2006).

Using US data, Chung and Zhang (2011) and Bushee et al. (2009) study the impact of 'effective corporate governance' on the percentage of institutional ownership while 'effective corporate governance' is measured by a comprehensive corporate governance index. Chung and Zhang (2011) use Institutional Shareholder Services (ISS) CG data and measure firm level CG with two comprehensive CG indices – GOV_SCORE1 and GOV_SCORE2. Their GOV_SCORE1 captures anti-takeover provisions in a firm's charter, bylaws and state law and GOV_SCORE2 consists of GOV_SCORE1 and 12 additional governance provisions related to board and audit committee characteristics, managerial ownership and compensation. They provide evidence that the percentage of institutional ownership is significantly determined by both GOV_SCORE1 and GOV_SCORE2. They further present evidence that the magnitude of the effect of corporate governance indices on institutional ownership depends on the legal types of institutional investors and on the information environment of portfolio firms. Bushee et al. (2009), however, find no significant effect of the anti-takeover index which is equivalent to GOV_SCORE1 of Chung and Zhang (2011) on the percentage of institutional ownership. Bushee et al. (2009), however, find a weak positive relationship between institutional ownership and the board characteristics index of portfolio firms. In a further analysis, Bushee et al. (2009) show that the positive association between institutional ownership and board characteristics index of portfolio firms is not affected by the legal types of institutional investors.

The evidence discussed in this section indicates that the consideration of an investee's CG by institutional investors while making their investment decisions is influenced by the context (World Bank 2005; PricewaterhouseCoopers, 2000) and by the type of institutional investors (Chung and Zhang, 2011; Bushee et al., 2009; Giannetti and Simonov, 2006; Dahlquist et al., 2003). More precisely, local institutional investors do not consider the investees' CG (e.g., independent directors) in making their investment decisions in non-Anglo-American countries (Giannetti and Simonov, 2006; World Bank, 2005; PricewaterhouseCoopers, 2000) while

international institutional investors value the investees' CG while making investment decisions (McKinsey and Company, 2002; McCahery et al., 2010).

2.5.2 Impact of corporate governance on lending decisions

A number of recent studies investigate the impact of borrower's CG on bank loan contract characteristics (Chava et al., 2009; Firth et al., 2009; Roberts and Yuan, 2010; Holder - Webb and Sharma, 2010; Lin et al., 2011; Francis et al., 2012; Ge et al., 2012). With the exception of Holder-Webb and Sharma (2010), these studies use agency theory as their main theoretical framework and apply archival methods. Holder-Webb and Sharma (2010) draw on resource dependence theory in addition to agency theory as their theoretical framework and use experimental methods.

These studies generally hypothesise that sound CG structure of borrowing companies influences loan contract characteristics in favour of borrowing companies. The rationale behind this hypothesis is that a sound CG structure reduces information asymmetry and agency conflicts between a borrowing company and banks (e.g., Francis et al., 2012; Ge et al., 2012; Rajan and Winton, 1995). These researchers test the impact of a large set of proxies for CG [e.g, Anti-takeover index, comprehensive CG index and its sub-components, CEO duality, board independence] on several price and non-price characteristics of bank loan contracts [e.g., bank interest rate or loan spread, loan maturity period, loan size and loan covenants]. A summary of these studies is presented in Appendix 2.4.

Appendix 2.4 shows that there is a lack of conclusive evidence that sound CG structure of borrowing companies affects price and non-price characteristics of bank loan contracts. For example, neither the comprehensive CG index nor the sub-indices of the comprehensive CG index of Ge et al. (2012) consistently maintains the predicted relationship with the price and non-price characteristics of bank loan contracts. This evidence reported by Ge et al. (2012) at best indicates that the association between CG and the characteristics of bank loan contracts depends on the choice of the dependent variable.

Appendix 2.4 further shows that there is a lack of consistent findings among studies. For example, Roberts and Yuan (2010) and Chava et al. (2009) report a negative significant relationship between anti-takeover index and the costs of bank

loans. This evidence is contrary to Ge et al. (2012) in that they find no significant impact of anti-takeover index on the loan spread. This difference may be a consequence of the samples of the study and the measurements of anti-takeover index. While Ge et al. (2012) use an international sample and measure the anti-takeover index by adding six takeover protection indicators, Roberts and Yuan (2010) and Chava et al. (2009) use a US sample and measure anti-takeover index by adding 24 takeover protection indicators as used by Gompers et al. (2003). Even if studies use a similar measurement for CG; they often find different results. For example, Francis et al. (2012) find no impact of CEO duality on loan spread, while Firth et al. (2009) finds that CEO duality deters access to bank finance and is negatively related to loan size.

Finally, studies that investigate the impact of country-level CG on characteristics of bank loan contracts also provide contradictory evidence. For example, Ge et al. (2012) find that firm-level CG significantly influences the characteristics of bank loan contracts in countries with common-law origins and strong creditor rights while Lin et al. (2011) find that the impact of their CG measure is less pronounced in environments with strong creditor and shareholder rights and efficient debt enforcement.

2.5.3 An analysis of sections 2.5.1 and 2.5.2 and identification of gaps in this literature

The research described in Sections 2.5.1 and 2.5.2 premises on at least four assumptions which are not always beyond question. Firstly, these researchers assume that a CG mechanism plays an effective role in reducing the risks of expropriations and other self-dealings (e.g., Chung and Zhang, 2011) and that the effectiveness of a CG mechanism does not vary from its perceived ability. A stream of prior literature, however, presents evidence that a CG mechanism plays a highly ceremonial role in an actual setting (Bédard and Gendron, 2010; Beasley et al., 2009; Cohen et al., 2002; 2007; Spira, 1999) due to capacity limitation and the cultural conviction of that CG mechanism[3].

[3] Aguilera and Jackson (2003) maintains that the independent directors may play different independence and accountability role in different countries due to their different capacity or cultural predisposition.

Secondly, these researchers argue that 'effective CG' positively affects the investment and lending decisions of institutional investors and bankers respectively in that 'effective CG' has a positive impact on firm performance (e.g., Khueshed et al., 2011; Bushee et al., 2009). This is based on previous evidence that accounting-based and market-based past performance have an impact on the investment and lending decisions of institutional investors and bankers respectively (Badrinath and Wahal, 2002; Nofsinger and Sias, 1999; PricewaterhouseCoopers, 2000; Falkenstein, 1996; Badrinath et al., 1989; Holder-Web and Sharma, 2010). However, prior empirical research as discussed in Section 2.6.4 does not provide conclusive evidence that CG has a positive impact on firm performance.

Thirdly, these researchers argue that firms' CG influences the investment and lending decisions of institutional investors and banks respectively because institutional investors and banks perceive a positive impact of CG on accounting reporting quality (e.g., Chung and Zhang, 2011; Khueshed et al., 2011; Bushee et al., 2009). This is again based on prior academic research and anecdotal evidence which shows that institutional investors and bankers prefer firms with better accounting reporting quality to firms with poor accounting reporting quality (Lang and Lundholm, 1996; Healy et al., 1999; PricewaterhouseCoopers, 2000; Bushee and Noe, 2000; Leftwich, 1983; Sengupta, 1998; Bharath et al., 2008; and Zhang, 2008). However, there is a lack of conclusive evidence that CG increases accounting reporting quality (see Section 2.6.4).

Fourthly, that research assumes that institutional investors and bankers are rational decision makers and that decisions are characterized as arm's length transactions. In the words of Chung and Zhang (2011), the investment decisions of institutional investors are guided by a 'prudent investment hypothesis'. The investment and lending decisions in reality, however, are guided by personal convictions and basic values of the decision makers as well as formal rules[4].

In addition, these researchers mainly use archival methods and thus, provide indirect evidence on the impact of observable CG characteristics (e.g., the percentage of independent directors, the presence of an audit committee, and the percentage of

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[4] Boytsun et al. (2011) propose that corporate governance decisions of shareholders, directors, managers and other stakeholders are affected by a country's formal rules and community values.

managerial ownership) on institutional ownership and characteristics of bank loan contracts. Although survey studies provide direct evidence, they also present inconclusive evidence on the impact of CG on institutional investors' investment decision making. Moreover, similar to archival studies, the survey studies examine the impact of observable CG characteristics on the investment decisions of institutional investors. Finally, survey studies, especially professional surveys by the World Bank (2005), PricewaterhouseCoopers (2000) and McKinsey and Company (2002), do not seek any theoretical justification from institutional investors on why institutional investors perceive or do not perceive an impact of investees' CG structures on investment decisions.

Moreover, these studies mainly use agency theory with the exception of Holder-Webb and Sharma (2010) who combine agency theory and resource dependence theory. Studies using agency theory and resource dependency theory have been criticized for using proxies for CG that do not comprehend the actual conduct of the CG mechanism (MacAvoy and Millstein, 2004; Doucouliagos, 1994; Pearce and Zahra, 1992; Hirsch et al., 1987); for providing an 'under contextualised' view (Wiseman et al., 2012; Filatotchev and Allcock, 2010; Aguilera et al., 2008); and for taking a 'closed system' approach (Aguilera et al., 2008, p. 475). Several studies have indicated that contextual factors, such as prior relationship with borrowers (McNamara and Bromley, 1997) and corruption (Weill, 2011), influence the evaluation of credit proposals.

Furthermore, prior empirical studies are conducted in developed countries where stock markets are well-developed and where CG is well-grounded. Holder-Web and Sharma (2010) present the only evidence that investigates the impact of borrower's CG on the lending decisions of banks in Singapore where Anglo-American-based CG has recently been introduced. Given the different institutional characteristics of developing countries, it cannot be expected that research findings in developed countries remain valid in developing countries. In fact, prior research shows that banks in developing countries depend on the reputation of the borrowers (Koford and Tschoegl, 1999), past relationship with the borrower (Singh and Zammit, 2006; La Porta et al., 2003) and quality of collateral (Koford and Tschoegl, 1999) because of institutional voids of developing countries such as the lack of

reliable accounting information, and weak legal protection of creditors (Koford and Tschoegl, 1999; Rajan and Zigales, 2003a, p. 144). Those researchers argue that reputation-based and relationship-based lending practices substitute for market inefficiencies in developing countries (Koford and Tschoegl, 1999; Selmier, 2013). The practices of reputation-based and relationship-based lending often lead to non-consideration of the profitability and financial health of the borrower company (Nenovsky, 2003).

Hence, an in-depth direct study using an 'open-system' approach which can capture the influence of contextual factors on the impact of CG on investment and lending decisions is warranted. This is because theoretical predictions and real world practices often differ due to contextual circumstances and the cognitive perceptions of decision makers. Furthermore, there is a dearth of direct academic evidence on how CG provides comfort to institutional investors and bankers given that CG practices and the institutional characteristics of developing countries are very distinct from those of developed countries.

2.6 Corporate governance in developing countries

This section discusses the CG problems in developing countries as suggested by the agency theorists, the reasons behind the adoption of CG codes based on an Anglo-American model, the effectiveness of CG codes based on an Anglo-American model, and prior research on five important CG mechanisms recommended by an Anglo-American model in developing countries.

2.6.1 Corporate governance problems in developing countries

Agency theorists argue that the main purpose of CG is to reduce agency problems (Section 2.2.1). This section, thus, discusses the type of agency problems faced by different types of companies in developing countries (Section 2.4.2).

The presence of controlling family shareholders in privately-owned companies reduces agency problems between shareholders and managers (Bebchuk and Hamdani, 2009). However, it increases agency conflicts between controlling shareholders and minority shareholders (Young et al., 2008; Bertrand et al., 2002; Bae et al., 2002; Dharwadkar et al., 2000; Villalonga and Amit, 2006; Kuo and Hung, 2012). This is because controlling family shareholders, having greater control

on decision making (Bammens et al., 2011; Morck and Yeung, 2004), have the opportunity to expropriate minority shareholder interests (Dharwadkar et al., 2000; Villalonga and Amit, 2006; Kuo and Hung, 2012).

CG researchers labelled this expropriation by controlling family shareholders with different terminologies such as *private benefits of control* (Denis and McConnell, 2003; Dyck and Zingales, 2004), *tunnelling* (Johnson et al., 2000), *expropriation of minority shareholders' interest* (Faccio et al., 2001), *entrenchment* (Claessens et al., 2000), and more recently *principal-principal conflicts* (Jiang and Peng, 2011; Young et al., 2008, p. 197; Dharwadkar et al., 2000, p. 651) and 'agency problem II'[5] (e.g., Villalonga and Amit, 2006; Kuo and Hung, 2012). According to agency theorists (e.g., Claessens and Fan, 2002; Liew, 2007; Su et al., 2008; Young et al., 2008; Love, 2010), an important purpose of a CG reform in a developing country is to reduce the private benefits of control enjoyed by controlling family shareholders.

In government-owned companies, the government, being a controlling shareholder, can act as an effective monitor of government appointed managers (Shleifer and Vishny, 1994; Yarrow et al., 1986). However, the objective of government monitoring is not always to increase shareholder wealth because a government sometimes tries to maximise social welfare (Vickers and Yarrow, 1988), appoints board members, senior managers and other employees based on political connection with limited consideration of experience and qualification (Barberis et al., 1996). More specifically, in a highly corrupted environment, government and government-appointed managers jointly expropriate the resources from government-owned companies (Boycko et al., 1996; Vickers and Yarrow, 1991; Bhagwati, 1982). As a result, government-owned companies, when listed on stock markets, suffer from agency conflicts which are often worse than that in privately owned companies (Cuervo-Cazurra and Dau, 2009; Vining and Boardman, 1992).

Finally, subsidiaries of foreign MNCs are significantly owned by foreign parent companies. The subsidiaries of foreign MNCs suffer from two types of agency conflicts: (1) between managers at headquarters and managers at subsidiaries, and (2)

[5] 'The large shareholder may use its controlling position in the firm to extract private benefits at the expense of the small shareholders' (Villalonga and Amit, 2006, p. 387).

between managers at subsidiaries and local shareholders (Du et al., 2011; Roth and O'Donnell, 1996; Keil et al., 2006). Of these two, agency conflicts between managers at headquarters and managers at subsidiaries is dominant (Du et al., 2011; Roth and O'Donnell, 1996) because local shareholders own only a minimum percentage of the subsidiaries of foreign MNCs (Keil et al., 2006). The main reason for the agency conflict between managers at headquarters and managers at subsidiaries is subsidiary managers' intention to execute strategies that promote local responsiveness at the expense of global integration (Doz and Prahalad, 1984). In order to promote global integration, managers at headquarters share institutions and corporate governance (Chari et al., 2010) through the appointment of a significant proportion of expatriates in top management positions (Boyacigiller, 1990; Jaussaud and Schaaper, 2006), staffing key management positions with personnel from regional headquarters (Jaussaud and Schaaper, 2006), the transfer of human resource practices (Björkman and Lervik, 2007), introduction of international accounting practices (Chari et al., 2010) and corporate culture (Baliga and Jaeger, 1984).

2.6.2 Reasons for corporate governance reform in developing countries

Prior research explains the adoption of CG codes around the world by using two theories: (1) efficiency and (2) institutional legitimacy (Aguilera and Cuervo-Cazurra, 2004; Zattoni and Cuomo, 2008). The proponents of CG reform in developing countries defend their strategy using efficiency-based reasons. They argue that CG reform will ensure (1) greater access to external financing by firms, (2) lower cost of capital and associated higher valuation of firms, (3) better operational performance of firms, and (4) more favourable treatment of all stakeholders (ROSC, 2013; IFC, 2013; Claessens and Yurtoglu, 2012, p. 17; Claessens, 2006, p. 99; Global Corporate Governance Forum, 2005, p. 6). However, prior research on the adoption of CG codes based on an Anglo-American model in developing countries indicates the domination of legitimacy-based reasons (e.g., Reed, 2002; Liew, 2008; Siddiqui, 2010). These legitimacy-based reasons include: direct and indirect coercive pressures from the IFIs (Reed, 2002; Siddiqui, 2010; Cuervo, 2002; Reid, 2003); intention to attract international institutional investors

(e.g., Rwegasira, 2000 in Africa; Yakasai, 2001 and Okike 2007 in Nigeria; Krambia-Kapardis and Psaros, 2006 in Cyprus; Liew, 2007 in Malaysia); and to restore the confidence of the market participants after the financial crisis (Oman, 2001; Liew, 2007 in Malaysia).

2.6.3 Inefficiency in implementation of an Anglo-American model of corporate governance in developing countries

The institutional characteristics of a particular country have an important bearing on the implementation of a newly adopted CG code (Klapper and Love, 2004; Doidge et al., 2007; Krambia-Kapardis and Psaros, 2006; Auilera et al., 2008). This is because the institutional characteristics of a country influence the private benefits of control of the existing controllers of companies and the efficiency in implementation the CG code.

Prior research in a cross-country setting finds that private benefits of control are positively associated with ownership concentration (Dyck and Zingales, 2004) and negatively associated with the depth of capital markets (Dyck and Zingales, 2004) and legal rights of minority shareholders (Nenova, 2003; Chari et al., 2010). This evidence indicates that private benefits of control are substantial in developing countries because of the institutional characteristics of developing countries (see section 2.4.2). Prior research evidenced use of different methods of extracting private benefits of control by controlling families in developing countries: (1) the appointment of less qualified family members or friends as executive managers (Faccio et al., 2001; Bertrand and Schoar, 2006); (2) execution of related-party transactions with organizations owned by, or associated with, controlling shareholders at non-arms-length terms (Cheung et al., 2006; Chang and Hong, 2000; Khanna and Rivkin, 2001); (3) execution of mergers between affiliated entities to extract resources out of the bidder or target (Johnson et al., 2000; Bae et al., 2002); (4) performance of strategies to advance personal, family, and political interest of controlling families (Backman, 1999; Bammens et al., 2011). A group of researchers argue that when private benefits of control are high, existing controllers of companies impede change in CG in order to protect these benefits (Bebchuk and Roe, 1999; Rajan and Zingales, 2003; 2003a; Rosser, 2003).

The institutional characteristics of a country also affect efficiency in the implementation of a newly adopted CG code. This is because the CG structure is embedded in a country's economic, legal, political and cultural structure (e.g., Doidge et al., 2007; Khanna et al., 2006; Li and Harrison, 2008; Wanyama et al., 2009; Aguilera et al., 2008; Aguilera and Jackson, 2003; 2010).

Firstly, the ownership structure of developing countries (see Section 2.4.2) reduces the monitoring and advising ability of independent directors (Jackling and Johl, 2009; Singh and Gaur, 2009). Moreover, institutional investors, being new and owning a minimum ownership percentage of companies, have limited disciplining ability to ensure compliance with a 'comply or explain' basis CG code by reducing the share price of companies that are poorly complied (Hamdani and Yafeh, 2013; Belev, 2003; Nam et al., 2001; Sarkar and Sarkar, 2000).

Secondly, poor investor protection rights affect insider's motivation for compliance with the newly adopted CG codes in different ways. When investor protection rights are poor, firms need to maintain secrecy (La Porta et al., 2000) and to maintain secrecy insiders become reluctant to share information with diverse groups such as independent directors. Moreover, poor investor protection rights reduce outside investors' and creditors' ability to enforce compliance with CG codes (Klapper and Love, 2004).

Thirdly, the illiquid and inefficient capital markets of developing countries indicate that there is lack of culture of equity finance (Mueller, 2006). The sponsor families are reluctant to issue a significant percent of shares in order to retain their private benefits of control (Fan et al., 2011; Singh, 2003; Black, 2001) or as a response to an institutional void emanating from weaker market and legal institutions in developing countries (Mueller, 2006; Luo and Chung, 2013). Illiquid and inefficient capital markets indicates that controllers of companies are not subject to adequate disciplinary pressures from stock markets (Paredes, 2004; Krambia-Kapardis and Psaros, 2006) and costs savings from lower cost of capital due to compliance with CG (e.g. appointment of independent directors) is low (Doidge et al., 2007). On the other hand, the close relationship between banks and non-financial companies (Nam et al., 2001) and the extension of bank credit based on relationships

and collateral (Ahunwan, 2002) make banks reluctant to monitor the CG structure of non-financial companies.

Fourthly, quality of accounting information is opaque in developing countries (Section 2.4.2). Whittington (1993) suggests that directors cannot carry out their monitoring and decision making functions effectively when accounting information is opaque. This is consistent with the argument of Aguilera et al. (2008) that independent directors cannot work effectively without the presence of adequate information disclosure.

Fifthly, there is limited empirical evidence that takeover activities in developing countries helps in disciplining the managers of companies (see review of takeover literature in Asia by Sun et al., 2010). Rather, evidence shows that controlling families sometimes use the takeover mechanism to expropriate the interest of minority shareholders (Bae et al., 2002).

Sixthly, extreme corruption in developing countries negatively affects insiders' legitimacy to good governance practices (dela Rama, 2012; Berglöf and Claessens, 2006; Judge et al., 2008) and regulatory authorities' enforcement capability (Rossouw, 2005; Okike, 2007). High levels of corruption also motivate insiders to maintain limited transparency because they often need to manage corrupt government agencies through illegal means (Dyer and Mortensen, 2005; p. 253).

Finally, the culture of a country influences not only insiders' motivation to comply with an Anglo-American model but also efficiency in implementation of an Anglo-American model. This is because the culture of a country influences people's attitude towards opportunistic behaviour (Doney et al., 1998), ethical practices (Chan and Cheung, 2012), decentralised control systems (Li and Harrison, 2008) and transparency (Gray, 1988; p. 11). A society with high power distance, high masculinity, high uncertainty avoidance and high collectivism maintains negative attitude towards ethical practices (Chan and Cheung, 2012) and decentralised control systems (Li and Harrison, 2008). Similarly, a country with high power distance and high uncertainty avoidance has a tendency to preserve confidentiality (Gray, 1988; p. 11) and thus, results in limited accounting disclosure (Dahawy et al., 2002). This evidence implies that the culture of a country with aforementioned characteristics contradicts the notion of an Anglo-American model.

The aforementioned institutional characteristics, however, may have differential influence on the CG structure of local privately-owned, government-owned and subsidiaries of foreign MNCs. This is because subsidiaries of foreign MNCs are less directly affected by the institutional characteristics of the host country (Kostova and Roth, 2002).

2.6.4 Prior research on five corporate governance mechanisms suggested by an Anglo-American model in developing countries

This section discusses prior research on five CG mechanisms: namely, separation of chairman and CEO, board of directors, audit committee, Chief Financial Officer (CFO) and Head of Internal Auditor (HIA).

2.6.4.1 Separation of CEO and Chairman of Board

One of the important CG mechanisms suggested by the Anglo-American model is separation of CEO and chairman of the board of directors. This separation is suggested based on the agency theory that CEO duality increases CEO's power and makes the board of directors a less effective monitor (Fama and Jensen, 1983). Prior archival evidence in the context of developed countries is mixed in this regard. To illustrate, prior literature on the impact of CEO duality on firm performance provides positive (Donaldson and Davis, 1991), negative (Rechner and Dalton, 1991; Pi and Timme, 1993) and no association evidence (e.g., Berg and Smith, 1978; Chaganti et al., 1985; Rechner and Dalton, 1989; Baliga et al., 1996; Daily and Johnson, 1997). An improvement over archival evidence is made by Hendry (2012). This study interviewed a sample of FTSE 100 CEOs and chairmen and finds that, in reality, a chairman cannot curb the CEO's discretion due to the practicality of the CEO's job.

In developing countries, CEOs are often members of controlling families (Claessens et al., 2000). Agency theorists argue that the controlling family affiliation of a CEO increases the risk of expropriation of minority shareholder resources (e.g., Bertrand et al., 2002). Hence, the appointment of an independent chairman or a professional CEO is recommended to reduce the expropriation of minority interests. However, there is an argument that controlling families appoint their members as CEOs as a response to the lack of market-based institutions in developing countries

(e.g., Burkart et al., 2003; Caselli and Gennaioli, 2013). Like developed countries, empirical evidence on the impact of CEO duality and firm performance is also mixed, as shown in Appendix 2.5. These studies, however, do not distinguish firms based on whether firms comply with the separation of chairman and CEO in form but not in substance, or both in form and in substance. Luo and Chung (2013) addressed this deficiency. They distinguish between family businesses based on ownership, strategic and operational control. Their results indicate that the appointment of an outside professional as a key operational manager reduces a controlling family's ability to expropriate minority shareholders' interest.

2.6.4.2 Board of directors

The Board of directors is regarded as the apex of a firm's internal control system (Jensen, 1993). According to agency theory, the board of directors is responsible for controlling and monitoring management and for running the company in the best interests of shareholders. Two dimensions of the board of directors have captured significant attention in prior literature both in developed and developing countries: board size and board independence.

Board size

Prior research on the association between board size and firm performance, however, provides mixed evidence in a developed country's context (see Adams et al., 2010; Hermalin and Weisbach, 2003 for reviews). Researchers relate this mixed evidence with the 'black-box' approach taken by these studies and argue that the board of directors should be studied as an open system (Aguilera et al., 2008).

The evidence on the association between board size and firm performance or accounting reporting quality in a developing country's context, is also mixed, as shown is Appendix 2.5 and 2.6 respectively. Although several of these studies speculate that sponsor family members often excessively represent the board in developing countries and thus, sponsor families have strong influence on both strategic and operational decisions of the companies (Schulze et al., 2001; 2003), there is limited research on the details of family representation on the board of directors in developing countries.

Independent directors

The appointment of independent directors on the board is advocated by agency theorists who perceive that the main role of the board of directors is to control and monitor opportunistic managers and thus, protect the interests of outside shareholders (Short et al., 1999, p. 339; Stiles and Taylor, 2001 cited in Zona and Zattoni, 2007). However, whether the independent directors are effectively executing their aforesaid responsibilities still remains an empirical question as archival evidence is mixed (see Adams et al., 2010; Hermalin and Weisbach, 2003 for reviews). Some improvement have been made in this regard by several studies that directly survey or interview independent directors (e.g., Hooghiemstra and van Manen, 2004; Nowak and McCabe, 2003). Both of these studies find that, in practice, the monitoring role of non-executive directors is highly constrained by access to information which is under the strict control of the CEO.

In the context of developing countries, there is a large body of recent archival research that investigates the association between board independence and firm performance (e.g., Black et al., 2012; Black and Kim, 2012; Chen et al., 2011; Ararat et al., 2010; Singh and Gaur, 2009). A summary of these studies is presented in Appendix 2.5. The main theoretical framework used by these studies is agency theory with limited reference to other theories. The results indicate that like developed countries, the effect of independent directors on firm performance is mixed.

The evidence on the association between board independence and firm accounting reporting quality is also mixed, as presented in Appendix 2.6. Being archival, each study defends its findings by speculating different reasons such as independent directors being a minority on the board cannot play a role (Black et al., 2012); independent directors lack in-depth knowledge about all firms of a group and do not properly understand the value of coordination among affiliated firms and unnecessarily interrupt the working of insider directors (Singh and Gaur, 2009); and the control of the board by controlling shareholders makes the board a rubber stamp (Chen et al., 2011). A limited number of survey-based studies in developing

countries find that firms often appoint a person who has some sort of relationship with the controlling family or the CEOs of the firms and thus, apparently comply with board independence director(s) (Varottil, 2010; Tengamnuay and Stapleton, 2009). These apparently independent directors are regarded as affiliated directors (BRC, 1999; Klein, 2002; Tengamnuay and Stapleton, 2009). Several researchers argue that affiliated directors are not able to speak out against the misdeeds of controlling shareholder managers or the CEOs in developing countries (Arosa et al., 2010; Clarke, 2006).

2.6.4.3 Audit committees

In the Anglo-American model of CG, the audit committee is responsible for monitoring the reporting and audit processes of financial statements (Bédard et al., 2004; Cohen et al., 2007). International best practices guidelines (e.g., BRC, 1999; Smith, 2003) recommend a set of provisions related to the audit committee which they believe are essential for its effectiveness.

A large body of literature investigates the impact of these provisions on the quality of financial reporting (Srinivasan, 2005; Beasley et al., 2010; Carcello et al., 2011; Cohen et al., 2010b; Klein, 2002; Naiker and Sharma, 2009; Krishnan and Visvanathan, 2008). This literature hypothesises that companies which complied better with the aforementioned provisions related to audit committees have better accounting reporting quality. The empirical evidence is, however, inconclusive. For example, Bédard and Gendron (2010) review 51 studies that investigate the association between the independence of the audit committee and accounting reporting quality. They report that 26 studies (51%) evidence a positive association with accounting reporting quality and 25 (49%) find no significant association. Most of these studies do not consider the contextual dynamic (e.g., relationship of the CEO with audit committee members) while investigating the association between audit committee characteristics and accounting reporting quality. One exception is Carcello et al. (2011) who report that audit committee independence and financial expertise do not have a negative association with financial restatements when the CEO is involved in the selection of directors. The qualitative studies on the audit committee also provide mixed evidence on its effectiveness. While early qualitative

evidence on the effectiveness of the audit committee indicates that audit committees mainly play ceremonial roles (e.g., Kalbers and Fogarty, 1998; Spira, 1999), recent research indicates that an audit committee plays both monitoring and ceremonial roles (Gendron and Bedard, 2006; Beasley et al., 2009).

With respect to developing countries, there are only a limited number of empirical studies on the effectiveness of the audit committee. Appendix 2.5 shows that event studies related to the announcement of legal requirements for the appointment of audit committees positively increase market-based performance of firms in India (Black and Khanna, 2007) and Korea (Black and Kim, 2012). However, studies (e.g., Lo et al., 2010; Ararat et al., 2010; Chen and Nowland, 2010) that test the association between the audit committee and firm performance provide mixed evidence [Appendix 2.5]. Most of these studies do not provide any satisfactory explanation to defend their results. The main purpose of the audit committee is, however, to ensure quality of accounting reporting (Spira, 1998). Hence, a number of studies investigate the existence of an audit committee and accounting reporting quality. The evidence is again mixed [Appendix 2.6]. Most of these studies investigate the audit committee by recognizing as 'black box'. Few survey-based (Lin et al., 2008; Tengamnuay and Stapleton, 2009) and interview-based (Zain and Subramaniam, 2007; Salleh and Stewart, 2012) studies respectively investigate the characteristics and effectiveness of the audit committee in developing countries. These studies find that the audit committee lacks several characteristics which are perceived as essential for its effectiveness (Lin et al., 2008; Tengamnuay and Stapleton, 2009), and plays a limited role in upholding the independence of internal (Zain and Subramaniam, 2007) as well as external auditors (Salleh and Stewart, 2012).

2.6.4.4 Chief Financial Officer (CFO)

Although the CFO had traditionally been a 'bean counter' (i.e., responsible for bookkeeping and budget preparation), the CFO is now an 'action hero' (i.e., responsible for strategic decision making and oversight of financial reporting process) in the Anglo-American countries (Smith and Briggs, 1999). The strategic decision making role of the CFO is now well-established and the CFO is 'often

second only to the chief executive officer (CEO) in the organizational hierarchy (Zorn, 2004). With respect to financial oversight responsibility, the CFO is equivalent to the chief executive officer (CEO) in USA (Tulimieri and Banai, 2010; Geiger and North, 2006). In that, under the Anglo-American model of CG CFO is regarded as one of the important CG mechanisms. However, simply hiring a CFO does not ensure the performance of CG roles (Li et al., 2010). The performance of CG roles depends on the qualifications (Aier et al., 2005; Li et al., 2010), level of authority (Bedard et al., 2011) and prior experience (Brochet and Welch, 2011) of the CFO. It is evidenced that accounting quality of firms is positively influenced by qualification (Aier et al., 2005; Li et al., 2010), board membership (Bedard et al., 2011) and prior experience (Brochet and Welch, 2011). In developing countries, there is no research to my knowledge that tests the impact of CFO authority and qualifications on accounting reporting quality.

2.6.4.5 Head of internal audit (HIA)

Internal audit is a key component of sound CG practice (Spira and Page, 2003). Internal audit is regarded as a prerequisite for the effectiveness of the audit committee. Prior research finds that a sound internal audit plays an important role in reducing information asymmetries between the audit committee and operational management (Raghunandan et al., 2001; Scarbrough et al., 1998). However, how effectively internal audit can play a role depends on several characteristics of the internal audit function of the company. More specifically, professional qualifications, experience (Prawitt et al., 2009) and the independence of internal audit (Christopher et al., 2009) and frequent meetings between internal audit and audit committee (Raghunandan et al., 2001; Sarens et al., 2009) are identified as essential requirements for the effectiveness of internal audit. The independence of internal audit is better ensured if the audit committee is given the sole authority to appoint and remove internal auditors (Christopher et al., 2009).

However, prior evidence, even in Anglo-American countries, finds that the internal audit function does not exist in all companies (Christopher et al., 2009) and the internal audit function lacks skilled and trained staff (Griffiths, 1999). Hence, it may be obvious that the internal audit function either does not exist or work

effectively in developing countries (Ebaid, 2011). It may be because the presence of sponsor family members on the board of directors reduces the need for an internal audit function (Adams, 1994).

2.6.5 Summary

The evidence in this section indicates that agency conflicts in the context of developing countries are different from those of Anglo-American countries and that these agency conflicts depend on the types of ownership of companies (Section 2.6.1). In addition, CG codes based on an Anglo-American model are more often adopted in developing countries due to legitimacy-based rather than efficiency-based reasons (Section 2.6.2). A likely consequence of the adoption of CG codes due to legitimacy-based reasons is ceremonial compliance. Moreover, the institutional characteristics of developing countries may negatively affect the level of compliance with CG codes based on an Anglo-American model because (1) institutional characteristics of developing countries positively affect the private-benefits of control of the existing controller, and (2) the institutional characteristics of developing countries hamper efficient implementation of CG codes (Section 2.6.3). Furthermore, the fragmented evidence with respect to different CG mechanisms suggested by an Anglo-American model indicates that they are to some extent ineffective in developing countries (Section 2.6.4). One important caveat of these studies is that they suggest reasons for the ineffectiveness of the board of directors because of control by sponsor families but they do not provide detailed accounts of how control by sponsor family affects different CG mechanisms. Finally, most of the archival studies that investigate the association between CG and firm performance, or accounting reporting quality, study the CG variable as a 'black box' and rarely distinguish between compliance in form rather than in substance and compliance in both form and substance.

2.7 Prior research on level of compliance with corporate governance codes by firms

A number of studies investigate the level of compliance (Arcot et al., 2010; Salterio et al., 2013; v. Werder et al., 2005; Talaulicar and v. Werder, 2008;

Akkermans et al., 2007) and non-compliance (MacNeil and Li, 2006; Hooghiemstra and van Ees, 2011; Hooghiemstra, 2012) with adopted CG codes in both Anglo-American countries and non-Anglo-American countries. Studies that investigate level of compliance commonly find that the majority of companies comply with most of the provisions of the adopted CG codes, irrespective of their country of incorporation. For example, 96.81 per cent of German companies on average comply with 90.64 per cent of the provisions of German CG code (v. Werder et al., 2005) and 95 per cent or more of UK companies comply with certain provisions of the combined code (Arcot et al., 2010). These findings raise questions about the underlying logic of the 'comply or explain' principle of CG codes. Consequently, several researchers (e.g., Arcot et al., 2010; v. Werder et al., 2005; Akkermans et al., 2007) explicitly caution that some companies may overstate compliance in compliance statements or annual reports and the underlying compliance may be different from the reported compliance.

These researchers speculate several reasons for this seeming over-compliance with CG codes: pressures from capital markets (Arcot et al., 2010; v. Werder et al., 2005; Akkermans et al., 2007) and peer companies (Wymeersch 2006; Talaulicar and v. Werder, 2008); monitoring by regulatory authorities such as stock exchanges and their regulators (Wymeersch 2006; Arcot et al., 2010; Burton, 2000; Aguilera & Cuervo-Cazurra, 2004); pressures from spontaneous constituents such as academics, consultancy firms and the media (Wymeersch, 2006; Akkermans et al., 2007); risks of reputational damage arising from non-compliance (Wymeersch 2006; Hooghiemstra and van Ees, 2011) and misinterpretation of disclosed 'explanations' justifying non-compliance with a CG provision (Moor, 2009; FRC, 2006).

There is a dearth of direct evidence from companies regarding the reasons for high-level compliance with adopted CG codes. One exception is Sanderson et al. (2010) who interviewed directors, company secretaries and legal counsellors in the UK and Germany. They report that their interviewees perceived enormous pressures for compliance from institutional investors, general market participants, peer companies and the media. Their interviewees also perceived a huge risk of penalties and reputational damage for non-compliance. Furthermore, most of their interviewees both in the UK and Germany perceive that there is no difference

between a 'comply or explain' basis code and hard law in reality with respect to compliance. Hence, Sanderson et al. (2010) conclude that their interviewees maybe incorrectly, perceive that full compliance is the only acceptable response.

In summary, the evidence on compliance with CG codes in developed countries indicates that companies tend to report full compliance with codes in response to different institutional pressures and several researchers doubt that there may be a gap between the compliance reported in compliance reports or annual reports and the actual underlying compliance. Hence, an important gap remains in this stream of research about whether the compliance reported in annual reports or compliance statements coincide with actual compliance.

2.8 Conclusion

Based on a review of theories that have been used in prior CG literature (see Section 2.2), I conclude that agency theory and neo-institutional theory are the most appropriate to investigate the accomplishment of the objectives of CG reform in a developing country. In respect of neo-institutional theory, I specifically intend to use Bebchuk and Roe's (1999) theory of path dependence of CG. With respect to RQ1, using interview data, I will investigate whether agency theory or theory of path dependence (Bebchuk and Roe, 1999) better explain the attitude of institutional investors and bankers towards the CG mechanisms suggested by the BCGG-2006. I will also use these two theories to formulate propositions related to RQ2. Moreover, I will use agency theory and the theory of path dependence supplemented by Oliver's framework to formulated hypotheses related to RQ3.

In Section 2.3, I presented different models of CG suggested by prior CG theorists and some detail on the Anglo-American model of CG. This section described the basic features of an Anglo-American model of CG. This analysis will help evaluate whether the BCGG-2006 is based on an Anglo-American model and interpret the findings of this thesis.

In Section 2.4, I discussed the institutional characteristics of Anglo-American and developing countries. More specifically, based on prior literature, I shed light on how the institutional characteristics of developing countries are different from those

of Anglo-American countries. This analysis will help formulate propositions, hypothesis and help analyse the results of this study.

In Section 2.5, I showed that prior literature on the impact of CG on investment and lending decisions has been studied using mainly archival methods and agency theory. This prior research provides mixed evidence, relies on a set of assumptions which remain debatable in the literature and takes a 'closed system' approach (Section 2.5.3). This indicates that there is an opportunity to extend this research using an 'open system' approach. Furthermore, there is a dearth of research in this area on developing countries where CG codes based on an Anglo-American model have been adopted recently. Hence, this study will investigate the impact of CG on investment and lending decisions in a developing country context using an inductive approach. This justifies RQ1 of this thesis.

The analyses in Sections 2.6.1 to 2.6.3 raised questions about the appropriateness and inefficient implementation of a CG code based on an Anglo-American model in developing countries. The fragmented research which investigates a single dimension of CG does not give a complete picture of compliance (Section 2.6.4). Few studies that investigate compliance with CG codes mainly use annual report disclosures on compliance. These studies often cannot study the internal relationship between different mechanisms of CG in detail, due to data limitations. Hence, this study intends to extend the prior research on compliance with CG codes using a survey method. This justifies RQ2 of this thesis.

Section 2.7 shows that prior literature on the level of compliance with CG codes finds that the level of compliance is apparently high and several prior researchers are suspicious about this high level of compliance. These studies also lack a systematic theoretical framework. The findings of these studies are often justified by speculation. This gap in the literature justifies RQ3 of this thesis.

To investigate the research questions outlined in the introduction to this chapter, I discuss the institutional characteristics of Bangladesh and the emergence of CG in Bangladesh in chapter three. Then, using the reviewed literature of chapter two and the discussion in chapter three, I formulate sub-questions related to RQ1, research propositions related to RQ2 and hypotheses related to RQ3, all in chapter four.

Chapter Three

Institutional Characteristics of Corporate Governance in Bangladesh

3.1 Introduction

The theory of path dependence of corporate governance (Section 2.2.7.1) posits that existing controllers of companies impede change to new CG practices because they want to protect their '*rent*' produced by initial CG practices and the change to new CG practices may lead to '*inefficiency*' (Bebchuk and Roe, 1999). In order to understand the '*rent protection*' motive of the existing controllers of companies and how the change to new CG practices leads to '*inefficiency*', this chapter describes the historical development of the corporate sector and the present institutional characteristics of Bangladesh. This chapter will help formulate propositions and hypotheses and to discuss the findings of this study.

Section 3.2 presents an economic overview of Bangladesh. Section 3.3 discusses the political regimes of Bangladesh and their consequences for the development of family capitalism. Section 3.4 presents an overview of the present status of the corporate sector of Bangladesh. Section 3.5 discusses other important institutional characteristics. Section 3.6 discusses the emergence of a CG guideline based on an Anglo-American model in Bangladesh, its related characteristics and local authorities that are responsible for monitoring CG practices in Bangladesh. Section 3.7 provides an overview of the banking sector and credit rating agencies of Bangladesh. Section 3.8 concludes.

3.2 An economic overview of Bangladesh

The People's Republic of Bangladesh ('Bangladesh') is a developing country in South Asia. In recent years, Bangladesh has maintained an impressive growth in its macroeconomic indicators. For example, during fiscal years 2006-2012, the average Gross Domestic Product (GDP) growth rate has been about 6.3 percent[6]. The

[6] Calculated by the author of this thesis based on individual annual GDP growth rate.

World Bank (2013) anticipates that the GDP of Bangladesh has a potential to grow at 8 percent in the near future. Against this impressive economic outlook, concerns are raised about an alarming increase in disparity of national income distribution (D'Costa, 2012), and failure to attract adequate foreign direct investment (FDI) (UNCTAD, 2013). The disparity of national income distribution as measured by the GINI coefficient increased at 0.16 percent between 2000 and 2010 (Titumir and Rahman, 2011). The percentage of people living below the poverty line was 31.5 percent as at 2010 (World Bank, 2013). The inflows of FDI decreased by 35.54 percent from 2008 to 2009, increased by 30.42 percent and 24.42 percent in 2010 and 2011 respectively and then, decreased by 12.85 percent in 2012 (UNCTAD, 2013). The World Bank (2013) argues that to achieve the desired 8 percent growth in GDP, Bangladesh needs to attract more FDI and one way to attract FDI is to improve the corporate governance structure.

3.3 Historical development of the Bangladesh corporate sector

Bangladesh became independent from Pakistan in 1971. After independence, the new government, led by Sheikh Mujibur Rahman, embarked on socialism (Ahmed, 1978). The government nationalised all industries with total assets of more than TK 2.5 million (Mir and Rahaman, 2005), suspended the operation of the Dhaka Stock Exchange and restricted the role of the private sector (Rahim, 1978). Within a few years, the management of SOEs became highly politicised and corrupted (Ghafur, 1976; Ahmad, 1976; World Bank, 1993). Efficiency declined and losses became so high that the operating loss of SOEs consumed about 30% of annual project aid (Uddin and Hooper, 2003).

General Ziaur Rahman came to power in 1975 (Uddin and Hooper, 2003). Zia built alliances with the military, the civil bureaucrats and the businessmen (Islam, 1986-1987). Islam (1984) observes that the businessmen dominated the Central Executive Committee of Zia’s political party as well as Zia’s parliament. Businessmen joined Zia’s alliance to gain state patronage and power (Jahan, 1980; p. 208; Quadir, 2000). Zia’s industrial policy issued in 1975 encouraged the large scale privatisation of SOEs and increased the role of the private sector in the economy

(Ahmed, 1978; Rahim, 1978). By December 1979, 159 SOEs were returned to their original owners who were members of the bourgeois class created during the previous Pakistan regime and 200 SOEs were sold to private businessmen who were member of Zia's alliance (World Bank, 1997; Rahim, 1978). Zia also approved the operations of a number of subsidiaries of foreign MNCs such as British American Tobacco and Glaxo SmithKline (Islam, 1986-1987).

General Hossian Mohammad Ershad came to power in 1981 (Ahmed, 1998). Ershad built a new alliance and several of the members of Zia's alliance joined (Nuruzzaman, 2004). He intensified the privatisation process by providing licences for private entrepreneurs to float banks and insurance companies (Nuruzzaman, 2004). These licenses to float banks and insurance companies were given to 37 and 44 entrepreneurial families respectively who had strong political affiliation with Ershad (Sobhan and Sen, 1989; Nuruzzaman, 2004). In order to satisfy the recommendation of the international financial institutions ('IFIs'), Ershad sold shares of many SOEs under the 51-49 plan[7] under the industrial policy of 1986 (Uddin and Hooper, 2003).

Private sector-led economic policy, as initiated by military juntas and promoted by the IFIs, created a limited number of family-owned industrial groups who controlled manufacturing, and the financial and service sectors of Bangladesh (Nuruzzaman, 2004). These family-owned industrial groups largely determined the process of industrial development in Bangladesh (Niruzzaman, 2004).

After the military era, the Bangladesh Nationalist Party ('BNP') headed by Khaleda Zia came to power in 1991. The Parliament of Khaleda Zia was dominated by businessmen (Jahan and Amundsen, 2012). The government of Khaleda Zia closely followed the IFIs' economic policy (Kochanek, 1996), accelerated the privatisation process by establishing the Privatisation Board in 1993 (Khan and Ahmed, 1997) and privatised 449 SOEs up to May 1993 (Nuruzzaman, 2004). Most of these companies were sold to businessmen who were affiliated to the ruling government (World Bank, 2009; Uddin, 2005).

[7] The government maintained control by retaining control 51 per cent of shares in each company and 49 per cent of shares were sold by initial public offerings (Humphrey, 1990).

In 1996, the Bangladesh Awami League ('BAL') government led by Sheikh Hasina came to power but continued the privatisation and assured IFIs that they would strengthen the Privatisation Board (Uddin, 2005). Businessmen constituted 48 per cent of its total membership (Jahan and Amundsen, 2012). The use of political connections with the ruling party and bribing party-leaders by businessmen became more predominant (Uddin and Choudhury, 2008).

During the following decade, the BNP headed by Khaleda Zia (2001-2006) and the BAL headed by Sheikh Hasina (2009-to date) alternately ruled Bangladesh (Ahmed, 2010). In the present parliament, businessmen constitute 56 percent of total membership (Jahan and Amundsen, 2012). Both parties appointed their partisan supporters as chiefs of government and non-government institutions, and politicised those institutions (Jahan, 2003). The businessmen MPs use their political power to capture government contracts, influence government regulations in their favour and can easily disregard rules because of the politicisation of government institutions (Jahan and Amundsen, 2012).

The government industrial policy and IFIs suggested reform initiative since independence patronise development of a generation of family-entrepreneurs who are still directly controlling their corporations (Lal, 2011, p. 161). In addition to the privately-owned companies, there are a number of government-owned companies which are 'partially privatised' through listing on the stock exchanges and a number of subsidiaries of foreign MNCs. These three types of companies are significantly different in terms of ownership and control, as discussed in Section 3.4.1.

3.4 An overview of the current status of the Bangladesh corporate sector

3.4.1 Corporate Ownership and Control

Previous studies show that ownership of Bangladeshi companies is concentrated predominantly in non-financial sectors (Imam and Malik, 2007; Haque et al., 2011) and these top shareholders mostly belong to sponsor families (Imam and Malik, 2007).

Previous studies do not distinguish among privately-owned, government-owned and subsidiaries of foreign MNCs, although these three types of companies

are significantly different in terms of ownership structure. For example, a calculation by the author of this thesis, based on all listed companies at December 31, 2012[8] reveals that foreign parents of subsidiaries of MNCs retained between 55.8 and 95 per cent of ownership while government retained more than 51 per cent of ownership in most government-owned companies listed on stock exchanges.

The aforementioned three types of companies are also different in terms of control. Privately-owned companies are managed by sponsor family affiliated executive managers and board members. Haque et al. (2011) found that sponsor family members represent 61.7 per cent of board membership in non-financial companies. The government owned companies are managed by government appointed managers while the subsidiaries of foreign MNCs are generally managed by local professional managers.

3.4.2 Institutional investors

The presence of sophisticated *institutional investors* is essential for monitoring compliance with a 'comply or explain' basis code (e.g., Wymeersch, 2006). In April 2011, institutional investors and foreign investors respectively owned 10 per cent and 1 per cent of market capitalisation (World Bank, 2011). Institutional investors mainly comprise mutual funds and life insurance companies (The Aries Group Ltd., 2012).

The mutual fund industry of Bangladesh is relatively new, smaller than that of other emerging markets and lacks professionally trained managers to efficiently run its operations (The Aries Group Ltd., 2012). On 30 June 2011, there were six asset management companies managing 35 mutual funds (BSEC, 2010-2011).

The Insurance industry of Bangladesh is still underdeveloped, suffers from undercapitalisation and lacks professional managers and trained insurance agents (The Aries Group Ltd., 2012). On 30 June 2011, there were ten life insurance companies in Bangladesh (BSEC, 2010-2011). Institutional investors as a whole have been found reluctant to play an active role in monitoring the management of these companies (ADB, 2005; World Bank, 2009).

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[8] Data were taken from the Dhaka Stock Exchange website at December, 2012.

3.4.3 Rights of outside shareholders

The rights of shareholders are protected by the Companies Act 1994. However, the exercise of statutory shareholder rights in reality is not straightforward. Shareholders' access to information is not free of charge and smooth (World Bank, 2009). Managements control the proceedings of the annual general meeting (AGM) by appointing a small group of people who prevent the participation of general shareholders in the discussion (Uddin and Chowdhury, 2008). Ultimately, shareholders have no ability to elect and remove directors (BEI, 2003). There have been no prosecutions for insider trading (World Bank, 2009; 2011). Furthermore, the judicial systems of Bangladesh are so inefficient and corrupt that shareholders cannot enforce their legal rights (The Aries Group Ltd, 2012).

On the other hand, shareholders are reluctant to attend and have limited interest in, and ability to contribute to, the proceedings of AGMs (BEI, 2003).

3.4.4 Capital Market

Bangladesh has two stock exchanges. DSE (Dhaka) is the main stock exchange in Bangladesh (World Bank, 2009) and most of the securities traded on CSE (Chittagong) are listed on DSE. In terms of number of listed companies (242), market capitalisation ($29,839 million) and market capitalisation as a percentage of gross domestic products (GDP) (26.27 percent), DSE is one of the smallest stock exchanges in South Asia as on December 31, 2012 (World Federation of Exchanges, 2012).

The companies listed on stock exchanges are less than 10 per cent of total public limited companies in Bangladesh (Chowdhury, 2013). The public limited companies do not perceive stock markets as a viable source of finance as bank loans are easily available on favourable terms (BEI, 2003). The volatility of stock prices in DSE since 2009 was so high that prominent Bangladeshi economist Rahman Sobhan labelled DSE as a 'Casino' (The Daily Star, 2011). DSE is populated mostly by ill-informed retail 'momentum' investors who have a low level of financial literacy (The Aries Group Ltd., 2012). Relatively few large investors, thus, can easily manipulate share price. The DSE crashed several times during 2009-2011 and street protests by general investors compelled government to form a probe committee. The

report of the probe committee revealed that 60 influential individuals, most of whom were pro-government business magnates and top officials of BSEC, manipulated the market (Khalid, 2011).

3.4.5 Information environment

Every company in Bangladesh prepares audited financial statements which present a 'true and fair view' of the state of affairs of the company (Section 181, Companies Act 1994). The Securities and Exchange Rules, 1987 supplement the Companies Act 1994 and state that companies in Bangladesh shall follow accounting standards adopted by Institute of Chartered Accountant of Bangladesh (ICAB) in preparing financial statements. Since 1997, the official accounting standards for preparing and presenting financial statements are International Accounting Standards (IASs) and International Financial Reporting Standards (IFRS) as adopted by the ICAB (Chowdhury, 2012).

A report by the World Bank (2009, p. 4) however, states that '[The] ICAB has incorporated a number of international standards, but not all have been adopted, and some that have not been updated'. Moreover, there is a company culture of non-compliance with IASs/IFRSs (Mir and Rahaman, 2005; World Bank, 2003) and avoidance of disclosure mandated by IASs/IFRSs (Ahmed and Nicholls, 1994; Uddin and Hooper, 2003; Akhtaruddin, 2005). For example, Mir and Rahaman (2005) find that the level of compliance with IASs is not satisfactory while Akhtaruddin (2005) finds that companies on average disclose only 44 per cent of mandatory items. Furthermore, the reliability of accounting reports in Bangladesh has persistently been questionable (World Bank, 2003; Wu, 2005). For instance, Wu (2005) finds that more than 50 per cent of Bangladeshi firms disclose less than 50 per cent of sales revenue on tax returns.

Prior researchers have identified a number of reasons for poor compliance with IASs/IFRSs and the limited reliability of financial statements. Firstly, accounting professional bodies lack the capacity to provide quality education and training, and monitor adherence to professional ethics (World Bank, 2003). For example, there is no independent oversight body for monitoring the quality of external audit (World Bank, 2003; World Bank, 2009). The ICAB is responsible for

monitoring audit quality but there is limited evidence that this self-regulation process works effectively (Siddiqui, 2010; World Bank, 2009). Secondly, the number of quality audit firms (Siddiqui, 2012) and qualified professional accountants is still insufficient relative to the size of the economy (World Bank, 2009; 2011). Finally, due to competition among external auditing firms, external auditors are poorly paid and they often compromise their independence and integrity to company managers (Uddin and Chowdhury, 2008; Mir and Rahman, 2005; World Bank, 1998; Karim and Moizer, 1996).

3.4.6 Other related characteristics of the Bangladesh corporate sector

Given a weak managerial labour market, in a country like Bangladesh, it is difficult to find competent managers to replace existing ones (Estrin and Wright, 1999). Bangladesh is characterized as a patrimonial, patron-client relationship-based society under which the prosperity of individuals depends on their loyalty to higher authority (Franda, 1982, p. 332). As a result, company officials below the top management serve the interest of the controlling shareholder managers instead of general shareholders (Uddin and Hooper, 2003). There is no legal protection of whistleblowers in Bangladesh (World Bank, 2009).

An active *market for corporate control* is regarded as an important complementary factor of Anglo- American corporate governance models (Humphery-Jenner and Powell, 2011; Weimer and Pape, 1999; Moreland, 1995; Sykes, 1994). In Bangladesh, an active market for corporate control is absent (Farooque et al., 2007).

3.5 Other important institutional characteristics of Bangladesh

3.5.1 Rampant corruption

Bangladesh was ranked the most corrupt country in the world over 2001-2005 on the Corruption Perception Index (TIB, 2005) with little improvement subsequently (TIB, 2012). This high level of corruption is the result of strong interpersonal ties between corrupt high level government officials and businessmen

(Ahmed, 2010). Endemic corruption negatively affects accountability and good governance (Haque, 2011; Mir and Rahman, 2005). A number of studies that investigate the implementation of IAS/IFRS in Bangladesh argue that endemic corruption in Bangladesh impedes the effective implementation of IAS/IFRS (Mir and Rahman, 2005; Chowdhury, 2012).

3.5.2 National culture

Bangladesh is characterised as a country with high power distance, high masculinity, high uncertainty avoidance and high collectivism (Hofstede et al., 2010). The concentration of authorities and power at the top is evident in every sphere of life in Bangladesh from political parties to individual families (Kochanek, 2000; Uddin and Choudhury, 2008). People in a society with high collectivism are less opportunistic (Li and Harrisson, 2008; Doney et al., 1998) but people in a society of higher power distance and masculinity are more opportunistic (Li and Harrisson, 2008; Doney et al., 1998). The high level of corruption from top to low spheres of Bangladesh suggests the opportunism of its people. High opportunistic behaviour negatively affects trust among members of society (Doney et al., 1998).

3.5.3 Antagonistic political environment

As mentioned in Section 3.3, Bangladesh has been ruled by two patrimonial political parties: the Bangladesh Nationalist Party, headed by Khaleda Zia, and the Bangladesh Awami League, headed by Sheikh Hasina alternately since 1991. However, this bipartisan political system has not led to the development of a democratic system (Hagerty, 2008; Jahan and Amundsen, 2012). The political environment of Bangladesh is characterised by violence and hostility between the two patrimonial political parties (Ahmed, 2013; D'Costa, 2012).

3.6 Corporate governance (CG) in Bangladesh

3.6.1 Emergence of the Bangladesh Corporate Governance Guidelines-2006

The CG structure of Bangladesh attracted the attention of IFIs and the domestic regulators after the stock-market crash in 1996. In November 1997, the

Asian Development Bank (ADB) funded an $80.00 million project to transform Bangladesh capital markets towards an Anglo-American model, which included institutional reforms within the Bangladesh Securities Exchange Commission (BSEC), automation of the stock exchanges and changing capital market laws and regulations (ADB, 1997). This programme consists of seven technical assistances; one of them is *Building Capacity of the Securities and Exchange Commission and Selected Capital Market Institutions* which costs $1.10 million. The first objective was to draft a comprehensive CG manual for public limited companies and security issuers. This project was executed by the ADB with the help of The Aries Group Ltd., a consultant from USA. The consultant formulated a CG guideline in line with the OECD's Principles of CG (ADB, 2005). The Bangladesh Securities and Exchange Commission (BSEC) adopted the guideline in 2006 (BSEC order No. SEC/CMRRCD/2006-158/Admin/02-08, dated 20 February 2006).

However, another initiative was started by a IFIs-funded private-sector think-tank organization, Bangladesh Enterprise Institute (BEI). In 2003, BEI conducted a comprehensive study on CG practices in Bangladesh and recognised that the Bangladesh corporate sector lacked sound CG due to country-level institutional weaknesses such as a lack of a qualified accounting and auditing profession, ineffective and inefficient government-funded regulatory agencies and a lack of effective financial media and shareholder groups. In 2004, BEI issued a CG code in line with the OECD Principles of CG-1999. Both projects of the BEI were funded by the Department for International Development (DFID), the Commonwealth Secretariat and the Global Corporate Governance Forum (BEI, 2003, p. 3). Siddiqui (2010) argues that the IFIs use BEI 'to pass on policies to the government' (p. 266) and raise awareness about CG in private and public sectors. The World Bank (2009) finds that most companies in Bangladesh do not comply with the CG code of BEI-2004, indicating that the awareness that IFIs tries to create through BEI does not significantly change the behaviour of public limited companies.

As mentioned earlier, the BSEC adopted a Corporate Governance Guideline in 2006 (hereafter The BCGG-2006) on a 'comply or explain' basis. Siddiqui (2010) argues that by adopting the BCGG-2006, which is remarkably similar to the CG code of BEI, the BSEC proved its legitimacy to the IFIs. According to the BCGG-2006,

listed companies have to include a '*comply box'* in their annual report or otherwise explain the reason for non-compliance. The BCGG-2006 is subsequently considered as part of the listing rules of both the DSE and CSE. The inclusion of the BCGG-2006 in the listing rules of stock exchanges creates coercive pressures (Aguilera and Cuervo-Cazurra, 2004), as evident by subsequent disclosure of high-level compliance by public limited companies. For example, reported average compliance with the BCGG-2006 reached 83 percent in 2008 (World Bank, 2009, p.41).

The financing of CG related projects of BEI by the IFIs and direct involvement of the ADB in drafting the BCGG-2006 and subsequent adoption of the BCGG-2006 by the BSEC indicate that IFIs create both normative and coercive pressures on the BSEC regarding CG reform in Bangladesh and on public limited companies regarding improvement of their CG practices.

3.6.2 Main provisions of the BCGG-2006

This thesis focuses on compliance with the BCGG-2006, the content of which is described in this section.

3.6.2.1 Board of Directors

- Different individuals should preferably be appointed in the positions of the chairman of the board and the CEO of the company. The respective roles and responsibilities of the chairman and the CEO should be clearly defined (The BCGG-2006, section 1.3). There is no independence requirement for the chairman of the board.
- The board of directors comprises between 5 and 20 members (The BCGG-2006, section 1.1). There is no requirement to appoint representatives of the minority shareholders on the board.
- Companies shall appoint 10 per cent of total board members, subject to a minimum of one, as independent directors on the board. This suggests that independent director (s) will be a minority on the board. The existing board of directors is responsible for the appointment of independent director(s). This provision may give an opportunity to the sponsor directors to appoint someone related to them. The independent director(s): (1) cannot hold any shares in the company or can hold less than one percent (1%) shares of the

total paid-up shares of the company; (2) cannot be a family member of the company's promoters or directors or shareholder who holds one percent (1%) or more than one percent (1%) shares of the total paid-up shares of the company; (3) cannot have any other relationship, whether pecuniary or otherwise, with the company or its subsidiary/associated companies; (4) cannot be a member, director or officer of any stock exchange; and (5) cannot be a shareholder, director or officer of any member of stock exchange or an intermediary of the capital market (The BCGG-2006, section 1.2). The BCGG-2006 is silent about any academic or business-experience related qualification for the independent director.

- The Companies Act, 1994 requires that a company shall convene at least one meeting of the board of directors in every three months and at least four such meetings during a year. The BCGG-2006 (section 1.4) does not set any new requirements regarding the number of board meetings but requires disclosures regarding the number of board meetings held during the year and attendance by each director at those meetings.

3.6.2.2 The Audit Committee

The BCGG-2006 introduced the concept of an audit committee (AC). The main responsibility of the AC is to assist the board of directors in ensuring that (1) the financial statements of the company reflect a true and fair view of the state of affairs of the company, and (2) a good monitoring system exists within the business (The BCGG-2006, section 3). The provisions related to AC are as follows:

- The AC should comprise at least three members of the board of directors.
- At least one member of the AC should be an independent director.
- One member of the AC should be selected as the chairman of the AC. The chairman should have a professional qualification or knowledge, understanding and experience of accounting or finance.
- The BCGG-2006 is silent regarding the number of AC meetings in a year. However, SEC notification and Stock Exchange listing rules require firms to publish their quarterly financial statements in at least two daily newspapers and quarterly earnings through the website of stock exchanges. If the audit

committee's main responsibility is to ensure transparency of financial statements, at least four meetings per year seem obvious.

- The activities of the AC should be communicated to the board of directors of the company, the BSEC and the shareholders and general investors. The AC only needs to communicate with BSEC if the board of directors does not take necessary action to rectify any weakness in the internal control systems of the company discovered by the AC, and it feels that the weakness in the internal control systems has a material impact on the financial condition and performance of the company.

3.6.2.3 The Head of Internal Audit (HIA)

Companies are recommended to appoint a HIA and the board of directors is assigned to clearly define respective roles, responsibilities and duties of the HIA (The BCGG-2006, section 2).

3.6.2.4 The Chief Financial Officer (CFO)

Companies are recommended to appoint a CFO and the board of directors is assigned to clearly define respective roles, responsibilities and duties of the CFO. The CFO of the company is entitled to attend board meetings of the company except that part of the meeting which involves consideration of an agenda item relating to the CFO (The BCGG-2006, section 2).

3.6.2.5 External audit and non-audit services

- Companies are recommended not to appoint same external auditor for more than three years consecutively.
- Companies are also recommended not to engage their external auditors to perform the following services; namely:-

  (i) Appraisal or valuation services or fairness opinions; (ii) Financial information systems design and implementation; (iii) Book-keeping or other services related to the accounting records or financial statements; (iv) Broker-dealer services; (v) Actuarial services; and (vi) Internal audit services (The BCGG-2006, section 4).

3.6.3 Organization related to enforcement of CG

The main organisations involved in the enforcement of CG are the Bangladesh Securities and Exchange Commission (BSEC), The Bangladesh Bank (BB), The Institute of Chartered Accountant of Bangladesh (ICAB), The Registrar of Joint Stock Companies (RJSC), the DSE and CSE. As CG in the banking sector is not covered in this thesis, I do not discuss BB.

3.6.3.1 The Bangladesh Securities and Exchange Commission (BSEC)

The BSEC is the government agency established in 1993 under the Securities and Exchange Commission Act 1993. The BSEC is a statutory body and is attached to the Ministry of Finance. The board of the BSEC consists of a chairman and four commissioners who are appointed on a full time basis by the government. The objective of the BSEC is to protect the interest of investors, maintain fairness, transparency and efficiency of the stock market and ensure compliance with securities laws (Hossain et al., 2005). To fulfil this objective, the BSEC is entrusted with significant rule making and enforcement power such as monitoring issuers, investigating any misconduct of issuers, imposing financial penalties on issuers and even reconstituting the board of directors of companies.

Although the BSEC has exercised some of these powers in recent years[9], it is still largely ineffective as a regulator of companies and stock exchanges (The Aries Group Ltd., 2012, p. 24). There is no significant improvement in its budgets, number of employees and employee remuneration since 1993 (World Bank, 2011). The employment and retention of highly qualified employees who are capable to discharge the monitoring and enforcement activities efficiently are hampered because of poor employee remuneration (The Aries Group Ltd., 2012; World Bank, 2009). In addition, the information systems of the BSEC are outdated (The Aries Group Ltd., 2012).

3.6.3.2 The Institute of Chartered Accountants of Bangladesh (ICAB)

The ICAB is responsible for setting accounting and auditing standards for Bangladesh (The Securities and Exchange Rules, 1978). ICAB is regarded as one of

[9] BSEC recently constitute board of directors of one company (World Bank, 2009)

self-regulatory bodies of CG in Bangladesh because of its activities regarding the disciplining of members through the development of a code of ethics and a code of conduct. ICAB accepts a ***Code of Ethics for Professional Accountants in SAFA Countries*** (2004) as its Code of Ethics. The Code of Conduct of ICAB lists activities which will be regarded as misconduct and ICAB can take disciplinary action against members who are involved in those activities. However, all these codes seem to have limited application in practice (World Bank, 2009). The ability of the ICAB as a self-regulated accounting oversight body remains questionable (The Aries Group Ltd., 2012). The ICAB has no role regarding monitoring of compliance with the BCGG-2006 as the compliance checklist that a company needs to include in its annual report is not subject to audit. Hence, ICAB can only play a voluntary role regarding enforcement of the BCGG-2006.

3.6.3.4 The Registrar of Joint Stock Companies (RJSC)

The RJSC has legal authority to enforce the provisions of the Companies Act, 1994 (World Bank, 2003). However, the enforcement capacity of RJSC is limited because it: (1) does not have the technical capacity to identify accounting and auditing violations, (2) does not even enforce timely filing of annual audited financial statements, and (3) lacks up-to-date information to verify the number of companies that failed to submit their required annual audited financial statements (World Bank, 2009; 2011).

3.6.3.5 DSE and CSE

The two stock exchanges act as self-regulated bodies and can formulate rules with the approval of BSEC under Securities Exchange Rules 1987 (The Aries Group Ltd, 2012). It has been found that the stock exchanges of Bangladesh fail to play effective oversight roles which resulted in stock market collapse in December 2010 (Khalid, 2011).

With respect to the BCGG-2006, stock exchanges in Bangladesh can play an effective monitoring role to ensure compliance with the BCGG-2006 as the BCGG-2006 is incorporated into listing rules of both the stock exchanges. The stock exchanges can delist a company for non-compliance with the BCGG-2006. Although

the DSE has delisted several companies for non-compliance with rules and regulations, there is no incidence of delisting for non-compliance with the BCGG-2006.

3.7 Banking sector and corporate credit rating agencies

3.7.1 Banking sector and lending regulations

The denationalisation of government-owned banks and permission to float banks under private initiatives started in 1982 gave rise to a private banking sector controlled by a few industrialist families (see Section 3.3). During 1982-1986, credit granting decisions in both private and state-owned banks remained under the control of few people who were affiliated to Ershad (Choudhury and Raihan, 2000). In 1987-1989, the World Bank executed a Financial Sector Reform Programme in order to liberalise interest rates, improve the effectiveness of monetary policy, strengthen the supervisory and regulatory ability of the central bank, and reduce default loan by improving debt recovery process (Bhattacharya and Chowdhury, 2003). However, several objectives of the reform were not achieved due to government control over the central bank, the oligopolistic structure of the banking sector, collusive behaviour between banks and borrowers, and the dominance of few large borrowers (Bhattacharya and Chowdhury, 2003).

Over the years, more licenses for floating new banks in private sectors were awarded to politically affiliated sponsors (Bhattacharya and Chowdhury, 2003; Beck and Rahman, 2006). On December 31 2011, the number of banks increased to 47 (4 nationalised commercial banks, 4 specialised banks, 30 private commercial banks and 9 foreign owned banks). The banking sector of Bangladesh suffers from fierce competition and excess liquidity because of overwhelming growth in deposits (Siddiqui, 2010).

A number of reform initiatives have also been undertaken since 1990. Based on the recommendations of the reform initiatives, Bangladesh Bank introduced a number of regulations collectively called prudential regulations for banks. Three among the prudential regulations for banks are relevant to the lending decisions of banks. These are: (1) Credit Risk Grading (CRG) Manual (Bangladesh Bank, 2005); (2) restriction on lending to a Director of a bank or to his relatives (Bangladesh

Bank, 1999); and (3) prohibition of lending to a company with any director who is a loan defaulter (Bangladesh Bank, 1999). The main purpose of the CRG Manual is to quantify the credit risk of a prospective credit facility and help banks make lending decisions based on sound fundamentals and thus, avoid name-based lending (Bangladesh Bank, 2005). As per the CRG Manual (Bangladesh Bank, 2005), a risk grade is to be assigned to a prospective facility by using CRG Score Sheet [Appendix 3.1]. The CRG Score Sheet does not put any weight on CG.

, Prior research documents that the successive reforms failed to eliminate the influence of political elites and sponsor shareholder directors on credit management and allocation decisions in national commercial banks and private commercial banks respectively (Reaz and Arun, 2006; Bhattacharya and Chowdhury, 2003). In addition, there is still a concern among the IFIs regarding the financial oversight capacity of the regulator of banks, the Bangladesh Bank (ADB, 2011).

3.7.2 Corporate credit rating agencies

The first credit rating agency in Bangladesh was established in 2002. On 31 December 2011 there were five credit rating agencies, of which three were established after January 2010. Credit rating agencies are regulated by the Credit Rating Company Rules, 1996 which sets out minimum licensing requirement for a credit rating company. According to the Credit Rating Company Rules 1996, a credit rating company should appoint at least two professional staff having professional or post-graduation degree in finance, accountancy, business, economics and/or law and experience for at least two years in credit rating or investment advisory activities. The World Bank (2011) raises a concern about the capacity and quality of credit rating agencies. The credit rating agencies are obliged to follow the Credit Risk Grading (CRG) Manual (BRPD Circular No. 18, dated December 2005) as described in Section 3.7.1.

3.8 Conclusion

This chapter shows that Bangladesh has promising economic prospects but needs to overcome challenges that require good governance (Section 3.2). The political patronisation by the military juntas and the IFIs suggested reform initiatives

gave rise to a generation of family entrepreneurs (Section 3.3) who are still directly controlling their businesses.

Institutions to complement an Anglo-American CG model are either absent or weak. Corporate ownership and control remains concentrated in the hands of entrepreneurial families, government or parents of subsidiaries of foreign MNCs, depending on the nature of companies (Sections 3.4.1). Institutional investors lack motivation and the capacity to play a monitoring role (Section 3.4.2), rights of shareholders are not protected and shareholders cannot enforce their rights (Section 3.4.3), the capital market is thin and highly volatile (Section 3.4.4), the level of accounting disclosure and reliability of accounting information are poor (Section 3.4.5), the market for labour and corporate control do not function properly (Section 3.4.6). These characteristics suggest that agency theory is less applicable in studying CG reform in Bangladesh. Moreover, other important institutional characteristics such as rampant corruption (Section 3.5.1), national culture (Section 3.5.2), and the lack of a democratic system (Section 3.5.3) are not conducive to an Anglo-American CG model. The corporate specific and other institutional characteristics suggest that private benefits of control are high and efficiency in implementation of the BCGG-2006 is low (see Section 2.6.3). This evidence indicates that the theory of path dependence of corporate governance (see Section 2.2.7.1) is more relevant in studying CG reform in Bangladesh.

The development process of the BCGG-2006 suggests that the IFIs influence the adoption of BCGG-2006. It has already been argued by prior researchers in Bangladesh that the BCGG-2006 is adopted by the BSEC due more to legitimacy-based reason than efficiency-based reasons (Section 3.6.1). An expected consequence of this can be symbolic compliance with the BCGG-2006 by companies without changing internal policies and practices. Furthermore, the organisations responsible for monitoring compliance with the BCGG-2006 are incapable or reluctant (Section 3.6.3).

Finally, the development and present characteristics of the banking sector suggest that there is an overlap between sponsor families of non-financial companies and that of banks (Section 3.7). As a result, few families can exercise control over credit granting decisions in both private and state-owned banks. Moreover, there was

no CRG Manual until recently and the present CRG Manual does not require an assessment of the CG of the borrower company. The credit rating agencies are newly introduced and lack capacity.

Chapter Four

Research Questions, Propositions and Hypotheses

4.1 Introduction

The aim of this chapter is to develop research sub-questions, propositions and hypotheses relating to the research questions of this thesis (see Chapter One, Section 1.2): *RQ1. Do institutional investors and bankers perceive that the level of compliance with the BCGG-2006 by the investee or borrowing company positively influences the investment and lending decisions respectively in Bangladesh? RQ2.1. To what extent is the BCGG-2006 implemented in form rather than in substance? RQ2.2. Is there a relationship between the nature of compliance and firm performance? RQ3.1. To what extent does reported compliance with the BCGG-2006, as reported in annual reports, overstate underlying compliance with the BCGG-2006? RQ3.2. Does the overstatement lead to a different relative ranking of a firms' corporate governance? RQ3.3. What factors influence the overstatement of compliance with the BCGG-2006 in annual reports?*

Section 4.2 develops sub-questions related to RQ1. Section 4.3 develops propositions related to RQ2.1 and RQ2.2 respectively. Section 4.4 develops hypotheses related to RQ3.1, RQ3.2 and RQ3.3.

4.2 Research questions related to RQ1

In Section 2.5.3, I show that prior literature on the impact of CG on the investment and lending decisions of institutional investors and bankers respectively has used mainly archival methods and agency theory. This prior research relies on a set of debateable assumptions to formulate hypotheses and takes a 'closed system' approach. Furthermore, this research is mainly conducted in a developed country context and provides mixed evidence. This indicates that there is an opportunity to extend this research using an 'open-system' approach in a developing country context. This study, thus, takes an inductive approach to investigate the impact of CG on investment and lending decisions in Bangladesh. Based on the argument of prior

research I formulate two questions (RQ1.1a and RQ1.1b) and in order to provide a theoretical explanation of the findings of RQ1.1a and RQ1.1b, I formulate one question (RQ1.2) as shown below:

Firstly, prior archival and experimental research hypothesises that CG of an investee and a borrower company has a positive impact on the investment and lending decisions of institutional investors (Section 2.5.1) and bankers (Section 2.5.2) respectively. This prior hypothesis is primarily based on the argument that better CG reduces risk of self-dealing and insider trading behaviour. Hence, the first research question investigated by this project is:

> **RQ1.1a** *How do the institutional investors and bankers in Bangladesh perceive a direct impact of a particular corporate governance mechanism of the BCGG-2006 on their investment and lending decisions respectively?*

This prior hypothesis is further based on the following two arguments: (1) sound CG positively affects firm performance and accounting reporting quality and (2) institutional investors and bankers prefer firms with better performance and better accounting reporting quality. Hence, if the interviewees' response on RQ 1.1a indicates that it is worthwhile to investigate the indirect impact of CG on their decisions, the following research question is asked:

> **RQ1.1b** *How do the institutional investors and bankers perceive the impact of a particular corporate governance mechanism of the BCGG-2006 on firm performance and accounting reporting quality?*

Secondly, prior academic research on the impact of CG on the investment and credit decisions of institutional investors and bankers respectively is mainly conducted in Anglo-American countries and at international level. That research mainly draws on agency theory. However, agency theory (1) does not consider the impact of social context on the behaviour of shareholders and managers and (2) may be less applicable in developing countries (Section 2.2.1). Practice-based research which investigates the impact of CG on the investment decisions of institutional investors at international level and at individual developing country level does not explicitly use any theory and provides contradictory evidence (Section 2.5.1). This

research, thus, intends to relate themes generated from the interviewees to a CG theory that better explains the impact of CG on the investment and credit decisions of institutional investors and bankers respectively in Bangladesh. Hence, the second research sub-question is:

> **RQ1.2** *Which theory of corporate governance explains better the impact of corporate governance on the investment and lending decisions of institutional investors and bankers respectively in Bangladesh?*

In order to answer the above sub-questions related to RQ1, this study interviews the investment managers of mutual fund management companies and life insurance companies, and credit rating analysts of banks and credit rating agencies using a semi-structured interview method (Section 5.3).

4.3 Propositions related to RQ2

The privately-owned companies of Bangladesh are significantly owned and strongly controlled by sponsor families (Section 3.4.1) indicating that agency conflict between controlling shareholder directors and minority shareholders is high (Section 2.6.1). Furthermore, protection of minority shareholder interest in Bangladesh is weak (Section 3.4.3). Agency theory suggests that when country-level protection of minority shareholders rights is weak, companies opt into CG mechanisms that offer better protection to minority shareholders (La Porta et al., 1999; Mittion 2002; Klapper and Love, 2004). CG reform provides an opportunity for privately-owned firms to reduce agency conflict between controlling shareholder directors and minority shareholders (Cuervo-Cazurra and Dau, 2009; Zattoni and Cuomo, 2008). Hence, according to agency theory, privately-owned firms implement the BCGG-2006 in form and in substance in order to reduce high agency costs.

However, the ownership and control characteristics of privately-owned companies (Section 3.4.1) and institutional characteristics of Bangladesh (Sections 3.4 and 3.5) suggest that sponsor families have an opportunity to extract private benefits of control (Section 2.6.1). These characteristics also suggest that '*relative efficiency*' in implementation of the BCGG-2006, as it is based on an Anglo-American model, is low (Section 2.6.3). According to the theory of path dependence

(Section 2.2.7.1), when private-benefits of control are high and '*relative efficiency*' in implementation of a new CG guideline is low, controlling shareholders impede implementation of the CG guideline. However, there are institutional pressures for compliance with the BCGG-2006 (Section 3.6.1) and these institutional pressures equally apply to privately-owned companies. A logical impact of these on the implementation of the BCGG-2006 is that privately-owned companies either do not implement the BCGG-2006 or implement the BCGG-2006 in a symbolic manner.

Thus, two competing theories provide competing predictions on compliance with the BCGG-2006 by privately-owned companies. Hence, the following propositions are:

P2.1a1 *Privately-owned companies in Bangladesh implement the BCGG-2006 in form and in substance as implied by agency theory.*

P2.1a2 *Privately-owned companies in Bangladesh either do not implement the BCGG-2006 or implement the BCGG-2006 in form but not in substance as implied by the theory of path dependence.*

Government-owned companies in developing countries which are listed on stock exchanges suffer from significant agency costs (Section 2.6.1). The persistent high-level corruption and low-level managerial efficiency of government-owned companies in Bangladesh (Section 3.3) indicate that agency conflict between government-appointed managers and outside shareholders is high (Ahunwan, 2002). Cuervo-Cazurra and Dau (2009) argue that pro-market reform[10] creates an opportunity for government-owned companies to reduce high agency costs and thus, to increase performance. The BCGG-2006 is initiated by the BSEC with the aim to increase investor confidence by reducing agency costs. Hence, using agency theory, it can be argued that the government-owned companies take the opportunity to redress the conflict between government-appointed managers and outside shareholders by implementing the BCGG-2006 in form and in substance.

However, persistent high-levels of corruption and low-levels of managerial efficiency in the government-owned companies of Bangladesh (Section 3.3) indicate

[10] The adoption of a CG Code is a sub-set of premarket reform (Reed, 2002)

that government or government appointed managers extract high private-benefits of control. According to the theory of path dependence, managers of government-owned companies have an interest in impeding CG reform to protect their rent-seeking behaviour (Rosser, 2003). In Bangladesh, Kochanek (1996) finds that the bureaucrats impede the implementation of liberalisation, privatisation and deregulation policies in order to protect their power and perks. Hence, the government owned companies either do not implement the BCGG-2006 or implement the BCGG-2006 in a symbolic manner as per the theory of path dependence.

Thus, two competing theories provide opposite predictions on compliance with the BCGG-2006 by government-owned companies. Hence, the following propositions are:

P2.1b1 *Government-owned companies in Bangladesh implement the BCGG-2006 in form and in substance as implied by agency theory.*

P2.1b2 *Government-owned companies in Bangladesh either do not implement the BCGG-2006 or implement the BCGG-2006 in form but not in substance as implied by the theory of path dependence.*

As noted in Section 2.6.1, there is a relatively strong agency conflict between the managers at subsidiaries of foreign MNCs and managers at their headquarters but there is a minimal agency conflict between managers at subsidiaries and local shareholders. Local shareholders, having a minimal percentage of ownership, cannot exert enough pressure on subsidiaries of foreign MNCs for compliance with host country CG regulations (Keil et al., 2006). Prior research has indicated that the reduction in agency conflicts between subsidiaries of foreign MNCs and local shareholders through pro-market reform is minimal (Cuervo-Cazurra and Dau, 2009). The subsidiaries of foreign MNCs in Bangladesh are significantly owned by their foreign parent (Section 3.4.1). Hence, using agency theory focused on the local relationship, it can be argued that subsidiaries of foreign MNCs implement the BCGG-2006 in form and in substance less than local privately-owned and government-owned companies.

However, the path of development of subsidiaries of foreign MNCs is different from that of local privately-owned and government-owned companies. The managers at headquarters share institutions and CG (e.g., staffing of key management positions with qualified and experienced employees and better corporate culture) with subsidiaries of foreign MNCs (see Section 2.6.1). The sharing of institutions and CG reduces the opportunity of managers at subsidiaries to extract private benefits of control to a minimum level (Chari et al., 2010). Thus, further reduction in private benefits of control of managers at subsidiaries due to compliance with the BCGG-2006 is negligible. Moreover, inefficiency in the implementation of the BCGG-2006 introduced by a local institutional void is less pronounced with respect to subsidiaries of foreign MNCs because there is a limited direct effect of local institutional environment on the subsidiaries of foreign MNCs (Kostova and Roth, 2002; Chari et al., 2010). Thus, according to the theory of path dependence, subsidiaries of MNCs will more effectively implement the BCGG-2006 than local privately-owned and government-owned companies.

Thus, two competing theories provide opposite predictions on compliance with the BCGG-2006 by subsidiaries of foreign MNCs. Hence, following hypotheses follow:

P2.1c1 *Subsidiaries of foreign multinational companies implement the BCGG-2006 in form and in substance less than privately-owned and government-owned companies as implied by agency theory.*

P2.1c2 *Subsidiaries of foreign multinational companies implement the BCGG-2006 in form and in substance more than privately-owned and government-owned companies as implied by the theory of path dependence.*

Agency theorists' view is that CG reduces moral hazard and adverse selection problems and thus, compliance with a CG mechanism recommended by the BCGG-2006 has a positive effect on firm performance (Section 2.2.1). On the contrary, the theory of path dependence suggests that existing controllers of companies impede compliance with the BCGG-2006 due to *rent protection* and low *relative efficiency* in implementation of BCGG-2006 (Section 2.2.7.1). However, companies are subject to coercive and normative pressures for compliance with the BCGG-2006 (Section

3.6.1). Consequently, companies will comply with the BCGG-2006 in form but not in substance. Prior research argues that testing the association between CG and firm performance is irrelevant because the CG mechanism, when adopted due to institutional pressures, only plays a ritualistic role (Cohen et al., 2008). This view is, however, criticised by a group of recent institutional researchers who argue that an organization's response to institutional pressures varies because different organizations face institutional pressures of different strength (e.g., Lounsbury, 2008; Oliver, 1991). With respect to the implementation of a CG mechanism recommended by the BCGG-2006, this indicates that some companies may not implement the CG mechanism; some companies may implement it *in form rather than in substance* while some other companies may implement it *in form and in substance*. Accordingly, if there is an association between a CG mechanism and firm performance, it will vary depending on the nature of implementation of the CG mechanism. As agency theory does not make a distinction between compliance *in form rather than in substance* and compliance both *in form and in substance*, the following testable proposition related to RQ 2.2 is suggested:

P2.2 *There is a difference in performance among companies that do not implement a corporate governance mechanism introduced by the BCGG-2006, those that implement the corporate governance mechanism in form but not in substance and those that implement the corporate governance mechanism in form and in substance.*

Institutional theory indicates that when a CG mechanism is implemented in form rather than in substance, it plays a ritualistic role. Consequently, implementation of a CG mechanism *in form rather than in substance* is equivalent to non-implementation of the CG. However, implementation of a CG mechanism both in form and in substance is different from non-implementation and implementation in form rather than in substance. It follows that the performance of a company that implements a CG mechanism in form rather than substance is not higher than that of a company that does not implement the CG mechanism. In addition, the performance of a company that implements a CG mechanism in form and in substance is higher than that of a company which does not implement the CG mechanism and that of a

company which implements the CG mechanism in form rather than in substance. This leads to the following propositions:

P2.2a *The performance of companies that implement a CG mechanism introduced by the BCGG-2006 in form but not in substance is not higher than that of companies that do not implement the CG mechanism.*

P2.2b *The performance of companies that implement a CG mechanism introduced by the BCGG-2006 both in form and in substance is higher than that of companies that do not implement the CG mechanism.*

P2.2c *The performance of companies that implement a CG mechanism introduced by the BCGG-2006 both in form and in substance is higher than that of companies that implement the CG mechanism in form but not in substance.*

Discussion related to P2.1 indicates that the motivation for the implementation of the CG mechanisms introduced by the BCGG-2006 varies among privately-owned companies, government-owned companies and subsidiaries of foreign MNCs. Previous research also shows that the effectiveness of a CG mechanism is affected by the ownership and control structure of companies (Bebchuk and Hamdani, 2009; Aguilera et al., 2008; Claessens et al., 2006). More specifically, CG mechanisms which effectively protect the interest of outside investors in a company without a controlling shareholder are often completely ineffective or harmful to protect the interests of outside investors of a company with a controlling shareholder (Bebchuk and Hamdani, 2009; Claessens, 2006). The characteristics of privately-owned companies of Bangladesh indicate that sponsors of companies maintain strong control and these sponsors are reluctant to reduce their control (Uddin and Chowdhury, 2008). This indicates that the CG mechanisms introduced by the BCGG-2006 are not effective in the case of privately-owned companies irrespective of their level of implementation. This suggests the following proposition related to RQ 2.2:

P2.2d *In the case of privately-owned companies in Bangladesh, corporate governance mechanisms introduced by the BCGG-2006 have no impact on firm performance irrespective of the level of implementation.*

In order to investigate above propositions related to RQ2.1 and RQ2.2, survey responses (Section 5.4) and other data sources (Section 5.5) are used. The measurement of variables and the statistical tests used for testing the above propositions are detailed in Sections 5.6 and 5.8 respectively.

4.4 Hypothesis related to RQ3

This section develops hypotheses with respect to RQ3.1, RQ3.2 and RQ3.3. Agency theory suggests that managers use bonding mechanisms so that shareholders perceive managers to be acting efficiently in the interest of shareholders (Morris, 1987). This is because agency costs are ultimately borne by managers as shareholders determine share price after consideration of agency costs (Jensen and Meckling, 1976). Production of accounting reports is an important bonding mechanism (Morris, 1987). Furthermore, prior research finds that shareholders react negatively to the detection of falsified financial statements in both developed and developing countries (e.g., Hribar and Jenkins, 2004 in USA and Firth et al., 2011 in China). This implies that managers of companies in Bangladesh report actual compliance with the BCGG-2006 in annual reports so that investors and creditors can make informed decisions.

In contrast, based on the theory of path dependence of corporate governance (Section 2.2.7.1), it can be argued that firms have limited incentives to actually comply with the provisions of the BCGG-2006. This is because (1) private benefits of control of present controllers are probably high, and (2) relative efficiency in the implementation of the BCGG-2006 is probably low. The high private benefits of control and low relative efficiency result from corporate and institutional characteristics of Bangladesh (Sections 3.4 and 3.5). However, firms in Bangladesh are subject to coercive and normative isomorphism (Section 3.6.1) to comply with the provision of the BCGG-2006. When firms are subject to institutional isomorphism, they often declare implementation of a CG mechanism without actual implementation (Westphal and Zajak, 1998). Coercive and normative isomorphism prevailing in Bangladesh, however, rarely result in incurrence of financial costs in the form of fines and penalties because of poor enforcement behaviour by regulatory agencies and no enforcement power of the IFIs. According to Oliver’s framework

(Section 2.2.7.2), firms adopt avoidance strategy when efficiency is low and legal coercion is moderate. As part of an avoidance strategy, firms often engage in 'window dressing' to conceal their non-conformity (Oliver, 1991, p. 154). Recent research on corporate social responsibility (CSR) in Bangladesh by Belal and Cooper (2011), seems to suggest that firms use 'window dressing' in order to represent themselves as socially responsible. This study reports the opinions of one of the company secretaries:

> We don't have any written equal opportunity policy. But in our job advert we do say that we're an equal opportunity employer (Belal and Cooper, 2011; p. 663).

A logical extension of these findings on CSR to reporting compliance with BCGG-2006 indicates that Bangladeshi companies may report compliance with the majority of the provisions of the BCGG-2006 in annual reports due to pressure from regulators and IFIs without actually complying with the provisions of the BCGG-2006. This study uses survey responses (as mentioned in Section 4.3) to obtain information on the actual level of compliance with the BCGG-2006.

Thus, two competing theories provide opposite predictions on reporting compliance with the BCGG-2006 in annual reports. Hence, the following hypotheses:

H3.1a: *Compliance with the* BCGG-2006 *as reported in annual reports is not higher than compliance with the* BCGG-2006 *as stated in the survey as implied by agency theory.*

H3.1b: *Compliance with the* BCGG-2006 *as reported in annual reports is higher than compliance with the* BCGG-2006 *as stated in the survey as implied by the theory of path dependence.*

A large body of prior literature investigates the association of the CG index with stock price (Gompers et al., 2003; 2010; Bebchuk and Cohen, 2005; Brown and Caylor, 2006; Bebchuk et al., 2009); abnormal returns (Bhagat and Bolton, 2008; Core et al., 1999); and the cost of bank loans (Francis et al., 2012; Ge et al., 2012). An implicit assumption of these studies is that institutional investors and bankers make a relative comparison of firms' governance structures while making their investment and credit decisions. The overstatement of compliance with the BCGG-

2006 increases information asymmetry between the managers of companies and outside investors and bankers and thus, increases agency costs. As the agency costs are ultimately born by managers (Jensen and Meckling, 1976), managers do not overstate compliance with the BCGG-2006 in annual reports to an extent leading to a different ranking of a firm when it is ranked based on compliance as reported in annual reports rather than when the firm is ranked based on compliance as stated in the survey.

However, firms may not actually implement a number of provisions of BCGG-2006 due to reasons of rent protection and relative low efficiency (Section 2.2.7.1). On the other hand, firms may report compliance in annual reports with the majority of the provisions of BCGG-2006, due to coercive and normative isomorphic pressures (Sections 2.2.7.2 and 3.6.1). In that case, the ranking of a firm on the basis of compliance as reported in annual reports will be different from that of the firm based on compliance as stated in the survey.

Thus, two competing theories provide opposite predictions on difference in the rankings of firms based on compliance with the BCGG-2006 as reported in annual reports and as stated in the survey. Hence, the following hypotheses:

H3.2a: *The ranking of a firm for its CG when the rank is assigned based on compliance with the* BCGG-2006 *as reported in annual reports is not different from that of the firm when the rank is assigned based on compliance as stated in the survey as implied by agency theory.*

H3.2b: *The ranking of a firm for its CG when the rank is assigned based on compliance with the* BCGG-2006 *as reported in annual reports is different from that of the firm when the rank is assigned based on compliance as stated in the survey as implied by the theory of path dependence.*

The discussion related to RQ3.1 and RQ3.2 suggests that, as per agency theory, there will be no difference between compliance with the BCGG-2006 as reported in annual reports and compliance with the BCGG-2006 as stated in the survey. Hence, as per agency theory, the nature of provisions of the BCGG-2006 will not affect the extent of overstatement of compliance with the BCGG-2006.

However, the theory of path dependence of corporate governance suggests that one of the reasons for non-compliance with new CG practices *is sunk adaptive costs* (Section 2.2.7.1). This implies that firms cannot easily alter internal management practices. Hence, according to the theory of path dependence, the extent of overstatement of compliance with the BCGG-2006 in annual reports is more pronounced with respect to the provisions of the BCGG-2006 which are less observable by outsiders.

Thus, two competing theories provide different predictions on the association between overstatement of compliance with the BCGG-2006 as reported in annual reports and nature of provisions. Hence, the first set of hypotheses with respect RQ3.3 is:

H3.3a1: *The extent of overstatement of compliance with the BCGG-2006 in annual reports does not differ between the observable and the less observable provisions of the BCGG-2006.*

H3.3a2: *The extent of overstatement of compliance with the BCGG-2006 is higher with respect to the provisions of the BCGG-2006 which are less observable by outsiders.*

Agency theory suggests that family control reduces agency conflict between ownership and control but increases agency conflict between majority and minority shareholders (Section 2.6.1). However, several prior researchers find that family control reduces overall agency conflict both in the USA (Ali et al., 2007) and in countries with weak market and legal institutions (Luo and Chung, 2013; Chen and Nowland, 2010). As a result, the optimal level of CG requirement for family firms is less than for other firms in those countries (Chen and Nowland, 2010). There is also evidence that family controlled-firms perform better than non-family firms (Villalonga and Amit, 2006; Lin and Hu, 2007). The better performance reduces market pressures for compliance with a comply or explain basis CG code (Arcot et al., 2010). Moreover, family firms provide better disclosure due to reputational concerns (Chen et al., 2008). This implies that family firms do not need to report compliance with the BCGG-2006 in annual reports unless they comply with it.

In contrast, controlling sponsor families have the opportunity to extract relatively high private benefits of control in an environment characterised by weak minority investor protection and weak property rights (Claessens and Fan, 2002; Shleifer and Vishny, 1997). Franks and Mayer (2001) use family control as a proxy for the existence of private benefits of control. In order to protect and maximize their private benefits of control, firms controlled by families intentionally maintain a weaker CG structure (Anderson and Reeb, 2004; Chen et al., 2008; Chen and Nowland, 2010). Moreover, *sunk adaptive costs* (Gedajlovic et al., 2004) and *endowment effects* (Gomez-Mejia et al., 2007) are relatively higher in family-controlled firms. On the other hand, family-controlled companies are equally under coercive pressure either to comply or explain non-compliance with the BCGG-2006 in order to maintain their listing status. Furthermore, the pressures from the IFIs, local research organizations funded by the IFIs and regulators do not vary between family and non-family firms. This indicates that family firms report compliance with the BCGG-2006 in annual reports even though they do not comply with it.

Thus, two competing theories provide different predictions on the association between overstatement of compliance with the BCGG-2006 and control by sponsor families. Hence, the second set of testable hypotheses related to RQ3.3 follow:

H3.3b1: *Overstatement of compliance with the BCGG- 2006 as reported in annual reports is negatively associated with family control.*

H3.3b2: *Overstatement of compliance with the BCGG- 2006 as reported in annual reports is positively associated with family control.*

A large body of agency theory-based literature argues that institutional investors, due to their expertise, experience and large ownership stake, have the capacity and incentives to monitor firms' management (e.g., Gillian and Starks, 2003; Donnelly and Mulcahy, 2008). Several prior researchers test this monitoring role of institutional investors by investigating the association between institutional ownership and several outcome variables. These researchers generally hypothesise and find a positive relationship between institutional ownership and outcome variables such as accounting reporting quality (e. g., Ajinkya et al., 2005; Karamanou and Vafeas, 2005; Abraham and Cox, 2007; Solomon and Solomon, 2006), firm performance (Elyasiani and Jia, 2010), executive compensation (Hartzell and Starks,

2003) and debt rating and cost of debt (Roberts and Yuan, 2010 and Bojraj and Sengupta, 2003). More specific to the monitoring of compliance with CG codes, Dedman (2000) and Mizuno (2010) find that the presence of institutional investors increases the level of compliance with CG code.

However, institutional investment organisations are newly introduced in developing countries and own a small percentage of ownership (Hamdani and Yafeh, 2013). Furthermore, institutional characteristics of developing countries such as a weak market and legal institutions create an opportunity for institutional investors to pursue self-interest and anti-competitive policies (Belev, 2003). It is also argued that incumbent financiers in countries with weak market and legal institutions do not play a monitoring role as they want to protect their rent (Rajan and Zingales, 2003). This argument is validated by the infrequent voting of institutional investors against insider-sponsored proposal in Israel (Hamdani and Yafeh, 2013) and lack of association between institutional ownership and firm performance in India (Sarkar and Sarkar, 2000). In the context of Bangladesh, institutional investment organisations are new, own a minimum percentage of ownership, lack professionally trained managers and play a limited monitoring role (see Section 3.4.2). Hence, the theory of path dependence suggests that there will be no impact on control by institutional ownership and overstatement of compliance with the BCGG- 2006.

Thus, two competing theories provide different predictions on the association between overstatement of compliance with the BCGG-2006 and control by institutional ownership. Hence, the third set of testable hypotheses related to RQ3.3 is:

H3.3c1: *Overstatement of compliance with the BCGG- 2006 as reported in annual reports is negatively associated with control by institutional investors.*

H3.3c2: *Overstatement of compliance with the BCGG- 2006 as reported in annual reports is not associated with control by institutional investors.*

In order to investigate the above hypotheses related to RQ3, the survey responses (Section 5.4) and other data sources (Section 5.5) are used. The

measurement of variables and the statistical tests used for testing above hypotheses are detailed in sections 5.7 and 5.9 respectively.

4.5 Summary

To investigate the research questions of this thesis, I develop research sub-questions related to RQ1, propositions related to RQ2 and hypotheses related to RQ3. RQ1 aims to (1) explore the impact of the BCGG-2006 on investment and lending decisions of institutional investors and bankers respectively and (2) derive a theory that explains better the impact of CG on the investment and lending decisions of institutional investors and bankers respectively. With respect to RQ2.1, I developed three propositions to examine the association between type of company and nature of compliance with the BCGG-2006. With respect to RQ2.2, I developed four propositions to investigate the association between nature of compliance with the BCGG-2006 and firm performance. Finally, five hypotheses with respect to RQ3 are developed to investigate whether companies overstate compliance with the BCGG-2006 in annual reports and what factors are associated with this overstatement.

The research methodology and methods associated with the research sub-questions, propositions and hypotheses are introduced and presented in Chapter Five.

Chapter Five

Research Methodology and Methods

5.1 Introduction

In Chapter Four, I developed research sub-questions related to RQ1, propositions related to RQ2 and hypotheses related to RQ3. The aim of this chapter is to present the research methodology and methods used in the investigation.

Section 5.2 presents the research methodology and mixed method. Section 5.3 justifies the use of semi-structured interviews for RQ1, describes interviewee selection, interview design and procedures, research ethics and analysis of interview data. Section 5.4 justifies the use of a survey, explains the administration of the survey and reports results of response bias tests. Section 5.5 presents sources of other data used to investigate RQ2 and RQ3. Sections 5.6 and 5.7 describe the measurement of variables required to test propositions related to RQ2 and hypotheses related to RQ3 respectively. Sections 5.8 and 5.9 present the statistical tests used for testing propositions related to RQ2 and hypotheses related to RQ3 respectively. Section 5.10 summarises.

5.2 Research methodology and mixed method

This study uses an inductive approach to investigate RQ1 and a deductive approach to investigate RQ2 and RQ3. A qualitative method (in the form of semi-structured interviews) is used to - collect the data required to investigate RQ1. A quantitative method (in the form of a questionnaire survey, annual reports and trading data) is used to collect the data required to investigate RQ2 and RQ3. This study takes the view that the nature of the research questions is the most important determinant of research methods (Punch, 2005; Mason, 2002; Abernethy et al., 1999) and uses mixed methods to investigate the accomplishment of the BCGG-2006 by (1) interviewing institutional investors and bankers, as these two groups are the main beneficiary stakeholders who interact with the companies and thus, know about the

level of effectiveness of the BCGG-2006; and (2) surveying company secretaries or CFOs directly[11]. Table 5.1 summarises the research questions and research methods.

Table 5.1: Research questions and respective methods

RQs	Research Method(s)
RQ1. Do institutional investors and bankers perceive that the level of compliance with the BCGG-2006 by the investee or borrowing company positively influences the investment and lending decisions respectively in Bangladesh?	Interviews with seven institutional investors (four investment managers of mutual funds and three investment managers of life insurance companies) and 21 bank credit analysts (17 corporate credit analysts of banks and 4 corporate credit analysts of credit rating agencies) (see table 5.2 for detail).
RQ2.1. To what extent is the BCGG-2006 implemented in form rather than in substance? RQ2.2 Is there a relationship between the nature of compliance and firm performance?	Surveys of 91 company secretaries or CFOs; annual reports of companies and trading data from the DSE (see section 5.4 and 5.5 for detail).
RQ3.1. To what extent does reported compliance with the BCGG-2006, as reported in annual reports, overstate underlying compliance with the BCGG-2006? RQ3.2 Does the overstatement lead to a different relative ranking of a firms' corporate governance? RQ3.3 What factors influence overstatement of compliance with the BCGG-2006 in annual reports?	Surveys of 91 company secretaries or CFOs; annual reports of companies and trading data from the DSE (see section 5.4 and 5.5 for detail).

Mixed methods research, combining qualitative and quantitative approaches, has been extensively used in accounting (e.g., Anderson and Widener, 2007; Lillis and Mundy, 2005; Modell, 2005) and CG literature (e.g., Mengoli et al, 2009; Wanyama et al., 2009; Hooghiemstra and van Manen, 2004; Westphal and Khanna, 2003). Social science scholars (e.g., Denzin, 1978; Jick, 1979), who initially advocate mixed methods, define mixed methods as combining multiple theories, methods and data sources with an objective to improve the validity of research findings. Mixed methods can reduce bias by capitalising on the strengths of multiple theories, methods and data sources while avoiding the accumulation of weaknesses (e.g., Punch, 2005; Jick, 1979). Recent scholars extend this initial idea and argue that mixed methods offer (1) increased validity or credibility and low known bias through

[11] Jick (1979) states that one way to use mixed methods is to (1) ask the person directly and (2) ask someone who interacts with the person about the research issue.

triangulation; (2) a more comprehensive understanding of a research issue from multiple perspectives and lenses; (3) a more insightful understanding of a research issue with new ideas, creative concepts and meanings; and (4) understanding of a research issue while acknowledging diversity of values (Greene et al., 2005). As such, mixed methods research bridges the traditional dichotomous ontological and epistemological divide (functionalist vs. interpretivist) and can be based on critical realism (Modell, 2010). Critical realism, instead of accepting naïve realism, assumes that partly mind-independent reality exists but this reality cannot be observed and explained without using a theoretical lense (Modell, 2009). Critical realism, thus, differs from social constructionsm because social constructionists argue against the notion of the existence of partly mind-independent reality (Houston, 2001).

5.3 Semi-structured interviews

Semi-structured interviews are the most frequently used qualitative method in CG research. Prior CG researchers have used semi-structured interviews in order to understand: (1) the roles played by a particular CG mechanism (e.g., Beasley et al., 2009; Turley and Zaman, 2007; Robert et al., 2005; Spira, 1998; 1999); and (2) how outsiders perceive the effectiveness of a particular CG mechanism (e.g., Cohen et al., 2007; 2010a). One reason may be that the use of observation is more difficult in the case of CG (e.g, access to board and audit committee meeting is extremely difficult). Another reason may be that the use of documentation that describes the conduct of a CG mechanism is not adequate to understand the roles of a CG mechanism. Furthermore, documents (e.g., minutes of board meeting) that describe the conduct of a CG mechanism are often confidential.

This thesis uses semi-structured interviews to collect data to answer RQ1. A semi-structured interview method is appropriate to investigate a focused topic (Rubin and Rubin, 1995, p.5) and perceptions of people (Mason, 2002, p. 63). The BCGG-2006 is a focused topic and this thesis intends to understand the perception of institutional investors and bankers about any direct or indirect impact of the CG structure of the investee or borrowing company. Moreover, a semi-structured interview method enables the researcher to adopt an 'extremely versatile approach' (Rubin and Rubin, 1995, p.3) and thus, to investigate an issue in more depth by

asking further questions (Marginson, 2004). This study takes an 'open-system' approach (Sections 2.5.3 and 4.2) to capture the influence of contextual factors on the impact of CG on investment and lending decisions. Alternative qualitative methods could be direct observation of the investment and lending decision making processes and analysis of the investment and lending decision manuals of institutional investors and banks respectively. However, direct observation of investment and lending decision making processes is not feasible as investment and lending decisions involve different levels of management and the decision making process is confidential. Similarly, the investment and lending decision manuals of institutional investors and banks respectively are not accessible due to confidentiality.

5.3.1 Selection and composition of interviewees

This study initially planned to interview investment managers of mutual fund and life insurance companies and corporate credit analysts of banks but was extended, as explained later in this section, to credit rating agencies. The researcher chose investment managers of mutual funds and life insurance companies because institutional investors are more sophisticated in terms of expertise and knowledge than individual investors and have incentives to collect and process information about their investee companies (e.g. Hand, 1990; Chan and Lakonishok, 1995; Walther, 1997; Sias et al., 2006). The researcher planned to interview corporate credit rating analysts of banks because bankers have first-hand knowledge about the firms' internal governance structure due to their better access to private information and superior information processing capabilities (Armstrong et al. 2010). Moreover, in developing countries like Bangladesh, banks are the main financial intermediaries to mobilise resources due to the small size and minimum role of stock markets (The Aries Group Ltd, 2012; cf Singh and Zammit, 2006).

In Bangladesh, there are different types of mutual fund companies, life insurance companies and banks (Table 5.2). This study initially planned to select interviewees with the objective to cover a wide range (Miles and Huberman, 1994, p. 28) of mutual fund management companies, life insurance companies and banks as representative of institutional investors and creditors. Two issues arose while

conducting interviews: (1) it was found very difficult to apply the maximum variety method given the poor research orientation among people in a developing country, Bangladesh and, (2) several corporate credit analysts of banks recommended interviewing the corporate credit rating analysts of credit rating agencies. Hence, corporate credit rating analysts of credit rating agencies are included in the target interviewees. The inclusion of new informants during data collection is legitimate in qualitative research (Eisenhardt, 1989b, p. 539). Due to the difficulty regarding access to interviewees, the personal network of the researcher was used and a total of 28 semi-structured interviews were finally conducted. Although the use of the personal network of the researcher indicates snow-balling sampling (Miles and Huberman, 1994, p. 28), there is still sufficient variety in terms of classification and sub-classification of organisations as indicated in Table 5.2.

Table 5.2: Summary of Interviewees

Classification of organisations	Sub-classification of organisation	Number of organisations in Bangladesh	Number of interviewee organisations
Banks by ownership	Local - Nationalised	4	1
	Local - Specialised	4	Nil
	Local - Private	30	12
	Foreign	9	3
	Sub-total	**47**	**17**
Banks by nature of operation	Traditional	36	15
	Islamic	7	2
	Specialised	4	Nil
	Sub-total	**47**	**17**
Credit Rating Agencies (All traditional)	**Local**	**5**	**4**
Mutual fund management companies (All traditional)	Local	5	3
	Foreign	1	1
	Sub-total	**6**	**4**
Life Insurance companies (all local)	Traditional	7	2
	Islamic	3	1
	Sub-total	**10**	**3**
Total		**61**	**28**

Consequently, this study makes no claim that interviewees represent institutional investors and bankers of Bangladesh as a whole in a statistical sense. It does, however, claim that the interviewees in this study have sound knowledge and extensive experience about investment and lending decision processes and the CG practices of their investee or borrowing companies. The qualifications and experience of interviewees are detailed in Appendix 5.1.

5.3.2 Interview instruments and data collection

I prepared and used three instruments to conduct the interviews: an introductory letter, a set of mini-research questions using the 'tree and branch' approach of Rubin and Rubin (1995, pp. 159-160) and a semi-structured interview card based on Mason (2002, p. 71). The introductory letter [see Appendix 5.2] described the main objective of this thesis and five broad questions to be asked (Rubin and Rubin, 1995, p. 146), promises of confidentiality by ensuring the anonymity of the interviewee and his organisation (Rubin and Rubin, 1995, p. 96) and offers of flexibility to amend any part of the interview transcripts through email (Annisette and Trivedi, 2013).

The ***semi-structured interview card*** is shown in Appendix 5.3. Before every interview, I read the mini-research questions and interview card. I also carried a copy of the mini-research questions and interview card with me during the interview so that I could maintain the sequence of relevant questions and cover all the relevant facts.

At the start of the interview, I thanked the interviewee for participating in the study. I set '*the interview stage'* (Kvale, 1996) by explaining the research topic and reaffirming the confidentiality and anonymity of the interviewee and his organisation. The interviewees were already acquainted with these as I sent the introductory letter beforehand by email. After this explanation, I requested the interviewee to sign the consent form and sought permission to tape-record the interview.

I started with a very broad general question about the assessment of board performance and accounting quality of a prospective investee or borrowing company and then attempted to narrow down the discussion to different aspects of governance as outlined in BCGG-2006. Drawing on Rubin and Rubin (1995, p. 148), I use '*attention probes'* such as '*can I quote you on that?'*, *continuation probes* such as *ritualistic*? *dummy….directors*?', and *clarification probes* such as *'can you clarify?'*. In respect of follow-up questions (Rubin and Rubin, 1995, p. 150), most of the questions were 'why questions' (e.g. *why do you think that? What leads you to perceive that?*) because interviewees' responses contradict the prior agency theory-based literature (see Section 2.5) that I reviewed in developing interview questions.

An electronic audio device was used to record the interview as the main interest of the researcher is in the content of interviews (Kvale, 1996, p. 161). However, 17 interviewees did not approve recording of their interview. The use of digital-recorder has both advantage and disadvantages. There is a risk that use of a tape-recorder prevents interviewees from disclosing some data (Rubin and Rubin, 1995, pp. 125-128). A detailed note of the conversation was taken for these 17 interviewees. The recorded audiotape was transcribed verbatim on the same day as the interview (Kvale, 1996; p. 170). The detailed note taken for interviews that were not audio-taped was also revised within 24 hours (Ryan et al., 2002, pp. 155-156). The interview transcripts and revised notes were sent to the interviewees by email (Bédard and Gendron, 2004, p. 199). None of the interviewees urged modification of any part of the transcripts and revised notes. The findings of one interview were incorporated in the design of the interview card for the next (Bédard and Gendron, 2004, p. 199) which helped the researcher improve interviewe responses from one interview to the next. This improvement is also evident in the transcripts. However, questions related to CG mechanisms recommended by the BCGG-2006 were asked of all interviewees.

5.3.3 Ethical issues

The interviews were conducted in compliance with *Level 1 and 2 Research Ethics Guidelines of the University of Edinburgh Business School*. Details of the research ethics applied while conducting interviewees is described in Appendix 5.4.

The data collected were securely held on the personal laptop of the researcher, with password protection. Only the researcher has access to the laptop. It is also assured that the data will be destroyed after completion of the PhD and any subsequent publications.

5.3.4 Analysis of interview data

This study analysed interview data in two main stages. Following Pratt (2008), for some part of the interview data, the analysis numerically counts the frequency of a certain type of responses as detailed in Stage 1 below. When generating theoretical explanation of the findings of Stage 1 analysis, the analysis

used grounded theory methodology based on Pratt et al. (2006) and subsequently used by Mair et al. (2012). This part of analysis method is described in Stage 2 below. This research applies grounded theory methods only for data analysis (cf. Efferin and Hopper, 2007). It does not pursue a full grounded theory study and does not intend to produce a comprehensive theory.

Stage 1: Assessing the direct or indirect impact of CG mechanisms on investment and lending decisions of institutional investors and bankers respectively. In this stage, RQ1.1a and RQ1.1b are used as a lens (Eisenhardt, 1989b). RQ1.1a and RQ1.1b are oriented to enquire whether CG mechanisms recommended by the BCGG-2006 have any impact on lending and investment decisions. The response of each interviewee with respect to a particular CG mechanism (e.g., independent director) was considered as a unit of analysis (Krippendorff, 2004, p. 86). For each response, the interviewee was coded as (1) '*perceives no impact*' (2) '*perceives an impact*' and (3) '*perceived impact depends on context'*. Very few responses are classified as '*perceived impact depends on context'*.

I read through every sentence of responses related to a particular CG mechanism and identified the reasons for '*perceives no impact*', '*perceives an impact*' and '*impact depends on context'.* I then counted the number of interviewees who provide identical reasons and grouped them together. This method draws on Pratt (2008).

One challenge at this stage of data analysis was that a few interviewees initially indicated a positive impact of a CG mechanism but, while providing an explanation regarding the practice of that CG mechanism, the nature of their comment pointed to the ineffectiveness of that CG mechanism. As an instance, CRA-2 responded positively on the impact of the audit committee on his credit rating decisions. However, when he commented on the structure of the audit committee, he provided the following comment:

In a good number of instances we have found that he is the chairman of board, he is the chairman of the executive committee and he is the chairman of the audit committee. So, in that case this becomes superfluous. Since the board, the executive committee and the audit committee are represented by him, it is very

natural what is appropriate for the executive committee, is also appropriate for the audit committee and the board. This is a conflict of interest (CRA - 2).

I classified this kind of response as '*perceives an impact*', based on initial response, on the grounds that it more closely represented the perception of the respondent on the impact of CG mechanisms on his decisions. There were two cases with respect to audit committee and 21 cases with respect to CFO.

The results of Stage 1 analysis are reported in Chapter Six, Section 6.2. The analysis suggests that the ineffectiveness of CG mechanisms, together with the traditional characteristics of investment and lending practices, have direct relevance to the limited impact of CG mechanisms on the decisions of interviewees. Keeping these Stage 1 findings in mind, the method for data analysis for RQ1.2 was developed as explained in Stage 2.

Stage 2: Identifying institutional characteristics leading to the ineffectiveness of CG mechanisms and traditional characteristics of investment and lending practices leading to non-consideration of CG mechanisms. In this stage, an iterative approach of travelling back and forth between interview data, relevant literature and CG theories (Section 2.2) is used to derive a theoretical explanation for the limited impact of CG mechanisms on investment and lending decisions. This method is based on strategies for generating theory from qualitative data as suggested by Strauss and Corbin (1998), Miles and Huberman (1984) and Eisenhardt (1989b).

Stage 2 analysis consists of three steps (Pratt et al., 2006; Mair et al., 2012). In the first step, the analysis identified relevant reasons reported by interviewees to explain why they perceived that the BCGG-2006 was not effectively implemented. I used open coding (Locke, 2001). These reasons include institutions that have been identified in prior comparative CG research (Aguilera et al., 2008; Paredes, 2004; Doidge et al., 2007; Claessens and Yurtoglu, 2013; Klapper and Love, 2004; Pistor et al., 2000) and individual non-Anglo-American country specific CG research (Krambia-Kapardis and Psaros, 2006; Wanyama et al., 2009; dela Rama, 2012). The analysis also identified new issues such as company specific characteristics.

A similar coding procedure was used to elaborate on characteristics of lending practices identified by credit analysts of banks in the Stage 1 analysis and to

identify its relevant constructs. As institutional investors less clearly mentioned that investment practices deter consideration of CG mechanisms, a search was made of whether the traditional characteristics mentioned by bankers were also directly or indirectly mentioned by investment managers of mutual fund companies and life insurance companies. For instance, a number of credit analysts of banks mentioned that they value their past relationship with a borrower company so much that they ignored formal appraisal of a subsequent loan proposal. A search was made in the transcripts of institutional investors to discover whether they also mentioned anything about the impact of the relationship on their investment decisions. This approach is based on Miles and Huberman's (1994, p. 249) recommendations for detecting similarities across interviewees. Interview transcripts were revisited twice to identify fit or misfit of data with the categories identified. Data that misfit with a category was abandoned or included in a revised category. For example, two separate codes were used for (1) the undue influence of bank directors on lending decisions and (2) the potential reduction in banks' profitability due to consideration of CG mechanisms. These two codes were collectively categorised as profit-seeking behaviour of banks. However, after reviewing the theory of path dependence (Bebcuck and Roe, 1999), it became evident that these two open codes implied two theoretical concepts namely (1) rent seeking behaviour of banks and (2) peer pressure not to consider CG mechanisms. Accordingly, the two initial codes were renamed according to the theoretical labels offered by the theory of path dependence.

In the second step of this stage, the first-order codes identified as reasons for the ineffective implementation of the BCGG-2006 were grouped into themes to relate with a CG theory. The first-order codes suggested that data fit better with Bebcuck and Roe's (1999) theory of path dependence for corporate governance. Hence, first-order codes were grouped into themes that Bebcuck and Roe (1999) suggest as reasons for path dependence. For instance, individual-centred management and the small size of companies were grouped into *high-sunk adaptive costs*. This is because these two items indicate that companies develop an internal management system aligned with size which hampers effective implementation of the BCGG-2006. A similar procedure is used to group first-order codes related to characteristics of investment and lending practices.

In the third step, the interrelationship between first-order codes is examined with the objective to understand how different themes related to ineffective implementation of the BCGG-2006 fit together, leading to persistence of sponsor-family aligned board and individual-centred management and ultimately making sponsor families reluctant to implement the BCGG-2006 effectively. Using an identical procedure, an attempt was made to understand how themes related to investment and lending practices indicated persistence of name-based and relationship-based investment and lending practices and thus, made institutional investors and bankers reluctant to consider compliance with the BCGG-2006. In this case, I was not able to use all the themes of Bebcuck and Roe (1999) due to insufficient evidence being available. For example, two interviewees mentioned that multiple optima exist between transaction-based and relationship-based investment and lending practices and thus, multiple optima theme is not used in case of explaining persistence of name-based and relationship-based investment. The results of Stage 2 analysis are reported in Chapter Six, Sections 6.3 to 6.5.

5.4 Survey

5.4.1 Survey design

A self-explanatory questionnaire survey was designed to collect detailed data on compliance with the provisions of the BCGG-2006, family relationship among directors, the composition of boards of directors and the ownership structure of the company. With respect to compliance with the BCGG-2006, the questionnaire emphasises detailed structural attributes of CG mechanisms recommended by the BCGG-2006. These structural attributes were selected based on international best practice recommendations and prior research on a particular CG mechanism. For example, with respect to the audit committee, the questions were designed to collect data on the size and composition of the audit committee; the background of the audit committee chairman and members; frequency and duration of audit committee meetings both internal and with external directors; and reporting on the audit committee activities etc. The questionnaire included both open and closed questions. The introductory letter of the survey described the purpose of the survey (Diamond, 2000), promised confidentiality by ensuring anonymity of the respondent and his

organisation (Van der Stede et al., 2005) and provided an assurance that the outcome of this research will not be published in Bangladesh [see Appendix 5.5]. The questionnaire was pre-tested in person with two company secretaries of local privately-owned companies. Based on the feedback of the pre-test, I deleted all questions related to internal board process, remuneration committees and nomination committees because these questions are not applicable to Bangladesh yet.

5.4.2 Survey administration and response bias test

The sample for this study consists of 91 non-financial companies that responded to a survey conducted during January – March, 2012. The survey was addressed to company secretaries. The names of the company secretaries and the addresses of headquarters of companies were retrieved[12] from Central Depository Bangladesh Limited on 31 December 2011. The survey was mailed to the company secretaries of 136 non-financial companies, all non-financial listed companies on the Dhaka Stock Exchange, Bangladesh on 31 December 2011. The survey was not sent to banks and financial institutions because they are subject to different governance rules from the central bank and other regulatory authorities.

Within one month of the survey being sent, 21 firms responded to the survey. Due to the initial low response rate, I visited companies whose registered offices were situated in Dhaka and personally persuaded the company secretaries or CFOs to take part in the survey in a structured interview manner. I often used my alumni connections to reach the respondents. This method of data collection provides additional confidence that the survey results represent better the underlying compliance with the BCGG-2006. In total, I ended up with 91 usable responses, a response rate of 66.91%. In order to test for response bias, distribution of responders is compared with that of population on the basis of industry sectors, market capitalization and total assets (Wallace and Mellor, 1988).

[12] http://www.cdbl.com.bd/issuer_details.php

Table 5.3: An analysis of respondent firms by industry sector, market capitalisation and total assets

	Population[b]		Sample[c]	
	n	**Percentage**	**n**	**Percentage**
(a) Industry sector[a]				
Cement	6	4.41	4	4.40
Ceramics	5	3.68	5	5.49
Enginnering	22	16.18	13	14.29
Food	16	11.76	9	9.89
Fuel and Power	13	9.56	9	9.89
IT	5	3.68	3	3.30
Jute	3	2.21	2	2.20
Miscellaneous	9	6.62	5	5.49
Paper and Printing	1	0.73	0	0.00
Pharmaceuticals	20	14.71	16	17.57
Services and Real Estate	4	2.94	3	3.30
Tannery	5	3.68	4	4.40
Telecommunications	1	0.73	1	1.10
Textile	25	18.38	17	18.68
Travel and Leisure	1	0.73	0	0.00
Total	**136**	**100.00**	**91**	**100.00**
(b) Market capitalisation[a]				
First Quartile	38	27.94	18	19.78
Second Quartile	35	25.74	21	23.08
Third Quartile	33	24.26	27	29.67
Fourth Quartile	30	22.06	25	27.47
Total	**136**	**100.00**	**91**	**100.00**
Test results	**$\chi2 = 2.89$; p = 0.409**			
(c) Total Assets[a]				
First Quartile	38	27.94	17	18.68
Second Quartile	35	25.74	23	25.28
Third Quartile	32	23.53	25	27.47
Fourth Quartile	31	22.79	26	28.57
Total	**136**	**100.00**	**91**	**100.00**
Test results	**$\chi2 = 2.99$; p = 0.392**			

[a]Chi-squre tests of significant difference between population and sample based on market capitalization group ($\chi2$=2.89; p=0.409) and total assets group ($\chi2$=2.99; p=0.392) are not rejected.
[b]Population consists of 136 non-financial companies listed on Dhaka Stock Exchange, Bangladesh on 31 December, 2011.
[c]Sample consists of 91 companies that responds the survey conducted in January – March, 2012.

Table 5.3 presents the results of the analysis. As shown in Table 5.3, there is no significant difference in the distribution of firms in each category of industry[13], market capitalisation and total assets between the population and the sample of this study. Hence, the sample of this study represents the population and the risk arising from non-response bias is minimal.

5.5 Other data

In order to answer RQ2.2, data on market-based and accounting-based performance measures are required. Data required for the calculation of market-based performance measures (Tobin's Q and stock returns) were collected from the Dhaka Stock Exchange, Bangladesh in a CD which contains trading and dividend data from 1991 to 2011. Data required for the calculation of accounting-based performance measures (ROA and ROE) were retrieved from Annual reports. Annual reports for all non-financial companies listed on the Dhaka Stock Exchange on 31 December 2011 were primarily collected from the library of the Bangladesh Securities and Exchange Commission (BSEC). Any annual report which was not available in the library of the BSEC was collected from the library of the Dhaka Stock Exchange (DSE). Annual reports for accounting years ending 2011 were used to retrieve financial data required for investigating RQ3.3. Compliance checklists included in annual reports for accounting years ending 2011 were used to measure reported compliance with the BCGG-2006.

5.6 Measurement of variables related to RQ 2

5.6.1 Classification of companies based on nature of compliance with the provisions of the BCGG-2006

In order to test propositions related to RQ2.1 and RQ2.2, I need to classify privately-owned, government-owned and subsidiaries of foreign MNCs into three sub-groups: (1) companies that do not comply, (b) companies that 'comply in form but not in substance', and (3) companies that 'comply in form and in substance'. In

[13] I cannot perform a Chi-Square test of difference between population and sample based on industry because of few observations in several cells but from inspection, it is evident that there is no material difference between population and sample based on industry.

the next sub-sections, I detail the classification of companies into above three sub-groups based on nature of compliance with five corporate governance mechanisms as recommended by the BCGG-2006: separation of chairman and CEO, board independence, audit committee, Chief Financial Officer (CFO) and head of internal auditor (HIA).

5.6.1.1 Separation of Chairman and CEO

A company is classified as 'do not comply' with respect to separation of chairman and CEO of the company if CEO duality exists. Using the argument of Lou and Chung (2013; Section 2.6.4.1), a company is classified as (1) 'comply in form but not in substance' with respect to separation of chairman and CEO of the company if both the chairman and the CEO are members of a sponsor family or sponsor shareholder directors from different families and (2) 'comply in form and in substance' with respect to separation of chairman and CEO of the company if either the CEO of the company is a non-shareholder executive director or the chairman the company is not a sponsor shareholder director.

5.6.1.2 Board independence

A company is classified as 'do not comply' with respect to board independence if the company does not appoint at least 10 per cent of board membership as independent director subject to a minimum of one (Section 3.6.2.1). A company is classified as 'comply in form but not in substance' with respect to board independence if the company appoints at least 10 per cent of board membership subject to a minimum of one independent director on the board and the appointed independent director (1) is a shareholder and was shareholder director before the introduction of the BCGG-2006; (2) is a current or previous employee of the company; (3) is a relative or descendent by birth or marriage of a member of the controlling family or CEO; (4) is a friend or previous colleague of a member of the controlling family or CEO; (5) jointly owns a partnership or a private limited company with a member of the controlling family or CEO; (6) holds a board position in another public limited company with a member of the controlling family or CEO; or (7) a professional who provides professional services to the company or other

business controlled by a member of the controlling family or the CEO (Sections 2.6.4.2 and 3.6.2.1). A company is classified as 'comply in form and in substance' with respect to board independence if the independent director (1) is a representative of institutional shareholders but is not nominated director at present or (2) has no relationship with the controlling family or CEO.

5.6.1.3 Audit committee

A company is classified as 'do not comply' with audit committee if the company does not appoint an audit committee. In order to classify the companies that have an audit committee into 'comply in form but not in substance' or 'comply in form and in substance', I select 16 criteria of audit committee that indicates effectiveness of the audit committee according to prior literature (Section 2.6.4.3) and best practice recommendations. Following Abbott et al. (2004), I use binary coding to calculate the total score for an audit committee of a company. These criteria and the binary coding procedure are detailed in Table 5.4.

Based on criteria as presented in Table 5.4, an audit committee is assigned a score of minimum 0 and maximum 16. If the score of a company is less than or equal to eight, the company is classified as 'comply in form but not in substance'. If the score of a company is greater than eight, the company is classified as 'comply in form and in substance' with the audit committee requirement.

The BCGG-2006 does not clarify the meaning of expertise in accounting and finance. This study, thus, follows BRC (1999), Abbott et al. (2004) and Bédard et al. (2004) to define expertise in accounting and finance and regards an audit committee chairman or member as an expert in accounting or finance if he or she has either a professional qualification in accounting such as FCA, FCMA a PhD in accounting or has held senior management position (e.g. Chairman and CEO) with another public limited company or financial institution but has not held that position because of his/her shareholding. Finally, I regard an audit committee chairman or member as financially literate if he or she has at least an undergraduate degree in business; or is an expert in accounting and finance as per the above definition of accounting or finance expert.

Table 5.4: Method for classification of companies based the nature on compliance with audit committee

Audit committee characteristics	Method of scoring
Chairman of Board or CEO sits on the audit committee (BRC, 1999; Smith, 2003)	The Chairman of Board or CEO does not sit on the audit committee =1; otherwise 0.
Sponsor family members on audit committee (Jaggi and Leung, 2007; Jaggi et al., 2009)	The number of sponsor family member on audit committee is less than 2 =1; otherwise 0.
Sponsor shareholder directors on audit committee (Jaggi et al., 2009; Klein, 2002)	Number of sponsor shareholder directors on audit committee is less than 2 = 1; otherwise = 0.
CFO is a member of audit committee (BRC, 1999)	CFO is not a member of audit committee = 1; otherwise 0.
Audit committee has at least one independent director (The BCGG-2006; Klein, 2002)	Audit committee has at least one independent director = 1; otherwise 0.
Qualification of audit committee chair (The BCGG-2006; Bédard et al., 2004; Carcello et al., 2006)	Audit committee chair has qualification in accounting and finance = 1; otherwise 0.
At least one member of the audit committee is financially expert (Bédard et al., 2004; Carcello et al., 2006; BRC, 1999)	At least one member of the audit committee is financially expert =1; otherwise 0.
Financial literacy of audit committee members (Ghosh et al., 2010; Krishnan and Visvanathan, 2008; BRC, 1999)	At least two members of audit committee are finally literate = 1; otherwise 0.
Independence of audit committee chairman (BRC, 1999; Bédard et al., 2004)	Audit committee chairman is an independent director = 1; otherwise 0.
Reporting of audit committee activities to board of directors (BRC, 1999)	Audit committee reports its activities to board of directors = 1; otherwise 0.
Reporting of audit committee activities to shareholders (BRC, 1999)	Audit committee reports its activities to the shareholders = 1; otherwise 0.
Audit committee written charter (BRC, 1999; Bédard et al., 2004; Abbott et al., 2004)	Audit committee has a written charter = 1; otherwise 0.
Number of audit committee meeting (Abbott et al., 2004; Farber. 2005)	Audit committee convenes 4 or more meeting = 1; otherwise 0.
No. of audit committee members (The BCGG-2006; Beasley and Salterio, 2001)	Audit committee has more than 3 members = 1; otherwise 0.
Average number of audit committee members present in meeting (Zain and Subramaniam, 2007)	On average more than or equal to 3 members of the audit committee present in meeting =1; otherwise 0.
Audit committee meeting with external auditors (BRC, 1999; Cohen et al., 2007)	Audit committee meets with external auditors at least two times during the year = 1; otherwise 0.

5.6.1.4 Chief financial officer (CFO)

A company is classified as ‘do not comply’ with provisions related to CFO if the company does not appoint a CFO. In order to classify the companies that have appointed a CFO into ‘comply in form but not in substance’ or ‘comply in form and in substance’, I selected 4 criteria of the CFO that indicates effectiveness of CFO according to prior literature (Section 2.6.4.4) and the BCGG-2006. Using binary coding, every CFO is scored on a four point scale. These criteria and the binary coding procedure are detailed in Table 5.5.

Table 5.5: Method for classification of companies based the nature on compliance with CFO

CFO characteristics	Method of scoring
CFO qualification (Aier et al., 2005; Li et al., 2010)	CFO is a professional accountant = 1; otherwise 0.
CFO attends board meeting (The BCGG-2006)	CFO attends board meeting = 1; otherwise 0.
CFO is a member of board of directors (Bedard et al., 2011)	CFO is a member of board of directors = 1; otherwise 0.
Experience of CFO (Brochet and Welch, 2011)	CFO has experience more than the average level of experience of CFO in sample firms = 1; otherwise 0.

The score assigned based on criteria mentioned in Table 5.5 is then used to classify firms that appoint CFO into two groups: (1) comply in form but not in substance - firms that have a CFO score at best two, and (2) comply in form and in substance – firms with CFO score greater than two.

5.6.1.5 Head of Internal Audit (HIA)

A company is classified as 'do not comply' with provisions related to HIA if the company does not appoint a HIA. In order to classify the companies that have appointed a HIA into 'comply in form but not in substance' or 'comply in form and in substance', I selected 4 criteria of HIA that indicates effectiveness of HIA according to prior literature on HIA (Section 2.6.4.5) and the BCGG-2006 (Section 3.6.2.3). Using binary coding, every HIA is scored on a four point scale. These criteria and binary coding procedure are detailed in Table 5.6.

Table 5.6: Method for classification of companies based the nature on compliance with HIA

HIA characteristics	Method of scoring
HIA qualification (Prawitt et al., 2009)	HIA is a professional accountant = 1; otherwise 0.
Appointment authority of HIA (Christopher et al., 2009)	Board of directors/chairman of board/ audit committee is the appointing authority of HIA = 1; otherwise 0.
Reporting authority of (Christopher et al., 2009)	HIA report to board of directors, audit committee or CEO = 1; otherwise 0.
Experience of HIA (Griffiths, 1999)	HIA has experience more than the average level of experience of CFO in sample firms = 1; otherwise 0.

The score assigned based on criteria mentioned in Table 5.6 is then used to classify firms that appoint HIA into two groups: (1) comply in form but not in substance - firms that have a HIA score at best two, and (2) comply in form and in substance – firms with HIA score greater than two.

5.6.2 Measurement of firm performance

Prior research that investigates the association between CG and firm performance uses a range of market-based [e.g., Tobin's Q (La Porta et al., 2002; Gompers et al., 2003; Bebchuk et al., 2009; Bebchuk et al., 2013), stock return (Bhagat and Bolton, 2008; Core et al., 1999)] and accounting-based [e.g., ROA (Bebchuk et al., 2013; Epps and Cereola, 2008; Daines et al., 2010), sales growth (Bebchuk et al., 2013), net profit margin (Bebchuk et al., 2013) and ROE (Epps and Cereola, 2008)] performance measures. Both market-based and accounting-based performance measures suffer from a number of limitations. Accounting-based performance measures are (1) subject to manipulation by management; (2) affected by choice of accounting policies such as revenue and expenditure recognition, depreciation and impairment, inventory valuation, and consolidation method (Chakravarthy, 1986). Similarly, market-based performance measures are influenced by a number of forces which are beyond the control of management (Hambrick and Finkelstein, 1995; Dutta and Reichelstein, 2005).

This study measures firm performance according to four alternatives. These alternatives include two market-based performance measures – Tobin's Q and stock returns, and two accounting-based performance measures - ROA and ROE.

Following the definition of Tobin's Q provided by Kaplan and Zingales (1997), this study calculates Tobin's Q as the ratio between the market capitalization of equity plus book value of preference shares plus book value of long-term debt, and the book value of total assets of a firm. This definition is subsequently used by Gompers et al. (2003; 2010), Bebchuk and Cohen (2005), Brown and Caylor (2006), Bebchuk et al. (2009; 2013). Annual stock return is calculated following Bhagat and Bolton, (2008) as the ratio between the market value of equity at the end of the fiscal year plus dividend minus market value of equity at the beginning of the fiscal year, and the market value of equity at the beginning of the fiscal year. ROA is calculated based on Epps and Cereola (2008) as the ratio between operating income and average total assets. ROE is also calculated based on Epps and Cereola (2008) as the ratio between income before extraordinary items available for common equity dividend and the sum of the book value of equity and deferred taxes.

An average of five annual measures for each of the four performance measures from 2007 – 2011 inclusive is used. This is because the BCGG-2006 was adopted in 2006 and the survey was conducted at the beginning of 2012. Annual data is used because data, especially accounting data, are available on an annual basis only.

5.7 Measurement of variables related to RQ3

5.7.1 Measurement of variables for H3.1a and H3.1b

In order to test H3.1a and H3.1b (Section 4.4), two measures of compliance [one for compliance as reported in annual reports (CG_AR) and one for compliance as stated in the survey (CG_SR)] with the BCGG-2006 for each company are required. The CG_AR and CG_SR are measured using compliance with 20 important easily comparable provisions of the BCGG-2006. These 20 provisions include five related to the board of directors, nine related to the audit committee and six related to the CFO, HIA, external auditors and non-audit services. Compliance with each of these 20 provisions is coded by a binary indicator [1 for compliance and 0 for non-compliance] separately for compliance as reported in annual reports and as stated in the survey by each company. The value of binary indicators are added together to derive company-specific values of CG_AR and CG_SR. This method of measuring corporate governance is regarded as the equally weighted summation method in the CG literature (Brown et al., 2011). Consequently, the theoretical minimum and maximum value of both CG_AR and CG_SR are 0 and 20 respectively.

The measurement of a CG index by using the equally weighted summation method was pioneered by Gompers et al. (2003) and has been extensively used by subsequent researchers (see, e.g., Ammann et al., 2011; Bebchuk et al., 2009; Cremers and Nair, 2005; Brown and Caylor, 2006). Alternative methods used for measuring a corporate governance index are: assigning unequal weights for different mechanisms depending on the importance of the mechanisms (Bhagat et al., 2008); and Principal Component Analysis (Larcker et al., 2007). However, the purpose of this study is to measure overstatement of compliance with the BCGG-2006 in annual reports rather than to measure the strength of CG of companies, implying that measuring CG index by assigning unequal weight or using Principal Component

Analysis is less appropriate. Hence, measuring corporate governance index by assigning weights is avoided.

5.7.2 Measurement of variables for H3.2a and H3.2b

In order to test H3.2a and H3.2b (Section 4.4), this study need *CG_AR* and *CG_SR* as described in Section 5.7.1. In order to test H3.2 for sub-components of *CG_AR* and *CG_SR*, each of *CG_AR* and *CG_SR* is divided into three sub-indices. These three sub-indices are: Board, Audit Committee (AC) and other sub-indices. Board sub-index consists of provisions related to board size, composition, separation of chairman and CEO, defining roles and responsibilities of chairman and CEO and minimum number of board meetings and thus, has a theoretical value from 0 to 5. The audit committee sub-index includes nine provisions related to audit committee formation and its characteristics and thus, has a theoretical value from 0 to 9. I have used here the nine specific characteristics of the audit committee recommended in the BCGG 2006 for disclosure through a '*comply box*' in the annual report. These nine are a subset of the broader 16 used in section 5.6.1.3. The other sub-index consists of six provisions related to CFO, internal control and audit, and external audit and thus, has a theoretical value from 0 to 6.

5.7.3 Measurement of variables for H3.3a1 and H3.3a2

In order to test whether the pattern of overstatement of compliance in annual reports with the BCGG-2006 varies depending on the nature of provisions, the aforesaid 20 provisions are classified into *observable* and *less observable*. *Observable* provisions are easily verifiable or are subject to strong monitoring by regulatory authorities such as the BSEC and the DSE. *Observable* provisions, thus, include nine provisions such as the number of board members, separation of the chairman and CEO, formation of an audit committee etc. as well as at least four board meetings per year. Board meetings are categorized as an *observable* provision because companies are under an obligation to announce the time, date and venue of the meeting before, and the decisions of board meeting after, the meeting is held through the DSE website. *Less observable* provisions are related to the internal practices of the company and thus, are relatively less visible to an outside individual

or organization. *Less observable* provisions, hence, include 11 provisions such as defining the roles and responsibilities of the chairman and CEO, having a written audit committee charter etc.

After classification, the difference between the proportions of firms that report compliance in annual reports and state compliance in the survey with each provision is tested using a one-tail two samples test of proportions. Secondly, based on the classification of provisions, *four* composite corporate governance sub-indices based on (1) compliance with *observable* provisions as reported in annual reports (observable *CG_AR*); (2) compliance with *observable* provisions as stated in the survey (observable *CG_SR*); (3) compliance with *less observable* provisions as reported in annual reports (less observable *CG_AR*): and (4) compliance with non-*observable* provisions as stated in the survey (less observable *CG_SR*) are constructed. In order to provide statistical evidence for hypothesis 3, this study calculates *overstatement in observable CG (CG_Ob_AR - SR)* and *overstatement in less observable CG (CG_LOb_AR - SR).*

5.7.4 Measurement of variables for H3.3b1, H3.3b2, H3.3c1 and H3.3c2

In order to test H3.3b1, H3.3b2, H3.3c1 and H3.3c2, this study needs to measure the extent of overstatement of compliance with the BCGG-2006 in annual reports and control by a sponsor family and control by institutional investors.

5.7.4.1 Overstatement of compliance in annual reports - dependent variable

Measuring the extent of overstatement of compliance with the BCGG-2006 in annual reports is not straightforward. In the management accounting literature, several experimental studies measure dishonesty in reporting managerial performance. The measure was pioneered by Evans et al. (2001) and has been subsequently used by several researchers (e.g Stevens, 2002; Hannan et al., 2006; Church et al., 2012). However, Evans et al.'s (2001) measure of dishonesty measures the extent to which managers use the available room for telling lies in order to maximize their monetary incentives. Managers with superior performance are often regarded as the most dishonest managers. For example, suppose there are a

maximum of twenty questions which are worth twenty points in an experimental setting. A manager can earn a maximum of twenty points. Now suppose that manager ‘A’ earns 19 points but reports 20 points and manager ‘B’ earns 15 points but reports 18 points. According to the measure of dishonesty as developed by Evans et al. (2001) and followed by others, manager A is 100 per cent dishonest as he has the opportunity to use one extra point dishonestly and he fully used that opportunity but manager B is 60 per cent dishonest in the sense that he used only three points dishonestly out of the five points available. In respect of the current study, firms that actually implement most of the provisions of the BCGG-2006 comply better with the BCGG-2006. This is because the BCGG-2006 is a ‘comply or explain’ basis code. Accordingly, to give credit to the firms that actually comply with a greater proportion of provisions of the BCGG-2006, this study calculates an overstatement statistic by calculating the difference between *CG_AR* and *CG_SR* and then scaling the difference by *CG_AR*. *CG_AR* is used for scaling the difference between *CG_AR* and *CG_SR* because this study intends to measure the extent to which the compliance reported in the annual reports is overstated. That is, the overstatement statistic is calculated as:

Overstatement statistic = (CG_AR – CG_SR)/ CG_AR expressed as a percentage

Where:

CG_AR is a CG compliance index of 20 important provisions of the BCGG-2006 as reported in annual reports;

CG_SR is a CG compliance index of same 20 important provisions of the BCGG-2006 as revealed by a survey.

In order to validate the measure, this study uses the above overstatement statistic to measure the extent of untruthfulness in reporting using an example. Suppose that company ‘A’ implemented 19 provisions but reports compliance with 20 provisions in its annual report while company ‘B’ implemented 15 provisions but reports compliance with 18 provisions.

According to the overstatement statistic calculated in this thesis, company ‘A’ is 5 per cent untruthful [(20-19)/ 20] and company ‘B’ is 16.67 per cent untruthful

[(18-15)/18]. If the extent of overstatement of compliance leads to suboptimal investment and credit decisions, institutional investors and creditors are more likely to make suboptimal decisions with respect to company 'B' than company 'A'. If a company truthfully reports compliance with the BCGG-2006 in its annual report, it will have an overstatement statistic of zero. In contrast, if a firm overstates the level of compliance with the BCGG-2006 in its annual reports, it will have a positive overstatement statistic. The distribution of the overstatement statistic is truncated at the lower bound of zero and is not symmetric.

5.7.4.2 Control by sponsor family

Prior literature uses a range of proxies to measure control by sponsor family. These measures include more than 10 per cent ownership holding by an individual or a family (Chen and Jaggi, 2000), controlling shareholder is a family or an individual who holds the position of CEO, honorary chairman, chairman, or vice chairman (Maury, 2006); the founder or a member of his or her family by either blood or marriage is an officer, a director, or a blockholder of the company (Anderson and Reeb, 2003); members of the controlling family are appointed in the position of both chairman and CEO (Luo and Chung, 2013; Yeh and Woidtke, 2005); percentage of sponsor family affiliated directors on board (Yeh and Woidtke, 2005); and number of sponsor family affiliated directors on the board (Chrisman et al., 2004). In the case of Bangladesh, a sponsor family can maintain excessive control by even limited percentage of ownership. Moreover, data on family ownership is not readily available. Hence, this study, following Luo and Chung (2013) and Yeh and Woidtke (2005), defines control by the sponsor family when sponsor family members being appointed to the positions of both chairman and CEO of the company. In additional analysis, control by the sponsor family is defined by a sponsor family member is appointed in the position of either Chairman or CEO of the company, percentage of sponsor family members on the board (Ho and Wong, 2001), and number of sponsor family members on the board (Chrisman et al., 2004).

5.7.4.3 Control by institutional investors

Prior literature uses two proxies to define control by institutional investors: percentage of ownership by institutional investors (Hartzell and Starks, 2003; Sarkar Sarkar, 2000) and concentration of institutional ownership (Hartzell and Starks, 2003). The calculation of concentration of institutional ownership requires individual ownership holding of at least five institutional investors (Hartzell and Starks, 2003). This kind of detailed information is not available in the case of Bangladeshi companies. Hence, this study defines control by institutional investors by percentage of outstanding shares owned by institutional investors at the end of a company's accounting period in 2011.

5.7.4.4 Control variables

Following prior literature on the determinants of compliance with CG codes and accounting reporting quality, this study includes a number of control variables while investigating the association between overstatement of compliance in annual reports and a firm's control characteristics. First, firms with better growth prospects are subject to high levels of information asymmetry (Smith and Watts, 1992; Gaver and Gaver, 1993). This high level of information asymmetry affects both internal governance structures (Lehn et al., 2009; Coles et al., 2008; Linck et al., 2008) and the quality of accounting disclosures (Chen et al., 2008; Cerbioni and Parbonetti, 2007). Prior literature, however, provides inconclusive evidence on the association of firms' growth opportunities with CG structures (Lehn et al., 2009; Coles et al., 2008; Linck et al., 2008; Boone et al., 2007) and accounting disclosure quality (Eng and Mak, 2003; Cerbioni and Parbonetti, 2007; Chua and Gray, 2010). Hence, this study controls for the firm's growth opportunities as measured by market-to-book ratio without any directional expectation.

Second, profitable firms better comply with CG codes and there is a positive association between profitability and accounting reporting quality. In respect of Bangladesh, Haque et al. (2011) find a positive association between profitability and the value of their survey-based CG index. The positive effect of profitability on the level of compliance and accounting reporting quality will reduce the extent of

overstatement of compliance with the BCGG-2006 in annual reports. Profitability is measured by return on assets (ROA).

Third, a large body of literature documents a positive association between firm size and level of compliance with CG codes (e.g., Werder et al., 2005; Dedman, 2000; Boone et al., 2007). This literature argues that larger firms suffer lower relative compliance costs (e.g., Dedman, 2000) and operational complexity (Demsetz and Lehn, 1985; Boone et al., 2007) which demands a stronger governance structure. In respect of Bangladesh, Haque et al. (2011) find a positive association between firm size and the value of their survey-based CG index. Moreover, there is evidence of a positive relationship between firm size and the quality of accounting disclosure (e.g., Lang and Lundholm, 1993; Ajinkya et al., 2005, Karamanou and Vafeas, 2005). That is, larger firms not only actually comply better with the BCGG-2006 but also more truthfully report the level of compliance with the BCGG-2006 in annual reports. The size of the firm is measured by the natural log of book value of total assets at the end of company's accounting period following Chen et al. (2008).

Fourth, prior research reports a positive association of auditor's quality with the quality of CG (e.g. Fan and Wong, 2005; Choi and Wong, 2004) and accounting disclosures (e.g., Becker et al., 1998; Kim et al., 2003; Basset et al., 2007; Gul et al., 2010). In the literature, there are competing arguments for and against positive associations: (1) better governed firms appoint quality auditors to credibly disseminate information to investors (Watts and Zimmerman, 1983; Titman and Trueman, 1986); (2) quality auditors do not engage themselves in poorly governed firms; and (3) quality auditors play an effective governance role in order to protect their reputations (DeAngelo, 1981). Similarly, due to the first reason outlined above, a large audit firm positively influences accounting reporting quality. Considering the evidence together, a negative association between the extent of overstatement of compliance with the BCGG-2006 in annual reports and auditor's quality is expected.

Table 5.7: Measurement and data sources for dependent and independent variables

Variables	Explanation	Proxy	Measurement	Sources of data
Dependent variable				
OVS_G	Overstatement of compliance with the BCGG-2006. A higher value corresponds to more overstatement.	Untruthfulness in reporting on compliance with the BCGG-2006.	Log (1 + Overstatement statistic)	Comparison of annual reports and survey conducted in January to March, 2012
Explanatory variables				
FC	Both the Chairman and CEO are members of the sponsor family	Control of the sponsor family	A dummy variable indicating the presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise.	Survey –January to March, 2012
INS_OWN	Institutional investor ownership	Control by institutional investors	Percentage of outstanding shares owned by institutional investors.	Survey –January to March, 2012
Control variables				
SIZE	Natural log of the book value of assets	Firm size	Natural log of book value of total assets at the end of company's accounting period in 2011	Annual Reports released during 2011
ROA	Return on assets	Profitability	The ratio of the profit before interest and taxes to average total assets of the company at the end of company's accounting period in 2011.	Annual Reports released during 2011
MB	Market to book ratio	Growth opportunity	Ratio of the firm's market value of common equity to book value of common equity at the end of company's accounting period in 2011. Market value of equity is calculated by multiplying the closing share price by the number of shares outstanding on 29.12.11.	Closing share price and the number of shares outstanding on 29.12.11 are collected from a CD-ROM available at the Dhaka stock Exchange, Bangladesh. Book value of the firm's common equity is collected from annual report of the company released during 2011.
AUDIT	Quality of auditor	Audit Quality	A dichotomous variable indicating that the company's auditor is affiliated with a big-four international audit firm; 0 otherwise (Lang and Lundholm, 1993; Ajinkya et al. 2005).	Name of auditor is collected from annual reports – 2011. The affiliation of auditor is gathered from website of audit firms.

Table 5.7 shows the names, proxies, measurement and sources of data for the independent variables used in this section. The data for this study are derived from multiple sources. Data on family control structure and institutional ownership are collected by the survey as described in Section 5.4. Firms' annual reports are used to obtain data on total assets, amount of long-term debt and auditor. Finally, whether the audit firm is affiliated with an international big-four audit firm is collected from the websites of the audit firms.

5.8 Data analysis for RQ2.2

In order to test P2.2, I use ANOVA on the means and Kruskal-Wallis test on the medians of four performance measures: five-year average Tobin's Q, five-year average stock return, five-year average ROA and five year average ROE (Section 5.6.2). ANOVA is used to test whether there are any significant differences between the means of three or more independent groups. ANOVA is a parametric test and thus, rests on two assumptions: (1) the dependent variable is normally distributed in each group that is being compared in the one-way ANOVA, and (2) the population variances in each group are equal. However, ANOVA is robust against violation of normality assumption. I also use Kruskal-Wallis test as an alternative to ANOVA because the assumption of homogeneity of variance is not met.

In order to test P2.2a, P2.2b and P2.2c, I use t-tests on the means and Wilcoxon Rank-Sum tests on the medians of four performance measures: five-year average Tobin's Q, five-year average stock return, five-year average ROA and five year average ROE. T-test and Wilcoxon Rank Sum test can be used for 'planned simple comparison' (Sheskin, 2007, p. 885). Like ANOVA, t-test is a parametric test and thus, rests on two assumptions: (1) the dependent variable is normally distributed in each group that is being compared by the t-test, and (2) the population variances in each group are equal. However, t-test is robust against the violation of normality assumption.

In order to test P2.2d, all the aforesaid tests are performed on the sample of local privately-owned companies. The differences in performance among these three firm groups are then tested using ANOVA on the means and Kruskal-Wallis test on

the medians. Additionally, between groups difference in performance is tested using t-tests on the means and Wilcoxon Rank-Sum tests on the medians.

5.9 Data analysis for RQ3

5.9.1 H3.1a and H3.1b

To test H3.1, the difference between CG_AR and CG_SR (see Section 5.7.1 for definition and measurement of CG_AR and CG_SR) is tested by using t-test on the mean and Wilcoxon Rank-Sum test on the median.

5.9.2 H3.2a and H3.2b

To test H3.2, Spearman rank correlation between *CG_AR* and *CG_SR* is tested. The Spearman rank correlation is also calculated between the three sub-indices (see Section 5.7.2) of *CG_AR* and *CG_SR*.

If compliance with the BCGG-2006 as reported in annual reports coincides with that as stated in the survey, a firm gets an identical rank whether the rank is calculated based on *CG_AR* or *CG_SR* index. Hence, the null hypothesis for testing the significance of the Spearman rank correlation coefficient between CG_AR and CG_SR is Ho: $\rho = 1.00$. Zar (1999, cited in Sheskin, 2007; p. 1364) contends that **Fisher's *z* transformation** can be used for testing the significance of a Spearman rank correlation coefficient against a hypothesized value of ρ when $n \geq 10$ and $\rho s < 0.9$. However, **Fisher's *z* transformation** is not possible if the hypothesised value is $\rho = 1.00$ (Zar, 1999, cited in Sheskin, 2007; p. 1243). Hence, the significance of correlation coefficients between CG_AR and CG_SR, and their sub-indices are tested against a hypothesised value of $\rho = 0.95$. This testing procedure is also used for testing the significance of Spearman rank correlation between the three paired sub-indices (see Section 5.7.2) of *CG_AR* and *CG_SR*.

5.9.3 H3.3a1 and H3.3a2

To test H3.3a, the difference in mean and median between *CG_Ob_AR–SR* and *CG_NOb_AR–SR* (see Section 5.7.3 for definition of *CG_Ob_AR–SR* and *CG_NOb_AR–SR*) is tested using t-tests and Wilcoxon rank-sum tests respectively.

5.9.4 H3.3b1, H3.3b2, H3.3c1 and H3.3c2

The distribution of overstatement statistic is truncated at the lower bound of zero, suggesting that Tobit regression is more appropriate to estimate the cross-sectional variation in overstatement statistic than ordinary least square (OLS). The use of OLS to predict a truncated dependent variable provides inconsistent estimates of the parameters (Woolridge, 2002, p. 668). Hence, in order to test H3.3b and 3.3c, this study adopts the Tobit model censoring the dependent variable at zero, as presented in the following equations[14], to identify the determinants of the cross-sectional variation in overstatement statistic.

OVS_G*[15] $= \beta 0 + \beta_1 FC + \beta_2 INS_OWN + \gamma_i$ Controls $+ \varepsilon i$

OVS_G=0 if OVS_G* ≤ 0

OVS_G= OVS_G* if OVS_G≥ 0

OVS_G = ln (1+ overstatement statistic) ………….. (1)

Where

FC, a dichotomous variable indicating presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise;

INS_OWN, percentage of outstanding shares owned by institutional investors at the end of a company's accounting period in 2011;

Control variables include the following:

MB, ratio of the firm's market value of common equity to book value of common equity at the end of company's accounting period in 2011;

ROA, the ratio of the profit before interest and taxes to average total assets of the company at the end of company's accounting period in 2011;

SIZE, natural log of book value of total assets at the end of company's accounting period in 2011;

AUDIT, a dichotomous variable indicating that a company's auditor is affiliated with a big-four international audit firm; 0 otherwise.

[14] See Wooldridge (2002) pp. 670-71 for an exposition of Tobit regression model.

[15] Stata command for this model is: tobit OVS_G FC INS_OWN MB ROA SIZE AUDIT, ll(0)

5.10 Summary

This chapter has discussed the methodological issues associated with data collection, measurement of proxy variables and data analysis. Firstly, I described the procedures I have used for collection and analysis of semi-structured interview data that will be used for answering RQ1. Secondly, I described the procedure that has been applied to collect data by using survey that will be used for answering RQ2 and RQ3. Thirdly, as RQ2 and RQ3 are deductive in nature, I described the measurement of proxy variables that will be used for testing propositions related to RQ2 and hypotheses related to RQ3. One significant challenge I face is measurement of the overstatement of compliance with the BCGG-2006 in annual reports. Finally, statistical tests to be used for testing propositions related to RQ2 and hypotheses related to RQ3 were discussed. Finally, I presented the Tobit regression model used in testing H3.3b1, H3.3b2, H3.3c1 and H3.3c2.

The following chapters will present the results.

Chapter Six

Impact of the BCGG-2006 on investment and credit decisions

6.1 Introduction

This chapter presents and analyses the findings of research question *RQ1. Do institutional investors and bankers in Bangladesh perceive that the level of compliance with the BCGG-2006 by an investee or a borrowing company influences the investment and lending decisions respectively?* This RQ1 is investigated by taking an inductive approach. It is divided into following sub–questions (Section 4.2):

RQ1.1a How do the institutional investors and bankers perceive a direct impact of a particular corporate governance mechanism of the BCGG-2006 on their investment and lending decisions respectively?

RQ1.1b How do the institutional investors and bankers perceive the impact of a particular corporate governance mechanism of the BCGG-2006 on firm performance and accounting reporting quality?

RQ1.2 Which theory of corporate governance explains better the impact of corporate governance on investment and lending decisions of institutional investors and bankers respectively in Bangladesh?

Section 6.2 presents findings on RQ 1.1a and RQ 1.1b. In order to answer RQ1.1a and RQ1.1b, I present interviewees' perceptions of: separation of CEO and chairman of the board; board size; board independence; audit committee; chief financial officer; and head of internal audit. The method of analysis of interviewee's responses with respect to the aforementioned CG mechanisms is described in Section 5.3.4 Stage1. In order to answer RQ1.2, three main themes are generated from interviews by using a grounded theory-based data analysis (Section 5.3.4 Stage 2). These themes are: (1) that the rent protection motive of the sponsor families hampers the implementation of the BCGG-2006 'in form and in substance', (2) corporate and

institutional characteristics of Bangladesh indicate low relative implementation efficiency of the BCGG-2006 and thus, discourages sponsor families from implementing the BCGG-2006 ‘in form and in substance’, (3) traditional characteristics of investment and lending practices. Section 6.3 presents first-order codes that indicate the rent protection motive of the sponsor families. Section 6.4 presents first-order codes that indicate the low relative implementation efficiency of the BCGG-2006 emanating from corporate and institutional characteristics of Bangladesh and section 6.5 presents the traditional characteristics of investment and lending practices. Section 6.6 theorises the impact of compliance with the BCGG-2006 on investment and lending decisions. Section 6.7 concludes.

6.2 Perceptions as to corporate governance provisions of the BCGG-2006

This section presents and analyses the findings of research question *RQ1.1a and RQ 1.1b* (Section 6.1). The respondents (Section 5.3.1) include investment managers from mutual funds and life insurance companies, and credit rating analysts from banks and credit rating agencies. The perceptions of credit rating analysts of credit rating agencies are treated as the perception of bankers because both bankers and credit raters appraise a company to assess its credit worthiness.

6.2.1 Perceptions as to separation of the chairman and the CEO

6.2.1.1 Direct impact of separation of the chairman and CEO on investment and lending decisions

The BCGG-2006 recommends that companies appoint separate people as the chairman of the board and the CEO of a company (Section 3.6.2.1). Hence, the interviewees are asked:

How do you perceive the impact of separation of the chairman and the CEO on your decisions?

Table 6.1 presents the perceptions of 28 interviewees on the impact of the separation of the chairman and the CEO on the investment and lending decisions. As shown in Panel A, 19 out of 28 interviewees (67.85%) state that the separation of the

chairman and the CEO has no direct impact on their investment and lending decisions.

Table 6.1: Perception as to direct impact of the separation of the chairman and the CEO on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total	%
Direct impact of separation of the chairman and the CEO	Number of interviewees	4	3	17	4	28	
	A: Separation of the chairman and the CEO has no direct impact on the decisions						
	Family relationship between chairman and CEO cancels out the impact of separation	2 [MFM1, MFM3]	1 [LIC3]	7 [DCB1, DCB2*, DCB7, DCB10, DIB2*, FCB2, FCB3]	2 [CRA2*, CRA3]	12	67.85 %
	Outside professional CEO is delegated limited authority	1 [MFM4]	0	3 [DCB2*, DCB6, DIB2*]	1 [CRA2*]	5	
	Lending practices hamper consideration of separation of the chairman and CEO	0	0	7 [NCB1, DCB2*, DCB3, DCB4, DCB5, DCB9, DIB1]	0	7	
	Total (A)	3	1	13*	2*	19*	
	B: Separation of the chairman and the CEO has direct impact on the decisions						
	Separation of chairman and CEO strengthen internal control system	0	1 [LIC2]	1 [DCB11*]	1 [CRA4]	3	32.15 %
	Succession plan	1 [MFM2]	0	3 [DCB8,DCB11*, FCB1]	1 [CRA1]	5	
	Chairman and CEO are two important positions.	0	1 [LIC1]	1 [DCB6]	0	2	
	Total (B)	1	2	4*	2	9*	

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = National Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank. * = interviewee mentions multiple reasons for no impact of separation of the chairman and CEO.

Twelve interviewees perceive that the family relationship between the chairman and CEO cancels out any impact of the separation of the chairman and the CEO. These interviewees are sceptical about the segregation of duties and responsibilities between the chairman and the CEO. A typical comment that represents the views of this group of interviewees is:

The separation of the chairman and the CEO does not affect my perception much. It is some sort of eyewash, actual segregation of duties between the chairman and the CEO is not practiced in most companies. If previously the family key man holds both the positions of the chairman and the CEO, now his wife is designated as the chairman and he designates himself as the CEO [LIC-3].

Five interviewees perceive no direct impact of the separation of the chairman and the CEO on their decisions because the sponsor chairman does not delegate enough decision-making authority to an outside CEO. According to these interviewees, most of the companies in Bangladesh were initiated by an individual entrepreneur as a sole proprietorship or by a number of entrepreneurs as partnerships. These sole proprietorships or partnerships were later converted into public limited companies without changing their internal control structure. Hence, the key sponsor still maintains strong control over the affairs of the company and delegates limited decision making authority to the appointed CEO. A typical comment is:

Most of our public limited companies were sole proprietorships or at best partnerships in the past. As a result, the sponsors run them as sole proprietorships. They [the sponsors] still retain absolute control over these companies. [...]. To comply with the provision regarding separation of the chairman and the CEO, they may appoint an outside professional CEO; but he [the CEO] is delegated only limited authority to run the company's day to day operation. As a result, separation of the chairman and the CEO does not have much impact on the accountability and consequently, on our lending decisions yet [DIB-2].

Seven interviewees argue that the name-based and collateral-based lending practices of the banks diminish consideration of the separation of chairman and CEO. Furthermore, the Credit Risk Grading (CRG) guidelines of the Bangladesh Bank do not require banks to consider the separation of the chairman and the CEO while appraising a loan proposal. A typical comment is:

*We do not consider it [*the separation of the chairman and the CEO*] yet. Basically, Bangladesh issued CRG guideline 5-6 years ago. Before that, the banks practiced name-based and collateral-based lending. You can say that we are still practicing some sort of name-based and collateral-based lending [DCB-5].*

On the other hand, nine out of 28 interviewees state that the separation of the chairman and the CEO has a direct impact on their investment and lending decisions (Table 6.1, Panel B). Three interviewees perceive that separation of the chairman and the CEO has a direct positive impact on their investment decisions because it has a positive effect on the internal control systems of the company. A typical comment is:

If chairman and CEO is the same person, the chairman is the main decision maker. This influences our investment decision a lot. We never invest in these companies [companies that do not separate the chairman and the CEO]. That man is

performing both the operational and strategic decision making roles. He is doing everything in the best interest of him and his family (LIC - 2).

Five interviewees perceive that the separation of the chairman and the CEO reduces the problem of succession, a major problem faced by a family-based company. A typical comment that represents the views of this group of interviewees is:

Chairman is an honorary post. […]. The main person is the CEO. He is the main working person. So, we want to see the both persons differently. We also want to know what functions they are doing. This also gives us an idea of succession plan. For example, Mr. A appointed his son Mr. B as managing director for one company of P Group. So, we feel confident that we will not be in a problem in absence of Mr. A [FCB-1].

Finally, the following comment indicates that interviewees consider the chairman and CEO of the company to be important people in a company:

[…] we always try to find out that there is a chairman, and there is a CEO and both these persons are important. Both are main men [LIC-1].

6.2.1.2 Indirect impact of separation of the chairman and CEO on investment and lending decisions

Among the perceptions of interviewees who do not perceive a direct impact of the separation of the chairman and the CEO on their decisions, 13 indicate that the separation of the chairman and the CEO has no impact on the internal control structure of the company (Table 6.1). Hence, the remaining 15 interviewees were asked:

How do you perceive the impact of the separation of the chairman and the CEO on firm performance and accounting reporting quality?

Table 6.2 presents the perceptions of interviewees regarding the impact of the separation of the chairman and the CEO on firm performance and accounting reporting quality.

Table 6.2: Perceptions as to the indirect impact of separation of the chairman and the CEO on investment and lending decisions

Indirect impact of the separation of chairman and CEO	Views	MFM	LIC	BANKS	CRA	Total
	Number of interviewees	4	3	17	4	28
	A: The question is not asked	3 [MFM1, MFM3, MFM4]	1 [LIC3]	7 [DCB1,DCB2, DCB7,DCB10, DIB2, FCB2, FCB3]	2 [CRA2, CRA3]	13
	B: The question is asked	**1**	**2**	**10**	**2**	**15**
	Separation of the chairman and the CEO has no indirect impact on the respondents' decision making	1 [MFM2]	0	7 [NCB1,DCB3, DCB6, DCB8, DCB9,DIB1, FCB1]	0	8/15
	Separation of the chairman and the CEO has an indirect impact on the respondents' decision making	0	0	3 [DCB4,DCB5, DCB11]	1 [CRA4]	4/15
	The indirect impact of separation depends on context	0	2 [LIC1, LIC2]	0	1 [CRA1]	3/15

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

Table 6.2 shows that eight out of 15 interviewees perceive that the separation of the chairman and the CEO has no impact on firm performance and accounting reporting quality. These interviewees reasoned that the family relationship between the chairman and the CEO, and the delegation of limited authority to the outside CEO, constrain the impact of the separation of chairman and CEO. A representative comment from one interviewee of this group is:

I do not think that the separation of the Chairman and the CEO has much impact on the performance and accounting reporting quality. The reason is that the ultimate authority remains with a single person – who is the man behind the machine: it may be chairman of the company or the managing director. If the managing director is an employed professional, he is not given enough authority. So, if there is any impact of the separation of the chairman and the CEO, it's negligible [DCB -3].

However, four out of 15 interviewees perceive a positive impact of the separation of the chairman and the CEO on firm performance and accounting reporting quality (Table 6.2). According to these interviewees: (1) the knowledge of the professional CEO will help to increase the performance of the company and (2) the appointment of an outside CEO promotes the development of a formal

accountability system which automatically triggers the development of an efficient internal accounting system. A typical comment is:

Well, I think that there is a chance of positive impact on performance and accounting reporting quality. For example, if the CEO is a professional and the chairman is a sponsor director, the CEO will run the company according to the advice of the chairman and use his own professional expertise. The two-way communication between the chairman and CEO will automatically trigger the development of a good MIS [DCB – 5].

Finally, three out of 15 interviewees report that they cannot generalise the impact of the separation of the chairman and CEO on the performance and accounting reporting quality of the company. A typical comment is:

It depends. I have seen that a dual CEO is running his company very smoothly and performing well. The accounting report of the company is also good relative to general standard of our country. Again there are companies with separate CEO and chairman is running very badly and to conceal their performance issue opaque reports [LIC -1].

6.2.1.3 Summary

The results provide strong evidence that the separation of the chairman and the CEO has no direct impact on the investment and lending decisions of institutional investors and bankers respectively (Table 6.1, Panel A). There is limited evidence that the separation of the chairman and CEO has a direct impact on the investment and lending decisions of institutional investors and bankers respectively (Table 6.1, Panel B).

The results presented in Section 6.2.1.2 also provide limited support for the perceived impact of the separation of the chairman and the CEO on the performance and accounting reporting quality of companies.

Hence, there is overall, a limited direct or indirect impact of the separation of the chairman and the CEO on investment and lending decisions of institutional investors and bankers respectively. This is because the sponsors and their families invalidate the separation of the chairman and CEO as a CG mechanism by either appointing family members to the position of both chairman and CEO or delegating limited authority when the CEO is an outside professional. There is also some

evidence that bankers do not exert pressure on companies for the separation of the chairman and the CEO because bankers are accustomed to name-based and collateral-based lending practices.

6.2.2 Perceptions of Board Size

6.2.2.1 Direct impact of board size on investment and lending decisions

The BCGG-2006 recommends that companies appoint a board of directors having between 5 and 20 members (Section 3.6.2.1). Hence, the interviewees are asked:

How do you perceive the impact of board size on your decisions?

Interviewees' perceptions are presented in Table 6.3 which reports that 23 out of 28 interviewees (82.14%) state that board size has no direct impact on their investment and lending decisions.

Ten out of 28 interviewees perceive that board size has no direct impact on their decisions because the board is dominated by the family members of the key sponsor executive director. According to these interviewees, these family board members do not have enough involvement in the company's affairs. Several interviewees also state that companies having a majority of sponsor family directors do not convene board meetings regularly. One typical comment that represents the views of this group of interviewees is:

We identify the total board. For example, there are six members on the board; two directors are key – the chairman and the CEO. Other directors are the spouses and the children of the chairman and the CEO. These spouses and children are not our concern because they have no involvement with the company's affairs. They often even do not attend board meeting and AGM [DCB – 6].

Eight interviewees perceive that the key sponsor executive directors dominate the decision making process due to their major shareholdings in the company. Other board members cannot play a role as they have minimum shareholdings and the key sponsor executive directors do not encourage them to participate in the decision making process. A typical comment is:

In Bangladesh, the CEO and the chairman are appointed based on major shareholdings and ultimately, they dominate the meetings process, and everything at 80 percent and in some cases at 100 percent level. [...]. The remaining board members are directors in name only. They generally do not have major shareholdings and thus, they do not have that much role in company decision making and everything [DCB - 11].

Table 6.3: Perceptions as to the direct impact of board size on investment and lending decision

	Views	MFM	LIC	BANKS	CRA	Total	%
Direct impact of board size	Number of interviewees	4	3	17	4	28	
	A: Board size has no direct impact on the investment and lending decisions						
	Sponsor family dominated board does not have enough involvement with the company's decision making process.	2 [MFM1, MFM4]	0	6 [DCB4*, DCB6, DIB2, FCB1, FCB2, FCB3]	2 [CRA3, CRA4]	10	82.14 %
	Participative board culture does not develop and the key sponsor executive directors exercise absolute authority	1 [MFM2]	2 [LIC1, LIC3]	3 [NCB1*, DCB4*, DCB11]	2 [CRA1, CRA2]	8	
	Board members lack qualification and experience	0	0	3 [NCB1*,DCB7, DCB11*]	0	3	
	Lending practices do not require analysis of total board of directors	0	0	5 [DCB2, DCB3, DCB9, DCB10, DIB1]	0	5	
	Total (A)	3	2	14	4	23	
	B: Board size has a direct impact on the investment and lending decisions						
	Large board is more prone to conflict which results in reduced efficiency	0	1 [LIC2]	3 [DCB1, DCB5, DCB8]	0	4	17.86 %
	Optimum board size is important	1 [MFM3]	0	0	0	1	
	Total (B)	1	1	3	0	5	

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank; * = interviewee mentions multiple reasons for no direct impact of board size on their decisions.

Three interviewees perceive that due to a lack of qualification and experience, the board of directors cannot play their decision making role. A typical comment is:

They are employing their own people to comply with the law. It is not like that they offer board position to qualified people and make good decisions through thesis and anti-thesis. Basically, authority and responsibility relies to the key person. I do not think that the board size has any impact on our decision making [DCB - 7].

Five interviewees argue that they do not consider board size when making their decisions because lending practices do not require consideration of the board of directors of the borrowing company.

Basically, we are concerned with 'the man behind the machine' because in our culture, either one or two persons of the total board are active and other board members are sleeping members. As a result, we consider key sponsor executive directors. For example, in case of S. Ltd, we consider two brothers as a basis. In case of G Ltd, we are concerned with Mr. S (DCB - 10).

In contrast, five interviewees perceive a direct impact of board size on their decisions (Table 6.3). Four interviewees prefer small boards because they perceive that the larger the board, the more the chance of conflict among board members. According to them, conflict among board members reduces the efficiency of the company. A typical response is:

My experience is that the larger the board is, the more the chance of conflicts in case of our country. We feel comfortable with a small board [DCB-5].

6.2.2.2 Indirect impact of the board size on investment and lending decisions

The responses of 18 interviewees who do not perceive any direct impact of board size as described in Section 6.2.2.1 suggest that the board of directors does not play an effective role. Hence, the remaining 10 interviewees are asked:

How do you perceive the impact of board size on firm performance and accounting reporting quality?

Table 6.4 presents the perceptions of interviewees on the impact of board size on firm performance and accounting reporting quality. Table 6.4 shows that five interviewees perceive no indirect impact of board size on their decisions. According to these interviewees, the board comprises family members of the key sponsor executive director and thus, the board has limited interest in rectifying the decisions taken by the key sponsor executive director. A typical comment is:

I do not think that board has that much role to influence performance or accounting reporting quality in case of our country. The main decision maker is the key sponsor director. Other members are his family members who are rarely informed about business decisions and thus, they unquestionably ratify the decisions of the key sponsor director [DCB – 3].

Table 6.4: Perceptions as to the indirect impact of board size on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total
Indirect impact of board size	Number of interviewees	4	3	17	4	28
	A: The question is not asked	3 [MFM1, MFM2, MFM4]	2 [LIC1, LIC3]	9 [NCB1, DCB4, DCB6, DCB7, DCB11, DIB2, FCB1, FCB2, FCB3]	4 [CRA1, CRA2, CRA3, CRA4]	18
	B: The question is asked	1	1	8	0	10
	Board size has no indirect impact on the respondents' decision making	0	0	5 [DCB2, DCB3, DIB1, DCB5*, DCB10]	0	5/10
	Board size has a negative indirect impact on the respondents' decision making	1 [MFM3]	1 [LIC2]	4 [DCB1, DCB5*, DCB8, DCB9]	0	6/10

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

However, six interviewees perceive that board size has an impact on the performance and accounting reporting quality of the company (Table 6.4). According to these interviewees, a large board negatively affects the performance and accounting reporting quality because the larger the board, the more the conflict. This conflict among board members negatively affects performance. Furthermore, a large board increases internal manipulation because board members in Bangladesh often use their directorship to personally benefit themselves. The company often manipulates accounting reports to disguise the impact of these personal benefits on company profit. A representative comment is:

[...] in case of our country small board often performs better because it suffers from less internal conflicts. It can quickly decide on available investment proposals. There are also instances that large board increases accounting manipulation. Every director uses his directorship to gain personally. For example, in case of banks, each director can recommend some loans. Hence, the more the number of directors on board is, the more the amount of recommended loan. S. Bank Ltd has eighteen members on board. It sanctions huge loan on directors' requests resulting in a significant amount of bad loan. There is a rumour in the market that it manipulates the amount of provision for bad loan in the last financial year to maintain its profit [DCB -1].

6.2.2.3 Summary

The results presented in Section 6.2.2.1 indicate that there is strong evidence that board size has no direct impact on investment and lending decisions. However, a limited number of interviewees perceive a negative impact of a large board. The board of directors may not have an impact on the decisions of the interviewees because the family-based structure of the board does not allow it to monitor or advise the key sponsor executive directors who are simultaneously the heads of the sponsor families. In a hierarchical society (Section 3.5.2), like Bangladesh, it is not possible for other members of the family: to advise the family head, the question of monitoring is absurd. Furthermore, the key sponsor executive director is often the most experienced person among the board members and thus, it is beyond the capacity of the board of directors to advise the sponsor executive directors. On the other hand, a large board negatively affects the decisions of the interviewees both directly and indirectly because a large board increases expropriations and is prone to conflict. This evidence implies that the board of directors is not playing an effective CG role in protecting the interest of outside investors and creditors.

6.2.3 Perceptions as to board composition: independent director(s)

6.2.3.1 Direct impact of independent director on investment and lending decisions

The BCGG-2006 requires companies to appoint at least 10 per cent of board membership subject to a minimum of one independent director on the board (Section 3.6.2.1). So, interviewees are asked:

How do you perceive the impact of independent director(s) on your decisions?

Table 6.5 summarises the perceptions of interviewees about the direct impact of the independent director on their decisions.

Table 6.5: Perceptions as to the direct impact of independent director on investment and lending decisions

Direct impact of independent director	Views	MFM	LIC	BANKS	CRA	Total	Per cent
	Number of interviewees	4	3	17	4	28	100
	A: Independent director has no impact on the investment and lending decisions						
	Independent director has a personal or a pecuniary relationship with the key sponsor executive director	3 [MFM1, MFM2, MFM4]	1 [LIC3]	4 [DCB2, DCB4, DCB10, FCB3]	3 [CRA1, CRA3, CRA4]	11	82.14
	Independent director has limited capacity to influence decisions in a sponsor family dominated board.	0	1 [LIC2]	2 [DCB5*, DIB1]	1 [CRA2]	4	
	Independent director has no involvement with the company's affairs	0	0	2 [DCB1*, DCB6]	0	2	
	Lending practices do not require consideration of the independent director	0	0	8 [NCB1,DCB1*, DCB3, DCB5*, DCB8, DCB9, DCB11, DIB2]	0	8	
	Total (A)	**3**	**2**	**15***	**4**	**23***	
	B: Independent director has an impact on the investment and lending decisions						
	Independent director is screened to ensure that he has no bad reputation	0	0	3 [DCB7, FCB1, FCB2]	0	3	
	Qualified independent director plays advisory roles	1 [MFM3]	1 [LIC1]	0	0	2	
	Total (B)	**1**	**1**	**3**	**0**	**5**	**17.86**

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank. * = interviewee mentions multiple reasons for no direct impact of board size on their decisions.

As shown in Table 6.5, 23 out of 28 interviewees state that the independent director has no direct impact on their decisions.

Eleven interviewees do not perceive any direct impact of independent directors on their decisions because the independent director has a personal or a monetary relationship with the key sponsor executive director. Their statements imply that the monitoring role of the independent director is substantially eroded. One typical comment from an interviewee of this group is:

Who is appointing the independent directors? - The sponsor directors. So, they will appoint their maternal cousin. There may be qualifications. How will you determine the qualification? – (1) the independent director must have at least 10 shares. Ok, sponsor directors will buy 10 shares in his name. (2) The independent director must have a Master's degree. Ok, they will appoint someone who has an MBA. Actually, it does not make difference that much (CRA -1).

Five interviewees do not perceive any impact of the independent director on their investment and lending decisions because the sponsor directors, being the majority on the board, do not consider the opinion of the independent directors while deciding on major issues in board meetings (Table 6.5). One interviewee comments:

Those who are key sponsor directors, they do not follow the independent director. There is no role of independent director. Those who are on the board for a long time take major decisions without considering the opinion of the independent director. As a result, there is no impact of the independent director on our investment decisions [LIC -2].

Two interviewees do not perceive any impact of the independent director on their lending decisions because the independent director has no connection with the company's affairs (Table 6.5). One of them comments:

Independent director is just a formality. First of all, independent director has no involvement with the company's affairs in most of the cases. It is just a formality and fulfilment of a legal requirement. He has no involvement in company's decision making and he has no power to influence company's affairs [DCB - 6].

Eight interviewees state that lending practices reduce consideration of the independent director (Table 6.5). According to these interviewees, banks cannot take a personal guarantee from the independent director because the independent director does not have a significant percentage of shareholding in the company. One typical comment is:

We do not [consider the independent director] because he [the independent director] has no shareholding and his [the independent director] net worth is not important to us; we cannot take a personal guarantee from him [the independent director] [NCB -1]

On the other hand, five interviewees perceive that the independent director has a direct impact on their investment and lending decisions (Table 6.5). Three credit analysts of banks perceive a negative impact of the independent director on their lending decisions only if the independent director of the borrower company has a bad reputation. One interviewee comments:

Yes, we see the name [of the independent director]. If it is a bad name, we try to reject the loan proposal. But it is not a bad name, I mean, if the independent director is not a loan defaulter or a politically affiliated person, then we go forward with the proposal [FCB - 1].

In addition, two investment managers indicated that they consider the independent director when making their investment decisions because qualified independent directors play an advisory role (Table 6.5).

We consider the independent director and I think that it is a good initiative. […]. The effectiveness of the independent director depends on his background and personality. If the independent director is knowledgeable and has the capacity to influence the decisions, it will surely add value [MFM -3].

6.2.3.2 Indirect impact of the independent director on investment and lending decisions

The arguments put forward by 17 interviewees suggest that the independent director does not play an effective role. Hence, the remaining 11 interviewees are asked:

How do you perceive the impact of an independent director on firm performance and accounting reporting quality?

Table 6.6 presents the perception of interviewees on the impact of an independent director on firm performance and accounting reporting quality.

Table 6.6: Perceptions as to the indirect impact of independent director on investment and lending decisions

Indirect impact of independent director	Views	MFM	LIC	BANKS	CRA	Total
	Number of interviewees	4	3	17	4	28
	A: The question is not asked	3 [MFM1, MFM2, MFM4]	2 [LIC2, LIC3]	8 [DCB1, DCB2, DCB4, DCB5, DCB6, DCB10, DIB1, FCB3]	4 [CRA1, CRA2, CRA3, CRA4]	17
	B: The question is asked	**1**	**1**	**9**	**0**	**11**
	Independent director has no indirect impact on respondents' decisions	1 [MFM2]	0	5 [NCB1, DCB3, DCB7, FCB1, FCB2]	0	6/11
	Independent director has an indirect impact on respondents' decisions	0	1 [LIC1]	4 [DCB8, DCB9, DCB11, DIB2]	0	5/11

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

Table 6.6 shows that six interviewees do not perceive any impact of independent director on firm performance and accounting reporting quality. According to these interviewees, the independent director does not have independence from the key sponsor director and thus, does not play any role. A representative comment is:

No. there is no impact of the independent director on accounting reporting quality. I just want to give an example. Professor M. is the independent director and member of the audit committee of A Ltd. He is an FCMA, a professor of accounting and was president of ICMAB for two terms. The SEC recently finds out that the accounting reports of A Ltd seriously non-comply with IASs and thus, fines TK 3,00,000 per director of A Ltd including Professor M. Basically Professor M is the friend of Mr B, the sponsor chairman of A Ltd and does not have any interaction with the company [DCB -3].

However, five interviewees perceive that, in spite of questionable independence, a qualified independent director contributes to firm performance and accounting reporting quality. A representative comment is:

When a board of directors includes an independent director, he may not be independent, he must be a professional. In general, the perception about him is that he is an expert person, and that is why he is independent. So, obviously he will give good comments for the betterment of the company performance and improvement of accounting reporting quality. Definitely it will have positive impact on performance and accounting reporting quality [DCB-8].

6.2.3.3 *Summary*

The results presented in Section 6.2.3.1 strongly suggest that institutional investors and bankers do not consider independent directors when making investment and lending decisions. There is, however, weak evidence that the bad reputation of the independent directors negatively affects the lending decisions of banks. It can be argued that the kinds of bad reputation mentioned by the interviewees should negatively affect loan granting decisions whether the director is independent or not. For example, a bank cannot extend credit to a company with a loan defaulter director as it is prohibited by a notification of the Bangladesh Bank (Section 3.7). Similarly, a bank may not extend credit to a company with a director who is highly politically affiliated because political affiliation increases credit risk. The business of politically affiliated directors may badly suffer when the relevant

party is not in power due to an antagonistic political culture in Bangladesh (Section 3.5.3) This evidence suggests that interviewees who perceive a direct negative impact of independent directors of bad repute on their decisions consider an independent director part of regulatory compliance, not because of the CG role of the independent director. Finally, there is only negligible evidence that a qualified independent director plays an advisory role.

The evidence reported in Section 6.2.3.2 again shows that a greater number of respondents do not perceive any impact of an independent director on firm performance and accounting reporting quality. The reasons put forward by these interviewees in favour of their arguments are similar to the reasons reported in Table 6.5. However, there is some evidence that a qualified independent director plays an advisory role.

The evidence, in sum, strongly suggests that institutional investors and bankers do not perceive any direct or indirect impact of an independent director on their decisions. This is because the governance role of the independent director is constrained by the sponsor shareholder directors, either employing someone as independent director who is closely related to the key sponsor executive director or disregarding the opinion of the independent director while making major corporate decisions. There is only limited evidence that the qualified independent director plays an advisory role and contributes to the performance and accounting reporting quality of the company. These findings imply that the independent director can do little to protect the interests of outside shareholders and creditors.

6.2.4 Perceptions as to audit committee

6.2.4.1 Direct impact of audit committee on investment and lending decisions

The audit committee is another important corporate governance mechanism introduced by the BCGG-2006 (Section 3.6.2.2). So, interviewees are asked:

How do you perceive the impact of an audit committee on your decisions?

Interviewees' perceptions about the direct impact of an audit committee on their decisions are presented in Table 6.7 which shows 23 interviewees state that the audit committee has no direct impact on their investment and lending decisions.

Table 6.7: Perceptions as to the direct impact of audit committee on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total	Per cent
Direct impact of audit committee	Number of interviewees	4	3	17	4	28	100
	A: Audit committee has no impact on the investment and lending decisions						
	The sponsor family members dominate the audit committee	2 [MFM1, MFM2]	1 [LIC3*]	7 [NCB1*, DCB3*, DCB4, DCB7, DCB10*, FCB3]	1 [CRA3]	11	89.28
	The key sponsor executive director, CEO, and finance director are often member of the audit committee	0	0	4 [NCB1*, DCB2*, FCB3, DCB10*]	1 [CRA2]	5	
	Audit committee members often lack qualifications	0	2 [LIC2*, LIC3*]	2 [NCB1*,DCB8*]	0	4	
	External auditor is not independent	0	1 [LIC2*]	4 [DCB4, DCB11, DIB1, FCB3]	1 [CRA4]	6	
	The audit committee is not prevalent yet in the non-financial companies.	0	0	4 [DCB1*, DCB6, DCB8*, DIB2, FCB2]	1 [CRA1]	5	
	Lending practices do not require consideration of the audit committee	0	0	7 [DCB1*, DCB2*, DCB5, DCB3*, DCB6, DCB9, FCB1]	0	7	
	Total (A)	2	2	17	4	25*	
	Audit committee has an impact on decisions	2 [MFM3, MFM4]	1 [LIC1]	0	2[a] [CRA1, CRA2]	5	9.72

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank; * = interviewee mentions multiple reasons for no direct impact of board size on their decisions. [i]nterviewees perceive positive impact of audit committee on their decisions but explanations indicate that audit committee is not effective.

Eleven interviewees do not perceive any direct impact of the audit committee on their investment and credit decisions because the audit committee is dominated by the members of the sponsor family. Their statements imply that the monitoring role of the audit committee is substantially reduced due to the presence of the sponsor family members on the audit committee. One typical comment from the interviewees of this group is:

[...] A Ltd of Mr. M is a good company in respect of our country. In its annual report, it discloses that it has an audit committee. Now the question is who the members of that audit committee are. Mr. N, the eldest son of Mr. M, Prof. F, a friend of Mr. M and another executive director of the company. Do you think that

Mr. N and Prof. F will be interested to disclose something that is against the interest of Mr. M's family? Is it possible or feasible in our culture? [LIC-3]

Five interviewees do not perceive any direct impact of the audit committee on their lending decisions because of the lack of separation between the audit committee members and the executives who are responsible for the preparation of the financial statements (Table 6.7). A typical comment on the limited separation of duties between the audit committee members and the executives is:

In a company where the board itself has no effectiveness, how can a sub-committee of that board can be effective? They are the owners of the company, they are the directors of the company and they are the chairman and members of the audit committee. Basically there is no segregation of the duties. How can an audit committee with these characteristics add value? [NCB – 1]

Three interviewees perceive that the audit committee is not effective because its members lack adequate qualifications to perform their role (Table 6.7). One investment manager of a life insurance company questions the qualification of audit committee chairmen and comments:

The chairman of the audit committee of X Bank Ltd is Mr Y, a famous terrorist of Bangladesh Chatra League [Student wing of Bangladesh Awami League]. He was a student of Islamic History. Somehow he became a director and the chairman of audit committee of the Bank. What does he know about accounting and the role of audit committee? [LIC -2]

Six interviewees perceive that the audit committee cannot directly influence their decisions because the external auditors are not independent (Table 6.7). Their response indicates that the external auditors do not raise issues to the audit committees and thus, the audit committee cannot augment accounting reporting quality:

The audit committee has no impact of my decision making. An audit committee can only add value if the external auditors are effective. In case of Bangladesh, the external auditors are not honest and independent; they are trained in such a way so that they can reduce the tax burden of the company. When the external auditors' job is to minimize tax, his audit will not be neutral. Thus, observation of audit committee will not be reflected in audited financial statements [FCB - 3].

Five interviewees perceive that audit committees are not actually appointed by companies and thus, there is no direct impact of the audit committee on their decisions (Table 6.7). A representative comment is:

Actually the audit committee or the structure that you are talking about is possible only in financial organizations; it does not exist in any corporate house. There may be, but I have not met any company yet as my client that has an audit committee [DCB - 8].

Seven interviewees state that they do not consider the audit committee while making their lending decisions because it is not required by the lending policy manual (Table 6.7). One typical comment from an interviewee of this group is:

No, I do not think that any bank in Bangladesh consider whether the borrower company has an audit committee or not. Again it is not required by the CRG guideline of Bangladesh Bank. We cannot ask the client for anything that is beyond the Bangladesh Bank's CRG guideline because our market is very competitive and there is an unhealthy competition among banks. If as a banker I do not extend loan, other bank will do it [DCB - 5].

Five interviewees, however, perceive that the audit committee has a direct impact on their investment and lending decisions. However, two analysts of credit rating agency do not give reasons for their view. Instead, their explanations indicate that the audit committee is largely ineffective. One of the analysts makes the following comment:

In a good number of instances we have found that he is the chairman of board, he is the chairman of the executive committee and he is the chairman of the audit committee. So, in that case this becomes superfluous [sic]. Since the board, the executive committee and the audit committee are represented by him, it is very natural what is appropriate for the executive committee, is also appropriate for the audit committee and the board. This is a conflict of interest (CRA - 2).

The explanations provided by the remaining three interviewees indicate that the audit committee is performing its CG role (Table 6.7). One interviewee of these three comments:

We also check the effectiveness of audit committee, whether the audit committee is only on paper. If it is only on the paper, it will not talk against the malpractices of the sponsor directors. If the audit committee is working effectively, the company will timely disseminate its quarterly, semi-annual and annual financial statements and those reports will have at least a reasonable quality [MFM - 4].

6.2.4.2 *Indirect impact of the audit committee on investment and lending decisions*

The arguments put forward by 20 interviewees suggest that the audit committee either does not exist or is ineffective. Hence, the remaining 8 interviewees are asked:

How do you perceive the impact of the audit committee on firm performance and accounting reporting quality?

Table 6.8: Perceptions as to the indirect impact of audit committee on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total
Indirect impact of audit committee	Number of interviewees	4	3	17	4	28
	A: The question is not asked	2 [MFM1, MFM2]	2 [LIC2, LIC3]	12 [NCB1, DCB1, DCB2, DCB3, DCB4, DCB6, DCB7, DCB8, DCB10, DIB2, FCB2, FCB3]	4 [CRA1, CRA2, CRA3, CRA4]	20
	B: The question is asked	2	1	5	0	8
	Audit committee has no indirect impact decisions	1 [MFM3]	0	4 [DCB5DCB11, DIB1, FCB1]	0	5/8
	Audit committee has an indirect impact on the decisions	1 [MFM4]	1 [LIC1]	1 [DCB9]	0	3/8

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

Table 6.8 presents their perceptions. It shows that five interviewees do not perceive any impact of the audit committee on firm performance and accounting reporting quality. According to these interviewees, the audit committee does not have sufficient independence from the management of the company and thus, does not differ with the decisions taken by the management of the company. A representative comment is:

A typical audit committee consists of two directors from the sponsor family and one independent director. As I said you earlier, the consideration of the opinion of the independent director depends on the whim of the sponsor directors. You can easily understand that this audit committee has no reason to differ with the executive management because the executive management is not separate from the sponsor family. So, the decisions taken by the executive management is also the decisions of the audit committee [DCB – 5].

Three interviewees, however, perceive that the audit committee is playing an effective role in increasing firm performance and accounting reporting quality. These interviewees, however, state that the positive impact of an audit committee on firm performance and accounting reporting quality can only result if the audit committee is properly constituted and its members have relevant qualifications. A typical comment is:

[...] it [audit committee] is a check and balance. There is an audit committee and the chairman of the audit committee who is not the chairman of the board generally. I think by law, it can't be happened. So there is another power point where there is a body which works as a check against the board and the management. So generally speaking, it helps. As per my experience, it helped a lot in many organizations [LIC-1]

6.2.4.3 Summary

The evidence reported in Section 6.2.4.1 strongly suggests that institutional investors and banks in Bangladesh do not perceive a direct impact of the audit committee on their decisions. The domination of the audit committee by the key sponsor directors and their family members, and the presence of key executives such as CEO and CFO on the audit committee, undermines its independence. The interviewees perceive that an audit committee comprising of the key sponsor directors and their family members will not do anything that goes against the interest of the sponsor family. Furthermore, the presence of the CEO or the CFO on the audit committee challenges its ability to assess management and the accounting reports of the company.

There is limited evidence that the lack of adequate knowledge of the audit committee members in accounting and financial management reduces the effectiveness of the audit committee (Section 2.6.4.3). This lack of expertise of the members is plausible given that Bangladesh as a developing country and has a limited number of qualified people. Furthermore, the first generation of Bangladeshi entrepreneurs are not well-educated (Section 3.3). There is also moderate evidence that the audit committee cannot influence accounting reporting quality because external auditors are not independent (Sections 3.4.5 and 3.6.3.2). The lack of independence of the external auditors reduces the chance of audit disagreement between the external auditors and the key sponsor executive directors. As a result,

the audit committee has limited scope to reinforce the independence of the external auditors and to add credibility to the audited financial statements. This evidence suggests that one of the important complementarities for the effectiveness of audit committees does not prevail in Bangladesh.

The evidence further suggests that several non-financial public limited companies in Bangladesh do not appoint an audit committee even though the BCGG-2006 recommends it. The sponsor directors may not appoint an audit committee because they are not interested in strengthening the internal CG structure or they perceive limited benefits of having an audit committee. Finally, there is a lack of pressure from bankers on companies to appoint an audit committee. The banks may not consider the audit committee important because they may reduce their information risk by some alternative mechanisms.

6.2.5 Perceptions as to Chief Financial Officer (CFO)

6.2.5.1 Direct impact of CFO on investment and lending decisions

The BCGG-2006 requires a company to appoint a CFO and properly define the roles and responsibilities of the CFO (Section 3.4.2.4). So, the respondents are asked:

How do you perceive the impact of the CFO on your decisions?

The perceptions of the respondents are summarised in Table 6.9 which shows that seven interviewees do not perceive any direct impact while 21 interviewees perceive a direct impact of the appointment of a CFO by an investee or a borrowing company on their decisions. This evidence is not consistent with the evidence reported in Sections 6.2.1 to 6.2.4. One reason may be that the CFO primarily makes direct contact with the institutional investors and banks while raising funds and this influences the perception of the interviewees.

A detailed analysis of the perceptions of the interviewees, however, reveals that several of 21 interviewees who perceive a direct impact of the CFO on their decisions percieve that the role of the CFO is constrained by several factors. Hence, I group the interviewees based on the factors that constrained the role of the CFO in Table 6.10 and the roles actually played by the CFO in Table 6.11.

Table 6.9: Perceptions as to the direct impact of CFO on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total	Per cent
Direct impact of CFO	Number of interviewees	4	3	17	4	28	100
	CFO has no impact on decisions	2 [MFM3, MFM4]	0	4 [DCB2, DCB11, DIB1, DIB2]	1 [CRA3]	7	28.57
	CFO has an impact on decisions	1 [MFM1, MFM2]	3 [LIC1, LIC2, LIC3]	13 [NCB1, DCB1, DCB3, DCB4, DCB5, DCB6, DCB7, DCB8, DCB9, DCB10, FCB1, FCB2, FCB3]	3 [CRA1, CRA2, CRA4]	21	71.43

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Domestic Development Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

According to nine interviewees, the CFO cannot play an adequate role because the sponsors delegate limited authority to the CFO (Table 6.10). These interviewees state that the CFO plays only a supporting role and does not have any decision making authority. One interviewee of this group comments:

[…] the CFO is still a support staff of the company and just supports the key sponsor director by providing information. Otherwise, the key decisions are taken by the main sponsor director. There are companies where the CFO is nothing but a clerk. He even cannot give us [the bank] a document without the prior permission of the key sponsor director. If the CFO adds any value to the company, that's because of information quality, not because of his decision making role [DCB 10].

Table 6.10 also shows that eight interviewees perceive that the CFOs in non-financial companies have insufficient qualifications to execute their role. Interviewees offer two arguments to explain the appointment of a less qualified CFO: (1) the sponsors of non-financial companies lack understanding of the return of reliable accounting information and (2) non-financial companies cannot afford qualified professional as CFOs. One representative statement from this group of interviewees is:

The people who are capable to do the work of the CFO are very much professional, they demand huge remuneration; and maximum non-financial companies of our country cannot afford that. As a result, companies re-designate the posts of general manager of finance, executive director of finance as CFO to comply with the Code [DCB – 8].

Table 6.10: Factors that constrain the role of the CFO

Views	MFM	LIC	BANKS	CRA	Total
Number of interviewees	4[a]	2[a]	11	3	21[a]
The sponsors delegate limited authority to the CFO	3 [MFM1,[b] MFM2[b], MFM4]	1 [LIC2[ab]]	3 [DCB2, DCB10[b], FCB3[b]]	2 [CRA3[a], CRA4[b]]	9
The CFO does not have adequate qualification	1 [MFM1[b]]	2 [LIC2[ab], LIC3[b]]	4 [NCB1[b], DCB5[b], DCB8[b] DIB1]	1 [CRA1[b]]	8
The CFO is not still prevalent in non-financial companies	1 [MFM3]	0	4 [DCB2, DCB7[b], DCB9[b], DCB11]	0	5
Family member of the sponsor is often appointed as CFO	0	0	1 [DIB2]	1 [CRA3[a]]	2

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank; [a] = interviewee mentions multiple reasons; [b] = interviewee perceives positive impact of the appointment of CFO but explains practice that implies that the CFO is not effectively playing its role.

Table 6.10 further shows that six interviewees perceive that the CFO is not appointed by most non-financial companies because the practice has not been developed. A typical comment is:

[…] if there is a CFO, we feel a little bit [of] comfort but it is not a point of consideration yet. Things do not develop yet in that level. Gradually it should be brought within the purview of analysis. Again the practice of appointment of CFO is not much prevalent [DCB -11].

Finally, two interviewees state that the CFO is often affiliated with the sponsor family and thus, does not play a governance role. One representative comment is:

There is a suggestion for appointment of a CFO. But you will often see that that CFO is a family member or a close relative of the chairman or the CEO of the company. The CFO of S Ltd is the daughter of Mr. A who is the main sponsor of S Ltd [CRA -3].

Table 6.11 summarises the interviewees' perception about the roles of CFO in Bangladesh. The interviewees state that the CFO is important to them because a professionally qualified CFO positively influences accounting reporting quality, operational efficiency, fund management and budget quality. Table 6.11 shows that 11 interviewees perceive that a professionally qualified CFO can positively influence

the quality of accounting reports. A representative comment of this group of interviewees is:

If the CFO of a company is a professional person especially an accounting and finance professional, the report quality of the company is generally better. I have seen the difference between the accounting reports prepared by a professional and a non-professional CFO. I have a lending relationship with a large export oriented company. Recently, it changed its CFO. The new CFO is a professional accountant. The report quality has changed dramatically. For example, the fixed asset schedule provided by it earlier and fixed asset schedule provided by it now is totally different. Current fixed asset schedule is totally clear [FCB - 3].

Table 6.11: Roles of the CFO

Views	MFM	LIC	BANKS	CRA	Total
Number of interviewees	2	1	11*	1	14*
A qualified CFO can improve the quality of accounting information	2 [MFM1, MFM2]	0	7 [NCB1[a], DCB1, DCB5[a], DCB7, DCB10,DCB11[b], FCB3]	2 [CRA1, CRA2]	11
A qualified CFO can improve the quality of fund management	0	0	4 [NCB1[a], DCB3, DCB5[a], DCB6[a]]	0	4
A qualified CFO can improve the quality of budget	0	0	3 [DCB4, DCB6[a], FCB1]	0	3
A qualified CFO can improve the operational efficiency	0	1 [LIC1]	3 [DCB1, DCB2[b], FCB2]	0	4
CFO helps the sponsor manipulate accounting information	0	1 [LIC2]	4 [DCB2, DCB3, DCB4, DCB6]	1 [CRA3]	6

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank; [a] = interviewee mentions multiple reasons for direct impact of the CFO on their decisions; [b] = interviewees do not perceive any impact of the CFO on his decision but explains benefits of the CFO.

In addition, four interviewees state that a CFO is important to them because a qualified CFO is efficient at managing funds and this reduces the chance of default and the need for emergency loans from banks (Table 6.11). A representative comment is:

[…] we are very concerned about the qualification and competence of the CFO. Basically, the proper fund management of the company depends on the qualification and competence of the CFO. […] we feel that a better CFO manages fund properly, reduces the need for emergency fund, and prepares more accurate budget. We see that companies with less qualified CFOs often ask for loan within two days due to fund crisis. This CFO cannot forecast the need of funds accurately. They are not good at preparing budgets. That's why, we often suggest client to properly manage fund by employing a qualified CFO [DCB – 6].

Moreover, three interviewees state that they directly assess the quality of the CFO while making lending decisions because a qualified CFO can better forecast the prospects of the project. Predicted cash flows are highly relevant to lending decisions, especially decisions relating to a project loan. A typical comment is:

We also consider his [CFO] previous business experience as well as forecasting power. This forecasting ability of the CFO is essential for smooth repayment of loan - the main point of consideration in our lending decisions [DCB - 4].

Furthermore, four interviewees state that a qualified CFO can improve the operational efficiency of the company. A typical comment is:

[…] what we want to see is the quality of the CFO. I personally always check who the CFO and the auditor of the company are and what people say about them. Because at the end of the day, it is the CFO whose quality actually matters, not the quality of the CEO or the chairman. If the CFO has a track record, I mean sound knowledge in business, and then you can always be 100 per cent certain about the quality of the company [LIC -1].

Finally, an interesting finding is that six interviewees perceive that the CFO helps the sponsors manipulate accounting information, especially if the sponsors lack qualification in accounting and finance. A typical comment is:

Basically accounting reports are prepared by professional accountants such as CFO. These professional accountants inform the chairman or managing director regarding which part of the reports needs to modify for what purpose [LIC-2].

6.2.5.2 Indirect impact of the CFO on investment and lending decisions

Section 6.2.4.1 provides the detailed perceptions of the interviewees regarding how the role of the CFO is constrained and how the quality of a CFO can help in improving firm performance and accounting reporting quality. Hence, a direct question regarding the impact of the CFO on firm performance and accounting reporting quality is not asked.

6.2.5.3 Summary

The evidence reported in this section shows that 21 interviewees perceive a direct positive impact of a qualified CFO on the investment and lending decisions of institutional investors and bankers respectively. However, 17 interviewees are concerned about the limited authority and poor qualifications of CFOs. In addition,

five interviewees state that most of the non-financial companies do not appoint a CFO after the adoption of the BCGG-2006 and in order to comply with the provision of the BCGG-2006 regarding CFO, these companies designate one of their accounting and finance managers as the CFO. Furthermore, two interviewees state that the sponsor family appoints one of its members to the position of the CFO.

On the role of the CFO, the interviewees perceive that the appointed CFO is burdened with maintenance of accounting reports, the management of funds and preparation of budgets. Prior literature (Section 2.6.4.4) provides evidence that accounting reports maintenance, fund management and budget preparation are the traditional roles of the CFO. The CFO who performs these traditional roles is regarded as a 'bean-counter'. This literature also reports that in order to be an 'action-hero', the CFO needs to play strategic and operational decision making roles. Only three out of 28 interviewees perceive that the CFO in Bangladesh plays an important role in increasing the operational efficiency of the company. This evidence indicates that the CFO in Bangladesh is still a 'bean counter' rather than an 'action-hero'. Hence, the adoption of the BCGG-2006 does not change the role of the CFO much in non-financial companies of Bangladesh.

6.2.6 Perceptions as to head of internal audit (HIA)

6.2.6.1 Direct impact of HIA on investment and lending decisions

The BCGG-2006 requires a company to appoint a HIA and properly define the roles and responsibilities of the HIA (Section 3.6.2.3). So, the respondents are asked:

How do you perceive the impact of the HIA on your decisions?

The perceptions of the interviewees are summarised in Table 6.12 which shows that 22 interviewees state that the appointment of a HIA by an investee or a borrowing company has no direct impact on their investment and lending decisions.

Seven interviewees perceive that the HIA has limited authority and performs responsibilities which are beyond internal audit. Their statements imply that the role of the HIA is substantially constrained by the lack of a direct communication channel

between the HIA and the audit committee or the board of directors. One representative comment from the interviewees in this group is:

> *[…] I have seen even in large companies that the HIA has no authority to directly communicate with the audit committee or the board of directors. I do not want to mention the name of the company. I find that it [a company] has two people in the internal audit department and the HIA reports to the head of accounts and finance, who is working under the CFO. That is, the internal audit has no access to the audit committee or the board of directors. So, I am confused about the role of the internal audit [CRA – 4].*

Table 6.12: Perceptions as to the direct impact of HIA on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total	Per cent
Direct impact of HIA	Number of interviewees	4	3	17	4	28	100
	A: HIA has no impact on the investment and lending decisions						
	The HIA has limited authority and extra duties	1 [MFM1]	0	2 [DCB5*]	4 [CRA1*, CRA2, CRA3*, CRA4]	7	82.14
	The board and the audit committee structure hamper the effectiveness of HIA	2 [MFM2*, MFM3*]	2 [LIC2, LIC3]	4 [NCB1, DCB2, DCB10, FCB1]	0	8	
	The HIA is not prevalent	3 [MFM2*, MFM3*, MFM4]	0	7 [DCB3*,DCB5*, DCB7, DCB8, DIB2, FCB2, FCB3]	3 [CRA1*, CRA3*, CRA4]	13	
	The HIA is not considered because accounting information lacks reliability	0	0	2 [DCB11, DIB1]	0	2	
	Lending practices do not require consideration of the HIA	0	0	4 [DCB1, DCB3* DCB4, DCB9]	0	4	
	Total (A)	**4**	**2**	**15**	**4***	**22***	
	HIA has an impact on the investment and lending decisions	0	1 [LIC1]	2 [DCB6, FCB3]	3 [CRA1, CRA2, CRA3]	6	23.81

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank. * = interviewee mentions multiple reasons for no direct impact of board size on their decisions.

Table 6.12 also shows that eight interviewees perceive that the structure of the board and the audit committee constrained the role of the HIA. According to

these interviewees, the HIA has no way to help monitor the key sponsor executive director as both the board and the audit committee are dominated by the sponsor family members and often the key sponsor executive director sits on both the board and the audit committee. One representative comment from the interviewees of this group is:

Well, the head of internal audit has no impact on our decisions. Under current structure of our companies, the internal audit cannot add much value. For example, A Ltd has appointed a qualified head of internal audit and followed the best practice recommendations. So, under best practice recommendations, the head of internal audit will report to the audit committee and audit committee will report to the chairman of the board about the execution of decisions by the CEO. The CEO of A Ltd is Mr. AR, the son of Mr. AN who is the chairman of the board and the audit committee consists of three members of their family and one previous colleague of Mr. AN. Do you think that Mr. AR does anything without the consent of Mr. AN? Does the head of internal audit have any capacity to report on the misdeeds of Mr. AR? So, ultimately it is Mr. AN as long as he is there. After that, it is Mr. AR. Whatever the quality of internal audit; it has nothing to do with the interest of the general shareholders and the creditors [FCB - 1].

Table 6.12 further reports that 13 interviewees state that the practice of internal audit is not prevalent in non-financial sectors. The opinions of these interviewees imply that the consideration of HIA as a criterion for investment and lending decisions will reduce the number of investible or bankable companies enough to sustain their own operation. A typical comment from an interviewee of this group is:

Most of the companies in Bangladesh do not have an internal audit system in place. May be few big corporate houses has it in the organization structure, but I don't think it is very efficient. But when we consider cases from our bank's point of view, at this moment we really cannot give much weight on this factor. If we do it, we will not be able to run our business [DIB - 2].

Two bank credit analysts state that they do not consider the HIA because their lending decisions do not depend on audited accounting information supplied by the borrowing company. These interviewees are very sceptical about the reliability of the audited accounting reports and state that accounting related matters are of little use to them. One interviewee comments:

The thing is that we do not bother about accounting related things. Our decisions are not based on accounting reports supplied [by the borrower]. We

collect information directly and make our analysis based on that. So, we have no concern about the HIA [DIB -1].

Five interviewees state that they do not consider the HIA when making their lending decisions because it is not required by the CRG guidelines of the Bangladesh Bank. One typical comment from an interviewee of this group is:

[…] for our decision making, so far I think no bank consider the internal auditor in case of granting credit. The lending practices do not require it [DCB - 3].

Table 6.12 also shows that six interviewees consider the HIA while making their investment and lending decisions. However, the explanations of all three analysts of credit rating agencies and one credit analyst of a bank indicate that internal audit is not practiced by a large number of Bangladeshi companies and if practiced, it is largely ineffective. One of the analysts of a credit rating agency comments:

We consider whether a public limited company has appointed the HIA or not. To whom he is reporting? He reports to the CEO. In some places, the HIA reports to his senior such as the CFO. The direct reporting to the CEO is more effective than reporting to the senior. It would be better if he can directly report to the audit committee or the board. But I didn't see any company where the HIA directly reports to the audit committee or the board of directors [CRA – 1].

The explanation provided by one of the remaining two interviewees indicates that he considers the presence of compliance officer to be more important than HIA.

We basically analyse the results. In case of RMG industries, for example, there are several regulatory or compliance issues such as whether companies pay minimum wages to workers, […] and inspector's certificate of factory visit. We seek all these certificates and when we find that all these certificates are valid, we assume that internal audit is very much sound. So, you can say that we by default assess the qualities of the HIA [DCB – 6].

The remaining interviewee states that the internal audit has a direct impact on his investment decisions because, according to him, the HIA has the capacity to positively influence accounting reporting quality. He comments:

We try to find out who the HIA [of the investee company] is. Because he [the HIA] is a part of the audit team. So, if there is a good internal audit department, we take it as a sign of corporate organization. We also try to find out [to whom the HIA reports]. This is actually [whether] he [the HIA] reports to the audit committee through the chairman [of the audit committee]. So, if there is a good internal audit team, it is obviously a plus [for us] [LIC -1].

6.2.6.2 *Indirect impact of the HIA on investment and lending decisions*

The perceptions of 21 interviewees as described in Section 6.2.6.1 suggest that Bangladeshi companies either do not practice internal audit or practice internal audit which is ineffective. Hence, the remaining 7 interviewees are asked:

How do you perceive the impact of HIA on firm performance and accounting reporting quality?

Table 6.13 presents the perception of interviewees on the impact of the HIA on firm performance and accounting reporting quality.

Table 6.13: Perceptions as to the indirect impact of HIA on investment and lending decisions

	Views	MFM	LIC	BANKS	CRA	Total
Indirect impact of HIA	Number of interviewees	4	3	17	4	28
	A: The question is not asked	4 [MFM1, MFM2, MFM3, MFM4]	2 [LIC2, LIC3]	11 [NCB1, DCB2, DCB3, DCB5, DCB7, DCB8, DCB10, DIB2, FCB1, FCB2, FCB3]	4 [CRA1, CRA2, CRA3, CRA4]	21
	B: The question is asked	0	1	6	0	7
	HIA has no indirect impact on the respondents' decision making	0	0	5 [DCB1, DCB4, DCB6, DCB11, DIB1]	0	5/7
	HIA has an indirect impact on the respondents' decision making	0	1 [LIC1]	1 [DCB9]	0	2/7

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

Table 6.13 shows that 4 out of 7 interviewees perceive that the appointment of a HIA has no impact on firm performance and accounting reporting quality. The reasons put forward by these interviewees are similar to the reasons cited in table 6.12. A typical comment is:

Truly speaking, the practice of internal audit has not yet developed in our non-financial sector. Few companies designate a person as the HIA and most companies do not even have that designation in their organogram. In case of companies that designate a person as the HIA, you will find that the person is basically an assistant of the chief accountant and he cannot do anything without the approval of the chief accountant. He has no power to recommend any changes in the internal control system of the company [DCB-4].

However, two interviewees perceive that the internal audit is practiced by many companies and the HIA is delegated enough authority by the companies to be effective. As a result, the HIA is perceived to positively contribute to firm performance and accounting reporting quality. A typical comment is:

> *[...] generally speaking, I've seen most of the companies want to have a strong internal audit team for their own benefit. So they [companies] delegate a reasonable amount of power [to the HIA] so that he [the HIA] can investigate and dig out what is out there. I think [that] he [the HIA] is performing more or less well [LIC – 1].*

6.2.6.3 Summary

The evidence reported in Section 6.2.6.1 strongly suggests that institutional investors and banks in Bangladesh do not consider the appointment of a HIA when making their decisions. Twenty-two opinions indicate that internal audit either (1) is not practiced effectively by most of the companies or (2) is not practiced at all. According to 15 interviewees, to the extent that internal audit is practiced, its effectiveness is mediated by limited authority, role ambiguity, and the structure of the board and audit committee. The authority of internal audit is compromised because the HIA is not given an upper level position in the organisational hierarchy and does not have direct access to the audit committee or the board of directors. Instead, the head of internal audit reports to the CEO or the CFO. This evidence implies that the internal audit function in Bangladesh follows traditional reporting channels and thus, the internal audit function lacks independence and objectivity.

Furthermore, the presence of the sponsor family members on the management, board and audit committee does not allow the audit committee to work as a forum to uphold the independence of the internal audit function. The internal auditor also may not raise a matter affecting the CG of the company with the audit committee because the interest of the audit committee is fully aligned to that of the management and ultimately, with that of the sponsor family. The structure of the board and the audit committee needed for safeguarding the independence and objectivity of the internal auditor is not present in non-financial companies in Bangladesh.

Thirteen interviewees state that internal audit is not practiced by most of the companies. Due to the direct presence of the sponsor family members on the board and on other executive management positions in the company, there is a minimum agency conflict between the management and board and thus, the board may not need the assurance services of the internal auditor (Section 2.6.4.5). The size of Bangladeshi companies is not large enough to generate the operational complexity necessary to require the presence of internal audit.

As accounting information lacks reliability in Bangladesh companies, the internal audit function does not influence the decisions of institutional investors and bankers. Finally, internal audit is not considered by the banks because the CRG guidelines of the Bangladesh Bank do not require it.

The interviewees who assessed the effectiveness of internal audit also perceived that internal audit is not functioning properly in Bangladesh. Only one interviewee states that internal audit enjoys appropriate authority and contributes to the quality of CG.

The evidence related to the impact of the appointment of HIA on firm performance and accounting reporting quality as reported in Section 6.2.6.2 also largely indicates that the sound practice of internal audit has not developed yet in Bangladesh. There is very limited evidence that the internal audit is effectively contributing to firm performance and accounting reporting quality.

6.2.7 Summary of Section 6.2

The results presented in this section strongly indicate that compliance with the BCGG-2006 is not considered by institutional investors and bankers when making investment and credit decisions respectively. The interviewees' perceptions suggest that the sponsors of companies either do not comply with the BCGG-2006 or comply with it in form but not in substance. Consequently, compliance with the BCGG-2006 makes limited change in the internal CG structure of companies. A contrary view is also evident from the description that lending practices prevent banks from considering compliance with the BCGG-2006 when making lending decisions.

The interview evidence suggests that the sponsors impede compliance with the BCGG-2006 in substance primarily by employing family members in the positions of both chairman and CEO and by creating a family-aligned board of directors (Section 6.2.1). The appointment of family members in the positions of both chairman and CEO does not allow the chairman to formally monitor and appraise the performance of the CEO. In addition, due to family relationships between the chairman and CEO, they may jointly serve the interest of the sponsor family rather than the interests of outside shareholders. Furthermore, the key sponsor director of the company retains key decision making authority when the CEO is an outside professional. The board of directors, the most important CG mechanism, is excessively populated by sponsor family members (Section 6.2.2). Given the culture of Bangladesh (Section 3.5.2), the family relationship between the board members and the CEO substantially reduces the monitoring role of the board. Moreover, the experience and qualification of these family directors is not beyond question. Consequently, the family members may not be able to play an advisory role. The newly appointed independent director has either a pecuniary or a personal relationship with the key sponsor executive director (Section 6.2.3). Furthermore, the independent director is a minority on the sponsor family-concentrated board. Hence, the independent director has no capacity to play a monitoring role. There is limited evidence that the qualified independent director is playing an advisory role. Overall, the evidence indicates that the board of directors as a whole has become a legal formality and plays a limited role in protecting the interests of the general shareholders and creditors (Sections 6.2.2 and 6.2.3).

A natural consequence of largely ineffective boards of directors is that the audit committees of companies also become ineffective (Section 6.2.4). As an audit committee is comprised of three directors from the board, the audit committee is also populated by the sponsor family members. A typical audit committee consists of two sponsor directors and one independent director whose independence is questioned by the majority of interviewees. As a whole, audit committees do not have minimum independence from the sponsors of the company. Furthermore, audit committee members lack the necessary qualifications to discharge their responsibilities. The scope of the audit committee is further reduced by the lack of independence and

objectivity of the external auditors of the company. In sum, the evidence suggests that audit committee characteristics and lack of complementarities reduce the impact of the audit committee on the internal CG structure of the companies in Bangladesh to a minimum level.

The internal audit function is not developed and is not practiced by a large number of Bangladeshi companies (Section 6.2.6). To the extent that it is practiced, the lack of authority and role ambiguity of the HIA reduces the effectiveness of the internal audit. The independence and objectivity of the internal audit is constrained by the presence of sponsor family members on the managements, boards and audit committees of companies.

The only important CG mechanism among the several mechanisms prescribed by the BCGG-2006 that positively influences the investment and lending decisions of institutional investors and bankers respectively is the CFO (Section 6.2.5). The interview evidence suggests that the CFO has both a direct and indirect impact on the decisions of institutional investors and bankers. However, there is evidence that the sponsors do not delegate enough authority and often employ a less qualified CFO. As a result, the CFO mostly plays a traditional 'bean counter' role and the impact of a CFO on the decisions of the institutional investors and bankers mainly result from the CFO's contribution to the maintenance of accounting reports, fund management and the preparation of budgets. That is, the CFO is not playing the role of an 'action hero' as expected by the Anglo-American model of CG.

6.3 Rent protection motive of sponsor families

The process of development of the Bangladesh corporate sector (Section 3.3) prompts family-based capitalism in Bangladesh. The perceptions of a number of interviewees indicate that control by the sponsor family hampers the effective implementation of the BCGG-2006. According to these interviewees, the sponsor family maintains its control over the company by one or more of the following mechanisms: (1) appointing its members to the positions of both chairman and the CEO; (2) delegating limited authority to an outside professional CEO (Section 6.2.1); (3) populating the board of directors by its members (Section 6.2.2); (4) appointing an independent director who is related to the sponsor directors (Section 6.2.3); and

(5) populating the audit committee by the members of the sponsor family (Section 6.2.4). A typical comment on the role of family control on the implementation of the BCGG-2006 is:

The fact is that 95% of the businesses of our country are owned by few families […] the family business becomes a chronic barrier on the way to transparency and good corporate governance [LIC - 2].

Hence, a question arises why the sponsor families are not interested in implementing the BCGG-2006 in form and in substance. One reason can be sponsor families enjoy private benefits of control and they intend to protect these benefits. This is plausible because the control structure of Bangladeshi companies and institutional characteristics of Bangladesh suggest that high private benefits of control exist (Section 3.4). Hence, if interviewees' perceptions indicate that sponsor families do not implement the BCGG-2006 in form and in substance in order to foster the interest of the families, the perceptions are interpreted as evidence of the rent protection motive of sponsor families.

Table 6.14 presents open-codes which indicate that the sponsor families have rent protection motives underlying non-compliance or compliance in form but not in substance with the BCGG-2006.

Responses of 13 out of 28 interviewees indicate that the sponsor families benefit from unreported related party transactions under the present control structure of companies. Two major types of related party transactions reported by the interviewees are: (1) transactions with unlisted sister concerns owned by the sponsor family and (2) personal transactions with the sponsor directors. One interviewee who gives an example of a personal transaction with a sponsor director comments:

Unfortunately, most of our directors use internal transactions and benefit themselves which they do not report in the accounts. For example, recently a large corporate house, I do not want to mention the name, bought a piece of land almost at double price than the actual market price; later on it was revealed that the land was owned by one of the influential directors of the company. It implies that a group of directors are actually reaping disproportionate benefits by using the corporate structure [MFM -3].

Table 6.14: The sponsor family has a rent protection motive behind non-compliance with the BCGG-2006

	Sub-themes	MFM	LIC	BANKS	CRA	Total
Rent seeking motive of the sponsor	Number of interviewees	4*	3*	16*	3*	28*
	Undisclosed related party transaction	3 [MFM1*, MFM3*, MFM4*]	1 [LIC3*]	8 [NCB1*,DCB2, DCB3*,DCB4*, DCB6, DCB8*, DCB11, DIB1]	1 [CRA2*]	13
	Manipulation of accounting reports to inflate the premium of IPO, to declare minimum or no dividend, and to purchase share at low prices	4 [MFM1*, MFM2, MFM3*, MFM4*]	1 [LIC3*]	6 [NCB1*,DCB1*, DCB3*, DCB7*, DCB8*, FCB1*]	2 [CRA2*, CRA3*]	13
	The sponsor uses directorship to indirectly gain monetary benefits	1 [MFM1*]	2 [LIC2* LIC3*]	4 [NCB1*,DCB1*, DCB5*, DCB7*]	1 [CRA3*]	8
	Employment of the sponsor family members	0	2 [LIC1, LIC2*]	5 [DCB4*, FCB1*, DCB10*, DIB2, FCB3]	3 [CRA2* CRA3,* CRA4]	10
	The sponsors retain control by undesirable means	3 [MFM1*, MFM2*, MFM3*]	2 [LIC2*, LIC3*]	4 [NCB1*, DCB5*, FCB2, DCB10*]	1 [CRA2*]	10

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank. * = interviewee reports more than one form of rent -seeking behaviours.

Responses of 13 out of 28 suggest that the sponsor families expropriate minority shareholders' interest by inflating IPO prices, declaring minimum or no dividend and buying shares at low prices from secondary markets through the manipulation of market price. In order to justify these expropriations, the sponsor family manipulates accounting reports in collaboration with the external auditors (see also Sections 6.4.7 and 6.4.8). One interviewee who is an institution-nominated director in several companies comments:

I will say that there are two kinds of companies in our country - both do manipulation in respect of accounting reporting and dividend declaration. One group shows as usual profit and declares limited percentage of dividend and takes the remaining profit in their back pocket. The second group is more dangerous - they show no profit and declare no dividend. All profit is back-pocketed by sponsor directors [MFM - 1]

Perceptions of eight out of 28 interviewees indicate that the sponsor directors use their directorship to indirectly gain monetary benefits. A typical example used by this group of interviewees is:

[…] directors sometimes use their recommendation to serve their monetary interest. According to a Bangladesh Bank order, directors of banks cannot take loans from their own banks. So what they do, they recommend loan for directors of other banks and take loans in exchange from the banks of those directors. So, you know, it is a give and take relationship [DCB – 7].

Responses of ten interviewees suggest that the sponsor families are not interested in implementing the BCGG-2006 because they use the company as a source of employment for their family members for reasons which are not easily justified. A typical comment is:

The sponsor directors use the companies as a source of employment for themselves and their future generations which is not often legitimate [DCB - 4]

Finally, perceptions of ten interviewees suggest that the sponsor families retain control over their companies by several undesirable means. These include stage managed AGMs that restrict the participation of general shareholders in decision making, seeking injunction from the courts against reform initiatives of the regulatory agencies, appointing family members to bypass the rules regarding rotation of directors, and influencing the appointment of top officials of the regulatory agencies, especially SEC. One interviewee describes how the sponsor directors bypassed the rotation of directors by employing his wife:

These people keep control in any manner. For example, Bangladesh Bank issued a notification regarding rotation of directors in banks. What the sponsors directors of banks do to comply with this notification, they appoint their wives as directors. Do you think that their wives run the banks? All decisions are taken by the sponsor directors; their wives just signed the resolutions. The wives do not participate in any board meeting [DCB – 10].

6.4 Low efficiency in implementation of the BCGG-2006

Although a rent protection motive is one of the reasons for either non-compliance or compliance in form but not in substance, prior literature on the effectiveness of an Anglo-American model of CG in developing countries (Section 2.6.3) suggests that the institutional characteristics of developing countries hamper

efficient implementation of an Anglo-American model of CG. Hence, it is plausible that the existing corporate and institutional characteristics of Bangladesh discourage sponsor families from implementing the BCGG-2006 in form and in substance. Table 6.15 presents first-order codes that negatively influence the efficient implementation of the BCGG-2006.

6.4.1 Corporate culture of individual-centred management

Perceptions of 24 out of 28 interviewees indicate that compliance with the BCGG-2006 does not make significant changes in the internal CG structure of companies. This is because the type of corporate culture required for the efficient implementation of the BCGG-2006 is not present in Bangladeshi companies. According to these interviewees, each of the local privately-owned listed companies of Bangladesh was initiated by a single entrepreneur as a sole proprietorship or as a private limited company. Later this sole proprietorship or private limited company was converted to a public limited company and then free-floated on the capital market. In order to fulfil legal requirements, the board of directors comprises his family members and the key sponsor director remained as the key executive director of the company. Consequently, decision making authority is confined to this key sponsor executive director as previously (see also Section 6.2.1.1). These first generation entrepreneurs still run the company. As the company performed well under individual-centred management, the key sponsor director does not feel any necessity to diversify the board and decentralise the decision making process. One typical comment is:

> *Every business of our country is started by a single person. For example, if you think about B Ltd, it is started by Mr S. Similarly, C Ltd was started by Mr T. They are the key man in their organizations. They are still chairman of their organizations. The decision making authority is very much centralized to them. They tried hard and became successful businessmen. They find no justification to corporatize themselves [DIB -1].*

Table 6.15: The efficiency-based reasons behind non-compliance with the BCGG-2006

Sub-themes	MFM	LIC	BANKS	CRA	Total
No. of interviewees	4	3	17	4	28
Corporate culture of individual centred management **(6.4.1)**	3 [MFM2*, MFM3*, MFM4*]	3 [LIC1*, LIC2*, LIC3*]	15 [NCB1*,DCB2*,DCB3*, DCB4*, DCB6, DCB7*, DCB8*,DCB9*, DIB1*, DCB10*, DIB2*,FCB1*, DCB11*,FCB2*,FCB3*]	3 [CRA1*, CRA2*, CRA3*]	24
Size of the companies **(6.4.2)**	1 [MFM2*]	0	6 [NCB1*, DCB2*, DCB4*, DIB1*, DCB7*, FCB2]	1 [CRA3*]	8
Non-family board lacks trust among members (**6.4.3**)	1 [MFM4*]	3 [LIC1*, LIC2*, LIC3*]	11 [DCB1*, DCB2*, DCB3*, DCB4*, DCB5*, DCB7*, DCB8*, DIB1*, FCB3*, DCB10*, DCB11*]	1 [CRA1*]	16
Professional directors lack commitment (**6.4.4**)	0	[LIC1*]	8 [NCB1*, DCB1*, DCB3*, DCB5*, DCB8*, FCB1*, DCB11*, DIB1*]	1 [CRA3*]	9
National rules and regulations are anti-corporate **(6.4.5)**	3 [MFM2*, MFM3*, MFM4*]	0	5 [NCB1*, FCB2*,DCB11*, FCB3*]	1 [CRA3*]	8
A national culture of corruption **(6.4.6)**	4 [MFM1*, MFM2*, MFM3*, MFM4*]	2 [LIC2*, LIC3*]	11 [NCB1*, DCB1*, DCB2*, DCB3*, DCB4*, DCB5*, DCB11*, DIB1*, FCB1*, FCB2*, FCB3*]	1 [CRA3*]	18
Lack of reliable accounting information **(6.4.7)**	4 [MFM1*, MFM2*, MFM3*, MFM4*]	3 [LIC1*, LIC2*, LIC3*]	14 [NCB1*, DCB1*, DCB2*, DCB3*, DCB4*, DCB5*, DCB7*, DCB8*, DCB10*, DCB11*, DIB1*, DIB2*, FCB2*, FCB3*]	4 [CRA1*, CRA2*, CRA3*, CRA4*]	25
Lack of accountability of external auditor **(6.4.8)**	4 [MFM1*, MFM2*, MFM3*, MFM4*]	3 [LIC1*, LIC2*, LIC3*]	15 [NCB1*, DCB1*, DCB2*, DCB3*, DCB4*, DCB5*, DCB6*,DCB7*, DCB8*, DCB10*, DCB11*,DIB1*, DIB2*, FCB2*, FCB3*]	3 [CRA1*, CRA2*, CRA3*, CRA4*]	25
Lack of market pressure for compliance **(6.4.9)**	1 [MFM2*]	1 [LIC3*]	9 [DCB2*, DCB3*, DCB4*, DCB5*, DCB7*, DCB9, DCB11*,DIB1*, FCB1*]	2 [CRA1*, CRA3*]	13
Lack of monitoring and enforcement **(6.4.10)**	4 [MFM1*, MFM2*, MFM3*, MFM4*]	2 [LIC2*, LIC3*]	11 [NCB1*, DCB1*, DCB2*, DCB3*, DCB5*, DCB7*, DCB10*, DIB2*, FCB1*, DCB11*, FCB3*]	2 [CRA2*, CRA3*]	19
High emotional attachment of sponsors with the company **(6.4.11)**	1 [MFM2*]	1 [LIC2*]	9 [DCB1*, DCB2*, DCB3*, DCB4*, DCB7*, DCB8*, DIB2*,FCB2*, FCB3*]	3 [CRA1*, CRA2*, CRA3*]	14

Peer companies' practices affect non-compliance **(6.4.12)**	2 [MFM2*, MFM4*]	1 [LIC3*]	3 [DCB2*, DCB3*, FCB2*]	1 [CRA3*]	7
Complied companies do not perform better than others **(6.4.13)**	1 [MFM2*]	2 [LIC1*, LIC2*]	10 [NCB1*, DCB1*, DCB2*, DCB3*, DCB5*, DCB6*, DCB7*, DCB8*, FCB1*, FCB2*]	3 [CRA2*, CRA3*, CRA4*]	16

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank. * = interviewee reports more than one form of efficiency-based reasons.

6.4.2 Size of companies

Most companies in Bangladesh are small and medium in size (Farooque et al., 2007). Several interviewees argue that the size of companies is constrained by the intense control desire of first-generation entrepreneurs. An interviewee comments:

They [sponsor directors] do not want to rely on the external management. Sometimes we see that directors often do not expand their businesses though there is good opportunity. Their tendency is to keep everything under personal control. This is one of the reasons that our companies fail to reach at global level [DCB-2]

The perceptions of eight interviewees suggest that the size of Bangladeshi companies hampers effective implementation of the BCGG-2006, especially provisions related to internal control and internal audit (Table 6.15). A typical comment is:

Basically the size of our companies is not large enough to accommodate all these provisions. For example, the number of employees needed for the effective internal control and internal audit cannot afford by our medium and small-sized companies [DCB -4]

6.4.3 Non-family board lacks trust among members

A family-concentrated board has been perceived by a number of interviewees as the most important factor for the ineffectiveness of compliance with the BCGG-2006 (Section 6.2 and 6.3). However, responses of 20 out of 28 interviewees (Table 6.15) indicate that a family-concentrated board is better suited in Bangladesh because the members of a non-family board do not trust each other after a certain period, especially when the business becomes profitable. One typical comment is:

Our bank has investment in several companies where directors were friends and neither of them have significant ownership or decision making hegemony. I observed that this type of ownership and decision making authority creates problem. If the project fails, then they [directors] remain good friends. However, when the company starts making profit, then they [directors] start thinking that others are taking major portion of the profits whether others actually take major portion of profit or not [DIB -1]

6.4.4 Professional directors lack commitment

Another reason for the persistence of strong family control of companies is the lack of commitment of the outside professional directors, more importantly the professional CEOs. The risk of conflict and low commitment of outside professional directors refrain the controlling family from appointing outside professional directors. A typical comment is:

I will say that X Ltd failed due to the appointment of a professional CEO. This is my personal opinion. Mr. S is a good entrepreneur. He [Mr. S] started many companies simultaneously and offered huge salary to the employed CEOs. […] I financed one of his projects but the project did not run well. Similar things happened in case of his [Mr. S] other projects. Why did this happen? I will say that the people who were employed as CEOs by Mr. S were over-salaried and did not perform their duties with sincerity or their integrity was questionable [DCB - 8].

6.4.5 National rules and regulations are anti–corporate

Seven interviewees perceive that national rules and regulations do not encourage corporatisation because they are not corporate friendly (Table 6.15). Important laws mentioned by these interviewees are related to tax, copyright, and takeover. Interviewees perceive that takeover regulations in Bangladesh eliminate the threat of takeover. A typical comment is:

There is limitation of law; you cannot easily take over a company by buying a significant percentage of shares [NCB-1].

Furthermore, weakness in copyright laws encourages control by the sponsor family because control by the sponsor family helps maintain confidentiality about new product development and innovation. A typical comment on the issue of copyright regulation is:

We have issues related to trademark, intellectual properties and other things; what happens is that entrepreneurs are fearful that they [entrepreneurs] may not

have security to protect their [entrepreneurs'] interest. That also brings inefficiency and non-compliance. It has traditionally been going on. [MFM -2]

6.4.6 A national culture of corruption

The perceptions of 18 interviewees suggest that rampant corruption in Bangladesh leads to non-compliance with the BCGG-2006 (see also Sections 6.4.4 and 6.4.8). These interviewees perceive that corruption is widespread from the office of the prime minister to the lowest level of administration. Companies have leeway to escape compliance with any laws by bribing government officials or by using political connections with the ruling party. As a result, companies are not interested in complying with mandatory rules; the spirit of a 'comply or explain' guideline is beyond consideration. One representative comment is:

As you know that in our country if there is a law, there is some way out. You can manage anything and everything if you have money and/or political connection. When I think about the issue of corporate governance, firstly I have to think about the matter of legal compliance. [...] If the companies can ignore [sic] legal compliance by undue means, they will not bother [to comply with a] comply or explain basis [sic] corporate governance code [DCB -11]

6.4.7 Lack of transparent accounting information

Twenty-four out of 28 interviewees perceive that audited financial statements in Bangladesh are not detailed and transparent (Table 6.15). According to the interviewees, the accounting information system has not been developed because the sponsor directors are not interested in investing in the development of accounting information systems. This is because the sponsor directors lack understanding of the benefits of maintaining detailed and transparent accounting information. In order to fulfill the legal requirement, the companies prepare a set of statements which does not present the true and fair position of the company and hires a low quality auditor who certifies the statements without proper verification. As a result, published accounting reports do not provide reliable information. A representative comment is:

[...] they [the sponsor directors] do not always value the quality of accounting. Because if it serves their purpose, then it is ok, they don't think about it much. This is a major weakness in our country -particularly the quality of reporting. [...].Our owners are top decision makers. Probably they have other priorities. They want to sell more, so they want to employ their resources in those areas like marketing and production. For accounting, I have hardly seen any organization who

takes good accountants willingly. […] May be they do not understand that this is an area where it is necessary to have good people. But resource constraint may be one factor where they can't always be good people and good systems. Another factor may be they don't value good quality reporting because if they value, they have to prepare a good accounting system -even bigger organizations. May be there is a value problem or perception problem [LIC -1].

6.4.8 Lack of accountability of external auditors

As shown in table 6.15, 25 out of 28 interviewees perceive that except for audit firms which are affiliated with international big-four firms, external auditors in Bangladesh do not have independence and integrity. Two interviewees of this group also raise questions about the independence and objectivity of audit firms affiliated with international big-four auditors. The interviewees perceive that the external auditors collaborate with the key sponsor directors to manipulate the accounting reports in order to minimise tax and dividends[16], certify different sets of accounting reports for a single company to serve different purposes of the company, prepare and certify accounting reports for companies without having qualified accountants, simultaneously revalue assets and certify the financial statements, and deliver artificial audited financial statements for minimum amount of fees. A common response about the integrity of the external auditors is:

[…] there is no accountability of our chartered accounting firms except few [large audit firms]. They prepare and certify a set of accounts if a company gives them a small sum of money. […]. At this moment, if a company gives TK 10,000 [£90] to a chartered accounting firm, it prepares and certifies a set of financial statements to serve the purpose of the company [DCB -11]

6.4.9 Lack of market pressure for good CG

The perceptions of 13 out of 28 interviewees suggest that there is a lack of pressure from shareholders as well as from banks for effective compliance with the BCGG-2006 (Table 6.15). Two comments – one describing the lack of pressures from the shareholder and one describing the lack of pressures from the banks – are:

[…] shareholders are not aware about corporate governance. I will say that there is a little demand for non-financial information from the shareholders'

[16] Sponsor shareholder directors minimise dividend in order to expropriate minority shareholder interest.

perspective. In many countries there are shareholders awareness program but in case of our country, there is nothing such [MFM -2].

Bankers lend money to the person behind the corporation, not to the corporation. This attitude prevails. […] As banks do not bother about corporate culture, companies do not bother about these things [CRA -1]

6.4.10 Lack of monitoring and enforcement

The regulatory authority cannot enforce compliance with an Anglo-American model of CG as it is a 'comply or explain' basis model (Section 2.3). However, 19 out of 28 interviewees perceive that the lack of monitoring and enforcement by the regulatory authorities, especially the BSEC, is one of the important reasons for the non-compliance with the BCGG-2006 (Table 6.15). Most of these interviewees articulate that corruption of BSEC officials and influence of the interest groups including government on the appointment of SEC officials are responsible for the impotence of the BSEC. Few interviewees, however, perceive that the BSEC lacks an adequate number of skilled personnel to monitor and enforce regulations. This again implies that the perceived benefit of compliance with the BCGG-2006 is low. One typical comment on the corruption of BSEC officials and interest groups' influence on the appointment of SEC officials is:

The responsibility for the non-compliance with the BCGG-2006 again goes to the BSEC. The BSEC is not independent, neutral. The BSEC chairman is appointed by an interest group to maximize its interest, not the interest of the general shareholders. If you consider the current turmoil of our capital market, I will say that the BSEC, Bangladesh Bank and Government are responsible for it [the turmoil]. […] the BSEC officials are happy with bribes [MFM -1].

An interviewee who perceives that the BSEC does not have an adequate number of skilled officials to monitor and enforce the governance states:

The BSEC does not have enough and qualified people. The issue department is run by seven people only. It is not possible to effectively monitor the companies with seven people [MFM – 4].

6.4.11 High emotional attachment of sponsors to companies

Although there is evidence that the sponsor families maintain strict control over the company in order to protect their private benefits (Section 6.3), 14 interviewees perceive that the strict control by the sponsor family is a matter of

emotion in the sense of belongingness to the company (Table 6.15). According to these interviewees, most Bangladeshi companies are still run by first generation sponsors. They have invested enormous effort in ensuring the success of their initiative. They have an emotional attachment with their companies and they are not ready to handover control to an outside professional CEO and appoint an independent director who has absolute independence. One typical comment is:

I do not see anything negative in this lack of good governance because all of these entrepreneurs started from very root level and built up their organizations by their flesh and blood. So, they do not believe in governance. Their mind-set is that they have made these success stories by themselves and thus, why should they share that success with other people? [...] they believe that professional managers will not be able to run their businesses properly [CRA -3].

6.4.12 Peer companies do not comply

Table 6.15 also reports that seven interviewees argue that compliance with the BCGG-2006 in form and in substance can be competitively disadvantageous for a company because compliance is costly and peer firms, especially private limited companies, do not comply with the BCGG-2006. A typical comment is:

The quality of corporate governance is affected by the peer practices. Assume that there are two companies- one has appointed a qualified managing director but other has not. The company with the qualified managing director may be at disadvantaged position unless it can capitalise the quality of managing director because of high remuneration paid to its managing director [FCB -2]

6.4.13 Family-controlled companies do not perform worse than others

The perceptions of 16 out of 28 interviewees suggest that accounting reporting quality and the performance of companies that comply with the provisions of the BCGG-2006 are not superior to companies that do not comply with the provisions of the BCGG-2006. For instance, one interviewee makes the following comment when answering the question whether companies controlled by professional CEOs have better performance and accounting reporting quality:

Not necessarily. The performance and accounting reporting quality of SP Ltd is better than the performance and accounting reporting quality of BP Ltd. However, the SP Ltd is managed by a sponsor family affiliated CEO and the BP Ltd is managed by an outside professional CEO [FCB2].

6.5 Investment and lending practices

Sections 6.3 and 6.4 respectively indicate that the rent-protection motive of the sponsor families and the institutional characteristics of Bangladesh hamper effective implementation of the BCGG-2006. This ineffective implementation of the BCGG-2006 is one of the reasons why institutional investors and bankers do not consider compliance with the BCGG-2006 in their decision making processes (Section 6.2). Sections 2.2.7.1 and 2.5.3, however, provide an indication that the lending practices of banks in developing countries often substitute for institutional weaknesses. I do not find any specific literature on the investment decision processes of institutional investors in developing country except a general indication that financing transactions in developing countries are not at arm's length (e.g., Singh and Zammit, 2006). Like lending practices, the investment practices of institutional investors in developing countries may have some characteristics that also substitute for institutional void.

Prior literature on organisational decision making also suggests that decision makers are bounded by their cognitive abilities (March and Simon, 1958) and typically lock themselves in the system's dynamics (Sydow et al., 2009) when the outcomes of their past decisions are self-reinforcing (e.g., Davis and Kottemann 1995). Institutional investors and bankers may lock-in investment and lending practices that are typical in developing countries (section 2.5.3). These practices may deter consideration of compliance with the BCGG-2006. Table 6.16 presents open codes that indicate that investment and lending practices hinder consideration of compliance with the BCGG-2006 while making investment and credit decisions.

6.5.1 Rent seeking behaviour of institutional investors and bankers

The perceptions of 14 out of 28 interviewees suggest that rent-seeking behaviour by directors of institutional investment companies and banks hinders analysts to rationally appraise a proposal and consider CG. One representative comment from a bank credit analyst is:

According to Bangladesh Bank order, directors of banks cannot take loans from their own banks. So what they did, they recommend loan for directors of other

bank and take loans in exchange from the banks of those directors. When directors recommend a loan, I have no role to play. I may not agree with a proposal but I have to sanction the loan as top management already decides to extend the loan [DCB-7]

Table 6.16: Characteristics of investment and lending practices

Views	MFM	LIC	BANKS	CRA	Total
Number of interviewees	4	3	17	4	28
Rent seeking behaviour of institutional investors and bankers **(6.5.1)**	1 [MFM3]	2 [LIC1, LIC2]	9 [NCB1, DCB1, DCB3, DCB4, DCB5, DCB7, DCB8, DCB11, DIB1]	2 [CRA3, CRA4]	14
Rent seeking behaviour of politicians (6.5.2)	-	-	8 [NCB1, DCB1, DCB2, DCB5, DCB7, DCB9, DIB2, FCB2]	-	8
Name-based lending and investment practices **(6.5.2)**	2 [MFM2, MFM4]	3 [LIC1, LIC2, LIC3]	15 [NCB1, DCB2, DCB3, DCB4, DCB5, DCB6, DCB7, DCB8, DCB9, DCB10, DCB11, DIB2, FCB1, FCB2, FCB3]	2 [CRA1, CRA3]	22
Relationship-based investment and lending practices **(6.5.3)**	2 [MFM2, MFM4]	1 [LIC1]	11 [DCB1, DCB3, DCB4, DCB5, DCB7, DCB8, DCB10, DIB1, FCB2, DCB11, FCB3]	1 [CRA1]	15
Preference to family legacy of key sponsor **(6.5.4)**	2 [MFM2, MFM4]	1 [LIC3]	11 [DCB1, DCB2, DCB3, DCB5, DCB6, DCB8, DCB11, DIB1, FCB1, FCB2, FCB3]	3 [CRA1, CRA3, CRA4]	17
Collateral-based and personal guarantee-based lending practices **(6.5.5)**	N/A	N/A	13 [NCB1, DCB1, DCB3, DCB4, DCB5, DCB6, DCB7, DCB9, DCB10, DIB1, DIB2, DCB11, FCB1]	1 [CRA1]	14
Lack of reliability of accounting information **(6.5.6)**	2 [MFM2, MFM4]	3 [LIC1, LIC2, LIC3]	16 [NCB1, DCB1, DCB2, DCB3, DCB4,DCB6, DCB7, DCB8, DCB9, DCB10, DIB1, DIB2, DCB11, FCB1, FCB2, FCB3]	3 [CRA1, CRA3, CRA4]	24
Minimum weight on CG in lending and credit rating regulations decisions **(6.5.7)**	N/A	N/A	10 [NCB1, DCB2, DCB3, DCB4, DCB5, DCB6, DCB7, DCB9, DCB11, DIB2]	1 [CRA3]	11
Peer banks and institutional investors do not consider CG **(6.5.9)**	3 [MFM2, MFM3, MFM4]	2 [LIC2, LIC3]	10 [DCB1, DCB2, DCB3, DCB4, DCB8, DCB9, DCB11, DIB1, DIB2, FCB1]	2 [CRA2, CRA3]	17

Key: Interviewee Code: MFM = Investment manager of mutual funds; LIC=Investment manager of life insurance companies; BANKS = Credit appraisal officer of banks; CRA = Credit rating analysts of corporate credit rating agencies; NCB = Nationalised Commercial Bank, DCB = Domestic Commercial Bank; DIB = Domestic Islamic Bank; FCB = Foreign Commercial Bank.

The following response from a managing director of a credit rating agency indicates that his organisation also seeks rent and thus, does not enforce compliance with the BCGG-2006.

Our credit rating guideline which is issued by Bangladesh Bank assigns 10 marks in management skill or you can say governance. If we follow that guideline and want to assign marks for governance, I am sure that most of the companies will get zero. So what we do, we give 10 marks in business performance and do not bother about governance [CRA-3].

6.5.2 Rent seeking behaviour of politicians

In Section 6.4.6, 18 interviewees state that rampant corruption in Bangladesh negatively affects compliance with the BCGG-2006. The perceptions of eight bank credit analysts indicate that they cannot practice transaction-based lending strategies because of political influence on lending decisions. The evidence suggests that political influence is more acute in government-owned banks. However, it also affects privately-owned banks and subsidiaries of foreign banks. One typical comment is:

There is a culture now – if anybody wants to take a significant amount of loan from a state owned bank, he has to approach to 'Pir-Murshid' (Politically affiliated directors). They [Pir-Murshid'] have strong connection with the prime minister's office. How can we ignore those 'Pir-Murshid'?[NCB-1]

6.5.3 Name-based lending and investment practices

Twenty-two out of 28 interviewees perceive that the characteristics of the key person of the borrower or investee company have an important bearing on their decisions (Table 6.16). The perceptions of credit analysts of banks and credit rating agencies give an indication that name-based lending has traditionally been practised by banks due to the absence of CRG guidelines and banks lock-in to a trajectory of name-based lending practices (see also Section 6.2.1.1). One typical comment from a bank credit analyst is:

It is not only my bank; I also know some other banks that do not consider whether a prospective borrowing company complies with the BCGG-2006. [It is because] banks finance a project based on the business acumen of the main man behind the project [...]. That practice continues since the emergence of the private

sector in 1980s. Now there are rules to do CRG but banks do CRG as a formality only [DCB-4].

The perceptions of several credit analysts of banks also suggest that they are so familiar with the key man of in some companies that they do not encourage compliance with the BCGG-2006. One typical comment is:

If I consider them [key men of three giant companies] as prospective customers, I will definitely give high score on management skill. On the other hand, if I have information that these companies are going to change their chairmen or managing directors, I will reduce my weight on management skill [FCB-1]

The perceptions of two investment managers of a mutual fund company and three investment managers of life insurance company also suggest that they overvalue the key person behind the company. A representative comment is:

[…] what I should say the main man or main decision maker is, I mean, nothing else can be more critical than this. […] it does not matter to us who are the members of board of directors as long as the main man is there [LIC -1].

6.5.4 Relationship-based lending and investment practices

Fifteen interviewees report that they practice relationship-based lending and investment strategies (Table 6.16). The perceptions of these interviewees indicate that past relationship with a borrower or an investee company introduces irrationality into the decision making process and thus, hampers consideration of compliance with the BCGG-2006. One typical comment on the impact of a past relationship on lending decisions is:

A company approached to us for an exposure in order to upgrade its raw materials. The company believed that this upgraded raw materials will improve the quality of the final product. This kind of project must be approved by some sort of a technical person, for example, an engineer. But we took the project without suggestion of an engineer because we have a past relationship with the company [DCB - 3].

One typical comment on the impact of a past relationship on investment decisions and its consequence for considerations of compliance with the BCGG-2006 is:

We have blacklisted a number of companies. We even do not look into the accounting reports of those companies. But some other people [institutional investors] do because of their relationships. If things are done based on relationships, rationality does not work. [MFM2].

6.5.5 Preference to the family legacy of the key man

The perceptions of 17 out of 20 interviewees indicate that they prefer the second generation of key persons rather than professional managers to mitigate risk arising from succession. This evidence indicates that the interviewees continue to rely on the legacy of the key sponsor executive directors. A credit analyst of a bank comments:

If Mr. NRS is replaced by someone from his family who has worked under Mr. NRS for 5-10 years, like his younger brothers – Mr. MRS or Mr. ARS, we feel comfortable. It implies that Mr. NRS has a succession plan in his mind. If someone who is not a member of S family is appointed as a CEO, we will feel a little bit discomfort [FCB-2].

The following comment by an investment manager of a mutual fund company also suggests preference to family legacy of the key sponsor director:

If we find someone such as his [the sponsor director] son is already in business and gathering experience, we feel comfort [MFM-4]

6.5.6 Collateral-based and personal guarantee-based lending practices

The responses of 14 credit analysts of banks and one analyst of a corporate credit rating agency indicate that collateral-based and personal guarantee-based lending practices of banks negatively affect consideration of CG mechanisms recommended by the BCGG-2006 (Table 6.16). Sections 6.2.1.1 and 6.2.3.1 also provide evidence that the practice of seeking collateral and personal guarantees from directors deters banks from considering the separation of chairman and CEO and independent directors respectively. One representative comment is:

More importantly, we check the personal net worth level of the directors and take personal guarantee. [...] the exposure of my bank may be more than the personal net worth of the key sponsor director but we want to ensure that he [the key sponsor director] will not take any decision against our interest [DCB – 9].

6.5.7 Lack of reliability of accounting information

Section 6.4.7 shows that 24 out of 28 interviewees perceive that audited financial statements in Bangladesh lack reliability. A consequence of lack of reliable accounting information is that interviewees rely on ‘soft information’ to evaluate the

financial condition of the company when making decisions (Table 6.16). Banks use a comprehensive approach to evaluating the financial conditions of the prospective borrowers in new loan cases. This comprehensive approach include comparison of the audited financial statements with the internal management reports and bank statements, use of Credit Information Bureau (CIB) reports, verification of the existence of inventory and fixed assets by visiting factory, appraisal of re-valued fixed assets by an internal expert of the bank, verification of the market share of the company's major product. One comprehensive comment from a banker in this group is:

Audited accounting report does not show true position of the company and thus, we use management report in case of making our analysis and to reduce the risk, we downgrade the rating the company. Then we try to cross-check this internal management report with some third-party sources of information such as collection of revenue reflected on bank statements, international/local price of the major products. We compare their industry position with their peer. We take monthly stock report and conduct valuation of stock quarterly, semi-annually and annually. We check import L/C and outstanding loan with different banks. As the market is small, we can easily know how much of a particular product has been imported in last year and which company import how much – from different banks we assess it. Assets presented in balance sheet are cross-checked during factory visit. In case of fair value of assets, we use our internal expert to determine the value of that particular asset [FCB -2].

The evidence also implies that the approach of comprehensive analysis is costly and influences banks to follow name-based and relationship-based practices:

We basically do relationship banking, we do not involve with a company to perform one transaction [FCB-2].

The institutional investors do not explicitly report that they use a comprehensive approach to analysis but their responses of the institutional investors also indicate that they use some form of internal information when taking their investment decisions. Two typical comments from institutional investors are:

I tell you that the audited financial reports are actually may be, if I say correctly, it should not weight more than 30% in decision making. I think the remaining 70 % is all what is important. The entrepreneurs, the main men, who are the persons behind the organization, what's their future plan, what they have done in the past. You will not find these things in audited financial reports [LIC -1]

[...] we have some internal communication which we use in ranking companies [MFM-4]

6.5.8 Minimum weight on CG in lending and credit rating regulations

The responses of 10 credit analysts of banks and one corporate credit rating analyst indicate that they do not seriously consider the CG mechanisms recommended by BCGG-2006 because lending and credit rating regulations do not assign sufficient importance to CG (see also Section 6.2.4.1).

We are not concerned with whether the BCGG-2006 is compiled or not; we do not have authority to check this as the Bangladesh Banks' credit rating guidelines (CRG) does not require us to check the strength of corporate governance of the borrowers while granting loans [DCB9].

6.5.9 Peer banks and institutional investors do not consider CG

The perceptions of 17 interviewees indicate that they cannot consider compliance with the BCGG-2006 because it may reduce their competitive advantage (see also Section 6.2.4). The perception of credit rating analysts of banks and corporate credit rating agencies indicates that competition in the industry deters them from considering compliance with the BCGG-2006. A typical comment is:

Bank is a business house. It cannot impose condition that it will not extend credit if a company does not comply with the BCGG-2006. If it [bank] does, [the] customer will not stay with that bank and switch to [another] bank where the customer will find [more] liberal requirements. So, if we consider the compliance with the BCGG-2006, we will lose our customers [DCB-3].

The perceptions of institutional investors also indicate that the profit maximization motive deters them from considering CG mechanisms suggested by the BCGG-2006:

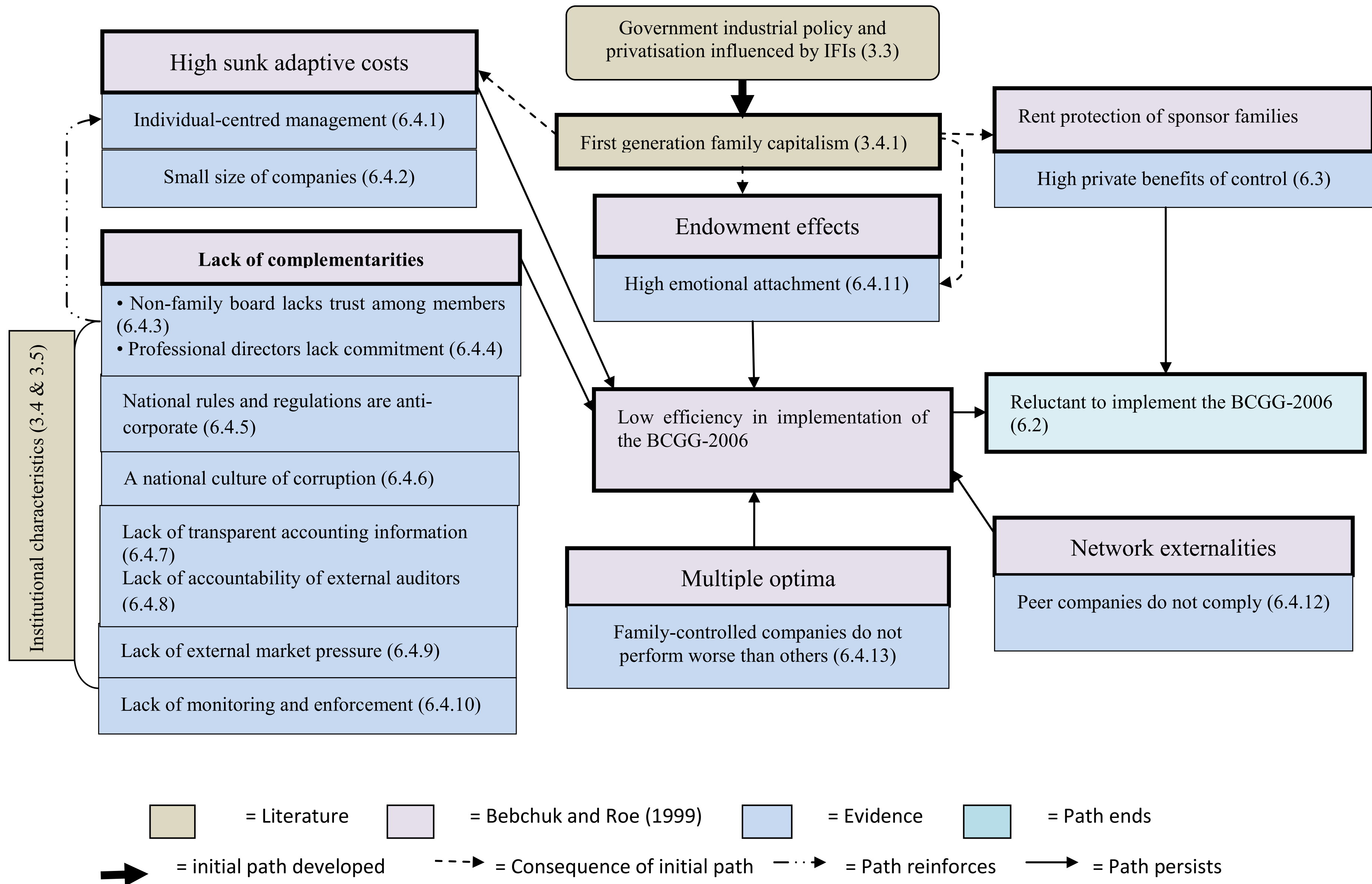
If we put weight on whether the role of chairman and CEO is truly separated or not, we will not be able to do our business. [MFM-3]

6.6 Theorising the impact of compliance with the BCGG-2006 on investment and lending decisions

Prior literature uses agency theory to predict and explain the positive impact of CG on the investment and lending decisions of institutional investors (Section 2.5.1) and bankers (Section 2.5.2) respectively. However, agency theory is less applicable in developing countries (Section 2.2.1) because the ownership and

management structure of companies are distinct from the ownership and management structure of companies found in Anglo-American countries. In addition, the findings reported in Section 6.2 indicate that a limited number of interviewees provide an agency theory-based explanation for consideration of a CG mechanism introduced by the BCGG-2006. Therefore, it is apparent that agency theory is not sufficient to explain the impact of CG mechanisms suggested by the BCGG-2006 on investment and lending decisions of institutional investors and bankers respectively in Bangladesh. This section explores whether the theory of path dependence can be used as a basis for explaining the attitude of institutional investors and bankers towards CG mechanisms suggested by the BCGG-2006. Path dependence refers to the persistence of existing business practices (Caron and Turcotte, 2009). Path dependence more likely results when organisations cannot depart from existing practices because they are embedded in a set of relationships and commitments (Ball, 2005). Section 6.6.1 explains path dependence on the part of Bangladeshi companies. The result of this path dependence is reluctance to implement the BCGG-2006 in form and in substance. Section 6.6.2 explains path dependence on the path of bankers and institutional investors. The result of this path dependence is the persistence of existing lending and investment practices and reluctance to consider the CG mechanisms suggested by the BCGG-2006 when making decisions.

Figure 6.1: Companies are reluctant to implement the BCGG-2006 in form and in substance (A path dependence-based explanation)



6.6.1 Path dependence on the part of companies to implement the BCGG-2006 in form and in substance

The evidence in Section 6.2 suggests that most of the companies either do not comply or comply with the BCGG-2006 in form but not in substance. Section 6.3 presents evidence that sponsor families extract private benefits of control in different ways. Section 6.4 presents evidence that the corporate and institutional characteristics of Bangladesh hamper efficient implementation of the BCGG-2006. Figure 6.1 combines the foregoing evidence and relates it to the theory of path dependence of corporate governance as proposed by Bebchuk and Roe (1999). Their theory is used to frame figures 6.1 and 6.2 following.

Figure 6.1 depicts how, since the 1980s, government industrial policy and IFI influenced privatisation led to the development of family capitalism in Bangladesh (Section 3.3). This family capitalism is reflected in the present ownership and management structure of Bangladeshi companies (Section 3.4.1). The evidence in Section 6.3 indicates that the existing controlling structure of companies in Bangladesh (the control by the key sponsor executive director and sponsor family-aligned board) permits the sponsor families to extract high private benefits of control in different ways. This study thus, argues that the protection of the private benefits of control of sponsor families is one of the reasons that motivates sponsor families to either not to comply or to comply in form but not in substance with the BCGG-2006 (Section 6.2).

The evidence reported in Section 6.4 suggests that present corporate and institutional characteristics of Bangladesh hamper the efficient implementation of the BCGG-2006. First, sunk adaptive costs are high due to individual-centred management style (Section 6.4.1) and the small to medium size of companies (Section 6.4.2). The evidence in Section 6.4.1 suggests that the initial success of family-enterprises locks the corporate culture of Bangladeshi companies into a trajectory of individual-centred management. The lock-in to the trajectory of sponsor family-aligned board and individual-centred management may be further reinforced by (1) lack of trust among non-family board members (Section 6.4.3) and (2) lack of commitment of outside professional directors (Section 6.4.4). The intention to keep

control by sponsors and not to appoint professional management limits the size of companies (Section 6.4.2). This suggests that a typical Bangladeshi company will not effectively comply with the BCGG-2006 without changing its management structure, authority relationships and without appointing qualified and experienced directors, internal control and internal audit personnel.

Second, the institutional characteristics of Bangladesh are not conducive to effective implementation of the BCGG-2006. Lack of trust among non-family board members (Section 6.4.3) and a lack of commitment of outside professional directors (Section 6.4.4) (which may be the results of high power distance and masculinity (Section 3.5.2)) suggest that relaxing family control (e.g., by appointment of outside professional CEO) is less efficient in Bangladesh. The anti-corporate rules and regulations (Section 6.4.5) and a national culture of corruption (Section 6.4.6) suggest that an Anglo-American model which is alternatively called 'open system of CG' is less efficient. In an environment with the aforementioned characteristics, the secrecy ensured by family control is important to safeguarding innovation (Rajan and Zingales, 2003) and to managing corrupted government officials (Dyer and Mortensen, 2005). In addition, lack of detailed and transparent accounting reports (Section 6.4.7) hampers the efficient monitoring of independent directors (Armstrong et al. 2010; Aguilera and Jackson, 2010) and the lack of accountability of the external auditor (Section 6.4.8) hampers the efficiency of the audit committee. Furthermore, lack of market pressures (Section 6.4.9) offers limited incentives to the existing controllers to comply efficiently with the BCGG-2006 (Aguilera and Jackson, 2003; Manne, 1965). Finally, the lack of monitoring and enforcement (Section 6.4.10) reduces penalties for non-compliance with the BCGG-2006 (dela Rama, 2012; Berglöf and Claessens, 2006).

Third, endowment effects are high because of the high emotional attachment of the first generation entrepreneurs to their companies (Section 6.4.11). The first generation entrepreneurs are not ready to handover control to outside professional CEOs and appoint a truly independent director.

Fourth, network externalities are high because of widespread non-compliance by other companies (Section 6.4.12) indicating that efficient compliance with the BCGG-2006 may become competitively disadvantageous.

Finally, the lack of consensus regarding the impact of control structures on performance or accounting reporting quality (Section 6.4.13) suggests that there is limited additional value from efficient compliance with the BCGG-2006.

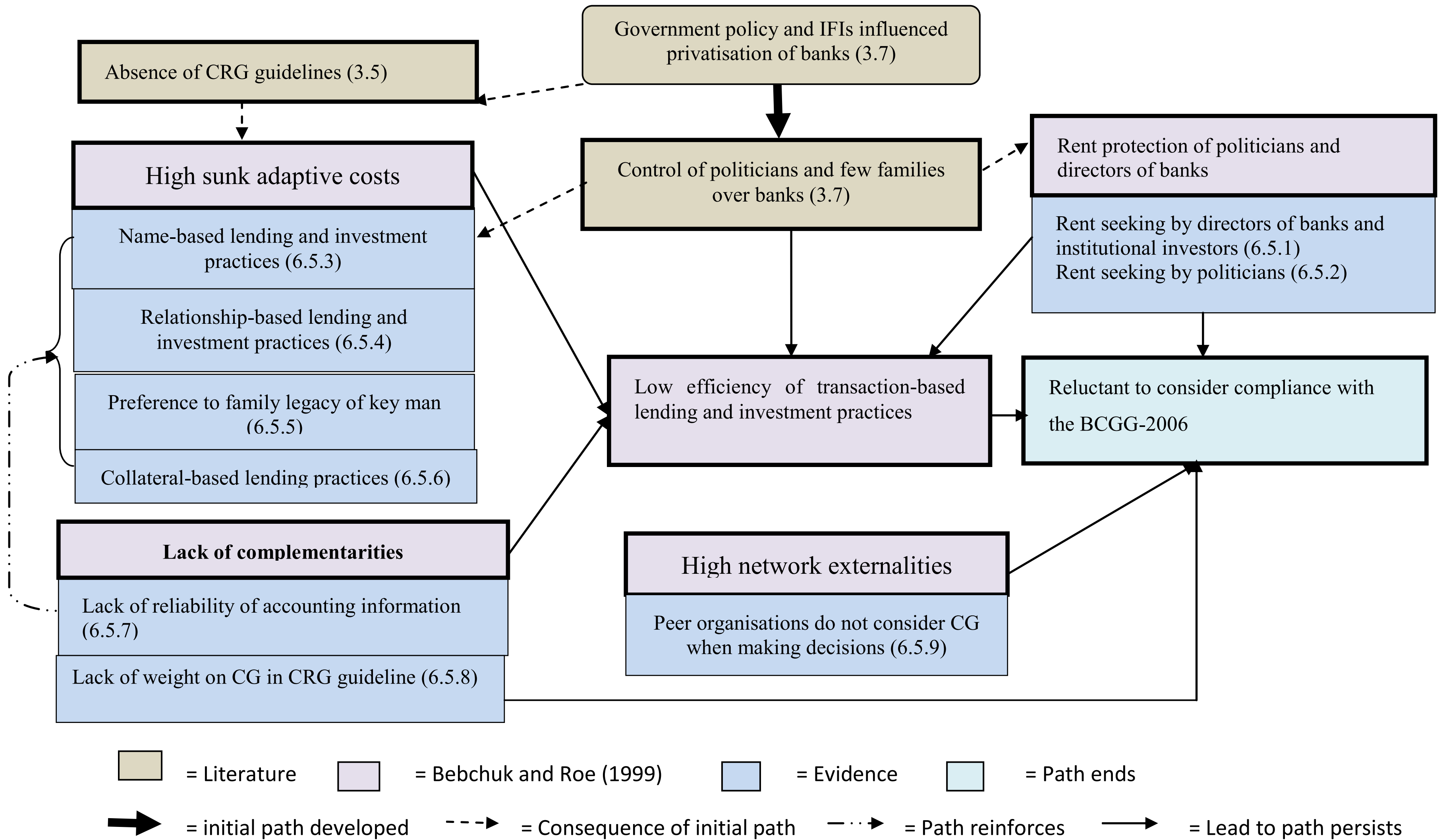
The evidence in Section 6.4 collectively suggests that efficiency in the implementation of the BCGG-2006 is low. This study thus, further argues that low efficiency in the implementation of the BCGG-2006 is another reason that motivates sponsor families to either not to comply or to comply in form but not in substance with the BCGG-2006 (Section 6.2).

6.6.2 Path dependence on the part of institutional investors and bankers

The evidence in Section 6.2 indicates that characteristics of investment and lending practices are one of the reasons for the limited impact of CG mechanisms recommended by the BCGG-2006. In Section 6.5, I describe the characteristics of investment and lending practices.

Figure 6.2 indicates that government policy and the privatisations of banks influenced by the IFIs lead to control over banks by politicians and a few sponsor families (Sections 3.3 and 3.7). The sponsor directors of banks (Section 6.5.1) and politicians (Section 6.5.2) extract rent by unduly influencing the lending decisions of bank credit analysts. There is also limited evidence of rent-seeking behaviour among institutional investors and credit rating analysts (Section 6.5.1). This evidence suggests that the rent seeking behaviours of politicians and directors of institutional investment companies and banks makes the implementation of transaction-based lending and investment practices less efficient. The inefficiency of transaction-based lending and investment practices negate consideration of CG mechanisms recommended by the BCGG-2006.

Figure 6.2: Banks and institutional investors are reluctant to consider compliance with the BCGG-2006 (A path dependence-based explanation)



In addition, investment and lending decisions are highly influenced by the name of the key sponsor directors (Section 6.5.3) and any past relationship with the investee or borrower company (Section 6.5.4). The responses of the interviewees, especially bank credit analysts, indicate that banks were historically accustomed to name-based lending practices due to the absence of any Credit Risk Grading (CRG) guideline; they continue name-based lending practices even after the CRG guideline has been introduced and conduct CRG analysis as a formality (Section 6.5.3). Although institutional investors do not give an indication when and how they start name-based and relationship-based practices, it can easily be inferred that institutional investors adhered to name and relationship practices in the past. This is because in a country with the institutional characteristics of Bangladesh, name-based and relationship-based investment and lending are more appropriate than transaction-based practices (Rajan and Zingales, 2003a; p. 144; Singh and Zammit, 2006). Furthermore, there is an indication that both banks and institutional investors do not rationally appraise a proposal when there is a past relationship with the borrowing or investee company (Section 6.5.4). This evidence indicates that institutional investors and bankers lock themselves into a trajectory of name-based and relationship-based investment and lending practices. The lock-in to the trajectory of name-based and relationship-based investment lending practices is reinforced by a lack of reliable accounting information (Section 6.5.7). This is because analysis of a loan or an investment proposal based on 'soft information' indicates a costly strategy (Section 6.5.7). The lock-in to the trajectory of name-based and relationship-based investment lending practices implies high sunk adaptive costs which hampers the efficient implementation of transaction-based investment and lending practices. The following comment by of one bank credit analyst indicates the difficulty regarding change of trajectory of lending practices:

> *It is hard to give up that practices so quickly and follow an internationally equivalent lending practice. We have relationship with them and we know about their business, repayment capability and behaviour [DCB-4].*

Furthermore, lack of reliable accounting information hampers the efficient implementation of transaction-based investment and lending practices and the lack of

weight on CG in CRG guidelines hampers consideration of CG mechanisms suggested by the BCGG-2006.

Finally, network externalities are high because due to competition among banks and institutional investors, consideration of CG mechanisms recommended by the BCGG-2006 may become competitively disadvantageous.

6.7 Conclusion

This chapter investigated *RQ1. Do institutional investors and bankers in Bangladesh perceive that the level of compliance with the BCGG-2006 by the investee or borrowing company influences the investment and lending decisions respectively?* In order to investigate RQ1, three sub-questions (RQ1.1a, RQ1.1b and RQ1.2) are answered. The findings related to RQ1.1a and RQ1.1b (Section 6.2) strongly indicate that the institutional investors and bankers perceive limited direct or indirect impact of CG mechanisms introduced by the BCGG-2006 on their investment and lending decisions respectively. This is because (1) the companies either do not comply or comply in form but not in substance with the BCGG-2006 and (2) investment and lending practices do not encourage consideration of the CG mechanisms introduced by the BCGG-2006.

In the course of investigating RQ1.2, it is found that a limited number of respondents perceive a positive impact of CG mechanisms introduced by the BCGG-2006 on their decisions. Furthermore, among this limited number of respondents, very few provide explanations in support of their perceptions which are consistent with agency theory. Hence, it is evident that agency theory does not provide adequate explanations for the impact of CG mechanisms introduced by the BCGG-2006 on investment and lending decisions respectively. This chapter then explored (1) why non-financial companies in Bangladesh either do not comply or comply in form but not in substance with the BCGG-2006 and (2) what are the characteristics of investment and lending practices of institutional investors and bankers respectively. It was found that non-financial companies in Bangladesh either do not comply or comply in form but not in substance with the BCGG-2006 because sponsor families extract high private benefits of control under the present control structure (Section 6.3) and the present corporate and institutional characteristics of Bangladesh do not

encourage sponsor families to comply with the BCGG-2006 in form and in substance (Section 6.4). This evidence is consistent with the theory of path dependence of corporate governance (Section 6.6.1).

On the other hand, institutional investors and bankers practise name-based and relationship-based investment and lending practices respectively. The name-based and relationship-based investment and lending practices deter them from considering CG mechanisms recommended by the BCGG-2006. The evidence suggests that name-based and relationship-based lending have long-been practised, especially by bankers due to the absence of CRG guidelines. The move to transaction-based practices is deterred by a lack of complementary institutions such as reliable accounting information. Further evidence shows that interviewees prefer family legacy to professional management control. The characteristics of investment and lending practices, in sum, suggest that institutional investors and bankers are also locked in the path of name-based and relationship-based investment and lending practices which in turn deter institutional investors and bankers from considering the CG mechanisms recommended by the BCGG-200.

In sum, compliance with BCGG-2006 by the companies has limited impact on the investment and lending decisions of institutional investors and bankers respectively. This is partly because the companies either do not comply with BCGG-2006 or comply with it ineffectively. The sponsor family finds little justification to effectively comply with the BCGG-2006 on the grounds of rent protection of the sponsor family and low efficiency in implementation of the BCGG-2006 given the present corporate and institutional characteristics of Bangladesh. On the other hand, name-based and relationship-based investment and lending practices of institutional investors and bankers respectively are also responsible for limited compliance with BCGG-2006. As institutional investors and bankers practise name-based and relationship-based lending practices, they do not bother about investee's or borrower's compliance with the BCGG-2006. This in turn exerts limited pressure on companies to comply with the BCGG-2006 in form and in substance. This evidence highlights an interaction between the weak CG structure of the companies and the investment and lending practices of institutional investors and bankers respectively.

Chapter Seven

The nature of compliance with the BCGG-2006 and its association with firm performance

7.1 Introduction

This chapter presents the results of the following research questions: *RQ2.1. To what extent is the BCGG-2006 implemented in form and in substance? RQ2.2. Is there a relationship between the nature of compliance with the CG mechanisms recommended by the BCGG-2006 and firm performance?*

With respect to RQ2.1 and RQ 2.2, propositions are developed in Section 4.3. In order to provide evidence regarding propositions related to RQ2.1, survey responses (Section 5.4) from 91[17] companies are presented. The survey covers compliance with five CG mechanisms introduced by the BCGG-2006: separation of chairman and CEO, board of directors, audit committee, Chief Financial Officer (CFO) and head of internal auditor (HIA). Formally a company may choose to comply or not to comply with a CG mechanism (e.g., separation of chairman and CEO) as the BCGG-2006 is a 'comply or explain' basis guideline. In practice, a company that apparently complies with a CG mechanism may comply in form but not in substance or it may comply both in form and in substance. Using this subdivision of compliance, companies are categorised into three sub-groups: (1) companies that do not comply (b) companies that comply in form but not in substance and (3) companies that comply both in form and in substance. Using the method discussed in Section 5.8, I test the propositions related to RQ2.2.

Sections 7.2 to 7.6 provide detailed analysis of compliance (RQ2.1) and in each case presents the results of statistical analysis relating performance to the nature of compliance (RQ2.2). On the face of Tables, I only mention propositions that are supported by the evidence. The propositions that are not supported by the evidence are mentioned in the text. Section 7.7 concludes.

[17] The sample includes 73 local privately-owned companies, seven government-owned companies and 11 subsidiaries of foreign-multinational companies.

7.2 Separation of chairman and CEO

The BCGG-2006 recommends companies to separate the position of chairman and CEO. Section 7.2.1 reports the survey responses on the separation of chairman and CEO. Section 7.2.2 reports the results of statistical tests on whether the performance of companies differs based on the nature of the separation of chairman and CEO. Section 7.2.3 provides a summary of this section.

Table 7.1: Nature of compliance with the provision related to the separation of chairman and CEO

Nature of compliance with the separation of chairman and CEO	**(1)** Total	**(2) P2.1a2** Privately-owned	**(3) P2.1b1** Govt. Owned	**(4) P2.1c2** Subsidiaries of MNC
Panel A: Do not comply				
The dual CEO is a member of the sponsor family.	18	18	0	0
Sub-total for Panel A	**18**	**18**	**0**	**0**
Panel B: Separate the chairman and CEO in form but not in substance				
Both the Chairman and CEO members of a sponsor family	37	37	0	0
Both chairman and CEO are shareholder directors but there is no family relationship between them	**13**	**11**	**1**	**1**
Sub-total for Panel B	**50**	**48**	**1**	**1**
Panel A + Panel B	**68**	**66**	**1**	**1**
Panel C: Separate the chairman and CEO in form and in substance				
Chairman is a sponsor shareholder director or nominee of sponsor but CEO is a non-shareholder executive director	21	6	6	9
Chairman is a institutional director investor and CEO is a sponsor shareholder director	1	1	0	0
Chairman is a non-executive independent director and CEO is a non-shareholder executive director	1	0	0	1
Sub-total for Panel C	**23**	**7**	**6**	**10**
Total number of firms	**91**	**73**	**7**	**11**

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

7.2.1 Survey evidence on the separation of chairman and CEO (RQ2.1)

The findings related to the separation of the chairman and the CEO is presented in Table 7.1. Table 7.1 shows that 66 out of 73 (90.41%) privately-owned companies either do not comply or comply in form but not in substance. This evidence supports P2.1a2 but does not support P2.1a1. However, the evidence supports P2.1b1 because in 6 out of 7 (85.71%) government-owned companies separate the chairman and the CEO both in form and in substance. This is because the minister or a senior officer of the ministry which controls a company by virtue of designation is appointed as chairman of the company. Finally, consistent with P2.1c2, 10 out of 11 (90.91%) subsidiaries of foreign MNCs comply in form and in substance.

7.2.2 Separation of chairman and CEO and firm performance (RQ2.2)

Panels A and B of Table 7.2 present descriptive statistics and the results of tests of difference in performance by type of separation of chairman and CEO for the total sample and local privately-owned companies respectively. The method used is discussed in Section 5.8. Column 4 tests the difference in performance among groups of firms that (1) do not separate the position of chairman and CEO, (2) separate the position of chairman and CEO in form but not in substance, and (3) separate the position of chairman and CEO in form and in substance. Columns 5 – 7 present results of tests of difference in performance between groups. For example, column 5 presents the results of tests of difference in performance between firms that do not separate the position of chairman and CEO and firms that separate the position of chairman and CEO in form but not in substance.

Table 7.2: Test of association between the nature of compliance with separation of chairman and CEO and firm performance

Panel A: Total sample (n=91)								
Performance		Separation of chair and CEO			p-value			
		(1) Do not comply	(2) in form only	(3) in form and in substance	**(4) P2.2** All[a]	**(5) P2.2a** (1) vs (2)[b]	**(6) P2.2b** (1) vs (3)[c]	**(7) P2.2c** (2) vs (3)[c]
	N	18	50	23				
Avg. Tobin's Q	Mean	1.24	1.75	2.02	0.034**	0.044**	0.003**	0.089*
	Median	1.23	1.54	1.93	0.023**	0.107	0.004**	0.133
	S.D	0.60	1.15	0.99				
Avg. stock return	Mean	0.33	0.27	0.24	0.874	0.708	0.677	0.599
	Median	0.42	0.41	0.34	0.776	0.656	0.495	0.669
	S.D	0.72	0.51	0.57				
Avg. ROA	Mean	8.49	9.42	13.24	0.059[c]**	0.529	0.028**	0.025**
	Median	7.65	8.77	10.77	0.163	0.545	0.082*	0.117
	S.D	4.77	6.65	9.32				
Avg. ROE	N	18	47	23				
	Mean	9.76	9.58	10.27	0.992	0.971	0.954	0.892
	Median	7.73	8.82	15.11	0.157	0.843	0.227	0.050*
	S.D	26.26	12.47	29.66				
Panel B: Local privately-owned firms (n=73)								
	N	18	48	7	**P2.2d**			
Avg. Tobin's Q	Mean	1.24	1.70	1.50	0.283	0.060*	0.318	0.716
	Median	1.23	1.48	1.49	0.317	0.142	0.607	0.561
	S.D	0.60	1.13	0.77				
Avg. stock return	Mean	0.33	0.30	0.33	0.972	0.817	0.505	0.444
	Median	0.42	0.43	0.60	0.594	0.773	0.506	0.301
	S.D	0.72	0.51	0.92				
Avg. ROA	Mean	8.49	9.12	6.94	0.572	0.357	0.782	0.814
	Median	7.65	8.39	6.96	0.538	0.357	0.817	0.836
	S.D	4.77	6.58	4.16				
Avg. ROE	N	18	45	8				
	Mean	9.76	9.26	-1.08	0.349	0.919	0.360	0.101
	Median	7.73	8.69	6.68	0.840	0.939	0.697	0.535
	S.D	26.26	12.62	29.91				

Key: Each performance measure is the average of its five annual measures over fiscal years 2007 – 2011 inclusive. Tobin's Q is the ratio between the market capitalization of equity plus book value of preference shares plus book value of long-term debt, and the book value of total assets of a firm. Stock return is the ratio between market value of equity at the end of fiscal year plus dividend minus market value of equity at the beginning of the fiscal year, and the market value of equity at the beginning of the fiscal year. ROA is the ration between operating income and average total assets. ROE is the ratio between income before extraordinary items available for common equity dividend and the sum of the book value of equity and deferred taxes. *Do not comply* indicates the presence of a single person holds the position of chairman and CEO in a firm; *In form only* indicates the presence of two separate person in the positions of chairman and CEO but they are members of a sponsor family or sponsors of a firm; *In form and in substance* indicates presence of either an outside professional CEO or an outside chairman in a firm (see Section 5.6.1.1 for this classification).

[a]p-value of comparison among groups using ANOVA on means and Kruskal-Wallis on medians.

[b]p-value (two-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians.

[c]p-value (one-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians

* and ** respectively indicate significant at less than 10 and 5 percent levels.

The evidence presented in Panel A (Table 7.2) is inconclusive for P2.2, P2.2a, P2.2b and P2.2c. It indicates that the association between the nature of compliance and firm performance depends on the performance measure used. While evidence related to Tobin's Q supports P2.2, P2.2b and P2.2c, the result related to stock return does not support P2.2, P2.2b and P2.2c. A similar type of contradictory evidence is provided with respect to ROA and ROE. The different results with respect to Tobin's Q and stock return suggest that market participants are willing to pay a higher price for companies that comply in form and in substance but they cannot earn an abnormal return using information on the nature of compliance. The results related to ROA and ROE may suggest that leverage plays a role.

The evidence presented in Panel B (Table 7.2), however, supports P2.2d that nature of compliance does not have an association with performance in local privately-owned companies.

The comparison of Panel A and Panel B (Table 7.2) suggests that the result in Panel A may be due to the inclusion of subsidiaries of foreign MNCs into sub-group (3) that comply in form and in substance. Hence, difference in firm performance between subsidiaries of foreign MNCs and local privately-owned companies that comply in form and in substance is tested using t-tests and Wilcoxon rank-sum tests. The results of tests (not reported) show that average and median Tobin's Q, average and median ROA and median ROE of subsidiaries of foreign MNCs, are significantly higher than those of local privately-owned companies at the 0.05 level or less.

7.2.3 Summary

The survey results show that in local privately-owned companies, sponsor family members occupy both chairman and CEO positions in 66 (90.41%) companies and either chairman or CEO position in the remaining 7 (9.59%) companies. This suggests more intense management control of sponsor families than previously evidenced in Haque et al. (2011) who find that roughly 85 per cent of their sample firms appointed at least one of the top three executives from the controlling families. This is because Haque et al. (2011) do not distinguish between local privately-owned, government-owned and subsidiaries of foreign MNCs. The

government-owned companies separate the positions of chairman and CEO due to government policy rather than the BCGG-2006. The subsidiaries of foreign MNCs, except one, appoint professional CEOs and thus, comply with the intent of the BCGG-2006. This result is consistent with the theory of path dependence of corporate governance rather than agency theory in that sponsor families are reluctant to sacrifice their control.

The univariate analysis in Section 7.2.2 provides inconclusive evidence with respect to P2.2, P2.2a, P2.2b and P2.2c but completely supports P2.2d. The result indicates that the overall structure of the company is more important for performance and a separation of chairman and CEO that is only mechanistic may not increase performance. For example, the separation of the positions of the chairman and the CEO in the local privately-owned companies makes limited difference in performance. This may be because control by sponsor families impedes proper segregation of duties and responsibilities between chairman and CEO even though these positions are separated.

7.3 Board of directors

The BCGG-2006 recommends companies to appoint: (1) a board of directors having between 5 and 20 members, and (2) 10 percent of board membership subject to a minimum of one, as independent directors (Section 3.6.2.1). Given the above recommendation about independent directors, it is possible that the sponsor family members represent 90 percent of the board of directors; yet still the company complies with the board independence rule. In order to understand the dynamics of the board of directors, this study investigates size, composition of total board and the appointment of independent directors. Section 7.3.1 presents survey evidence on board size, board composition, and board independence and section 7.3.2 tests the association of board size and board independence with firm performance. Section 7.3.3 provides a summary of this section.

7.3.1 Survey evidence on board of directors [RQ2.1]

Section 7.3.1.1 presents survey evidence on compliance with the provision related to board size, Section 7.3.1.2 presents survey evidence on total board

composition and Section 7.3.1.3 presents detailed survey evidence on the nature of board independence.

7.3.1.1 Survey evidence on the size of board of directors [A general background for RQ2.1]

The survey results regarding board size are presented in Table 7.3. The average board size as reported in Table 7.3 indicates that the responding firms on average comply with the provision related to board size. However, three local privately-owned firms appoint fewer than five members, the minimum board size recommended by the BCGG-2006. Table 7.3 further shows that the maximum board size observed is 19, indicating that no firm exceeds the maximum board size recommended by the BCGG-2006.

The t-tests of difference between the average board size of local privately-owned companies and that of government-owned companies and subsidiaries of foreign MNCs show that both government-owned companies and subsidiaries of MNCs have a significantly larger average board size than local privately-owned companies. The Wilcoxon rank sum tests also provide similar evidence.

Table7. 3: Description of size of board of directors

Size of board of directors	(1) Total	(2) Privately -owned	(3) Govt. Owned	(4) Subsidiaries of MNC	p-value		
					(5) All[a]	6[b]= (2) vs. (3)	7[b]= (2) vs. (4)
Number of firms	**91**	**73**	**7**	**11**			
Minimum	3	3	7	5			
Mean	7.51	7.26	8.85	8.27	0.116	0.046**	0.095*
Median	7	7	9	9	0.011**	0.015**	0.045**
Maximum	19	19	11	12			
Standard deviation	2.34	2.43	1.46	1.85			

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

[a]p-value (two-tailed) of comparison among groups based on ANOVA on means and Kruskal-Wallis on medians

[b]p-value (two-Tailed) of comparison between groups based on t-tests on the means and Wilcoxon rank-sum tests on board size.

7.3.1.2 *Survey evidence on composition of board of directors [A general background for RQ2.1]*

Table 7.4 shows that the board of directors of local privately-owned companies is strongly represented by controlling family members, sponsor shareholder directors and their family members. Moreover, the average percentage of independent directors appointed by local privately-owned companies is just above the minimum percentage of independent directors recommended by the BCGG-2006. Finally, the board of directors of local privately-owned companies is highly represented by interlocking directors, confirming the dominance of a few wealthy families in the corporate sector of Bangladesh (see Section 3.3).

Table 7.4: Description of composition of board of directors

	(1) Total	**(2)** Privately -owned	**(3)** Govt. Owned	**(4)** Subsidiaries of MNC	p-value[d] of t-tests		
					5 = (2) vs (3)	6 = (2) vs (4)	7 = (3) vs (4)
Number of firms	**91**	**73**	**7**	**11**			
Average percentage of controlling family members[a]	45.39	60.50	4.76	3.03			
Average percentage of sponsor shareholders and their family members/sponsor nominated directors	74.11	75.26	76.21	65.10	0.891	0.087*	0.370
Average percentage of independent directors[b]	12.05	12.00	0	17.85	-	0.042**	-
Average percentage of interlock directors[c]	42.93	47.93	16.75	19.28			
No. of companies with at least one institutional investor director	21	16	0	5			

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

[a]Controlling family indicates either a family that owns more than 10 per cent of ownership or a family that has highest number of representative on board.

[b]independent directors indicates a directors who is designated by the survey respondents as independent. This director may not be a true independent director.

[c] interlock directors are directors who sit on board of multiple companies.

[d]p-value (two-Tailed) of comparison between groups based on t-tests on the means and Wilcoxon rank-sum tests on board size.

* and ** respectively indicate significant at less than 10 and 5 percent levels.

The board of directors of government-owned companies is also heavily dominated by government-nominated directors and completely lacks independence. The board of directors of subsidiaries of foreign MNCs is less dominated by sponsor-nominated directors and more represented by independent directors than the boards of local privately-owned companies and government-owned companies. The board of directors of subsidiaries of foreign MNCs is also less dominated by interlocking directors than the boards of local privately-owned companies.

This evidence indicates that the board of directors of local privately-owned companies and government companies may be less able to play a monitoring role in form and substance than the boards of directors of subsidiaries of foreign MNCs. This provides general support for P2.1a2, P2.1b2 and P2.1c2 but does not provide support for P2.1a1, P2.1b1 and P2.1c1.

7.3.1.3 Survey evidence on independent director(s) [RQ2.1]

Prior research on independent directors also indicates that their playing an effective monitoring role depends on his level of independence (Section 2.6.4.2). Hence, whether an independent director is independent in form and in substance is also investigated. Table 7.5 sub-classifies each group of companies into (1) do not comply with board independence, (2) comply with board independence in form but not in substance, and (3) comply with board independence in firm and in substance.
Table 7.5 shows that 71 out of 73 (97.26%) privately-owned companies either do not comply or comply in form but not in substance with minimum board independence provisions recommended by the BCGG-2006. This is consistent with P2.1a2 but not with P2.1a1. None of the government-owned companies appoint an independent director. This evidence supports P2.1b2 but does not support P2.1b1. With respect to subsidiaries of foreign MNCs (Table 7.5, Column 4), five companies (45.45%) appoint a person as independent director who has neither a personal nor financial relationship with the CEO of the company. Furthermore, four (36.36%) subsidiaries of foreign MNCs appoint a professional as an independent director. In sum, with respect to subsidiaries of foreign MNCs, the evidence supports P2.1c2 but does not support P2.1c1.

Table 7.5 Nature of compliance with board independence

Nature of compliance with the provision related to independent directors	No. of Firms			
	(1) Total	**(2) P2.1a2** Privately-owned	**(3) P2.1b2** Govt. Owned	**(4) P2.1c2** Subsidiaries of MNC
Panel A: Do not comply with the board independence recommendation				
Do not appoint any independent director	19	12	7	0
Appoint one independent director but do not meet the minimum requirement	4	3	0	1
Sub-total for Panel A	**23**	**15**	**7**	**1**
Panel B: Comply with the board independence recommendation in form but not in substance				
Owns less than 1% of total ownership and was a director before the introduction of the BCGG-2006.	6	5	-	1
An existing or a former officer or executive of the company	16	15	-	1
A relative or descendent by birth or marriage of a member of the controlling family or the CEO	15	15	-	-
A friend or previous colleague of a member of the controlling family or the CEO	21	21	-	-
Jointly owns a partnership or a private limited company with a member of the controlling family or the CEO	22	21	-	1
Holds a directorship in another public limited company with a member of the controlling family or the CEO	18	18	-	-
A professional providing services to the company or other business controlled the controlling family or the CEO	17	13	-	4
Sub-total* for Panel B	**60**	**56**	**-**	**5**
Panel A + Panel B	**83**	**71**	**7**	**6**
Panel C: Comply with the board independence recommendation in form and in substance				
A representative of an institutional shareholder	2	1	-	1
Has no relationship with the controlling family or the CEO	5	1	-	4
Sub-total* for Panel C	**7**	**2**		**5**
Total number of firms	**91**	**73**	**7**	**11**

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

*Sub-total of firms Panel B is not equal to sum of numbers in different rows because several firms report that the independent director has multiple relationships with the controlling family or the CEO.

7.3.2 Board of directors and firm performance [RQ2.2]

Section 7.3.2.1 tests the difference in firm performance based on board size and Section 7.3.2.2 tests difference in firm performance based on the nature of independence of independent directors.

7.3.2.1 Board size and firm performance [A general background for RQ2.2]

In order to test the difference in performance based on board size, firms are grouped into (1) small size board, (2) medium size board and (3) large size board. Using the method described in Section 5.8 and the format in Section 7.2.2, the difference in performance among and between groups is tested (results are not reported). This evidence provides limited support of a non-linear relationship between board size and stock returns. The evidence, however, does not indicate any significant association of board size with Tobin's Q, ROA and ROE at 0.05 level. This result is consistent whether the sample includes or excludes subsidiaries of foreign MNCs. In sum, the evidence casts doubt on whether the board of directors plays any role in augmenting the performance of firms.

7.3.2.2 Board independence and firm performance

Panels A and B of Table 7.6 present descriptive statistics and the results of tests of difference in performance by: (1) companies that do not comply with board independence, (2) companies that comply with board independence in form but not in substance, and (3) companies that comply with board independence in form and in substance for the total sample and local privately-owned companies respectively. The testing methodology and format employed are as in Sections 5.8 and 7.2.2 respectively. The evidence presented in Panel A (Table 7.6) is inconclusive for P2.2, P2.2a, P2.2b and P2.2c. The evidence with respect to market-based performance measures, however, is not consistent with evidence in Section 7.2.2. Here stock return maintains a more significant association with nature of compliance with board independence than Tobin's Q. Even the stock return of firms that appoint an independent director in form but not in substance is significantly greater than the stock return of firms that do not appoint an independent director. The contradictory evidence with respect to ROA and ROE again indicates that leverage may play a

role. Hence, further tests after controlling for firm characteristics are required to draw any conclusion regarding difference in performance due to the nature of board independence.

The evidence presented in Panel B (Table 7.6) provides strong support for P2.2d at the 0.05 level. This may indicate that independent director(s), even with independence in form and in substance, do not play an effective role in local privately-owned companies.

The comparison of Panel A and B again suggests that significant results in Panel A may be affected by the inclusion of subsidiaries of foreign MNCs in sub-group (3).

7.3.3 Summary

In the case of local privately-owned companies, the percentage of directorship occupied by controlling family members is 60.50 per cent and the percentage of directorships represented by the sponsor shareholder directors and their family members is as high as 75.26 per cent. This evidence again indicates more intense control by sponsor families than in previous survey evidence reported by Haque et al. (2011) who find that three-fifths of the board members of non-financial firms comprise representatives of the sponsor families. As mentioned in Section 7.2.3, Haque et al. (2011) do not distinguish among local privately-owned, government-owned and subsidiaries of foreign MNCs. Haque et al. (2011) collect data in 2004-2005 which is before the introduction of the BCGG-2006. Hence, a comparison of results of this study and Haque et al. (2011) suggests that control by sponsor families is not diluted with the appointment of independent director(s).

Table 7.6: Test of association between nature of compliance with board independence and firm performance

Panel A: Total sample (n=91)								
Performance		Board independence			p-value			
		(1) Do not comply	(2) in form only	(3) in form and in substance	**P2.2** (4) All[a]	**P2.2a** (5) = (1) vs (2)[b]	**P2.2b** (6) = (1) vs (3)[c]	**P2.2c** (7) = (2) vs (3)[c]
	N	24	60	7				
Avg. Tobin's Q	Mean	1.84	1.59	2.61	0.039**	0.113	0.176	0.032**
	Median	1.82	1.35	2.57	0.025**	0.071*	0.089*	0.031**
	S.D	0.83	1.08	1.19				
Avg. stock return	Mean	0.05	0.33	0.63	0.031**	0.021**	0.023**	0.021**
	Median	0.24	0.48	0.52	0.045**	0.048**	0.034**	0.243
	S.D	0.67	0.51	0.45				
Avg. ROA	Mean	7.91	10.33	17.68	0.012**	0.151	0.005***	0.021**
	Median	8.87	8.70	21.3	0.150	0.593	0.053*	0.079*
	S.D	6.14	7.04	9.51				
Avg. ROE	N	21	60	6				
	Mean	5.49	10.11	21.73	0.244	0.393	0.151	0.161
	Median	8.94	9.42	22.52	0.151	0.762	0.054*	0.068*
	S.D	25.65	19.58	12.92				
Panel B: Local privately-owned firms (n=73)								
	N	16	55	2	**P2.2d**			
Avg. Tobin's Q	Mean	1.85	1.45	2.18	0.175	0.107	0.747	0.247
	Median	1.77	1.26	1.93	0.133	0.072*	0.737	0.284
	S.D	0.99	0.96	1.51				
Avg. stock returns	Mean	0.17	0.34	0.44	0.581	0.323	0.297	0.412
	Median	0.37	0.47	0.44	0.724	0.425	0.779	0.931
	S.D	0.67	0.59	0.21				
Avg. ROA	Mean	7.37	8.89	12.96	0.311	0.352	0.209	0.259
	Median	9.14	7.76	7.92	0.962	0.989	0.823	0.775
	S.D	5.69	5.61	12.29				
Avg. ROE	N	14	54	3				
	Mean	7.09	8.20	14.03	0.854	0.852	0.558	0.616
	Median	8.47	8.40	12.66	0.722	0.820	0.378	0.475
	S.D	19.04	19.76	11.20				

Key: Each performance measure is the average of its five annual measures over fiscal years 2007 – 2011 inclusive. Tobin's Q is the ratio between the market capitalization of equity plus book value of preference shares plus book value of long-term debt, and the book value of total assets of a firm. Stock return is the ratio between market value of equity at the end of fiscal year plus dividend minus market value of equity at the beginning of the fiscal year, and the market value of equity at the beginning of the fiscal year. ROA is the ration between operating income and average total assets. ROE is the ratio between income before extraordinary items available for common equity dividend and the sum of the book value of equity and deferred taxes. *Do not comply* indicates a firm that has not appointed at least 10 percent of independent directors on its board. *Comply in form* indicates a firm that has appointed at least 10 percent of independent director but the independent director has a personal or an pecuniary relationship with the sponsor family or the CEO of the company. *Comply in substance* indicates a firm that has appointed at least 10 percent of independent director and the independent director has no personal or pecuniary relationship with the sponsor family or the CEO of the company (see Section 5.6.1.2 for this classification)..

[a]p-value of comparison among groups using ANOVA on means and Kruskal-Wallis on medians.

[b]p-value (two-tailed) of comparison between CEO duality and CEO in form but in substance groups using t-tests on the means and Wilcoxon rank-sum tests on the medians.

[c]p-value (one-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians

*,and ** respectively indicate significant at less than 10 and 5 percent level.

Moreover, 71 out of 73 (97.26%) local privately-owned companies either do not comply or comply in form but not in substance with board independence. The evidence suggests that there is an extensive tendency in local privately-owned companies to appoint a person who is not independent in form and in substance. This evidence is not surprising given that (1) the board of directors which prior to the BCGG-2006 and until now, is highly dominated by the controlling family members and sponsor shareholder directors (Section 7.3.1.2), is entrusted with the responsibility to select and appoint the independent directors by the BCGG-2006; and (2) general shareholders do not and are not willing to amend the selection of directors at the AGM (see Section 3.4.3). In sum, the evidence with respect to composition of the board of directors indicates that control by sponsor families is not at all altered by the compliance with the BCGG-2006, thus supporting P2.1a2.

In government-owned companies, government-nominated directors represent 76.21 per cent of board membership indicating that government officials maintain strong control over these companies. There is no independent director on the boards of government-owned companies. This evidence supports P2.1b2.

Although the board of directors of subsidiaries of foreign MNCs is dominated by sponsor-nominated directors, the percentage of sponsor-nominated directors on the board of these companies is significantly lower than that of local privately-owned and government-owned companies. Moreover, subsidiaries of foreign MNCs differ from local privately-owned and government-owned companies on two grounds with respect to board independence: (1) the subsidiaries of foreign MNCs on average appoint more independent directors to the board (Table 7.4), and (2) a proportionately higher number of subsidiaries of foreign MNCs appoint at least one independent director who is independent in form and in substance (Table 7.5). This evidence supports P2.1c2.

There is limited evidence that market participants earn a significantly lower return by investing in firms with a smaller or larger board than firms with medium board size (Section 7.3.2.1). However, the evidence also indicates that board size is not related to other performance measures.

With respect to the association between the nature of the independent director and firm performance, the results presented in Table 7.6 (Panel A) provide

inconclusive support for P2.2, P2.2a, P2.2b and P2.2c. The results in Table 7.6 (Panel B) show that there is no significant association between the nature of independence of the independent director and firm performance at the 0.05 level in case of local privately-owned companies. Thus, there is strong support for P2.2d. The evidence related to the nature of independence of independent directors and the finding of no significant association between nature of board independence and firm performance in local privately-owned companies, may indicate that sponsor families invalidate the independent director as a CG mechanism.

7.4 The audit committee and its characteristics

The BCGG-2006 recommends that companies appoint an audit committee with a number of characteristics (Section 3.6.2.2). Prior literature and international best practice recommendations also suggest that the effectiveness of an audit committee depends on certain characteristics (Section 2.6.4.3). Hence, survey respondents were asked questions related to these characteristics of the audit committee if a responding firm appointed an audit committee.

Section 7.4.1 presents survey evidence on the appointment and characteristics of the audit committee. Section 7.4.2 presents the results of tests of difference in performance of (1) firms that do not appoint an audit committee, (2) firms that appoint an audit committee in form but not in substance, and (3) firms that appoint an audit committee in form and in substance. Finally, Section 7.4.3 summarises this section.

7.4.1 Survey responses relating to the appointment and characteristics of the audit committee [RQ2.1]

This section presents survey evidence on the appointment and characteristics of audit committees. The survey covers a number of audit committee characteristics and thus, I provide my final opinion on P2.1a1, P2.1a2, P2.1b1, P2.1b2, P2.1c1 and P2.1c2 in Section 7.4.3.

7.4.1.1 Survey responses on appointment, size and composition of the audit committee

Table 7.7 presents information on the appointment and size of the audit committees of the sample firms. The average size of audit committee is calculated based on firms that state that they have appointed an audit committee. Table 7.7 (Panel A, Column 1) shows that 31 out of 91 (34.07%) companies do not appoint an audit committee. Non-appointment is evident in local privately-owned and government-owned companies but not in subsidiaries of foreign MNCs. Moreover, the size of the audit committees appointed indicates that a higher percentage of local privately-owned companies comply with the words rather than the spirit of audit committee regulations than foreign MNCs (Panel B).

Table 7.7: Description of appointment and size of audit committee

	(1) Total	(2) Privately-owned	(3) Govt.-owned	(4) Subsidiaries of MNC
Panel A: Appointment of audit committee				
Do not appoint an audit committee	31	27	4	0
Appoint an audit committee	60	46	3	11
Total number of firms	91	73	7	11
Panel B: Size of the audit committee				
Number of firms with audit committee	60	46	3	11
2	3	3	0	0
3	46	40	1	5
4	11	3	2	6
Average[a]	3.16	3.02	3.67	3.54

Key: Sample is 60 firms that appoint an audit committee. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

[a]T-test of government-owned companies have larger audit committee size than local privately-owned companies is rejected at 0.01 level (p=0.0023) and t-test of subsidiaries of multinational companies have larger audit committee size than local privately-owned companies is rejected at 0.01 level (p=0.0001).

Table 7.8 presents information on the composition of the audit committees of the 60 firms that appoint them. Table 7.8 (Panel A) shows that nine companies do not claim to appoint an independent director to their audit committee and 46 out 51 (90.20%) companies (Panel A.1) that claim compliance with audit committee independence appoint an independent director who is not independent in form and in

substance. All audit committees of government-owned companies completely lack independence.

Table 7.8: Description of composition of the audit committee

	(4) Total	(1) Privately - owned	(2) Govt.-owned	(3) Subsidiaries of MNC
No. of firms with AC	60	46	3	11
Panel A: No. of independent director(s) on the audit committee stated by the respondents				
2	3	0	0	3
1	48	41	0	7
0	9	5	3	1
Panel A.1: No. independent director(s) in form but not in substance on audit committee[b]				
2	1	0	0	1
1	46	40	0	6
Panel A.2: No. of independent director(s) in form and in substance on audit committee[a]				
2	1	0	0	1
1	4	1	0	3
Panel A.1 + Panel A.2	52*	41	0	11*
Panel B: At least one member of the audit committee is an institutional investor director	9	7	0	2
Panel C: No. of controlling family member(s) on the audit committee				
0	22	9	3	10
1	18	17	N/A	1
2	17	17	N/A	0
3	3	3	N/A	0
Panel D: No. of sponsor shareholder/sponsor nominated director(s) on audit committee				
0	8	6	0	2
1	13	12	0	1
2	32	24	1	8
3	6	4	2	0
Panel E: The chairman of the board or CEO of the company is a member of the audit committee	21	13	1	7
Panel F: The finance director or the CFO of the company is a member of the audit committee	14	9	1	4

Key: Sample is 60 firms that appoint an audit committee. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

[b]Panel A.1 and A.2 classify the firms that state that they have appointed independent director(s) on their audit committees based on the nature of independence of independent director(s). Hence, the total of Panel B.1 and Panel B.2 should be 41 for privately-owned companies, 0 for government-owned companies and 10 for subsidiaries of multinational companies.

*One subsidiary of a multinational company reports that it has two independent directors: one of them is a legal consultant and other one is truly independent. Hence, total of subsidiaries of multinational companies becomes eleven when independent directors are categorised into apparent independent and true independent.

Compared to local privately-owned companies, the independence in form and in substance is more pronounced in subsidiaries of foreign MNCs. A proportionately higher number of subsidiaries of foreign MNCs appoint (1) two independent directors who are independent in appearance, and (2) at least one independent director who is independent in form and in substance on their audit committees. This evidence is in line with the evidence on board independence. It once again suggests that subsidiaries of foreign MNCs comply better with the BCGG-2006 in form and in substance than local privately-owned companies and government-owned companies.

Panel B (Table 7.8) shows that only nine (seven local privately-owned and two subsidiaries of foreign MNCs) out of 60 companies appoint at least one institutional investor director on their audit committee suggesting limited influence of the institutional investor director in internal decision making as on board of directors.

As the sponsors and their families maintain a strong control over companies in Bangladesh (Section 3.4.1), this research further examines the representation of controlling family members and sponsor shareholder directors on audit committees. Table 7.8 (Panels C and D) shows that the audit committees of local privately-owned companies are populated by the members of the controlling families and sponsor shareholder directors. For example, 37 out of 46 (80.43%) privately owned firms include at least one member of the controlling family on their audit committees (Panel C, Column 2). This evidence suggests that controlling families and sponsor shareholders maintain their strong control over audit committee as they do over boards of directors.

The audit committee of government-owned companies is fully controlled by government-nominated directors (Table 7.8, Panel D, Column 3). The audit committees of the subsidiaries of MNCs are also dominated by parent-nominated directors. For example, 8 out of 11 (72.73%) firms appoint two parent nominated directors to their audit committees (Table 7.8, Panel D, Column 3). This finding implies that even subsidiaries of MNCs do not find it legitimate to have an audit committee dominated by independent directors and thus, do not comply with the international best practice recommendations in an economy where the local CG code

is a lenient one and the audit committees of local privately-owned companies are not independent.

Table 7.8 (Panel E) shows that 21 out of 60 (35%) firms appoint either the chairman of the board or the CEO of the company as a member of their audit committees. Finally, 14 out of 60 (23.33%) firms include their CFOs or finance directors on their audit committees (Table 7.8, Panel F). In proportion, more subsidiaries of foreign MNCs than other companies appoint the chairman, CEO and CFO or finance director to their audit committee. The appointment of the chairman or the CEO and the CFO or the finance director contradicts the best practice recommendation about the composition of the audit committee (BRC, 1999; Smith, 2003). The appointment of the chairman or the CEO and the CFO or finance director on the audit committee undermines the segregation of duties and responsibilities.

7.4.1.2 Background of the audit committee chairman and members

Table 7.9 presents evidence on the financial expertise and literacy (Section 5.6.1.3) of the audit committee chairman and members for 60 companies that appoint audit committees. Table 7.9 (Panel A, column 1) shows that 34 (15 +19) out of 60 (56.67%) companies fail to comply with the recommended qualification of audit committee chairman, 24 out of 60 (40) companies do not appoint any audit committee member who is expert in accounting and finance and 50 (20+22+8) companies do not meet the audit committee literacy requirement.

Table 7.9 further shows that the percentage of non-compliance with financial expertise and literacy of audit committee chairman and members is higher in local privately-owned companies than in the subsidiaries of foreign MNCs. Although two out of three government-owned companies appoint an audit committee chairman who is financially expert, the financial literacy of audit committee members of government-owned companies is worse than on those of the subsidiaries of foreign MNCs.

Table 7.9: Description of qualification of the audit committee chairman and members

	(1) Total	(2) Privately-owned	(3) Govt. Owned	(4) Subsidiaries of MNC
No. of firms with AC	**60**	**46**	**3**	**11**
Panel A: Financial expertise* and literacy^γ of the audit committee chairman				
Chairman is an expert in Accounting and Finance	26	18	2	6
Chairman is not an expert in Accounting and Finance but a financially literate person	15	13	0	2
Chairman is neither an expert in Accounting and Finance nor a financially literate person	19	15	1	3
Panel B: No. of audit committee members including chairman with financial expertise*				
3 or more	2	0	0	2
2	9	4	1	4
1	25	19	1	5
0	24	23	1	0
Panel C: No. of audit committee members including chairman with financial literacy^γ				
3 or more	10	4	0	6
2	20	16	1	3
1	22	19	1	2
0	8	7	1	0

Key: Sample is 60 firms that appoint an audit committee. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

*An audit committee chairman or member is regarded as an expert in accounting or finance if he or she has either professional qualification in accounting such as FCA, FCMA and PhD in accounting or has held senior management position (e.g. Chairman and CEO) with another public limited company or financial institution but has not held that position because of his/her shareholding.

γAn audit committee chairman or member is regarded as financially literate if he or she has at least an undergraduate degree in business; or is an expert in accounting and finance as per the above definition of accounting or finance expert.

7.4.1.3 Frequency and duration of audit committee meetings

Table 7.10 presents a summary of survey responses related to the frequency and duration of audit committee meetings. Table 7.10 (Panel A) shows that 39 out of 60 (65%) audit committees do not convene meetings as per international best practice recommendations. Moreover, the average number of members present at audit committee meetings and the average duration of audit committee meetings suggest that audit committee members are reluctant to attend and participate. Furthermore, 28 out of 60 (46.67%) audit committees do not convene any meetings

with the external auditors. This evidence clearly questions the audit committee's role regarding the protection of the independence of external auditors.

Table 7.10 Description of audit committee meetings

	(1) Total	(1) Privately-owned	(2) Govt. Owned	(3) Subsidiaries of MNC
No. of firms with AC	**60**	**46**	**3**	**11**
Panel A: No. of internal meeting of the audit committee per year				
Panel A.1: Do not comply with international best practice recommendations				
1	5	3	0	2
2	26	24	1	1
3	8	4	0	4
Sub-total	**39**	**31**	**1**	**7**
Panel A.2: Comply with international best practice recommendations				
4 or more	21	15	2	4
Panel A.1 + Panel A.2	**60**	**46**	**3**	**11**
Panel B: Average number of audit committee member present in a meeting	2.87	2.85	3.33	2.81
Panel C: Average duration per meeting in hour	1:31	1:20	2:10	2:10
Panel D: No. of meeting of the audit committee with external auditor per year				
0	28	26	0	2
1	19	13	2	4
2 or more	13	7	1	5

Key: Sample is 60 firms that appoint an audit committee. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

There may be several reasons for the evidence presented in Table 7.10: (1) the domination of controlling family members and sponsor shareholder or sponsor nominated directors may reduce the motivation of other members of the audit committee to attend and participate at the meeting (Section 7.4.1); (2) the BCGG-2006 is silent about audit committee meeting frequency and the remuneration of audit committee members; and (3) audit committee members lack appropriate qualifications to contribute at both internal and external meetings with the auditors (Section 7.4.2).

The non-compliance with best practice recommendation on audit committee meeting frequency does not differ significantly between privately-owned companies, government-owned companies and subsidiaries of foreign MNCs. In addition, there

is no significant difference between local privately-owned companies and the subsidiaries of MNCs with respect to the attendance of audit committee members at meetings. However, subsidiaries of foreign MNCs on average convene more frequent audit committee meetings, on average convene meetings for longer periods and on average more frequently meet with external auditors than local privately-owned companies. There is little difference between government-owned companies and subsidiaries of foreign MNCs in this respect.

7.4.1.4 Communication of audit committee activities

Table 7.11 presents a summary of survey responses related to the communication of audit committee activities to the board of directors and general shareholders. The provisions relating to the communication of audit committee activities to the board of directors and general shareholders are described in Section 3.6.2.2.

Table 7.11: Description of communication of the audit committee findings

	(1) Total	(2) Privately-owned	(3) Govt. Owned	(4) Subsidiaries of MNC
No. of firms with AC	**60**	**46**	**3**	**11**
Panel A: Communication of audit committee activities with board of directors				
No formal reporting takes place	7	7	Nil	Nil
Reporting to sponsor chairman or CEO	14	14	Nil	Nil
Reporting to board of directors	39	25	3	11
Panel B: Communication of audit committee activities with general shareholders				
Audit committee activities are not reported to general shareholders	33	28	1	4
Audit committee activities are reported to general shareholders	27	18	2	7

Key: Sample is 60 firms that appoint an audit committee. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

Table 7.11 shows that 21 (7+14) out of 60 (35%) audit committees do not report their activities to the board of directors. This may imply that either the board of directors or the audit committee does not work effectively in these companies. Moreover, 23 out of 60 (38.33%) audit committees do not report their activities to

the general shareholders. This disclosure failure may indicate either that the audit committees in these companies do not play a credible role that can be disclosed to general shareholders, or a general tendency towards the non-disclosure of information to general shareholders (Section 3.4.5).

Table 7.11 further shows that the audit committees of government-owned companies and subsidiaries of foreign MNCs establish better communication with the board of directors than local privately-owned companies. This may be because the board of directors of government-owned companies and subsidiaries of MNCs are not subject to family control. Finally, a proportionately higher number of audit committees of government-owned companies and subsidiaries of foreign MNCs report their activities to general shareholders than local privately-owned companies.

7.4.2 Audit committee and firm performance [RQ2.2]

Based on the audit committee characteristics discussed in Sections 7.4.1, this study develops a composite score for audit committees and then divides the firms into three groups: (1) firms that do not appoint an audit committee, (2) firms that appoint an audit committee in form but not in substance, and (3) firms that appoint an audit committee in form and in substance (Section 5.6.1.3). Using this classification, Panels A and B of Table 7.12 present the results of tests of difference in performance by type of compliance with audit committee regulations for the total sample and local privately-owned companies respectively. The testing methodology and format employed are as in Sections 5.8 and 7.2.2 respectively.

The evidence in Panel A (Table 7.12) once again provides mixed evidence with respect to P2.2, P2.2a, P2.2b and P2.2c. All four propositions are supported if Tobin's Q and ROA are used to measure performance. However, none of these propositions is supported if stock return is used to measure performance.

Table 7.12: Test of association between nature of compliance with audit committee and firm performance

Panel A: Total sample (n=91)								
Performance		Level of compliance with AC			p-value			
		(1) Do not comply	(2) in form only	(3) in form and in substance	**P2.2** (4) All[a]	**P2.2a** (5) = (1) vs (2)[b]	**P2.2b** (6) = (1) vs (3)[c]	**P2.2c** (7) = (2) vs (3)[c]
	N	31	30	30				
Avg. Tobin's Q	Mean	1.54	1.43	2.18	0.009***	0.367	0.028**	0.005***
	Median	1.53	1.12	2.00	0.010**	0.359	0.018**	0.006***
	S.D	0.81	0.93	1.25				
Avg. stock return	Mean	0.31	0.39	0.13	0.261	0.573	0.886	0.969
	Median	0.40	0.46	0.28	0.203	0.874	0.088*	0.174
	S.D	0.60	0.48	0.59				
Avg. ROA	Mean	7.71	9.18	13.79	0.002***	0.348	0.002***	0.014**
	Median	8.03	7.84	12.85	0.009***	0.493	0.005***	0.015**
	S.D	6.43	5.70	8.23				
Avg. ROE	N	29	29	30				
	Mean	6.57	7.41	15.24	0.215	0.875	0.062*	0.217
	Median	8.31	5.37	15.54	0.008***	0.882	0.002***	0.033**
	S.D	11.64	26.34	21.70				
Panel B: Local privately-owned firms (n=73)								
	N	27	28	18	**P2.2d**			
Avg. Tobin's Q	Mean	1.48	1.40	1.92	0.133	0.473	0.156	0.057*
	Median	1.42	0.94	1.82	0.126	0.399	0.138	0.059*
	S.D	0.84	0.95	1.25				
Avg. stock returns	Mean	0.33	0.40	0.13	0.308	0.658	0.848	0.939
	Median	0.45	0.48	0.35	0.444	0.762	0.228	0.311
	S.D	0.64	0.50	0.69				
Avg. ROA	Mean	7.48	8.41	11.05	0.138	0.533	0.075*	0.139
	Median	7.51	7.63	10.82	0.151	0.608	0.078	0.105
	S.D	6.06	4.91	6.97				
Avg. ROE	N	26	27	18				
	Mean	5.79	5.29	16.13	0.128	0.929	0.010**	0.112
	Median	8.15	4.95	12.66	0.055*	0.957	0.018**	0.055*
	S.D	11.88	26.05	13.50				

Key: Each performance measure is the average of its five annual measures over fiscal years 2007 – 2011 inclusive. Tobin's Q is the ratio between the market capitalization of equity plus book value of preference shares plus book value of long-term debt, and the book value of total assets of a firm. Stock return is the ratio between market value of equity at the end of fiscal year plus dividend minus market value of equity at the beginning of the fiscal year, and the market value of equity at the beginning of the fiscal year. ROA is the ration between operating income and average total assets. ROE is the ratio between income before extraordinary items available for common equity dividend and the sum of the book value of equity and deferred taxes. *Do not comply* indicates absence of an AC; *Only in form* indicates an AC having a composite score at best 8 and *in form and in substance* indicates an AC having a composite score greater than 8 on a 16 point scale (see Section 5.6.1.3 for this classification).
[a]p-value of comparison among groups using ANOVA on means and Kruskal-Wallis on medians.
[b]p-value (two-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians.
[c]p-value (one-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians
*,** and ***respectively indicate significant at less than 10, 5 and 1 percent level.

Panel B (Table 7.12) provides consistent evidence that there is no difference among firm groups based on nature of compliance with audit committee related provisions in terms of any performance measure at the 0.05 level. There is a difference in ROE between firms that do not have an audit committee and firms that comply with audit committee related provisions in form and in substance at the 0.05 level, none of the other differences in performance is significant at the 0.05 level. This evidence supports P2.2d.

7.4.3 Summary

The evidence provided in Section 7.4.1 indicates the following: firstly, non-appointment of an audit committee and non-compliance with several audit committee characteristics is more evident in local privately-owned companies. Secondly, 4 (57.14%) government-owned companies do not appoint an audit committee and 3 government-owned companies that appoint an audit committee fail to comply with several important audit committee characteristics. Thirdly, all subsidiaries of foreign MNCs appointed an audit committee. Although the audit committees of subsidiaries of foreign MNCs are not in full compliance with the BCGG-2006 and international best practice recommendations, they are in better compliance than the audit committees of local privately-owned companies and government-owned companies in several respects.

Table 7.13: Classification of firms based on nature of compliance with audit committee

Nature of compliance with audit committee	**(1)** Total	**(2) P2.1a2** Privately-owned	**(3) P2.1b2** Govt. Owned	**(4) P2.1c2** Subsidiaries of MNC
Do not appoint an audit committee	31	27	4	0
Appoint an audit committee in form but not in substance	30	28	1	1
Appoint an audit committee in form and in substance	30	18	2	10
Total	91	73	7	11

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

In order to provide more objective support for P2.1a1, P2.1a2, P2.1b1, P2.1b2, P2.1c1 and P2.1c2, a summary measure of level of compliance with audit committee is required. This study, thus, develops a composite index for audit committee based on 16 criteria (Section 5.6.1.3). The composite index takes a minimum value of zero and a maximum value of 16. Using the value of this composite index, firms in each of local privately-owned, government-owned and subsidiaries of foreign MNCs are divided into three sub-groups: (1) firms that do not appoint an audit committee, (2) firms that appoint an audit committee in form but not in substance, and (3) firms that appoint an audit committee in form and in substance. The sub-classification of firms in each group is presented in Table 7.13.

Table 7.13 shows that non-compliance is pronounced in local privately-owned companies and government-owned companies but not in subsidiaries of foreign MNCs. Furthermore, compliance with audit committee regulations in form but not in substance is dominated by local privately-owned companies. On the other hand, compliance in form and in substance is proportionally dominated by the subsidiaries of foreign MNCs. Hence, the evidence in Table 7.14 supports P2.1a2, P2.1b2 and P2.1c2 but does not support P2.1a1, P2.1b1 and P2.1c1.

The tests of difference in performance based on nature of compliance with the audit committee related provisions provide evidence that the extent of compliance makes a difference in Tobin's Q, ROA and ROE in the case of a sample including subsidiaries of foreign MNCs, government-owned companies and local privately owned companies. But there is no difference in performance if measured by stock returns based on the extent of compliance with the audit committee related provisions. This evidence provides mixed support for P2.2, P2.2a, P2.2b and P2.2c. However, the level of compliance with provisions relating to the audit committee makes almost no difference in performance when the sample includes only local privately-owned companies. This evidence provides supports for P2.2d.

In sum, the findings demonstrate that the audit committee is playing a passive role especially in the case of local privately-owned companies because the controlling families and sponsor shareholders are reluctant to sacrifice their control over the companies. As a result, the extent of compliance with audit committee

provisions has little effect on performance in the case of local privately-owned companies.

7.5 Chief Financial Officer (CFO)

The BCGG-2006 recommends companies to appoint a CFO and empower the CFO to attend board meetings. The BCGG-2006, however, does not specify the qualifications of the CFO. Prior research (Section 2.6.4.3) indicates that the board position, professional qualification and experience of CFO are positively associated with accounting reporting quality and the strength of the internal control system. Hence, survey respondents are asked about the appointment, board membership, qualifications and experience of the CFO.

Section 7.5.1 presents results of the survey question relating to the CFO provisions. Section 7.5.2 investigates the difference in firm performance based on compliance with CFO related provisions.

7.5.1 Survey evidence relating to the appointment and characteristics of CFO

Table 7.14 (Panel A) shows that 10 out of 91 (10.99%) companies do not appoint CFOs. However, 33 out of 81 (40.74%) appointed CFOs who are not empowered to attend board meeting (Panel B) and 40 out 81 (49.38%) appointed CFOs who do not have a professional accounting or finance qualification (Panel C). These results are, however, highly influenced by local privately-owned companies and government-owned companies but not by subsidiaries of foreign MNCs. All subsidiaries of foreign MNCs appoint CFOs with professional qualifications in accounting and empower their CFOs by at least permitting their attendance at board meetings. Although there is no significant difference in the average experience of CFOs between government-owned companies and subsidiaries of foreign MNCs, the average experience of CFOs in local privately-owned companies is less than that of government-owned companies and subsidiaries of foreign MNCs.

Table 7:14: Description of appointment, authority, qualification and experience of CFO

	(1) Total	**(2) P2.1a2** Privately owned	**(3) P2.1b2** Govt. owned	**(4) P2.1c2** Subsidiaries of MNC
Panel A: Appointment of CFO				
Do not appoint a CFO	10	10	0	0
Appoint a CFO	81	63	7	11
Total number of firms	**91**	**73**	**7**	**11**
Panel B: Authority of appointed CFO				
CFO does not attend board meeting	33	31	2	0
CFO attends board meeting including director CFO	48	32	5	11
CFO is a member of board	21	12	1	8
Panel C: Qualification of CFO				
Number of firms	**81**	**63**	**7**	**11**
Panel C.1: CFO without professional qualification				
CFO without business related qualification	3	3	0	0
CFO has an MBA	4	4	0	0
CFO has Masters in accounting and finance	33	30	3	0
Sub-total Panel C.1	**40**	**37**	**3**	**0**
Panel C.2: CFO with professional qualification				
CFO has Chartered Accountant (CA) qualification	33	18	4	11
CFO has cost and management accounting (CMA) qualification	8	8	0	0
Sub-total Panel C.2	**91**	**26**	**4**	**11**
Panel D: Experience of CFO (in years)	13.38	12.77	15.83	15.64

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.

7.5.2 CFO and firm performance

Based on CFO appointment and characteristics discussed in Section 7.5.1, this study develops a composite score for CFO (Section 5.6.1.4) and then divides the firms into three groups: (1) firms that do not appoint a CFO, (2) firms that appoint a CFO in form but not in substance, and (3) firms that appoint a CFO in form and in substance. Using this classification, Panels A and B of Table 7.15 present the results of tests of difference in performance by type of compliance with CFO provisions for total sample and local privately-owned companies respectively. The testing methodology and format employed are as in Sections 5.8 and 7.2.2 respectively.

Table 7.15: Test of association between the nature of compliance with CFO and firm performance

Performance		Compliance with CFO			p-value			
		(1) Do not comply	(2) in form only	(3) in form and in substance	**P2.2** (4) All[a]	**P2.2a** (5) = (1) vs (2)[b]	**P2.2b** (6) = (1) vs (3)[b]	**P2.2c** (7) = (2) vs (3)[b]
Panel A: Total sample (n=91)								
	N	10	55	26				
Avg. Tobin's Q	Mean	1.51	1.47	2.31	0.001***	0.988	0.012**	0.000***
	Median	1.71	1.28	2.13	0.001***	0.662	0.056*	0.002***
	S.D	0.82	0.96	1.12				
Avg. stock return	Mean	0.39	0.32	0.15	0.359	0.700	0.905	0.888
	Median	0.41	0.46	0.28	0.176	0.942	0.203	0.075*
	S.D	0.40	0.61	0.52				
Avg. ROA	Mean	4.20	8.72	15.63	0.000***	0.029**	0.000***	0.000***
	Median	5.56	7.92	14.27	0.000***	0.023**	0.000***	0.000***
	S.D	4.34	6.12	7.30				
Avg. ROE	N	10	52	26				
	Mean	-8.92	10.02	16.56	0.003***	0.005***	0.003***	0.076*
	Median	3.56	8.59	17.60	0.001***	0.023**	0.000***	0.000***
	S.D	27.03	16.82	22.40				
Panel B: Local privately-owned firms (n=73)								
	N	10	50	13	**P2.2d**			
Avg. Tobin's Q	Mean	1.51	1.45	1.99	0.189	0.913	0.128	0.031**
	Median	1.71	1.25	1.70	0.159	0.579	0.321	0.058*
	S.D	0.82	0.99	1.14				
Avg. stock returns	Mean	0.39	0.34	0.13	0.138	0.781	0.862	0.847
	Median	0.41	0.47	0.28	0.386	0.766	0.352	0.179
	S.D	0.40	0.63	0.64				
Avg. ROA	Mean	4.20	8.42	13.30	0.000***	0.028**	0.002***	0.003***
	Median	5.56	7.64	12.61	0.000***	0.026**	0.000***	0.003***
	S.D	4.34	5.57	5.81				
Avg. ROE	N	10	33	16				
	Mean	-8.92	9.06	17.85	0.003***	0.009***	0.002***	0.043**
	Median	3.56	8.31	17.12	0.002***	0.026**	0.000***	0.003***
	S.D	27.03	17.11	11.18				

Key: Each performance measure is average of its five annual measures over fiscal years 2007 – 2011 inclusive. Tobin's Q is the ratio between the market capitalization of equity plus book value of preference shares plus book value of long-term debt, and the book value of total assets of a firm. Stock return is the ratio between market value of equity at the end of fiscal year plus dividend minus market value of equity at the beginning of the fiscal year, and the market value of equity at the beginning of the fiscal year. ROA is the ration between operating income and average total assets. ROE is the ratio between income before extraordinary items available for common equity dividend and the sum of the book value of equity and deferred taxes. *Do not comply* indicates a firm that has not appointed a CFO. *In form* only indicates a firm that has appointed a CFO and the CFO has a total score at best two on a four point scale. *In form and in substance* indicates a firm that has appointed a CFO and the CFO has a total score greater than two on a four point scale (see Section 5.6.1.4 for this classification).

[a]p-value of comparison among groups using ANOVA on means and Kruskal-Wallis on medians.

[b]p-value (two-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians.

[c]p-value (one-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians

*,** and ***respectively indicate significant at less than 10, 5 and 1 percent level.

Panel A (Table 7.15) does not provide consistent evidence on the association between level of compliance with CFO provisions and firm performance. This evidence once again suggests that the association between CG and firm performance depends on which performance measure is used. For example, if Tobin's Q is used to measure performance, P2.2, P2.2a, P2.2b and P2.2c are supported. On the other hand, when ROA is used, P2.2, P2.2b and P2.2c are supported but P2.2a is not supported.

Panel B (Table 7.15) also provides mixed evidence with respect to P2.2d. The evidence related to market-based performance measures provides more support forP2.2d but evidence related to accounting-based performance measures does not support P2.2d. This evidence indicates that firms that appoint a more qualified CFO and empower their CFO have a better operating performance than other firms but market participants neither offer higher prices for these firms nor earn abnormal returns by investing in these firms. This may indicate that market participants do not distinguish between local privately-owned firms based on the level of compliance with CFO related provisions of the BCGG-2006.

7.5.3 Summary

In order to provide more precise evidence for P2.1a1, P2.1a2, P2.1b1, P2.1b2, P2.1c1 and P2.1c2, this study develops a composite score for CFO (Section 5.6.1.4) and then divides the firms into three groups: (1) firms that do not appoint a CFO, (2) firms that appoint a CFO in form but not in substance, and (3) firms that appoint a CFO in form and in substance. The results show that consistent with P2.1a2 and P2.1b2 respectively, 60 privately-owned companies and four government-owned companies either do not appoint a CFO or appoint a CFO in form but not in substance. On the other hand, 10 out of 11 (90.90%) subsidiaries of foreign MNCs appoint a CFO in form and in substance. This evidence thus provides strong support for P2.1c2 but does not support P2.1c1.

The tests of difference in firm performance (Section 7.5.2) based on nature of compliance with the CFO related provisions provide mixed evidence (Table 7.15, Panel A). Firms that appoint CFOs in form but not in substance have significantly higher accounting-based performance but not market-based performance than firms

that do not appoint CFO. Similarly, firms that comply in form and in substance have significantly higher Tobin's Q, ROA and ROE but not stock returns than firms in the other two groups. Hence, there is lack of complete support for P 2.2, P2.2a, P2.2b and P2.2c.

The tests of difference in firm performance (Table 7.15, Panel B) based on nature of compliance with the CFO related provisions in the case of local privately-owned firms also provides mixed evidence. Although the accounting-based performance of local privately-owned firms that comply with CFO related provisions in form and in substance are substantially higher, the market-based performance of these firms is not different from the other two groups. This evidence suggests that market participants hardly distinguish between local privately-owned companies based on quality, empowerment and experience of the CFOs.

7.6 Head of Internal Audit (HIA)

The BCGG-2006 recommends that companies appoint a HIA. However, the BCGG-2006 does not recommend anything regarding the several characteristics of HIA that prior research (Section 2.6.4.5) finds essential for such an appointment to be an effective CG mechanism. Using prior literature, survey respondents are asked about the appointment, qualification and experience of a HIA, and the appointing, removing and reporting authority of the HIA. Section 7.6.1 presents survey evidence on this subject.. Section 7.6.2 presents the results of statistical analysis of the difference in firm performance based on level of compliance with HIA related provisions. Finally, Section 7.6.3 summarises this section.

7.6.1 Survey evidence relating to the appointment and characteristics of HIA

Table 7.16 presents survey results related to the appointment and characteristics of a HIA. Table 7.16 (Panel A) shows that the majority of local privately-owned companies are reluctant to appoint and ensure the independence of their HIA. For example, 54 local privately-owned companies do not appoint an HIA (Table 7.16, Panel A, Column 2) and CEO or chairman of board retain the appointment and dismissal authority of the HIA in all privately-owned companies

that appoint an HIA (Table 7.16, Panel D, Column 2). This finding indicates that the main sponsor retains the sole authority for the appointment and dismissal of the HIA and thus, the HIA is not independent of the sponsor families. This evidence supports P2.1a2 but does not support P2.1a1.

Table 7.16: Description of Head of Internal Audit (HIA)

	(1) Total	(2) **P2.1a2** Privately owned	(3) **P2.1b2** Govt. owned	(4) **P2.1c2** Subsidiaries of MNC
Panel A: Appointment of HIA				
Number of firms	**91**	**73**	**7**	**11**
Do not appoint HIA	57	54	3	0
Appoint HIA	34	19	4	11
Panel B: Qualification of HIA				
Number of firms	**34**	**19**	**4**	**11**
Panel B.1: HIA does not have professional qualification				
HIA has not business related qualification	2	1	0	1
HIA has an MBA	4	2	0	2
HIA has Masters in accounting and finance	8	3	2	3
Sub-total	**14**	**6**	**2**	**6**
Panel B.1: HIA has professional qualification				
HIA has Chartered Accountant (CA) qualification	16	10*	1	5
HIA has cost and management accounting (CMA) qualification	5	4*	1	0
Sub-total	**21***	**14***	**2**	**5**
Panel C: Experience of HIA (in Years)	8.19	6.28	12.25	10.00
Panel D: Appointing and dismissing authority of HIA				
Number of firms	**34**	**19**	**4**	**11**
CEO	14	9	2	3
Chairman of board	10	10	0	0
Board of directors	6	0	2	4
Audit committee	3	0	0	4
Panel E: Reporting authority of HIA**				
Number of firms	**34**	**19**	**4**	**11**
CFO	15	12	3	0
CEO	8	2	1	5
Chairman of board	5	2	0	3
Audit committee	11	5	0	6

Key: Sample is 91 firms. Privately-owned companies indicate the companies that are significantly owned by Bangladeshi residents and neither the government of Bangladesh nor a foreign individual or company has a significant percentage of ownership. Government-owned companies indicate companies in which the government has a substantial ownership interest and one of the top two positions in management is occupied by a government official. The subsidiaries of foreign multinational companies indicate companies in which a foreign parent company has a substantial ownership interest and a representative of the foreign company occupies one of the top two positions in management.
*One internal auditor has both CA and CMA qualification.
**Total does not match as several HIAs report to multiple authorities.

Like local privately-owned companies, 3 out of 7 government-owned companies do not appoint an HIA (Table 7.16, Panel A, Column 3). Fifty per cent of

government-owned companies that appoint an HIA retain the appointing and dismissal authority with CEO (Table 7.16, Panel D, Column 3) and none of these firms ensure the access of the HIA to the audit committee or the board of directors (Table 7.16, Panel E, Column 3). This evidence supports P2.1b2 but does not support P2.1b1.

All subsidiaries of foreign MNCs appoint an HIA (Table 7.16, Panel A, Column 4). In addition, in 8 out of 11 subsidiaries of foreign MNCs, the board of directors or the audit committee is the appointing and dismissal authority of the HIA (Table 7.16, Panel D, Column 4). Moreover, 9 subsidiaries of foreign MNCs ensure the access of their HIA to the board of directors or audit committee (Table 7.17, Panel E, Column 4). This evidence supports P2.1c2 but does not support P2.1c1.

7.6.2 HIA and firm performance

Based on HIA appointment and characteristics discussed in Section 7.6.1, this study develops a composite score for HIA and then divides the firms into three groups: (1) firms that do not appoint a HIA, (2) firms that appoint a HIA in form but not in substance and (3) firms that appoint a HIA in form and in substance (see Section 5.6.1.5).

Using this classification, Panels A and B of Table 7.17 present the results of tests of difference in performance by type of compliance with HIA for the total sample and local privately-owned companies respectively. The testing methodology and format employed are as in Sections 5.8 and 7.2.2 respectively.

The evidence in Panel A (Table 7.17) provides mixed support for P2.2, P2.2a, P2.2b but no support for P2.2c. The complete lack of support for P2.2c may indicate that the firms that appoint a HIA in form but not in substance and firms that appoint HIA in form and in substance are very similar in other respects that HIA quality makes little difference in performance.

The content of Panel B (Table 7.17) again provides mixed evidence with respect to P2.2d. This evidence is consistent with evidence for CFOs that firms that appoint a more qualified HIA and empower their HIA have better operating performance than other firms but market participants neither offer higher prices for these firms nor do they earn abnormal returns by investing in these firms.

Table 7.17: Test of association between the nature of compliance with HIA and firm performance

Performance		Type of board			p-value			
		(1) Do not comply	(2) in form only	(3) in form and in substance	**P2.2** (4) All[a]	**P2.2a** (5) = (1) vs (2)[b]	**P2.2b** (6) = (1) vs (3)[b]	**P2.2c** (7) = (2) vs (3)[b]
Panel A: Total sample (n=91)								
	N	57	19	15				
Avg. Tobin's Q	Mean	1.95	2.40	2.49	0.0764*	0.137	0.017**	0.308
	Median	1.77	2.11	2.45	0.067**	0.153	0.033**	0.567
	S.D	0.96	1.33	1.08				
Avg. stock return	Mean	0.31	0.22	0.23	0.769	0.538	0.693	0.487
	Median	0.45	0.34	0.28	0.459	0.497	0.215	0.959
	S.D	0.58	0.52	0.60				
Avg. ROA	Mean	7.41	13.71	16.33	0.000***	0.000***	0.000***	0.185
	Median	8.03	13.09	14.09	0.002***	0.001***	0.001***	0.456
	S.D	4.76	7.71	9.19				
Avg. ROE	N	55	19	14				
	Mean	4.49	20.14	16.63	0.006***	0.001***	0.032**	0.670
	Median	6.44	17.48	23.88	0.000***	0.000**	0.001***	0.743
	S.D	18.53	12.72	31.06				
Panel B: Local privately-owned firms (n=73)								
	N	54	12	7	**P 2.2d**			
Avg. Tobin's Q	Mean	1.93	2.29	2.08	0.546	0.293	0.317	0.612
	Median	1.72	2.07	1.63	0.593	0.302	0.768	0.799
	S.D	0.98	1.38	1.02				
Avg. stock returns	Mean	0.31	0.40	0.14	0.667	0.650	0.755	0.794
	Median	0.45	0.48	0.28	0.535	0.549	0.342	0.398
	S.D	0.59	0.48	0.87				
Avg. ROA	Mean	7.51	11.62	12.98	0.011**	0.020**	0.005***	0.365
	Median	7.90	10.18	10.12	0.097*	0.103	0.103	0.735
	S.D	4.65	8.14	8.08				
Avg. ROE	N	53	12	6				
	Mean	4.30	19.26	20.70	0.011**	0.013**	0.023**	0.429
	Median	6.44	14.81	18.36	0.004***	0.005***	0.031**	0.925
	S.D	18.85	15.37	17.17				

Key: Each performance measure is the average of its five annual measures over fiscal years 2007 – 2011 inclusive. Tobin's Q is the ratio between the market capitalization of equity plus book value of preference shares plus book value of long-term debt, and the book value of total assets of a firm. Stock return is the ratio between market value of equity at the end of fiscal year plus dividend minus market value of equity at the beginning of the fiscal year, and the market value of equity at the beginning of the fiscal year. ROA is the ration between operating income and average total assets. ROE is the ratio between income before extraordinary items available for common equity dividend and the sum of the book value of equity and deferred taxes. *Do not comply* indicates a firm that has not appointed a HIA. *In form only* indicates a firm that has appointed a HIA and the HIA has a total score at best two on a four point scale. *In form and in substance* indicates a firm that has appointed a HIA and the HIA has a total score greater than two on a four point scale (see Section 5.6.1.5 for this classification).

[a]p-value of comparison among groups using ANOVA on means and Kruskal-Wallis on medians.

[b]p-value (two-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians.

[c]p-value (one-tailed) of comparison between groups using t-tests on the means and Wilcoxon rank-sum tests on the medians

*, ** and ***respectively indicate significant at less than 10, 5 and 1 percent level.

7.6.3 Summary

The classification of companies based on the appointment and characteristics of a HIA (Section 7.6.2) shows that 66 (90.41%) local privately-owned companies and six (85.71%) government-owned companies are classified into the first two sub-groups while seven (63.64%) subsidiaries of foreign MNCs are classified the third group. These findings support P2.1a2, P2.1b2 and P2.1c2 but do not support P2.1a1, P2.1b1 and P2.1c1.

The tests of difference in performance between firms based on extent of compliance with HIA provisions suggest that there is a lack of conclusive evidence to support P2.2, P2.2a, and P2.2b. However, the evidence does not provide any support for P2.2c. Similarly, there is a lack of complete support for P2.2d. Although based on no significant difference in market-based performance measures between and among sub-groups of local privately-owned firms, P2.2d can be supported; P2.2d cannot be supported if accounting-based performance measures are used.

7.7 Conclusion

The aim of this chapter has been to investigate (1) whether firms in Bangladesh comply with the provisions of the BCGG-2006 in form and in substance and (2) whether the nature of compliance with the provisions of the BCGG-2006 is associated with firm performance. Using detailed survey responses from 91 companies on five important CG mechanisms of the BCGG-2006, this chapter shows that compliance in form and in substance at its highest is 32.97 per cent in the case of audit committees and at its lowest is 7.69 per cent in the case of independent directors. In all other cases, the firms either do not comply or comply in form but not in substance. This evidence indicates that the majority of companies either do not comply or comply in form but not in substance with the BCGG-2006.

The compliance in form and in substance is less evident in local privately-owned companies. Here, compliance in form and in substance at its highest is 24.66 per cent in the case of audit committees and at its lowest is 2.74 per cent in the case of independent directors. In all other cases, the firms either do not comply or comply

in form but not in substance. This evidence supports P2.1a2 but does not support P2.1a1.

Although 85.71 percent of government-owned companies comply in form and in substance with the separation of chairman and CEO; compliance in form and in substance by government-owned companies with board independence, audit committee, CFO and head of internal audit is not high. For example, none of the government-owned companies appoint independent director(s) and compliance in form and in substance with respect to an audit committee, CFO and head of internal auditor respectively is 28.58, 42.86 and 14.29 percent. This evidence supports P2.1b2 but does not support P2.1b1.

In comparison with local privately-owned companies and government-owned companies, compliance in form and in substance is more evident in subsidiaries of foreign MNCs. The evidence shows that compliance in form and in substance by subsidiaries of foreign MNCs at its highest is 90.91 per cent in the case of separation of chairman and CEO, audit committee and CFO and at its lowest is 63.64 per cent in the case of head of internal audit. This evidence supports P2.1c2 but does not support P2.1c1.

The aforementioned evidence is consistent with the theory of path dependence of corporate governance. In Bangladesh, the private benefits of control are high and the relative efficiency of an Anglo-American based CG model is low. As a result, a significant percentage of companies in Bangladesh either do not comply or comply in form but not in substance with the BCGG-2006. Furthermore, the private benefits of control are higher in local privately-owned and government-owned companies than subsidiaries of foreign MNCs. This variation in the private-benefits of control makes a difference in the level of compliance in form and in substance. This evidence suggests that local private-owned and government-owned companies are more reluctant to comply in form and in substance with the BCGG-2006 in order to protect the high private benefits of control.

With respect to the association between extent of compliance with the provisions of the BCGG-2006 and firm performance in the total sample, the evidence is inconclusive in relation to all five CG mechanisms tested in this chapter. The evidence indicates that the inclusion of subsidiaries of foreign MNCs the sample and

the selection of performance measure affects the results of tests. This conflicting evidence may indicate the omission of some firm characteristics that mediate the association between nature of compliance with the provisions of the BCGG-2006 and firm performance.

The evidence also does not provide conclusive support for P2.2d. Although the tests relating to the separation of chairman and CEO, independent director and audit committee supports P2.2d, the tests relating to CFO and HIA provide mixed evidence. It may indicate that in the case of Bangladesh, internal structure of the company rather than the separation of chairman and CEO, board composition and audit committee makes a difference to performance. This result may indicate that in local privately-owned companies, second-tier management (e.g. CFO and HIA) plays an important role as the board and audit committee may be ineffective due to family concentration.

Chapter Eight

Overstatement of compliance with the BCGG-2006 in annual reports and its determinants

8.1 Introduction

This chapter presents the results of the following research questions: *RQ3.1. To what extent does reported compliance with the BCGG-2006, as reported in annual reports, overstate underlying compliance with the BCGG-2006? RQ3.2 Does the overstatement of compliance reported in annual reports lead to a different relative ranking of a firms' corporate governance? RQ3.3 What factors influence the overstatement of compliance with the BCGG-2006 in annual reports?*

I developed hypotheses H3.1a and H3.1b with respect to RQ3.1, hypotheses H3.2a and H3.2b with respect to RQ3.2 and hypotheses H3.3a1, H3.3a2, H3.3b1, H3.3b2, H3.3c1 and H3.3c2 in Section 4.4. This chapter uses survey responses (Section 5.4) from 91 companies on compliance with 20 provisions of the BCGG-2006, together with the annual reports of these 91 companies and trading data from the Dhaka Stock Exchange (DSE) as sources. I discuss two measures of compliance in Section 5.7.1 [compliance reported in annual reports is denoted (CG_AR) and compliance stated in the survey is denoted (CG_SR)]. These are required for testing hypotheses H3.1a and H3.1b related to RQ3.1 and hypotheses H3.2a and H3.2b related to RQ3.2 (see Sections 5.7.1 and 5.7.2). The method for testing H3.1a and H3.1b is discussed in Section 5.9.1. In order to test H3.2a and H3.2b, Spearman rank correlations (Section 5.9.2) between *CG_AR* and *CG_SR* and between the three sub-indices of *CG_AR* and *CG_SR* (Section 5.7.2) are calculated. The significance of Spearman rank correlations is tested against 0.95 using Fisher's z transformation (Section 5.9.2). The measurement of variables and method required for testing H3.3a1 and H3.3a2 are detailed in Section 5.7.3 and 5.9.3 respectively. The measurement of variables and method required for testing H3.3b1, H3.3b2, H3.3c1 and H3.3c2 are detailed in section 5.7.4 and 5.9.4 respectively.

Section 8.2 presents evidence related to H3.1a and H3.1b. Section 8.3 presents evidence related to H3.2a and H3.2b. Section 8.4 presents evidence related to H3.3a and H3.3b. Section 8.5 presents evidence related to H3.3b1, H3.3b2, H3.3c1 and H3.3c2. Section 8.6 concludes the chapter.

8.2 Overstatement of compliance with the BCGG-2006 in annual reports (H3.1a and H3.1b)

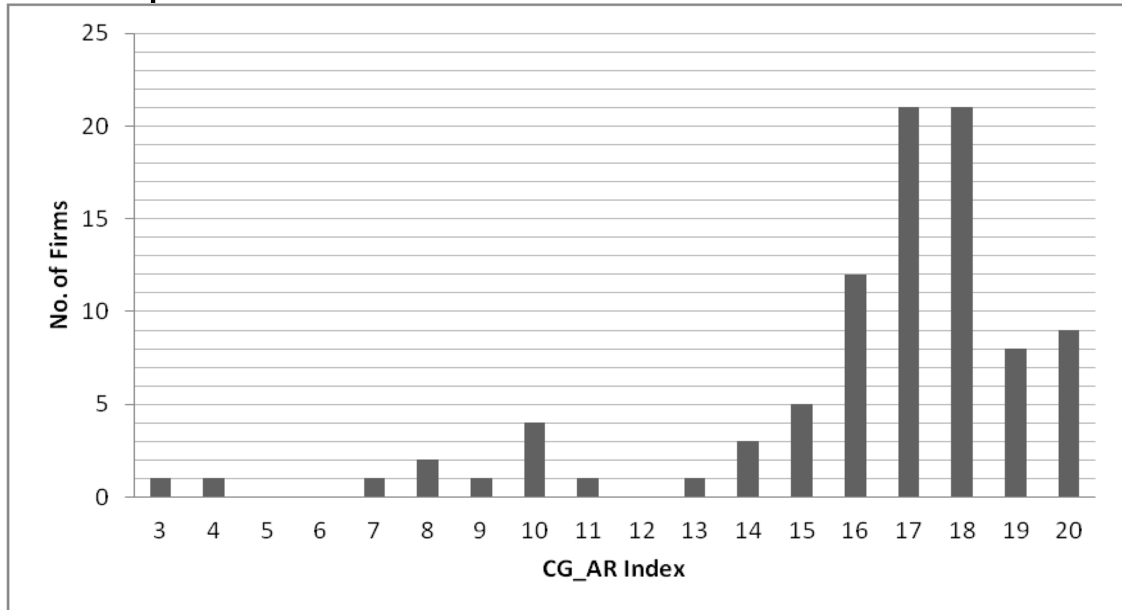
This section presents evidence related to H3.1a and H3.1b. It discusses the value of *CG_AR* and *CG_SR,* presents comparative distribution of *CG_AR* and *CG_SR* and then presents the results of statistical test of H3.1a and H3.1b.

The minimum and maximum values of both *CG_AR* and *CG_SR* are 3 and 20 respectively. One company has a *CG_AR* value of 3 even though this company does not include the '*comply box*' in its annual report. However, it has a *CG_AR* score of 3 because disclosures about the board of directors and external auditors in annual reports indicate compliance with three provisions. On the other hand, one other company has a *CG_SR* score of 3. This additional company also does not comply with the BCGG-2006 but scores three because it has a board of directors which complies with three provisions of the BCGG-2006. With respect to the maximum values of *CG_AR* and *CG_SR*, eight and five companies have a maximum *CG_AR* and *CG_SR* score respectively. The *CG_AR* and *CG_SR* values of the other companies remain within the range of 3 - 20. Although no company has a *CG_SR* score greater than *CG_AR*, detailed analysis shows that a few companies state compliance in the survey only with respect to individual provisions. Further detail on the difference between compliance reported in annual reports and compliance stated in the survey with respect to each provision is provided in Section 8.4. Figures 8.1 and 8.2 respectively present the distribution of *CG_AR* and *CG_SR* scores.

Figure 8.1 highlights that the distribution of *CG_AR* is heavily weighted toward the 16 - 20 range while Figure 8.2 shows that relatively few companies have a *CG_SR* score in the 16 - 20 range. The comparison of these two figures clearly suggests that the level of compliance with the BCGG-2006 as reported in the annual reports does not always represent underlying compliance. The findings that a greater number of companies have a *CG_AR* between 16 to 20 and a fewer number of

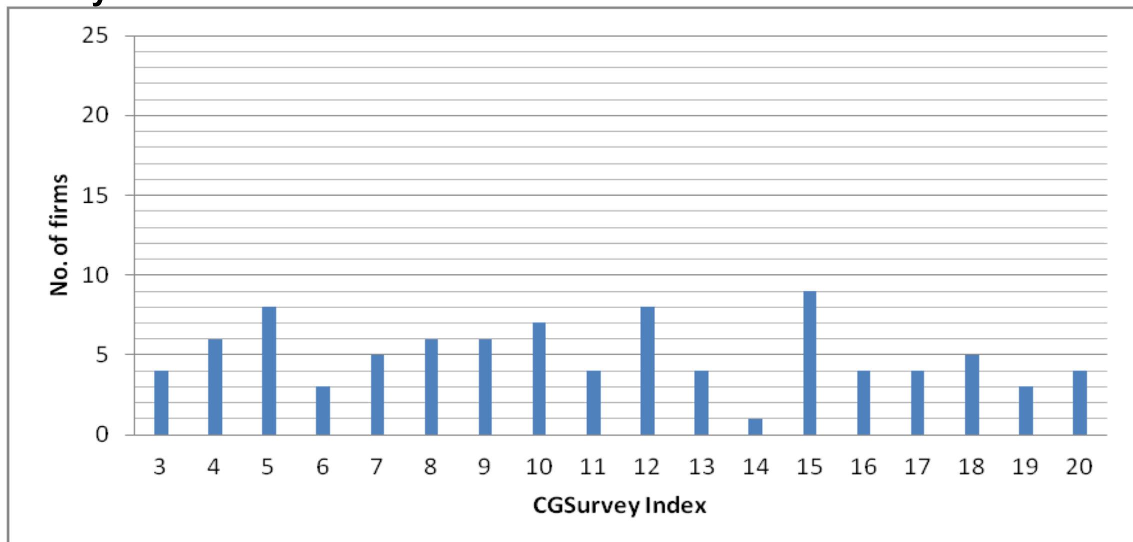
companies have a *CG_SR* between 16 to 20 are consistent with the argument that compliance with the BCGG-2006 is reported in the annual reports to depict an image that companies maintain a sound CG structure that is not implemented in reality.

Figure 8.1: Distribution of CG index based on compliance as reported in annual reports



Key: Sample is 91 firms. Corporate governance compliance index of 20 important provisions of the BCGG-2006.

Figure 8.2: Distribution of CG index based on compliance as stated in survey.



Key: Sample is 91 firms. *C*orporate governance compliance index of 20 important provisions of the BCGG-2006.

Table 8.1 shows that the mean (median) of *CG_AR* is significantly higher than the mean (median) of *CG_SR* at less than 0.01 level. The results, thus, support H3.1b but do not support H3.1a.

Table 8.1: Univariate tests comparing CG index based on annual reports and CG index based on survey

	CG_SR	CG_SR	P-value
Mean[a]	16.25	11.04	0.000***
Median[b]	17.00	11.00	0.000***
S. D	3.46	4.98	

Key: Sample is 91 firms. *CG_AR* is a corporate governance compliance index of 20 important provisions of the BCGG-2006 as reported in annual reports. *CG_SR* is a corporate governance compliance index of 20 important provisions of the BCGG-2006 as revealed by the survey.
[a]Difference in means is tested by using t-tests with unequal variance.
[b]Difference in medians is tested by using Wilcoxon rank sum tests.
*** Significant beyond 0.01 levels (one-tail).

8.3 Impact of overstatement of compliance with the BCGG-2006 in annual reports on relative ranking of a firm's CG (H3.2a and H3.2b)

Table 8.2 presents the results of the Spearman rank correlation between *CG_AR* and *CG_SR*, and between corresponding sub-components of *CG_AR* and *CG_SR*. The significance of the correlation coefficient is tested against $\rho = 0.95$ (see Section 5.9.2).

Table 8.2: Spearman Rank Correlation between Reported Compliance Indices and Survey Compliance Indices (significance of correlation coefficients is tested against $\rho = 0.95$**)**

	CG_AR	BD_AR	AC_AR	O_AR
CG_SR	***0.5750***[a]			
BD_SR		***0.6228***[a]		
AC_SR			***0.5546***[a]	
O_SR				***0.2876***[a]

Key: Sample is 91 firms. Variable definitions: CG_AR is a corporate governance compliance index of 20 important provisions of the BCGG-2006 as reported in annual reports. CG_SR is a corporate governance compliance index of the same 20 provisions of the BCGG-2006 as revealed by a survey. BD_AR is a five point corporate governance index based on compliance with board related provisions as reported in annual reports. BD_SR is a five point corporate governance index based on compliance with board related provisions as revealed by a survey. AC_AR is a nine point corporate governance index based on compliance with provisions related to audit committee as reported in annual reports. AC_SR is a nine point corporate governance index based on compliance with provisions related to audit committee as revealed by a survey. O_AR is a six point corporate governance index based on compliance with provisions related to CFO, internal control and internal audit, and external audit as reported in annual reports. O_SR is a six point corporate governance index based on compliance with provisions related to CFO, internal control and internal audit, and external audit as revealed by a survey. Significance of correlation coefficients between reported score and survey score are tested against Ho: $\rho = 0.95$ using Fisher's transformation.
[a]correlation coefficient is significantly different from $\rho = 0.95$ at .01 level.

Although all the correlation coefficients are positive, all are significantly different from the hypothesised value of $\rho = 0.95$ at the 0.01 level. The significance of all four correlation coefficients is also tested against the hypothesised value of $\rho = 0.99$ and the tests yield similar results. The results, thus, support H3.2b but do not support H3.2a. These results indicate that when investment and credit analysts use compliance reported in annual reports to rank a firm's CG structure, they will get a different ranking than when they use compliance as stated in a survey.

8.4 The nature of provisions and overstatement of compliance in annual reports (H3.3a1 and H3.3a2)

Having established that the mean and medians of *CG_AR* are significantly greater than that of *CG_SR*, and that the rank of companies differ when an investor or a credit rating analyst uses *CG_AR* instead of CG_SR, Table 8.3 compares the number of companies that report compliance in annual reports with the number of companies that state compliance in the survey with respect to each of the 20 provisions of the BCGG-2006. The provisions of the BCGG-2006 are divided into observable and less observable provisions (Section 5.7.3). Column 3 of Table 8.3 reports the difference between the proportion of firms that report compliance in annual reports and the proportion of firms that state compliance in the survey with respect to each provision.

Table 8.3 shows that the number of companies that report compliance with each of the 20 provisions of the BCGG-2006 in annual reports is relatively higher than the number of companies that state compliance in the survey. The only exception is compliance with board size, where there is no difference between the numbers of companies. A detailed analysis of annual report disclosures on compliance compared to the survey responses shows that companies that state compliance with a particular provision in the survey generally report the same in their annual reports. For example, 60 firms that state that they have an audit committee in the survey also report the same in their annual reports.

Table 8.3: Description of number of companies complied as reported in annual reports and as stated in the survey

Corporate Governance Provisions	Nature of provisions	(1) Compliance as reported in Annual Reports		(2) Compliance as per survey responses		(3) [a]Difference between percentage of firms in (1) and (2)
		No. of firms	%	No. of firms	%	
Board size (Min 5, max 20)	Observable	88	96.70	88	96.70	0
Independent directors (10% with a minimum one)	Observable	77	84.62	68	74.73	9.89**
Separation of chairman and CEO	Observable	77	84.62	73	80.22	4.40
Define the roles and responsibilities of the chairman and CEO	Less observable	39	42.86	20	21.97	20.89***
Board meetings (at least four per year)	Observable	90	98.90	69	75.82	23.08***
An audit committee is constituted	Observable	81	89.01	60	65.93	23.08***
Written charter for audit committee	Less observable	42	46.15	22	24.18	21.94***
Audit committee size	Observable	79	86.81	57	62.64	24.17***
Presence of an independent director on audit committee	Observable	73	80.22	51	56.04	24.18***
Appointment of the chairman of audit committee	Observable	80	87.91	60	65.93	21.98***
Qualification of the chairman of audit committee	Less observable	79	86.81	26	28.57	58.24***
Audit committee meetings (at least four per year)	Less observable	31	34.07	21	23.08	10.99*
Audit committee reports its activities to the board of directors	Less observable	77	84.62	39	42.86	41.76***
Audit Committee reports to the shareholders	Less observable	59	64.84	27	29.67	35.17***
Appointment of Chief Financial Officer	Less observable	89	97.80	81	89.01	8.79***
The Chief Financial Officer attends board meeting	Less observable	88	96.70	48	52.75	43.95***
System of internal control is sound in design, effectively implemented and monitored	Less observable	88	96.70	28	30.77	65.93***
Appointment of Head of Internal Auditor	Less observable	81	89.01	34	37.36	51.65***
External audit has not been engaged in non-audit services	Less observable	87	95.60	50	54.95	40.65***
External auditor is rotated in every three years	Observable	81	89.01	79	86.81	2.20

Key: Sample is 91 firms. Observable provisions are easily verifiable or are subject to strong monitoring by regulatory authorities such as SEC and DSE. Less-observable provisions are related to internal practices of a company and thus, are relatively less visible to an outside individual or organization. An audit committee chairman has a qualification in accounting or finance if he has either professional qualification in accounting such as FCA, FCMA and PhD in Accounting or has held a senior management position (e.g. Chairman and CEO) with another public limited company or financial institution but has not held that position because of his/her shareholding.

[a]Difference in percentage of firms between (1) and (2) is tested using two sample tests of proportions.

***, ** and * statistically significant at less than 0.01, 0.05 and 0.10 level (one-tail) respectively.

The only exceptions relate to three provisions. These are (1) defining the roles and responsibilities of the chairman and CEO, (2) having a written charter for the audit committee, (3) convening at least four meetings of the audit committee per year. In respect of defining the roles and responsibilities of the chairman and CEO, one company states compliance in the survey but does not report that compliance in its annual report. In respect of having a written charter for the audit committee, and convening at least four meetings of the audit committee per year, six and five companies respectively state compliance in the survey but do not report compliance in their annual reports.

The test of difference between the proportion of companies that report compliance in annual reports and the proportion of companies that state compliance in the survey is rejected in respect of 17 out of 20 provisions. This result again supports the evidence that companies overstate compliance with the BCGG-2006 in their annual reports. Table 8.3 also shows that the test of difference between the proportion of companies that report compliance in annual reports and that of companies that state compliance in the survey is rejected in the case of all non-observable provisions. However, the test is rejected in the case of six out of nine observable provisions. This evidence provides preliminary support that the difference between the proportion of companies that disclose compliance in annual reports and the proportion of companies that state compliance in the survey is more pronounced in respect of non-observable provisions.

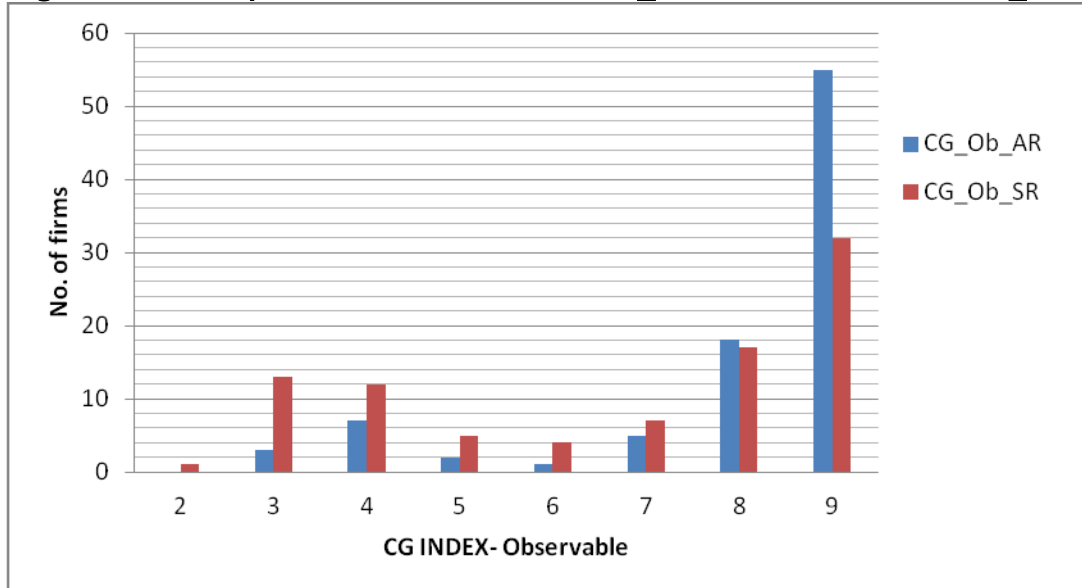
Table 8.4: Descriptive statistics of observable CG_AR, observable CG_SR, non-observable CG_AR, non-observable CG_SR

Statistics	*(1) Obs_CG_AR*	*(2) Obs_CG_SR*	*(3) Non-obs_CG_AR*	*(4) Non-obs_CG_SR*
Minimum	3.0	2.0	0	0
Mean	7.99	6.71	8.27	4.41
Median	9.0	8.0	9.0	4.0
Maximum	9.0	9.0	11.0	11.0
S.D	1.73	2.36	2.17	3.21

Key: Sample is 91 firms. Obs_*CG_AR* is a corporate governance compliance index of nine important provisions of the BCGG-2006 as reported in annual reports; Obs_*CG_SR* is a corporate governance compliance index of nine important provisions of the BCGG-2006 as stated in survey. Non-obs_*CG_AR* is a corporate governance compliance index of 11 important provisions of the BCGG-2006 as reported in annual reports; Non-obs_*CG_SR* is a corporate governance compliance index of 11 important provisions of the BCGG-2006 as revealed by a survey.

In relation to detailed evidence presented in Table 8.3, this study separates CG_AR into observable CG_AR and less observable CG_AR, and CG_SR into observable CG_SR and less observable CG_SR (Section 5.7.3). Table 8.4 presents descriptive statistics of the aforementioned CG indices. The mean (median) values of observable CG_AR, non-observable CG_AR, observable CG_SR and non-observable CG_SR indicates that the gap between non-observable CG_AR and CG_SR is higher than the gap between observable CG_AR and CG_SR.

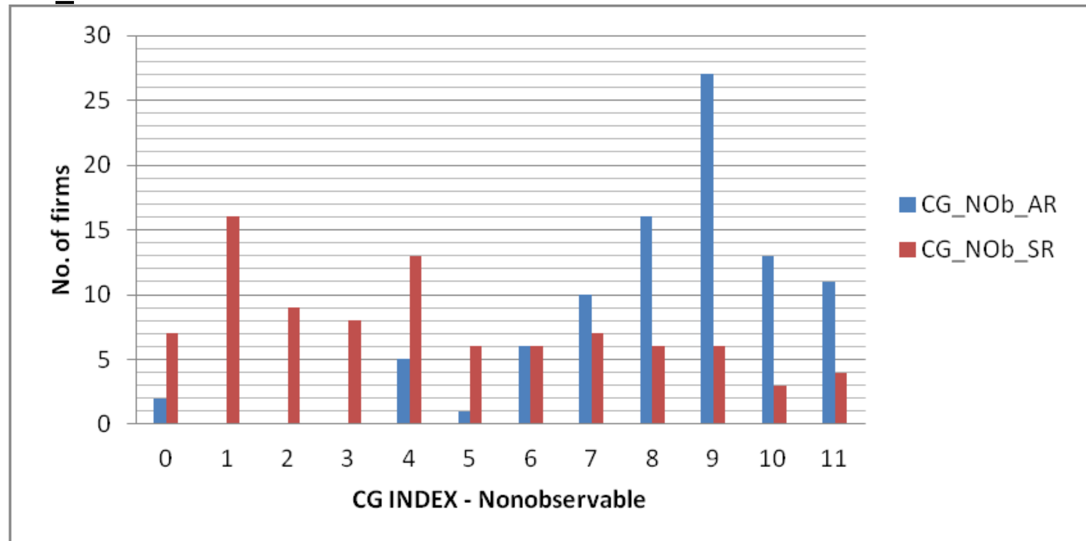
Figure 8.3: Comparison of observable *CG_AR* with observable *CG_SR*.



Key: Sample is 91 firms. Obs_*CG_AR* is a corporate governance compliance index of nine important provisions of the BCGG-2006 as reported in annual reports; Obs_*CG_SR* is a corporate governance compliance index of nine important provisions of the BCGG-2006 as stated in a survey.

In order to focus more on the overstatement of compliance in annual reports with respect to observable and non-observable provisions, Figure 8.3 compares the distribution of observable *CG_AR* with observable *CG_SR* and Figure 8.4 compares the distribution of non-observable *CG_AR* with non-observable *CG_SR*.

Figure 8.4: Comparison of non-observable *CG_AR* with non-observable *CG_SR*



Key: Sample is 91 firms. Non-obs_*CG_AR* is a corporate governance compliance index of 11 important provisions of the BCGG-2006 as reported in annual reports; Non-obs_*CG_SR* is a corporate governance compliance index of 11 important provisions of the BCGG-2006 as revealed by the survey.

Figure 8.3 shows that a large number of companies have identical observable *CG_AR* and observable *CG_SR*. Consequently, the distribution of observable *CG_AR* and the distribution observable *CG_SR* roughly move together and are heavily weighted toward the 8-9 range. However, there is a considerable difference between less observable *CG_AR* and less observable *CG_SR* (Figure 8.4). While the distribution of less observable *CG_AR* is negatively skewed, the distribution of less observable CG_*SR* is slightly positively skewed. A comparison of Figure 8.3 and 8.4 suggests that overstatement of compliance with the BCGG-2006 in annual reports mostly results with respect to less observable provisions of the BCGG-2006.

Now I determine two new distributions: *overstatement in observable CG* and *overstatement in less observable CG* (Section 5.7.3) using the values of observable CG_AR, observable CG_SR, less observable CG_AR, and less observable CG_SR as summarised in Table 8.4. The difference in means is tested using a t-test while the difference in medians is tested using a Mann-Whitney U-test. The results of tests are presented in Table 8.5 showing that the mean and median of *overstatement in non-observable CG* are significantly higher than that of *overstatement in observable CG* at the 0.01 level. This evidence provides support for Hypothesis 3.3a2 that

overstatement of compliance in annual reports is more pronounced with respect to less observable provisions of the BCGG-2006.

Table 8.5: Descriptive statistics and univariate tests comparing overstatement in observable and less observable *CG*

	OVS_Less-obs_CG	*OVS_Obs_CG*	P-value
Minimum	0	0	
Mean[a]	3.87	1.27	0.000***
Median[b]	3	0	0.000***
Maximum	10	6	
S. D	2.89	1.96	

Key: Sample is 91 firms. OVS_Less-obs_*CG* is the difference between less-observable *CG_AR* and less-observable *CG_SR*. OVS_Obs_*CG* is the difference between observable *CG_AR* and observable *CG_SR*. Less-observable *CG_AR* is a corporate governance compliance index of 11 less-observable provisions of the BCGG-2006 as reported in annual reports. Less-observable *CG_SR* is a corporate governance compliance index of 11 less-observable provisions of the BCGG-2006 as revealed by a survey. Observable *CG_AR* is a corporate governance compliance index of nine observable provisions of the BCGG-2006 as reported in annual reports. Observable *CG_SR* is a corporate governance compliance index of nine observable provisions of the BCGG-2006 as revealed by a survey
[a]Difference in means is tested by using t-tests with unequal variance.
[b]Difference in medians is tested by using Wilcoxon rank sum tests.
*** Significant beyond 0.01 levels (one-tail).

8.5 Overstatement of compliance with the BCGG-2006 in annual reports and control by families and institutional investors (H3.3b1, H3.3b2, H3.3c1 and H3.3c2)

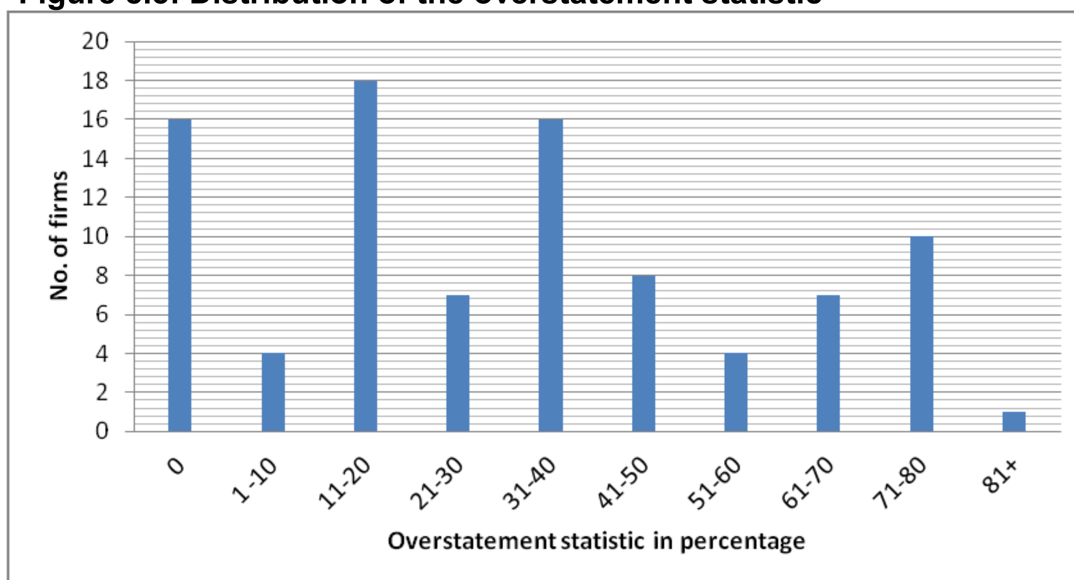
8.5.1 The value of the dependent variable

The dependent variable for testing H3.3b1, H3.3b2, H3.3c1 and H3.3c2 is the overstatement statistic (Section 5.7.4.1). The value of the overstatement statistic as a percentage is presented in a bar diagram in Figure 8.5. Figure 8.5 shows that 16 firms do not overstate compliance in their annual reports and have an overstatement statistic equal to zero. However, the remaining 75 companies have a positive overstatement statistic. The mean (median) of the overstatement statistic is 31.92 (31.25) per cent and the standard deviation is 24.87 per cent. This result suggests that on average, the level of compliance reported in the annual reports is not a very good reflection of actual compliance with the BCGG-2006. The maximum value of the overstatement statistic is 82.35[18] per cent. The distribution of the overstatement statistic is truncated at the lower bound of zero and is not symmetric. Hence, for

[18] The overstatement statistic cannot be 1 because it is obvious for firms to report several items of the BCGG-2006 such as name of the chairman, CEO and members of board which indicates compliance with provisions related to separation of CEO, board size and composition.

incorporation in statistical tests, 1 is added to the overstatement statistic in decimal form and then log is taken on the resulting variable[19]. This log (1+ overstatement statistic in decimal form) (*OVS_G*) is used as the dependent variable in Tobit model.

Figure 8.5: Distribution of the overstatement statistic



Key: Sample is 91 firms. Overstatement statistic is calculated by scaling the difference between CG_AR and CG_SR by CG_AR. CG_AR is a corporate governance compliance index of 20 important provisions of the BCGG-2006 as reported in annual reports and CG_SR is a corporate governance compliance index of 20 important provisions of the BCGG-2006 as revealed by a survey.

Table 8.6: Descriptive statistics of dependent and independent variables

Variables	N	Mean	S.D.	Min	Median	Max
OVS_G	91	0.2597	0.1869	0	0.2700	0.5988
INS_OWN	91	16.54	12.68	0	15.71	61.14
SIZE	91	21.44	1.62	17.32	21.45	25.41
ROA	91	6.39	7.14	-12	4.6	29.37
MB	91	4.44	6.26	-0.77	3.04	55.46
Dichotomous variables		1		0		
FC	91	55 (60.44%)		36 (39.56%)		
AUDIT	91	24 (26.37%)		67 (73.63%)		

Key: OVS_G is Log (1 + overstatement statistic in decimal form). The overstatement statistic is the difference between CG_AR and CG_SR scaled by CG_AR. INS_OWN is percentage of outstanding shares owned by institutional investors at the end of a company's accounting period in 2011. SIZE is the natural logarithm of book value of total assets at the end of company's accounting period in 2011. ROA is the ratio between net profit before extraordinary items and average total assets at the end of company's accounting period in 2011. MB is the ratio between market value and book value of equity at the end of company's accounting period in 2011. FC is a dummy variable indicating presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise. AUDIT is a dummy variable equals 1 if the audit firm of the company is affiliated with international big-four audit firms, 0 otherwise.

[19] See Woolridge (2002) p. 671 on linearization of a truncated distribution.

Table 8.6 presents descriptive statistics for the dependent and independent variables used for testing H3.3b1, H3.3b2, H3.3c1 and H3.3c2.

Table 8.7: Difference in the value of explanatory variables between firms with higher and lower OVS_G

Variables	N	OVS_G>Median	OVS_G<Median	Mann-Whitney U-test	Chi-square test
FC	91	1 = 38	1= 17		χ^2 = 19.12***
		0 = 8	0 = 28		
INS_OWN	91	μ = 17.93	μ = 15.20	Z = 1.056	
		σ = 12.50	σ = 12.38		
SIZE	91	μ = 20.62	μ = 22.28	Z = 5.03***	
		σ = 1.36	σ = 1.43		
ROA	91	μ = 4.32	μ = 8.51	Z = 3.31***	
		σ = 5.78	σ = 7.83		
MB	91	μ = 5.04	μ = 3.83	Z = 0.556	
		σ = 8.45	σ = 2.55		
AUDIT	91	1 = 2	1= 22		χ^2 = 23.25***
		0 = 44	0 = 23		

Key: OVS_G is log of (1 + overstatement statistic in decimal form). The overstatement statistic is the difference between CG_AR and CG_SR scaled by CG_AR. FC is a dummy variable indicating presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise. INS_OWN is percentage of outstanding shares owned by institutional investors at the end of a company's accounting period in 2011. SIZE is the natural logarithm of book value of total assets at the end of company's accounting period in 2011. ROA is the ratio between net profit before extraordinary items and average total assets at the end of company's accounting period in 2011. MB is the ratio of the firm's market value of common equity to book value of common equity at the end of company's accounting period in 2011. AUDIT is a dummy variable equals 1 if the audit firm of the company is affiliated with international big-four audit firms, 0 otherwise.
*** = Statistically significant at less than 0.01 level.

8.5.2 Univariate Analysis – means and medians

Table 8.7 reports descriptive statistics on the explanatory variables under analysis across the OVS_G for both firms with an OVS_G value higher than the median and those with an OVS_G lower than the median. To assess the difference between firms with an OVS_G value higher than median and those with an OVS_G lower than median, a Komolgorov-Smirnov z test is performed on the continuous variables to test for the normality of the distribution. None of the continuous variables are distributed normally. Therefore, differences between the groups of firms are tested using a non-parametric Mann-Whitney U-test for these variables. Chi-square tests were used for dummy variables. Table 8.7 reveals statistically significant differences for FC, SIZE, ROA and AUDIT between companies with an OVS_G value higher than median and those with an OVS_G lower than median. However, there is no statistically significant difference between firms with higher

than the median and firms with lower than the median OVS_G with respect to INS_OWN and MB.

Table 8.8: Pearson and Spearman correlation between variables

	OVS_G	FC	INS_OWN	SIZE	ROA	MB	AUDIT
OVS_G		0.478***	-0.121	-0.616***	-0.481***	-0.019	-0.638**
FC	0.486***		0.203*	-0.303***	-0.302***	-0.030	-0.230**
INS_OWN	-0.1186	0.206*		-0.098	-0.100	0.037	0.056
SIZE	-0.612***	-0.328***	-0.088		0.293***	-0.240**	0.388***
ROA	-0.407***	-0.232**	0.061	0.353***		0.20*	0.369***
MB	0.101	0.122	-0.051	-0.262	-0.194*		0.258**
AUDIT	-0.629***	-0.229**	0.054	0.361***	0.311***	0.042	

Key: OVS_G is log of (1 + overstatement statistic in decimal form). The overstatement statistic is the difference between CG_AR and CG_SR scaled by CG_AR. FC is a dummy variable indicating presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise. INS_OWN is percentage of outstanding shares owned by institutional investors at the end of a company's accounting period in 2011. SIZE is the natural logarithm of book value of total assets at the end of company's accounting period in 2011. ROA is the ratio between net profit before extraordinary items and average total assets at the end of company's accounting period in 2011. MB is the ratio of the firm's market value of common equity to book value of common equity at the end of company's accounting period in 2011. AUDIT is a dummy variable equals 1 if the audit firm of the company is affiliated with international big-four audit firms, 0 otherwise.
***, **, * = Statistically significant at 0.01, 0.05 and 0.10 level.

8.5.3 Bivariate Analysis - correlations

Table 8.8 presents the correlation coefficients between variables. OVS_G is positively correlated with FC and the correlation coefficient is significant at the 0.01 level. This result provides initial evidence for H3.3b2. OVS_G is not significantly correlated with INS_OWN at the 0.10 level. This evidence provides primary support for H3.3c2. SIZE, ROA and AUDITOR are negatively correlated with OVS_G and all coefficients are significant at the 0.01 level except coefficient between OVS_G and AUDIT which is significant at the 0.05 level. MB does not have any significant correlation with OVS_G. FC is significantly positively correlated with INS_OWN. It may indicate that institutional investors take part in private benefits of control through their relationships with sponsor families in a country with weaker market and legal institutions (Belev, 2003; Rajan and Zingales, 2003a). FC is negatively correlated with SIZE, ROA and AUDIT. This is in line with prior research and suggests that family-controlled firms are on average small in size, less profitable (Faccio et al., 2001) and appoint a less qualified auditor (Niskanen et al., 2010). Furthermore, there are significant correlations between ROA and SIZE, ROA and

AUDIT, and SIZE and AUDIT which is consistent with prior studies (Abbott and Parker, 2000; Johansen and Petterson, 2013). However, none of the coefficients between the independent variables is greater than (the absolute value of) 0.40. This indicates that multicollinearity is not a serious issue here (Hooghiemstra, 2012).

8.5.4 Multiple regression

In order to test H3.3b1, H3.3b2, H3.3c1 and H3.3c2, five different versions of equation (1) (see Section 5.9.4) with varying explanatory variables are estimated. The results are shown for Models (1) to (5) in Table 8.9.

The results in Model 1 show that the coefficient of FC is positive and significant at less than the 0.01 level, indicating that control by the sponsor family as measured by sponsor family affiliated chairman of the board and CEO is positively associated with the overstatement of compliance with the BCGG-2006 in annual reports. This result provides support for H3.3b2 but does not provide support for H3.3b1.

In Model 2, the coefficient of INS_OWN is negative but not significant at less than the 0.10 level. This result indicates that institutional investors do not play a monitoring role to reduce overstatement of compliance with the BCGG-2006 in annual reports. This evidence supports H3.3c2 but does not support H3.3c1.

In Model 3, when both FC and INS_OWN are included, the coefficient of FC has positive sign and remains significant at the 0.01 level. However, the coefficient of INS_OWN surprisingly becomes significant at the 0.05 level although INS_OWN does not differ significantly between companies with an OVS_G value higher than median and companies with an OVS_G lower than median (Table 8.7) and INS_OWN is not significantly correlated with OVS_G (Table 8.8). The significant coefficient of INS_OWN may be the result of a significant positive correlation between FC and INS_OWN (Table 8.8).

Table 8.9: Tobit regression results using OVS_G* as the dependent variable

Model 1: $OVS_G^* = \beta_0 + \beta_{1i.}FC + \varepsilon$
Model 2: $OVS_G^* = \beta_0 + \beta_{2i.}INS_OWN + \varepsilon$
Model 3: $OVS_G^* = \beta_0 + \beta_{1i.}FC + \beta_{2i.}INS_OWN + \varepsilon$
Model 4: $OVS_G^* = \beta_0 + \beta_{1i.}FC + \beta_{2i.}INS_OWN + \gamma_3 MB + \gamma_{4i}ROA + \gamma_5 SIZE + \varepsilon$
Model 5: $OVS_G^* = \beta_0 + \beta_{1i.}FC + \beta_{2i.}INS_OWN + \gamma_3 MB + \gamma_4 ROA + \gamma_5 SIZE + \gamma_{6i.}AUDIT + \varepsilon$

		Model 1		Model 2		Model 3		Model 4		Model 5	
Explanatory variables	Pred. Sign	Coef	t	Coef	t	Coef	t	Coef	t	Coef	t
Constant		0.115***	3.48	0.274***	7.19	0.168***	4.39	1.595***	6.59	1.267***	5.96
FC	+	0.209***	4.97			0.229***	5.51	0.146***	4.26	0.125***	4.28
INS_OWN	-			- 0.002	- 1.12	-0.004**	- 2.42	-0.004***	- 3.34	-0.003***	-3.08
MB	?							-0.005*	-1.95	-0.003	-1.16
ROA	-							-0.007***	-3.08	-0.005**	-2.35
SIZE	-							-0.061***	-5.54	-0.044***	-4.57
AUDIT	-									-0.199***	-5.78
Pseudo R^2		1.059		0.060		1.334		3.425		4.859	
LR chi-square statistics		22.05***		1.25		27.77***		71.31***		101.17***	

Key: FC is a dummy variable indicating presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise. INS_OWN is percentage of outstanding shares owned by institutional investors at the end of a company's accounting period in 2011. SIZE is the natural logarithm of book value of total assets at the end of company's accounting period in 2011. ROA is the ratio between net profit before extraordinary items and average total assets at the end of company's accounting period in 2011. MB is the ratio of the firm's market value of common equity to book value of common equity at the end of company's accounting period in 2011. AUDIT is a dummy variable equals 1 if the audit firm of the company is affiliated with international big-four audit firms, 0 otherwise.
***, **, * = Statistically significant at 0.01, 0.05 and 0.10 level respectively.

In Model 4, MB, ROA and SIZE are included in addition to FC and INS_OWN. The coefficient of FC continues to have a positive sign and remains significant at the 0.01 level. The coefficient of INS_OWN continues to have negative sign and becomes significant at the 0.01 level. The coefficient of MB is surprisingly significant at the 0.10 level although MB does not differ significantly between companies with an OVS_G value higher than median and companies with an OVS_G lower than median (Table 8.7) and MB is not significantly correlated with OVS_G (Table 8.8). Hence, the significant coefficient of MB may be the result of a significant negative correlation between ROA and MB (Table 8.8). However, the significant correlation between ROA and MB does not indicate a problem of multicollinearity as the correlation between ROA and MB is -0.194 (see Section 8.5.3). The coefficient of ROA is negative and significant at the 0.01 level. This is consistent with previous evidence that profitable firms have a better CG structure in place (Linck et al., 2008; Coles at al., 2008) and better accounting reporting quality (Cheng and Courtenay, 2006). The coefficient of SIZE is negative and significant at the 0.01 level. This is not surprising given a large body of prior literature that documents that both the quality of CG (Lehn et al., 2009; Boone et al., 2007) and accounting disclosure (e.g. Ajinkya et al., 2005, Karamanou and Vafeas, 2005) are positively associated with firm size.

In Model 5, after inclusion of AUDIT in the model, the sign and significance level of coefficients of FC and INS_OWN do not change. The coefficient of AUDIT has the expected sign and is significant at the 0.01 level. This is consistent with prior evidence that large audit firms play strong CG role (e.g., Gul et al., 2010) and quality of auditor is positive related with the quality of accounting disclosure (e.g., Basset et al., 2007). This is, however, not consistent with Ajinkya et al. (2005). There is no change in the sign and significance level of coefficient of SIZE. However, the coefficient of ROA is now significant at the 0.05 level and the coefficient of MB is no longer significant. Table 8.8 shows that MB and ROA are significantly positively correlated with AUDIT. It is possible that the correlation of AUDIT with MB and ROA affects the significance level of MB and ROA although the magnitude of correlation of AUDIT with MB and ROA does not indicate a problem of multicollinearity (see Section 8.5.3). The result in Table 8.7, 8.8 and Model 5 of

Table 8.9, in total, indicates that MB does not have a significant relationship with OVS_G. This evidence is consistent with previous evidence that MB is not significantly related with the firm's CG structure (Coles et al., 2008; Lehn et al., 2009) and accounting reporting quality (Chua and Gray, 2010; Ajinkya et al., 2005; Eng and Mak, 2003).

The results in Tables 8.7, 8.8 and 8.9, in sum, indicate that FC is positively significantly associated with OVS_G. These results provide support for H3.3b2 but do not provide support for H3.3b1. Moreover, the results in Tables 8.7, 8.8 and Model 2 of Table 8.9, in total, indicate that INS_OWN does not have a significant relationship with OVS_G. These results provide support for H3.3c2 but do not provide support for H3.3c1.

8.5.6 Sensitivity analysis for H3.3b1, H3.3b2, H3.3c1 and H3.3c2

The robustness of the results presented in Table 8.9 is tested for alternative measurement of dependent variable and independent variables, and alternative estimation methods. First, the independent variables of Model 5 are regressed on the overstatement statistic without linearization. The result is presented in Model 6 in Table 8.10. Second, control by sponsor family is measured by three alternative variables: either the chairman of the board or the CEO is a member of the sponsor family (F_CH/CEO), percentage of sponsor family directors on board (PFD) and the number of sponsor family directors on board (NUMFD). Model 7, 8, and 9 are run by using these three alternative measures of control by sponsor family respectively. The results are presented in Table 8.10. Finally, Model 5 is estimated by OLS regression. The result is presented in Model 10 of Table 8.10.

Table 8.10: Regression results using OVS_G and overstatement statistic as the dependent variable

Model 6: OVS_G_RAW = $\beta_0 + \beta_1$FC + β_2INS_OWN + β_3MB + β_4ROA + β_5SIZE + β_6AUDIT +ε

Model 7: OVS_G* = $\beta_0 + \beta_1$ F_CH/CEO + β_2INS_OWN + β_3MB + β_4ROA + β_5SIZE + β_6AUDIT +ε

Model 8: OVS_G* = $\beta_0 + \beta_1$PFD + β_2INS_OWN + β_3MB + β_4ROA + β_5SIZE + β_6AUDIT +ε

Model 9: OVS_G* = $\beta_0 + \beta_1$NUMFD + β_2INS_OWN + β_3MB + β_4ROA + β_5SIZE + β_6AUDIT +ε

Model 10: OVS_G = $\beta_0 + \beta_1$FC + βINS_OWN + $\beta_3 MB_i + \beta_4 ROA_i + \beta_5 SIZE_i$ + β .AUDIT +ε

		Model 6 (Tobit)		Model 7 (Tobit)		Model 8 (Tobit)		Model 9 (Tobit)		Model 10(OLS)	
Dependent variable		OVS_G_RAW		OVS_G*		OVS_G*		OVS_G*		OVS_G	
Explanatory variables	Pred. Sign	Coefficient	t	Coefficient	t	Coefficient	t	Coefficient	t	Coefficient	t
Constant		1.74***	6.03	1.33***	5.72	1.359***	5.95	1.44***	6.43	1.216***	6.53
FC	+	0.171***	4.30							0.114***	4.39
F_CH/CEO	+			0.108**	2.65						
PFD	+					0.133**	2.57				
NUMFD	+							0.013**	2.37		
INS_OWN	-	-0.005***	-3.11	-0.003**	- 2.24	-0.002*	-2.04	-0.002*	-1.91	-0.003***	-3.12
MB	?	-0.003	-1.09	-0.002	- 0.77	-0.002	-0.96	-0.002	-0.93	-0.001	-0.72
ROA	-	-0.006**	-2.14	-0.005**	- 2.43	-0.004*	-1.92	-0.005**	-2.06	-0.003	-1.60
SIZE	-	-0.063***	-4.80	-0.048***	- 4.68	-0.049***	-4.80	-0.052***	-5.07	-0.042***	-4.99
AUDIT	-	-0.250***	-5.36	-0.194***	- 5.13	-0.203***	-5.48	-0.214***	-5.76	-0.160***	-5.39
Pseudo R^2		1.593		4.439		4.37		4.33		R^2 = 67.45	
LR chi-square		99.05***		91.54***		91.00***		90.12***		F = 29.02***	

Key: OVS_G_RAW is overstatement statistic. OVS_G is log of (1+ overstatement statistic in decimal form). The overstatement statistic is the difference between CG_AR and CG_SR scaled by CG_AR. FC is a dummy variable indicating presence of both chairman and CEO from the sponsor family or an individual member of the sponsor family holding both the position of chairman and CEO; 0 otherwise. F_CH/CEO is a dummy variable indicating the presence of either chairman or CEO is a member of sponsor family; 0 otherwise. PFD is the percentage of sponsor family directors on board. NUMFD is the number of sponsor family directors on board. INS_OWN is the percentage of shares owned by institutional investors. SIZE is the natural logarithm of book value of total assets at the end of company's accounting period in 2011. ROA is the ratio between net profit before extraordinary items and average total assets at the end of company's accounting period in 2011. MB is the ratio of the firm's market value of common equity to book value of common equity at the end of company's accounting period in 2011. AUDIT is a dummy variable equals 1 if the audit firm of the company is affiliated with international big-four audit firms, 0 otherwise.

***, **, * = statistically significant at less than 0.01, 0.05 and 0.10 level.

The results of different models in Table 8.10 generally support the results in Model 5 as presented in Table 8.9. The only difference is that the coefficients of control by sponsor family in Models 7, 8 and 9 are significant at the 0.05 level. This is consistent in the sense that as the control by a sponsor family is gradually reduced, the strength of association between control by the sponsor family and the overstatement of compliance with the BCGG-2006 is lessened.

To summarise, with respect to control by the sponsor family, the results of the sensitivity checks provide support for H3.3b2 but do not provide support for H3.3b1. With respect to control by institutional ownership, the results provide support for H3.3c1 but do not provide support for H3.3c2. This is, however, surprising given the evidence provided in Tables 8.7, 8.8 and Model 2 of Table 8.9.

8.6 Summary and concluding remarks

This chapter has focused on the overstatement of compliance with the BCGG-2006 as reported in annual reports and the association between the extent of this overstatement and firms' control characteristics. The results reported in this chapter find that compliance with the BCGG-2006 as reported in annual reports is significantly higher than the compliance as stated in the survey. In addition, this chapter finds that outsiders in general, and investors and credit analysts in particular, get a different ranking of a firm for its CG structure if compliance reported in annual reports is used instead of underlying compliance.

Moreover, this study finds that the overstatement of compliance with the BCGG-2006 in annual reports is more pronounced with respect to non-observable provisions than observable provisions. This is probably because firms cannot easily change their internal authority relationship but are aware of the consequences of disclosure of non-compliance such as loss of reputation and decline in share price. The results indicate that firms overstate compliance with the BCGG-2006 because the benefits of compliance are low but there is institutional pressure on firms for compliance. Thus, users cannot rely solely on the disclosures of compliance in annual reports to evaluate whether the

companies are actually complying with the provisions of the BCGG-2006 and have a sound CG structure in place.

Furthermore, this study finds that overstatement of compliance in annual reports is positively associated with control by the sponsor family. These results hold after taking into consideration a number of control variables, under alternative definitions of control by the sponsor family and control by the institutional investors and under an alternative estimation method. The firms under control of sponsor families may find it legitimate not to comply with specific provisions of the BCGG-2006 on the grounds of 'rent protection' as discussed in Sections 2.2.7.1 or low 'relative efficiency' of the BCGG-2006 as suggested by the institutional characteristics of Bangladesh discussed in Sections 3.4 and 3.5. However, in order to avoid undesirable consequences (e.g., delisting from stock exchanges, loss of reputation, decline in share price) of non-compliance, firms under the control of sponsor families report compliance with the provisions of the BCGG-2006 in their annual reports. The positive association between overstatement of compliance in annual reports and control by sponsor family is in line with previous findings that family controlled companies maintain a weaker CG structure (Anderson and Reeb, 2004; Chen et al., 2008; Chen and Nowland, 2010).

Finally, this study finds that overstatement of compliance in annual reports is not significantly associated with institutional ownership. This result is consistent with prior research on institutional investors in developing countries (Hamdani and Yafeh, 2013; Belev, 2003; Sarkar and Sarkar, 2000) but is in contrast with prior research on institutional investors in developed countries (Elyasiani and Jia, 2010; Solomon and Solomon, 2006; Hartzell and Starks, 2003). In respect of Bangladesh, this result supports Farooque et al. (2007) that institutional ownership is not associated with firm performance.

The results of this chapter, in total, are consistent with the theory of path dependence rather than with agency theory.

Chapter Nine

Conclusion, Limitations and Future Research

9.1 Introduction

This thesis has aimed to investigate the main research question: *Does a corporate governance reform based on an Anglo-American-based corporate governance model accomplish its intended objectives in a developing country?* and related sub-questions as introduced in Section 1.2. These research questions merit investigation as indicated by gaps in the prior literature on CG (Chapter Two, more specifically Sections 2.5; 2.6 and 2.7). These research questions are also timely to investigate given the wide-spread adoption of Anglo-American-based CG codes in developing countries due to the influence of international financial institutions (IFIs) and because these countries are expending a significant amount of scarce funds on CG reform.

In order to investigate the research questions, I developed propositions and hypotheses in chapter 4 based on agency theory and neo-institutional theory, prior literature and characteristics of Bangladesh. The research methods were discussed in chapter 5. Chapters 6 to 8 presented the results to RQ1, RQ 2 and RQ3 respectively. Hence, this chapter aims to relate the findings of this study with prior research (Section 9.2), discuss the theory-based and the policy-based contributions of this thesis (Section 9.3), discuss some of the limitations of this study (Section 9.4) and offer suggestions about future research (Section 9.5).

9.2 Discussion of key results

9.2.1 Impact of corporate governance mechanisms recommended by the BCGG-2006 on investment and lending decisions

This study finds that institutional investors and bankers do not consider CG mechanisms recommended by the BCGG-2006 while making their investment and lending decisions respectively. This evidence is consistent with prior practice-based

research in developing countries (PricewaterhouseCoopers, 2000; World Bank, 2005). However, this evidence is in contrast with prior research in Anglo-American countries (Chung and Zhang, 2011; Bushee et al., 2009; Khurshed et al., 2011) and at the international level (Leuz et al., 2009; McKinsey and Company, 2002; McCahery et al., 2010; Ge et al., 2012). Institutional investors and bankers perceive limited impact of the CG mechanisms recommended by the BCGG-2006 on their decisions because (1) they perceive that CG mechanisms are not implemented in form and in substance, and (2) they practise name-based and relationship-based investment and lending.

Analysing the reasons put forward by interviewees for non-implementation of CG mechanisms in form and in substance, this study shows that family controlled companies do not comply effectively with CG mechanisms because the controlling families intend to protect their high private benefits of control (Bebchuk and Roe, 1999; Rajan and Zingales, 2003; 2003a; Rosser, 2003), and the institutional characteristics of Bangladesh makes the implementation of the BCGG-2006 ineffective (Doidge et al., 2007; Wanyama et al., 2007; Paredes, 2004; dela Rama, 2012; Okike, 2007).

On the other hand, institutional investors and bankers lock-in to the path of name-based and relationship-based investment and lending practices respectively. This evidence is consistent with prior research on investment and lending practices in developing countries (Koford and Tschoegl, 1999; La Porta et al., 2003; Singh and Zammit, 2006; Selmier, 2013). The lock-in to the path of name-based and relationship based investment and lending practices leads to non-consideration of the CG mechanisms recommended by the BCGG-2006. This evidence confirms arguments of prior researchers (Nam et al., 2001; Nenovsky, 2003; Ahunwan, 2002; Rajan and Zingales, 2003; Belev, 2003; Black and Coffee, 1994) that relationship-based and collateral-based lending practices make institutional investors and banks reluctant to monitor the CG structure of borrower companies.

In sum, the interview evidence suggests that path dependence occurs both on the part of the sponsor families of non-financial companies and on the part of incumbent financiers regarding CG practices.

9.2.2 Nature of compliance with the BCGG-2006 and the association between the nature of compliance with the BCGG-2006 and firm performance

The results regarding the nature of compliance with the BCGG-2006 indicates that most of privately-owned and government-owned companies either do not comply with the BCGG-2006 or comply with the BCGG-2006 in form but not in substance. This evidence is consistent with the argument that (1) sponsor families of the privately-owned companies (Arcot et al., 2010; Krambia-Kapardis and Pasros, 2006) and managers of government-owned companies (Kochanek, 1996) impede compliance with the BCGG-2006 in order to protect their private benefits of control, and (2) the institutional characteristics of Bangladesh lead to inefficient implementation of the BCGG-2006 are more pronounced in the case of the privately-owned and government-owned companies. In contrast, most of the subsidiaries of foreign MNCs comply with the BCGG-2006 both in form and in substance indicating that (1) the managers of subsidiaries of foreign MNCs have limited opportunity to extract rent due to sharing institutions and CG practices from their headquarters, and (2) sharing of institutions and CG practices makes implementation of the BCGG-2006 more efficient. The survey evidence substantiates interviewees' perceptions regarding the ineffectiveness of CG mechanisms recommended by the BCGG-2006. The survey evidence is, however, in contrast to Cuervo-Cazurra and Dau (2009) who argue that pro-market reform reduces agency conflicts more in privately-owned and government-owned companies than in the subsidiaries of foreign MNCs.

The results regarding the association between the nature of compliance with CG mechanisms recommended by the BCGG-2006 and firm performance are mixed and confirm findings of prior research (Section 2.6.4) in the case of the total sample. However, this study finds that in the case of local privately-owned companies, there is no association between the nature of compliance with CG mechanisms and firm performance (namely, separation of CEO and chairman, board independence and appointment of an audit committee). This evidence confirms the argument of Bebchuk and Hamdani (2009) and Claessens (2006) that CG mechanisms designed for solving

agency problems of companies in Anglo-American countries are not effective for companies with concentrated ownership and control in developing countries.

9.2.3 Overstatement of compliance with the BCGG-2006 in annual reports and its determinants

This study finds that companies in Bangladesh on average overstate compliance with the BCGG-2006 in their annual reports. This evidence supports the suspicion of prior researchers (Arcot et al., 2010; v. Werder et al., 2005; Akkermans et al., 2007) who doubt that companies overstate compliance with CG code due to perceived institutional pressures. One interpretation of this result is that the institutional characteristics of Bangladesh offer high private benefits of control to the present controllers of companies and thus, make them reluctant to implement the CG mechanisms recommended by the BCGG-2006. A related interpretation is that the institutional characteristics of Bangladesh make implementation of the CG mechanisms recommended by the BCGG-2006 ineffective. This study also finds that overstatement of compliance with the BCGG-2006 leads to different ranking of firm's governance compared to ranking of firm's governance based on underlying CG. This implies that the ranking of firm's governance as calculated by IFIs (e.g., World Bank, 2009) based on compliance reported in annual reports may not represent a true ranking of a firm's governance.

This study further finds that overstatement of compliance is more pronounced with respect to less observable CG provisions. This evidence may imply that firms cannot quickly change their internal structures due to high sunk adaptive costs (Gedajlovic et al., 2004; Khanna et al., 2006; Yoshikawa and Rasheed, 2009). Furthermore, overstatement of compliance is positively related with control by sponsor family. This evidence may indicate that family sponsors are reluctant to comply with the BCGG-2006 but report compliance due to institutional pressures. The explanation is either that they seek to protect their rent or that they perceive high sunk adaptive costs and endowment effects. Finally, overstatement of compliance is not associated with institutional investors. This may indicate either that institutional investors are reluctant activists (Belev, 2003; Black and Coffee, 1994) or that they share private benefits of

control with the sponsor families (Rajan and Zingales, 2003). The evidence on overstatement of compliance in annual reports, in total, points toward the theory of path dependence (Bebcuck and Roe, 1999) more than agency theory (Jensen and Meckling, 1976).

9.3 Contributions

9.3.1 Theoretical contributions of this study

First, the results of the interviews are consistent with the findings of prior practice-based studies on the impact of CG on investment decisions of institutional investors in developing countries (PricewaterhouseCoopers, 2000; World Bank, 2005). However, this study extends that research by showing that the theory of path dependence rather than agency theory dominates the behaviour of controllers of companies and financial incumbents with respect to compliance with the BCGG-2006. This study shows that path dependence occurs both on the part of the controlling families of non-financial companies regarding compliance with the BCGG-2006 and on the part of institutional investors and bankers regarding investment and lending practices. Consequently, CG mechanisms recommended by the BCGG-2006 do not have an impact on the investment and credit decisions of institutional investors and bankers respectively.

Second, by providing the reasoning for no impact of CG on investment and lending decisions in Bangladesh, this study opens up the black box of contradictory findings (Section 2.5.3) in developed and developing countries (cf Eisenhardt 1989b; p. 546). The findings of this study suggests that in explaining the behaviour of controllers of companies and financial incumbents with respect to CG practices in developing countries, researchers should take an 'open-system' approach as suggested by Aguilera et al., (2008) and they should not mechanically apply agency theory which is more relevant to Anglo-American countries.

Third, the analysis of the survey responses contributes to understanding how the nature of compliance with the BCGG-2006 varies depending on the nature of ownership

and control (Bebchuk and Hamdani, 2009; Claessens, 2006; Bebchuk and Roe, 1999). This is because the nature of ownership and control not only dictates the path of existing CG practices but also affects the efficiency with which CG practices are implimented. For example, local privately-owned companies, being significantly owned and controlled by sponsor families, have a family affiliated CEO and chairman, a family dominated board and a family dominated audit committee. The presence of family members at three important levels may reduce the efficiency of the board and the audit committee.

Fourth, the findings regarding the association between the nature of compliance with CG mechanisms introduced by the BCGG-2006 and firm performance suggest that CG researchers in developing countries need to consider privately-owned companies, government-owned companies and the subsidiaries of foreign MNCs separately when conducting archival studies. This is because the inclusion of subsidiaries of foreign MNCs can significantly affect the findings. Moreover, the findings regarding the association between the nature of compliance with CG mechanisms introduced by the BCGG-2006 and firm performance in the case of local privately-owned companies suggest that CG researchers in developing countries need to include the effectiveness of second-tier management (e.g., CFO and HIA) when measuring CG variables or index for privately-owned companies because the quality of second-tier management may make a difference in the operating performance of firms.

Fifth, this study uses an innovative research design to investigate compliance with the BCGG-2006 by comparing disclosure on compliance in annual reports with disclosure on compliance in a survey. This study thus sheds light on the suspicions of prior researchers (Arcot et al., 2010; v. Werder et al., 2005; Akkermans et al., 2007) that companies might overstate compliance with CG codes due to perceived institutional pressures. This study, thus, questions the validity of prior research that measures CG variables based on annual report disclosures either to measure compliance only or to test association between CG and outcome variables in developing countries.

Sixth, this study develops a measure of overstatement of compliance in annual reports. This measure can be a tool for future CG and accounting disclosure researchers to investigate congruity between underlying practices and accounting disclosure.

In sum, this study shows that change in CG practices in a developing country is hindered by the rent-seeking behaviour of the controllers of companies, institutional investors and bankers and institutional characteristics. This study theoretically contributes to a prior stream of CG literature that contends that importing a CG code does not produce radical change in national CG practices (Paredes, 2004) and that such practices persist because of its strong path dependence (Bebchuk and Roe, 2009).

9.3.2 Policy-based contributions of this study

CG reform in developing countries has become widespread and involves a large amount of scarce resources which is often borrowed from IFIs (Section 3.6.1). Such reform is initiated with the expectation that it will strengthen the CG of firms and better CG will ensure better investment and credit decisions and firm performance (Section 1.1). The findings of this thesis indicate that CG mechanisms introduced by the BCGG-2006 have a limited impact on the investment and credit decisions of institutional investors and bankers respectively. The perception of institutional investors and bankers regarding the ineffectiveness of CG mechanisms of the BCGG-2006 is substantiated by the survey results which indicate that privately-owned and government-owned firms (as the main targets of CG reform) do not implement the CG mechanisms introduced by the BCGG-2006, or implement them in form rather than in substance. Furthermore, the performance of privately-owned firms whose survey response indicates that CG mechanisms are implemented in form and in substance is not different from that of firms that state that they do not implement the CG mechanisms introduced by the BCGG-2006 or implement them in form rather than in substance. This evidence indicates that due to some underlying constructs of privately-owned firms, CG mechanisms of the BCGG-2006 fail to contribute to performance. Finally, there is a concern regarding the authenticity of compliance with the BCGG-2006 as reported in annual reports. These findings, in sum, suggest that policy makers and advocates of CG reform based on an

Anglo-American model in developing countries should take the initiative to educate sponsor families about the value of CG rather than emphasising solely the monitoring role of CG. They should also take the initiative to address institutional characteristics (e.g., corruption) before committing scarce resources to CG reform.

9.4 Limitations

9.4.1 Limitations of interviews

With respect to interviews, three limitations are noted. Firstly, 17 interviewees did not approve the recording of the interview. The researcher tried to minimise the threats to reliability and validity of these interview data (Section 5.3.2) by immediate revision of field notes (Ryan et al., 2002; pp. 155-156) and by emailing the revised field notes to the respective interviewees for modification of any part with which they do not agree (Annisette and Trivedi, 2013). Secondly, a number of interviewees used a mixture of English and Bengali[20] in answering questions even though the questions were asked in English. The researcher, being fluent in both languages, translated the Bengali portion of responses into English verbatim. In the cases where the researcher did not find a suitable word in English to express the meaning of a Bengali word, he expresses the Bengali word using English (Latin) alphabet (see Section 6.5.2 *'Pir-Murshid'*). Finally, one interviewee per organisation was selected because of the difficulty in gaining access and identifying multiple knowledgeable respondents in each organisation. For example, the researcher was seeking to interview an analyst from MFM-2 and CRA-3. However, the contact persons recommended interviewing the CEOs of MFM-2 and CRA-3. Having interviewed the CEOs, the researcher did not believe that additional insight could be derived from interviewing other people (analysts) in these same organisations.

Apart from these issues, there is relatively little concern about the reliability and validity of interview data and findings. The researcher attempted to minimise threats to the reliability and validity of interview data (Section 5.3.2) by asking probe and follow-up questions (McKinnon, 1988), by the immediate transcribing of audio-tapes and field

[20] The first language of Bangladeshi people.

notes when tape-recording was not permitted (Ryan et al., 2002; pp. 155-156), and by emailing the transcripts to the interviewees for modification (Annisette and Trivedi, 2013). The threats to reliability and validity were further reduced by selecting interviewees from four different groups of financial incumbents and asking questions related to CG mechanisms, consistently to each respondent (Miles and Huberman, 1994; p.29; McKinnon, 1988). The validity and reliability of data analysis was maintained by reading every sentence of responses, moving back and forth between interview data, relevant literature and CG theories, and by seeking consistency among interviewees (Section 5.3.4). The validity and reliability of interview findings were partially supported by the survey findings that CG mechanisms recommended by the BCGG-2006 have not been implemented in form and in substance, especially in local privately-owned companies and government-owned companies (Miles and Huberman, 1994, p. 36).

9.4.2 Limitations of the survey

This study may suffer from a number of limitations introduced by the survey method. First, the sample size is 91 companies. This is small because the number of non-financial listed companies in Bangladesh is small. The response rate (66.91%) of the survey is above the average response rate (55%) in other accounting studies (Van der Stede et al., 2005). Second, the survey method is generally criticised for response bias (Zimmerman, 2001). The sample of the survey represents the distribution of the underlying population with respect to industry, market capitalisation and total assets, indicating that there is minimal concern about response bias (Section 5.4.2). A final and an important concern is the reliability of data obtained in the survey (Young, 1996). With respect to this research, some respondents may state over-compliance in the survey. This was, however, reduced by pre-testing the survey instrument with two company secretaries and by the assurance that the outcome of this research will never be published in Bangladesh (Section 5.4.1).

9.4.3 An analysis of endogeneity issue with respect to RQ3

An important limitation of the results showing an association between overstatement of compliance with the BCGG-2006 and control by sponsor family is the likely endogeneity of control by the sponsor family. This study does not address the issue of causality directly because it uses survey data. Survey data by nature are cross-sectional (Van der Stede, 2013). Hence, several econometric tests of causality (e.g., the effect of change in control by sponsor families on change in overstatement of compliance with the BCGG-2006 in annual reports (Woodward, 2003, pp. 35-36) cannot be performed. Furthermore, there is no plausible instrument for control by sponsor families. However, control by the sponsor families is unlikely to be endogenous because family control is a general pattern of control in Bangladesh (Haque et al., 2011). Moreover, the BCGG-2006 was introduced in 2006, indicating that overstatement of compliance with the BCGG-2006 in annual reports is not the cause of control by sponsor families. With respect to the association between overstatement of compliance with the BCGG-2006 and control by institutional investors, this study does not find any significant association. Thus, the issue of endogeneity does not arise.

9.4.4 A limitation with respect to theory

This study cannot disentangle the relative role of the rent protection desire of the existing controller and financial incumbents, and relative inefficiency in the implementation of the BCGG-2006 and transaction-based lending practices resulting from lack of complementary institutional characteristics in Bangladesh.

9.5 Future Research

Future research on the subject of this thesis could explore a number of themes.. Firstly, a board-based survey of institutional investors and bankers can investigate the impact of CG mechanisms on investment and lending decisions in line with the theory of path dependence..

A detailed interview or case based study might disentangle the relative role of the rent protection desire of the existing controller or the relative efficiency of Anglo-American CG codes behind non-compliance or compliance in form rather than substance with the BCGG-2006. Researcher might target interviewees who are internal professional (e.g., CFO), not the members of the sponsor families because they may not disclose their rent protection desires.

A more detailed measure of compliance in form and in substance with the CG code is essential. This, of course, requires a more detailed survey with respect to each of the five mechanisms tested here. Alternatively, future research might investigate compliance with only one mechanism such as the audit committee and test the difference in performance among firms with respect to nature of compliance with the mechanism.

In order to shed further light on overstatement of compliance with the BCGG-2006, future research might collect data from alternative sources such as credit rating reports, prospectuses issued for rights issues and identify gaps in compliance as reported in annual reports and as reported in the aforementioned alternative documents.

Finally, BSEC recently introduced an updated version of the BCGG-2006 and Bangladesh Corporate Governance Guidelines- 2012 (the BCGG-2012) is mandatory. A comparative study may help our understanding of whether the imposition of mandatory guidelines increases or reduces firms’ motivation to comply and financial incumbents’ attitude toward the CG mechanisms recommended by the BCGG-2012.

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Appendix 2.1: Summary of theory-based corporate governance models

The principal- agent or finance model	The myopic market model	The abuse of executive power model	The stakeholder model
Agency theory	Myopic market theory	Managerial hegemony theory	Stakeholder theory
Jensen and Meckling (1976); Manne (1965)	Charkham (1994); Sykes (1994)	Patton and Baker, 1987; Hutton (1995); Kay and Silberston (1995)	Freeman (1984); Clarkson (1994); Blair (1995)
Maximisation of shareholder wealth in short- term	Maximisation of shareholder wealth in long - term	Maximisation of total wealth of shareholders and society	Maximisation of total wealth of corporation
Agency conflicts	Managers emphasise on maximisation of short-term rather than long term profitability and return on investment.	Abuse of power by corporate elites such writing compensation contracts themselves, appointing directors based on social ties.	The interest of one group of stakeholder can be compromised to that of another
* Separation of control from ownership * Shareholders cannot directly observe the effort of managers *Shareholders and managers have different attitudes towards risks	* Institutional investors invest in short-term and do not play corporate governance role * Managers concentrate more on short-term profitability and return.	* Managers have excessive power due to structure of corporation	*Stakeholders' interest is not protected by the current system of corporate governance
*Managers act opportunistically to maximise their own interest before shareholders *Markets for capital, labour and corporate control are efficient	* Stock market undervalues long-term investment * Threat of takeover leads managers to maximise short-term profitability	*Managers bias nomination and selection, and restrict the role of non-executive directors. *Non-executive directors lack expertise and incentive to monitor managers.	All stakeholders who contribute special inputs in company have interest identical with that of shareholders
Any external intervention in market mechanisms	Governance through market mechanisms	Current systems of board, audit process and role of market for corporate control	Shareholders' primacy over other stakeholders
* No interference in markets * Aligning managerial incentives * Introduction of a voluntary code	* Increasing shareholder loyalty and voice * Increasing barriers to reduce exit of shareholders * Encouraging shareholders and managers to maximise wealth in long-term	* Introduction of mandatory governance code * Fixed four-year term of CEO * Nomination of independent directors by regulators * Increase authority of non-executive independent directors	* Developing trust and long-term relationship between firm and its stakeholders. * Employee's participation in strategic decisions. * Introducing code of ethics

Source: Based on Keasey et al. (1997), Blair (1995).

Appendix 2.2: OECD Principles of Corporate Governance

Principle	Explanation
(1) Ensuring the Basis for an Effective CG Framework	The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
(2) The Rights of Shareholders and Key Ownership Functions	The corporate governance framework should protect and facilitate the exercise of shareholders' rights.
(3) The Equitable Treatment of Shareholders	The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
(4) The Role of Stakeholders in Corporate Governance	The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
(5) Disclosure and Transparency	The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
(6) The Responsibilities of the Board	The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Source: OECD Principles of Corporate Governance 2004

Appendix 2.3: A summary of studies on impact of corporate governance on investment decisions of institutional investors

Study	Theory	Data sources	Method	Sample	Dependent variable	Independent variable	Main results	Argument behind hypothesis or explanation of findings
Chung and Zhang (2011)	Prudent investment hypothesis and Agency theory	Several databases	OLS, 2SLS	12,093 firm-year observations from USA	Percentage of institutional ownership	GOV SCORE1	+***	Institutional investors invest in companies with good governance to meet fiduciary responsibilities; Good corporate governance reduces monitoring on the perspective of institutional investors and reduces information asymmetry.
						GOV SCORE2	+***	
						Board independence	+**	
						Insider ownership	+**	
						Dual class shares	-**	
							2SLS indicates that association depends on type of institutions	
Khurshed et al. (2011)	Agency theory	Several databases	Tobit	674, 577, and 569 U.K firms for 1996, 1999 and 2003	Aggregated institutional block-holding	Directors' ownership	-***	High directors' ownership makes them entrenched
						Board independence	+***	Independent directors protect blockholders.
McCahery et al. (2010)	Agency theory	Survey	-----------	118 international institutional investors who has investment in US and Netherlands	Investment decision of institutional investors	Equity-based compensation	All these criteria are at least somewhat important for investment decisions. Preference depends on type of institutional investors.	Governance mechanisms reduce agency conflicts between mangers and shareholders as well as between large and small shareholders.
						Board independence		
						High free float		
						Transparency of large shareholders' ownership		
						Management ownership		
Li et al. (2008)	Prudent investment hypothesis	Several databases	OLS	8,360 single-class firms and 614 dual-class Firms from US for 1995-2002.	Percentage of market value owned by institutional investors	Dual-class share	-***	Fiduciary duties of institutional investors lead them to investment in better governed firms.
						Insider ownership	-***	
						Board size	-***	
						Board independence	+***	
						CEO duality	insignificant	
						The magnitude of affect differs across type of institutional investors.		
Bushee et	Agency	Several	OLS	15,892	Percentage	Board index	+*	Strong corporate governance

al. (2008)	theory and Prudent investment hypothesis	databases		observations from US for 1995-2004	institutional ownership	GINDEX	insignificant	offset monitoring costs of institutional investors; Corporate governance positively affect firm performance; Fiduciary duties of institutional investors lead them to investment in better governed firms; Strong corporate governance reduces high exit costs; Political motivation
			Tobit	8992 firm year observations from US for 1995-2004	Portfolio weight (governance sensitive investors -only 11%)	Board index	+*	
						GINDEX	-**	
					Portfolio weight (governance insensitive investors)	Board index	insignificant	
						GINDEX	+***	
						Cannot establish causality		
Leuz et al. (2010)	Agency theory	Several databases	Tobit	4,409 firms around the world	Percentage of holding by US institutional investors	Insider ownership	Significant negative relationship in countries with weak disclosure requirement, low securities regulation, not English common law and low anti-director index.	Firm level governance matter more in countries with weak disclosure requirement, low securities regulation, not English common law and low anti-director index.
Giannetti and Simonov, 2006	Agency theory	Several databases	Probit	354 Swedish companies listed as of June 29, 2001	Foreign financial institutions' investment	Ratio of control to cash flow rights	insignificant	Investors who only get security benefits avoid risk of expropriation while making investment.
						Control premium	-***	
						Entrenchment	-***	
					Domestic financial institutions' investment	Ratio of control to cash flow rights	+***	
						Control premium	-***	
						Entrenchment	-***	
McKinsey & Company (2002)	No theory	Questionnaire-based survey of institutional investors	N/A	200 institutional investors around the World	Investment decisions	**Main findings:** Investors put corporate governance on a par with financial indicators; Majority of investors are prepared to pay a premium for good governed firms.		No explanation

World Bank (2005)	No theory	Questionnaire-based survey of institutional investors	N/A	Indian institutional investors – number of respondents is not mentioned.	Investment activism and Investment decisions	**Main findings:** Most institutional investors are dormant and does not play CG role; Most institutional investors consider neither the presence of independent directors nor the appointment of audit committee as important factors in their investment decision.	No explanation

Key: OLS = Ordinary Least Square; 2SLS = 2 Stage Least Square;
***, ** and * implies significant at the one, five and ten per cent level

Appendix 2.4: A summary of studies relating impact of corporate governance on lending decisions of banks

Study	Theory	Data sources	Method	Sample	Dependent variable	Independent variable	Main results	Argument behind hypothesis
Ge et al. (2012)	Agency theory	Loan Pricing Corporation DealScan database; SS Corporate Governance Quotient (CGQ) database	OLS	2659 facility–year observations from 22 countries	Firm-level evidence on the effect of GOV on loan characteristics with control for country characteristics			Better governance reduces information and agency risks. However, better governance may exacerbate agency conflicts between shareholders and bankers as better governance ensures more protection of shareholders' wealth.
					Loan spread	GOV	-**	
					Maturity	GOV	+***	
					Loan size	GOV	+**	
					Collateral	GOV	Insignificant	
					Covenants	GOV	-**	
					Firm-level evidence on the effect of component of GOV on loan characteristics with control for country characteristics			
					Loan spread	Board	insignificant	
						Anti-takeover index	+*	
						Audit	-**	
						Compensation and ownership	-**	
					Maturity	Board	+**	
						Anti-takeover index	insignificant	
						Audit	+**	
						Compensation and ownership	+*	
					Loan size	Board	insignificant	
						Anti-takeover index	insignificant	
						Audit	+***	
						Compensation and ownership	insignificant	
					Collateral	Board	insignificant	
						Anti-takeover index	+*	
						Audit	insignificant	
						Compensation and ownership	-*	
					Covenants	Board	Insignificant	
						Anti-takeover index	Insignificant	
						Audit	insignificant	

						Compensation and ownership	-*	
Lin et al. (2011)	Agency theory	Dealscan database; We then use the Factset, OSIRIS, and World-scope global ownership databases etc.	OLS	13,331 bank loans made to 3,468 firms in 22 countries during 1996 - 2008.	Cost of bank loan	Control-ownership wedge	+***	Higher divergence between control rights and cash flow rights increases risk of creditors due to tunnelling by controlling owners.
						Cash-flow rights	-**	
						Family firm	+**	
						Family CEO	+**	
						State owned	-*	
					Conclusion of additional findings	The positive association between the control-ownership wedge and loan spreads is weakened for firms in environments with strong creditor and shareholder rights and efficient debt enforcement.		
Francis et al. (2012)	Agency theory	IRRC; Thomson Reuters LPC DealScan database; Compustat etc	OLS	3,867 firm-level for 1,088 U.S firms for 1998 - 2006.	Loan spread	Board independence	-***	Good corporate governance reduces information asymmetry and agency costs and lower information asymmetry and agency costs positively affect debt contract terms.
						Board size	-***	
						CEO duality	insignificant	
						Directors' interlock	insignificant	
						AC independence	-**	
						AC size	-*	
						AC financial expertise	-**	
						Directors' shareholding	insignificant	
					Conclusion	Most of the governance variable has no relation with non-price loan terms.		
Roberts and Yuan (2010)	Agency theory: Monitoring, information opacity, risk shifting and no effect hypothesis	SDC syndicated loan database; Thomson Financial 13F database; Compustat; CRSP	OLS; 2SLS	7820 observations involving 2006 U.S borrowers for 1995-2000	Cost of bank loan	% of institutional ownership	-***	Presence of institutional investors increases monitoring and agency conflicts between shareholders and banks.
						% of institutional holdings squared	+***	
						Anti-takeover index	-***	
					Conclusion	A U shape relationship exists between loan spread and institutional ownership.		
Holder-Webb and Sharma	Agency theory and resource dependence theory	Experiment	Logistic	62 professional lenders from Singapore	Loan grant	Board strength	+**	Board of directors provide an interface between company and resource providers and reduce opportunistic
						Board independence	insignificant	
						Board qualification	+*	
						Board financial expertise	insignificant	

(2010)						Board industry expertise	insignificant	behaviour of management
Chava et al. (2009)	Agency theory	Several databases	OLS	6468 loan issued to 1274 non-financial U.S firms over 1990 - 2004	Loan Spread	Takeover index	+***	Vulnerability to takeover increases risk of banks as creditors.
					Conclusion	Firms with higher vulnerability to takeovers pay higher bank loan spread. Loan with covenants are less worried about takeover index		
Firth et al. (2009)	Agency theory	World Bank and the Enterprise Survey Organization of China	OLS	1868 Chinese private non-listed firms	Access to bank finance	Board independence	insignificant	Good corporate governance can help reduce credit risks by mitigating the agency problems between shareholders and managers and also by improving corporate transparency and the quality of financial information
						CEO duality	**-**[d]**	
						CEO experience	+***	
						CEO ownership	+***	
						CEO compensation	+***	
					Loan size	Board independence	+***	
						CEO duality	**-****	
						CEO experience	**+***[d]**	
						CEO ownership	insignificant	
						CEO compensation	+***	
					Conclusion of additional findings	Governance attributes have no effect on access to bank finance or loan size in case of small firms.		

Key: OLS = Ordinary Least Square; 2SLS = 2 Stage Least Square;
***, ** and * implies significant at the one, five and ten per cent level

Appendix 2.5: A summary of studies relating corporate governance and firm performance in developing countries

Study	Theory	Data sources	Estimation Method	Sample	Dependent variable	Independent variable	Main results	Argument behind hypothesis or Explanation of findings
Luo and Chung. (2013)	Agency and institutional economics	Taiwan Economic Journal electronic database	Two-stage least square	631 Taiwan firms with 4482 firm year observation	Industry-adjusted ROA	Family ownership control	ROA of firms with family ownership > ROA of non-family firms.	Combined family ownership and strategic control fills institutional void. Outside operational control reduces the expropriation by controlling family.
						Family ownership and strategic control	ROA of firms with family ownership and strategic control > ROA of firms with family ownership.	
						Family ownership, strategic and operational control	ROA of firms with family ownership and strategic control > ROA of firms with family ownership, strategic and operational control.	
Black et al. (2012)	No theory	Survey data	Random Effect Regression	66 Brazilian listed firms during the period 2004	Tobin's q	CG index	+***	Independent directors are minority on board, no explanation on audit committee
						Board independence index	insignificant	
						Audit committee index	insignificant	
Black and Kim, (2012)	Agency theory	Korean stock exchange	Event study, Differences in Differences, 2SLS, 3SLS and Fixed	All companies listed on Korean stock exchange excluding	Cumulative MAR, cumulative industry adjusted	4 event date related to announcement of Korean corporate governance code	Large firms have significantly higher performance when reform related to	Board independence and audit committee indicate good governance

			Effects Regression	banks and government owned in 1999	return, Tobin's q		board and audit committee is announced	
Connelly, Limpaphayom and Nagarajan, (2012)	Agency theory	Publicly available data from different sources	OLS, 2SLS	216 firms listed in Thailand in 2005	Tobin's q	CGI	+** in case of total sample, insignificant in family firm sub-sample	Governance in substance matter but not in form
						Board independence	insignificant	
						Board size	insignificant	
Chen et al. (2011)	No theory	Public database	OLS	1164 group Chinese companies	ROA	CEO Duality	insignificant	Controlling shareholders control board and makes board a rubber stamp
						Board size	insignificant	
						Board independence	insignificant	
Chen and Nowland (2010)	Agency theory	Annual Reports and Compustat	Fixed Effects Regression	47 firms from Hong Kong, 58 firms from Malaysia, 32 firms from Singapore, and 48 firms from Taiwan for 1998-2004	Tobin's q	CEO duality	-* (Family firms) -*** (Non-family firms)	Board monitoring brings less benefits but more costs in family business. No justification is provided for insignificant relationship between performance and governance in non-family firms
						Board size	insignificant	
						Board independence	Concave* (Family firms); insignificant (Non-family firms)	
						Audit committee		
Ararat et al. (2010)	Agency theory	Annual Reports	OLS	118 firms listed on Istanbul Stock Exchange for 2004-2006	Tobin's q	Board independence	insignificant	Independent directors are not independent enough
						Audit committee	insignificant	
Lo et al. (2010)	Agency theory	Public database and annual reports	OLS	266 listed companies in China for 2004	1 – (the gross profit ratio from related-party sales/	Board independence	-**	Independent director reduces opportunistic related party transaction
						Audit committee	insignificant	These governance mechanism little care about number of
						CEO duality	insignificant	

					the gross profit ratio from unrelated-party sales)	Audit committee Financial expertise	insignificant	related party transaction
Ramdani and Witteloostuijn (2010)	Agency theory	Survey conducted by Asian Development Bank Institute	OLS, Robust Ordinary Least Square and Quintile Regression	61 firms in Indonesia, 75 in Malaysia, 111 in S. Korea and 61 in Thailand in 2003	ROA	Board independence	Insignificant (OLS regression, robust OLS regression), mixed (quintile regression)	The impact of corporate governance on performance varies depending on performance
						CEO duality	+** (OLS regression)	
						Board size	Insignificant (OLS regression, robust OLS regression), mixed (quintile regression)	
Singh and Gaur, 2009	Agency and institution theory	Public data from several sources	OLS	Top 400 Indian and 413 Chinese firms	ROA	Board size	insignificant	Independent directors lack in-depth knowledge, fail to understand the value of coordination among affiliated firms and interrupt the working of insider directors
						Board independence	-**	
Jackling and Johl(2009)	Agency theory	Annual reports	3SLS	180 firm observations from India in 2005-06	ROA and Tobin's q	Outside director	Insignificant (ROA), +*(Tobin's q)	**Study is expletory, family business need further study**
						CEO Duality	insignificant	
						Board size	Insignificant (ROA), +**(Tobin's q)	
						Board busyness	insignificant	
Kaymak and Bektas (2008)	Agency theory	Bank Association of Turkey	OLS	27 banks in Turkey for 2001–2004	ROA	Board independence	--** /insignificant	Outside directors does not play role or many of outside directors are insiders which is not
						CEO duality	insignificant	

						Board size	insignificant	possible to detect by public data
						Board size	Insignificant in all countries	
Lefort and Urzua (2008)	Agency theory	Chilean Regulatory authority	OLS, Fixed Effects Regression and 3SLS	160 listed firms from Chile 2000 - 2003	Tobin's q	Board independence	Insignificant	No explanation
						Percentage of professional director	Insignificant	
Kyereboah-Coleman (2007)	Agency theory	Stock exchange fact books and INET-Bridge	OLS	103 listed firms from Ghana, South Africa, Nigeria and Kenya for 1997-2001	Dividend per share, Earnings per share	Board size	+**	Small board, more independent directors and CEO non-duality positively influence shareholder value
						Board independence	Mixed	
						CEO duality	-**(Dividend per share)	
Cheung, Connelly, Limpaphayom, and Zhou (2007)	Agency theory	Several publicly available sources	OLS	168 listed firms from Hong Kong 1990-2003	MTB, ROE	CGI	+**	Corporate governance improves performance
						Rights of shareholders	Insignificant	
						Equitable treatment of shareholders	Insignificant	
						Role of stakeholders	Insignificant	
						Disclosure and transparency	Mixed	
						Board responsibilities	Insignificant	
Choi, Park and Yoo (2007)	Agency theory	Several public sources	OLS and 2SLS	457–464 firms from Korea for 1999-2002	Tobin's q	Outside directors	+**	Independent directors play monitoring role
						Independent outside directors	+*	
						Gray outside director	Insignificant	
						Foreign institutional directors	Insignificant	
						Board size	Insignificant	

Cho and Kim (2007)	Agency theory	Korean Stock Exchange database	OLS	347 listed firms from Korea for 1999	ROA	Outside directors	Insignificant but significant after controlling for ownership	Too early to determine the effectiveness of outside directors
Black and Khanna (2007)	Agency theory	Bombay Stock exchange	OLS, Event study	159 large, 378 mid-size and 254 small firms from India	Raw return, MAR and CAR	Announcement of Clause 49	Large and medium firms have significantly higher raw return, Market-adjusted returns and Cumulative abnormal return than small firms	investors expected the Clause 49 reforms to benefit large firms, and likely also medium-sized firms
Elsayed (2007)	Agency and Stewardship Theory	Egyptian capital market agency	OLS, Least Absolute Value Regression	92 Egyptian firms for 2000-2004	ROA, Tobin's q	CEO Duality	insignificant	There is no monotonic relationship between CEO duality and corporate performance.
						Board Size	insignificant	
Ghosh (2006)	Agency and resource dependency	Prowess database	OLS	127 listed Indian large firms in 2003	ROA, ROE, the average value of ROA, ROE and ROS, adjusted Tobin's q	Board size	-***	No explanation
						Non-executive directors	insignificant	
Black, Jang and Kim (2006)	Agency theory	Korea Stock Exchange (KSE) survey	OLS and 2SLS	515 Korean companies in 2001	Tobin's q, MTB, MTS	CGI	+***	corporate governance is an important factor in explaining the market value of Korean public companies
						Board structure index	+***	

Key: OLS = Ordinary Least Square; 2SLS = 2 Stage Least Square; 3SLS = 3 Stage Least Square ROA = Return on Assets; ROE= Return on Equity; MTB = Market to Book Ratio; MTS = Market to Sales Ratio; ROS = Return on Sales; MAR = Market Adjusted Return; CAR = Cumulative Adjusted Return
***, ** and * implies significant at the one, five and ten per cent level

Appendix 2.6: A summary of studies relating corporate governance and accounting reporting quality in developing countries

Study	Theory	Data sources	Estimation Method	Sample	Dependent variable	Independent variable	Main results	Argument behind hypothesis or Explanation of findings
Cheng and Courtenay (2006)	Agency Theory	Annual reports	OLS and 2SLS	104 firms in Singapore for 1998 and 2000	Voluntary disclosure	Board size	insignificant	
						CEO Duality	insignificant	
						Independent directors	+***	
Eng and Mark (2003)	Agency theory	Annual reports	OLS	158 Singapore firms for 1995	Voluntary disclosure of strategic, non-financial and financial information	Independent directors	-**	
Ho and Wong (2001)	Information and Agency Theory	Survey about CG and perception of disclosure quality	OLS	98 Hong Kong firms for 1997-98	Importance adjusted relative disclosure index	CEO Duality	insignificant	
						Board independence	insignificant	
						Audit committee	+**	
Chen and Jaggi (2000)	Agency theory	Annual reports	OLS	87 Hong Kong firms for 1993 – 1994	Disclosure score within mandatory and voluntary disclosure framework	Board independence	+***	
						Equity hold by outsiders	insignificant	
Firth, Rui and Wu (2011)	No theory	Annual reports and stock market data	Probit Regression	271 firms in China from 2000-2005	Financial statement fraud	Board size	insignificant	No explanation for insignificance results
						Outside directors	insignificant	
						CEO Duality	insignificant	
						CFO on Board	insignificant	

						Finance background of directors	-*	
Shen and Chih, 2007	Agency theory	Credit Lyonnais Security Asia	*Weighted least square*	204 firms from nine Asian countries	Earnings Manageme nt	CGI	-***	Corporate governance deter earnings management
Sarkar et al. 2006	No theory	Prowess database	*OLS*	500 Indian firms for 2003 and 2004	Earnings Manageme nt	Board independence	insignificant	Board diligence is more important than independence in constraining earnings management
						Board busyness	+***	
						Board diligence	-***	
						CEO duality	-**	
						Promoter influence	+*	
Liu and Lu (2007)	Agency theory	CSMAR Financial Databases	*OLS and* Random-effect models	1009 firms from China for 1999 to 2005	Earnings managemen t	CEO Duality	insignificant	There is limited variation in CEO duality in sample firms; Outside directors reduce tunnelling
						Outside Directors	-***	
Jaggi, Leung and Gul (2009)	Agency Theory	Global Vantage database	*2SLS*	~ 400 listed firms in Hong Kong for 1998-2000	Earnings managemen t	Proportion of non-executive directors	-***	a higher proportion of INEDs is likely to deter earnings manipulation; the monitoring effectiveness of INED's is reduced by family control
						Board size	insignificant	
						CEO Duality	Insignificant	
						Audit committee	insignificant	
Haniffa and Cook (2005)	Legitimacy theory	Annual Reports	*OLS*	139 Malaysian companies for 1996 and 2002	Corporate Social disclosure	Outside directors	-**	No explanation
						Chairman busyness	+*	
Siregar and Utama	Agency Theory	Annual Reports	*OLS*	144 Indonesian listed firms 1999-2002	Efficient earnings managemen t	Independent directors	Insignificant	Independent director does not play role. No explanation about audit committee
						Audit committee	insignificant	
Duh, Lee and Lin (2009)		Taiwan Economic Journal Database		55 reversal and 55 non-reversal firms from Taiwan in 2004–2005	Reversal of impairment loss	CGI	-**	effective corporate-governance mechanisms help deter earnings management

Wan-Hussin (2009)	No theory	Annual Reports	*Probit and multinomial regression*	64 listed firms from Malaysia for 2001	Compliance with segment disclosure	Non-executive independent directors	insignificant	No explanation
						Non-executive affiliated directors	+*	
						Board size	insignificant	
Li, Xiao and Tang (2008)	Institutional theory	Survey	*N/A*	259 questionnaires from investors, creditors, external auditors, company management, independent directors	N/A	N/A	Respondents recognise the ceremonial roles of audit committee but do not appreciate substantial roles. The characteristics of audit committee indicate that audit committee is ineffective.	No explanation

Key: OLS = Ordinary Least Square; 2SLS = 2 Stage Least Square
***, ** and * implies significant at the one, five and ten per cent level

Appendix 2.7: A summary of studies relating level of compliance with corporate governance codes

Study	Theory	Data sources	Estimation Method	Sample	Dependent variable	Main findings	Future research
Arcot, Bruno and Faure-Grimaud (2010)	No theory	Annual Reports	Descriptive statistics	245 non-financial companies from UK for 1998–2004	Level of compliance	* Very high compliance amongst certain provisions of the code in the region of 95% and above in 2004. * On average, less than 10% of all firms were not compliant with a given single provision. * Companies do not use the flexibility of the Code to fine-tune their governance to their changing circumstances, possibly due to the existence of enforcement and monitoring issues. *Firm size is positively associated with level of compliance. *Lagged poor performance positively affects compliance. *Firms with a dominant shareholder comply less. * Use of standard explanations in case of non-compliance. * Minority shareholders have limited enforcement powers reducing managers' motivation to justify non-compliance. * The difference in stock return between compliant and non-compliant companies is not significant.	Some companies could state their compliance (e.g. related to the judgment of director independence), while in fact they are not, which could explain the high rate of compliance.
Salterio, Conrod and Schmidt (2013)	No theory	Annual reports and proxy statements	Descriptive analysis	742 Canadian firms and trusts	Level of compliance	Firms comply with 82 per cent of provisions and provide explanation for 4 per cent of provisions.	Nothing explicitly mention
v. Werder, Talaulicar and Kolat (2005)	No theory	The compliance declarations	Content analysis	408 firms listed at the Frankfurt Stock Exchange	Level of compliance	* Among the sample companies, 96.81 per cent on average comply with 90.64 per cent provisions. *Different companies provide identical explanation to justify their non-compliance with neuralgic code recommendations. *Large firm comply better with the provisions of code. *Firms with growth potential comply more with the provisions of code.	* Identify firm characteristics that explain variation in level of compliance. * Actual can be different from declared compliance.

Talaulicar and v. Werder (2008)	No theory	Survey conducted on behave of Government Commission German Corporate Governance Code	Principal component analysis; Cluster analysis	200 companies listed at the Frankfurt Stock Exchange	Pattern and similarities in compliance with German corporate governance code	*Mean compliance rate is 81.71 per cent of total recommendations and 57.89 per cent of total suggestions. * The kind of conformity with the GCGC bears similarities across different firms. *the size of supervisory board is positively related to level of compliance *Firms with similar size are clustered into different groups. *Governance performance studies should consider pattern of compliance rather than overall level of compliance.	*Governance prediction studies need to more variables.
Akkermans et al. (2007)	No theory	Annual reports	Descriptive analysis	150 largest Dutch listed corporations	Level and similarities in explanation for non- compliance among companies	* Compliance with the code is generally high. *Larger firms comply significantly more with provisions than smaller companies *There is minor difference between survey responses and public disclosure. *Local companies on average comply better with the code. *Non-compliance are remarkably similar across companies *Symbolic adherence with the code	*Compliance rates based on public information may overstate actual compliance.
Bianchi et al. (2011)	No theory	Annual reports and results of survey conducted by stock exchange	Ordinary Least Square	236 Italian listed companies for 2007	Gap between formal and actual compliance	Size — Insignificant Industry — Mixed Board independence — insignificant Minority directors — Mixed AC independence — Significant Family control — Insignificant State ownership — Insignificant Institutional investors attend GMS — Significant Shareholdings by institutional investors — insignificant	There is a gap between formal and actual compliance. Independent directors only matter if they play major role in committee
Hooghiemstra and van Ees (2011)	Institutional theory	Annual reports	Count regression analysis	126 Dutch firms for 2005	Number of non-compliance	* Larger firms comply significantly more with provisions than smaller companies * Ownership concentration and interlocked director are not associated with extent of non-compliance.	Internal process that motivate non-compliance
MacNeil and Li (2006)	No theory	Annual reports and market return data	Descriptive analysis	18 UK companies	Investor response to non-compliance	*Explanation justifying non-compliance is uninformative. *investors do not bother about non-compliance when performance of the company is good. *the "comply or explain" approach is not working	Investigate process of monitoring compliance by investors.

Appendix 3.1: Credit Risk Grading Score Sheet

Borrower Details	**Aggregate Score**	**Risk Grade**	
Number	**Grading**	**Short**	**Score**
1	Superior	SUP	Fully cash secured, secured by Government/International Bank Guarantee
2	Good	GD	85+
3	Acceptable	ACCPT	75-84
4	Marginal/Watchlist	MG/WL	65-74
5	Special Mention	SM	55-64
6	Substandard	SS	45-54
7	Doubtful	DF	35-44
8	Bad/loss	BL	<35
Criteria			
A Financial Risk		**Weight = 50%**	
Financial ratios		**Maximum score**	
1 Leverage		15	
2. Liquidity		15	
3.Profitability		15	
4 Interest coverage		5	
Total Score–Financial Risk		50	
B. Business/Industry Risk		**Weight =15%**	
1. Size of Business		5	
2. Business Outlook		3	
3. Industry Growth		3	
4. Market Competition		2	
5. Entry/Exit Barriers		2	
Total Score-Business/Industry Risk		**15**	
C. Management Risk		**Weight = 15%**	
1. Experience		5	
2. Second Line/ Succession		5	
3. Team Work		5	
Total Score-Management Risk		**15**	
D. Security Risk		**Weight = 10%**	
1. Security Coverage		4	
2. Collateral Coverage		4	
3. Support (Guarantee)		2	
Total Score- Security Risk		**10**	
E. Relationship Risk		**Weight = 10%**	
1. Utilization of Limit		3	
2. Account Conduct		3	
3. Compliance of Covenants/Conditions		2	
4. Personal Deposits		**2**	
Total Score-Relationship Risk		**10**	
Grand Total- All Risk		**100**	

Source: BRPD Circular 16

Appendix 5.1: Details of interviewee qualification and experience

Category	Code	Type of organisations	Designation	Work experience	Academic qualification	Interview Date	Interview Time	Tape recording /Note taking
Managers of Institutional Investors	MFM1	Mutual Fund Company (Nationalised)	GM	32 years 3 months	M.Com, FCA	07.03.12	11:00 am - 2:00 pm	Note taking
	MFM2	Mutual Fund Company (Domestic - Private)	CEO	25 years	MBA	22.03.12	11:00 am - 12:45 pm	Tape recording
	MFM3	Mutual Fund Company (Domestic - Private)	FAVP	8 years 10 months	MBA	21. 03.12	11:00 am to 11:42 am	Note taking
	MFM4	Mutual Fund Company (Foreign)	SVP	12 years 9 months	CFA	10.03.12	10:00 am to 12:12 pm	tape recording
	LIC1	Life Insurance Company (Private-Traditional)	EVP	16 years	MBA	18.01.12	2:45 pm to 3:58 pm	tape recording
	LIC2	Life Insurance Company (Private-Islamic)	CFO	28years 8 months	FCA	25.01.12	2:15 pm to 3:35 pm	Note taking
	LIC3	Life Insurance Company (Private-Traditional)	Adviser	37 Years	FCA	28.01.12	10:00 am to 12:10 pm	Note taking
Credit Rating Analyst s of Banks and Credit Rating Agencies	NCB1	Nationalised Commercial Bank	GM	28 years 10 months	FCA	26.03.12	2:00 pm to 3:05 pm	Note taking
	DCB1	Domestic Commercial Bank (Private)	SAVP and Manager Operations	12 years 5 months	Master in Agro-Eco and Business Mgt.	13.03.12	2:15 pm to 3:40 pm	Note taking
	DCB2	Domestic Commercial Bank (Private)	FAVP and Credit- in-Charge	9 years	M.Com Accounting	20.02.12	4:00 pm to 7:30 pm	Note taking
	DCB3	Domestic Commercial Bank (Private)	Head of Credit, Wholesale Banking	12 years 4 months	MBA	09.01.12	11:30am to 1:30 pm	Note taking
	DCB4	Domestic Commercial Bank (Private)	SAVP	15 years	M.Com, MBA	24.01.12	2:00 pm to 4:05 pm	Note taking
	DCB5	Domestic Commercial Bank (Private)	EVP and Head of Credit	20 years 6 months	MSc Statistics	30. 01.12	3:15 pm to 4 pm	Note taking
	DCB6	Domestic Commercial Bank (Private)	AVP	8 years 2 months	MBA	29. 02.12	6:00 pm to 7:45 pm	tape recording
	DCB7	Domestic Commercial	SAVP	12 years 1 month	M B A	01.02.12	11:35 am to 12:55 pm	Note taking

		Bank (Private)						
	DCB8	Domestic Commercial Bank (Private)	VP and Head of Credit	17 years	MBA	19. 01.12	11:15 am to 12:01 pm	Tape recording
	DCB9	Domestic Commercial Bank (Private)	SVP	15 years 6 months	MBA	28. 03.12	12:10 pm to 1:00 pm	tape recording
	DCB10	Domestic Commercial Bank (Private)	VP and In Charge, Credit	18 years 5 months	MBA	01. 03.12	10:15 am to 11:35 am	Note taking
	DCB11	Domestic Commercial Bank (Private)	VP	12 years 4 months	Masters, sociology	07. 03.12	11:00 am to 12:25 pm	Tape Recording
	DIB1	Domestic Islamic Bank (Private)	VP	10 years 2 months	MBA	15. 02.12	11:05 am to 12:09 pm	Tape recording
	DIB2	Domestic Islamic Bank (Private)	SEVP	27 years 3 months	M.Com	25. 01.12	11:30 am to 12:10 pm	Tape recording
	FCB1	Foreign Commercial Bank	Senior GM	47 years 8 months	M.Com	14.03.12	11:25 am to 12:10 pm	Note Taking
	FCB2	Foreign Commercial Bank	FAVP	8 years 2 months	MBA	17. 01.12	11:30 am to 12:45 pm	Note taking
	FCB3	Foreign Commercial Bank	Senior manager	10 years	MBA	12. 02.12	3:30 pm to 4:33 pm	Note taking
	CRA1	Credit Rating Agency	VP and Head of Rating	11 years 6 months	MBA	13.02.12	11:40 am to 12:18 pm	Tape recoring
	CRA2	Credit Rating Agency	VP and Chief Rating Officer	10 years and 4 months	MBA	16.02.12	2:00 pm to 3:30 pm	Note Taking
	CRA3	Credit Rating Agency	CEO	24 years	Masters	22.03.12	11:40 am to 12:20 pm	Note taking
	CRA4	Credit Rating Agency	Senior rating analysts	8years 1 month	MBA	06. 03.12	2:20 pm to 2:57 pm	Tape recording

Appendix 5.2: Introductory letter to the interviewee

Md. Abdus Sobhan
PhD Student, Accounting and Finance Group
University of Edinburgh Business School
29 Buccleuch Place, Edinburgh, EH8 9JS
Cell: +44(0)7580473146, Email:M.A.Sobhan@sms.ed.ac.uk

Date: 14.01. 2012

Credit Analyst of Bank
United Commercial Bank Limited,
Bangladesh

Subject: **Request to be an interviewee for a PhD research project.**

Dear Sir,

I am Md. Abdus Sobhan, Assistant Professor, Department of Accounting and Information Systems, University of Dhaka. Currently, I am studying PhD in the University of Edinburgh, United Kingdom under the supervision of Professor Bill Rees and Professor Pauline Weetman. My research topic is corporate governance reform in the non-financial sector of Bangladesh. As part of the project, I want to investigate ***how the state of a publicly listed company's corporate governance influences a bank's lending decision to it.*** *The broad questions I want to discuss are as follows:*

1. What ***factors*** do you consider in assessing ***how the directors manage*** the company?
2. How do you evaluate the ***accounting reporting quality*** of a prospective corporate borrower?
3. Do you see any ***relationship*** between ***how the directors manage the company and the accounting reporting quality*** of a company? If yes, what kind of association do you observe?
4. How do you perceive the ***impact of recent corporate governance reform*** in Bangladesh on ***how the directors manage the company and accounting reporting*** quality? The reform recommended separation of chairman and CEO, appointment of an independent director, an audit committee, CFO and head of internal audit (HIA) etc.
5. How do the ***unique characteristics*** of the Bangladesh corporate sector affect your assessment of how the directors run the company and of the accounting reporting quality of a company? The unique characteristics include family ownership and control of companies, political affiliation of sponsor shareholder directors, corruption etc.

All the information collected will be kept confidential and the PhD thesis and any research publish from it in future will analyse your comments anonymously without mentioning your and your organisation's identity. I will send a summary of interview for your kind consideration by email and if you disagree with any part of the summary, you can amend accordingly.

Thank you in advance for your time and effort.

Yours Sincerely,

Md. Abdus Sobhan

Name of the Bank: ....

Interviewee Name: ....

Gender: M ☐ F ☐ Age: .... years

Maximum Level of Education Achieved:..Discipline:..................

Designation: ....

Experience in current position: ....years.....................months

Experience in corporate lending: ....years......................months

Number of Banks served in career: ....

Approximate percentage of market share of your bank in corporate credit: ....percent

Major industrial sectors financed by your bank (may be more than one):
....

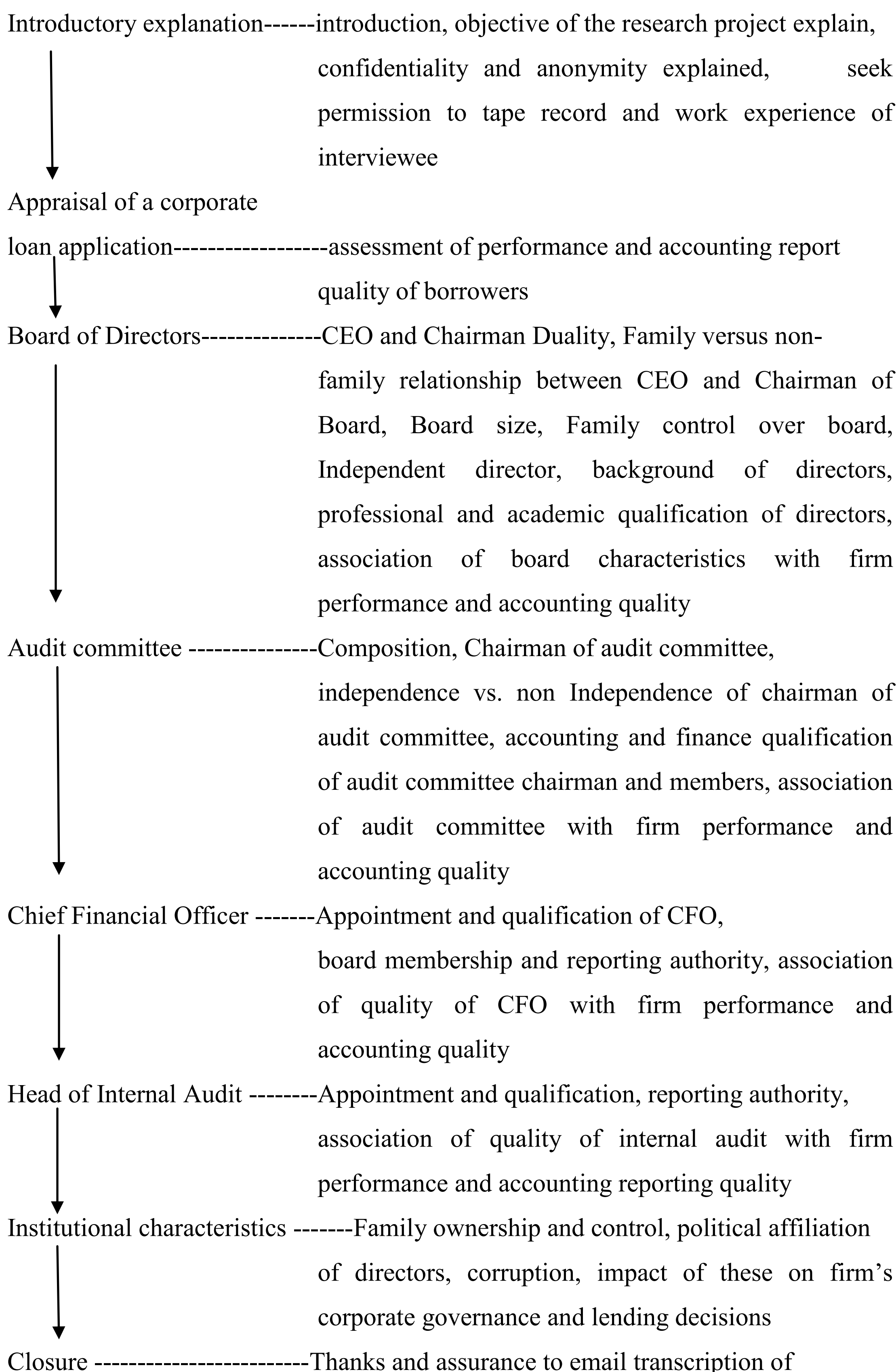
Estimated time: 1:00 -1:30 hours

Interview Time started: ....

Time Finished: ....

Note Taking / tape recording: ....

Appendix 5.3: Semi-structured interview card



Appendix 5.4: Research Ethics

University of Edinburgh Business School
Level 1 and 2 Research Ethics Applications

Title of Proposal: ***Corporate Governance Reform in a Developing Country – The Case of Bangladesh.***

Please provide a brief outline of the research aims and the proposed methodology, highlighting any anticipated ethical issues (on separate sheet if necessary):

The interviewees, aged between 30- 72 years, are mid and senior level corporate credit analysts of banks and credit rating agencies and investment managers of life insurance companies and mutual funds who have no physical or mental vulnerability. The research issue is not a sensitive topic (Lee, 1993) and does not require interviewees disclose governance information of any particular borrower (Mason, 2002; p. 79). Thus, there are minimum ethical issues. In spite of that, I explain confidentiality and anonymity as well as take voluntary consent as described below.

I explain that except the researcher and his supervisors, no other person will have access to the data as part of confidentiality. I also explain anonymity by clarifying that in case of writing thesis or further publications, I will quote their response without the name of the interviewees and their banks. Finally, I explain that full confidentiality may not be ensured (Mason, 2002; p. 80) through restrictive access to data and anonymity because Bangladesh has limited number of banks, credit rating agencies, life insurance companies and investment management companies and a determined investigator can easily associate the comments to a particular bank based on some description of banks.

Voluntary consent is initially achieved when they agree to be interviewed because I send a consent form with the introductory letter. I again ensured it by using the same consent form which the interviewee filled and signed during interview. The consent form gives the respondents the opportunity to withdraw from

the research at any time and to make any amendments that they felt were necessary (Mason, 2002; p. 80). Voluntary consent is finally ensured by giving them opportunities to make amendments to transcripts which I send them by email after transcription (Hagens et al. 2009). All interviewees replied that they do not find any significant discrepancy between interview and transcript. This approval of transcripts also increases validity of data (Hagens et al. 2009).

I have read the *Business School Research Ethics Policy* and agree to abide by it.

In the case of human subjects in research: (delete as necessary) Participants will be told about the objectives of the study.	Yes/No
Any hazards will be explained to them.	Yes/No
Participants will be informed they are participating of their own free will and consent.	Yes/No
They will be informed that they are free to withdraw at any point should they wish to.	Yes/No
Information will be held in confidence and any information used will be used anonymously unless consent has been given otherwise	Yes/No
I confirm that this study does NOT involve children (under 18), institutionalised people; or other individuals who are vulnerable or unable to give consent.	Yes/No
I have considered the risks of physical or psychological harm to research participants (including the researchers) and how to address these	Yes/No

Appendix 5.5: Survey questionnaire

The Company Secretary,

Aramit Cement Ltd

Dear Sir,

I am inviting you to participate in a survey. I am studying the current state of corporate governance of non-financial companies of Bangladesh as part of a PhD project in University of Edinburgh, United Kingdom, under supervision of Professor Bill Rees and Professor Pauline Weetman.

Along with this letter, I enclosed a questionnaire that asks a variety of questions about the governance structure of your company. I am requesting you to complete the questionnaire and return it to me.

As a company secretary, you have valuable insights into the underlying governance structure of your company. I believe that your opinion could be extremely valuable for the development of the current state of governance structure. If you would like to share your views further, please contact me at M. A. Sobhan@sms.ed.ac.uk.

The results of this project will primarily be used for writing a PhD thesis. ***I guarantee that your identity will be kept absolutely confidential to me and my supervisors and the outcome of this research will never be published in Bangladesh***. If you like to receive a summary of my initial findings, please fill in your details at the end of the questionnaire.

Thank you very much for taking the time to assist me in this research.

Yours Sincerely,

Md. Abdus Sobhan

PART A: Ownership Structure

4. Please provide following information about ownership structure of your company:

	Largest shareholder	Top 3 shareholders	Top 5 shareholders	Top 10 shareholders	All directors	Sponsor	Govt.	Institutions	Foreigners	General public	Blockholders*
% of ownership											

*Blockholders means any shareholders owning at least 10% of ownership of the company.

PART B: ***Board of Directors***

1. Profile of Board

Please write the name of each director and tick (√) each relevant column based on the attributes of each individual director.

Name	Executive*	Non-executive**	Independent¥	Member of controlling family	Current/ previous employee of the company	Director of a company controlled by primary family	Affiliated with another listed company	Nominee of sponsor family or company	Nominee of banks or institutional investors

**Executive Director: A person who is a director and officer of the company*
***Non-executive: A person who is a director but not an officer of the company*
¥Independent director: A director with less than 1% of share ownership and not an executive director
ΨBEI: Bangladesh Enterprise Institute, the private sector research organization that issued first corporate governance code in Bangladesh and currently provides training to directors.

2. Chairman and CEO Duality:

Is the CEO of your company a different individual from the Chairman of the board?

[a] Yes [b] No

If yes, is there a family relationship between the Chairman and the CEO?

[a] Yes [b] No

5. If Chairman and CEO are different people, does your company specify their duties and responsibilities in written form?

[a] Yes [b] No

6. Board Independence: (Please complete if your company appoints independent director(s), otherwise go to question 4)

a. The primary reason for appointing independent director on the board

(Please tick (√) final column)

To ensure compliance with Bangladesh Corporate Governance Guideline 2006	
To build reputation that firm maintains strong governance	
To ensure that management activities are targeted to wealth maximization of shareholders	
To get access to expertise that is not available from executive and shareholders directors	
To ensure external connection of the firm through network of independent director	
Anything else (Please mention)……………………….	

b. Description that describes the identity of the independent director(s) of your company [Multiple answer can be selected]:

(Please tick (√) final column)

	ID 1	ID 2
A shareholder director owns less than 1% of total ownership		
A representative of minority shareholders		
A representative of an institutional shareholder		
A former officer or executive of the company		
A person who is a relative or descendent by birth or marriage of a member of the controlling family		
A person who is a friend or previous colleague of a member of the controlling family		
A person who jointly owns a partnership or a private limited company with a member of the controlling family		
A person who holds a board position in another public limited company with a member of the controlling family		
A professional who provides professional services to the company or other business controlled by a member of the controlling family or to the family itself		
None of the above (please specify)……………………………………		

c. How often does the independent director(s) of your company dissent the decision taken by executive directors

☐ Very frequently ☐ Frequently ☐ ccasionally ☐ Rarely ☐ Never

7. Board Meetings and Minutes:

Please provide details for first three columns and tick (√) yes or no for last two columns

Number of Board meeting held in 2010	Average number of directors present in each board meeting	Approximate duration of each meeting	Maintenance of written minute (please tick (√))		Recording of voting outcome (please tick (√))	
			Yes	No	Yes	No

PART C: ***Board Committees:***

8. Please tick (√) appropriate (***yes or no)*** column for the following items:

	Yes	No
An Audit Committee exists		
An audit committee constitution or charter or bylaw exists to govern the operation of audit committee		
Audit committee presents a separate audit committee report to shareholders annually		
A management committee exists		
A management committee constitution or charter or bylaw govern the operation of management committee		

9. A. If an audit committee exists, please fill up following details about audit committee members

Name of director	Designation on audit committee (chairman or member)	Academic/ professional qualification with discipline

B. If an audit committee exists, please provide following information regarding audit committee meeting:

Number of meeting held in 2010	Minimum No. of members present in a meeting	Approximate duration of a meeting	Number of meetings with external auditor

C. To whom does the audit committee report within the company?

☐ Board of Directors ☐ Chairman of the Board ☐ CEO/ Managing Director

☐ Any other (please mention) ………………………………..

PART D: ***Chief Financial Officer (CFO)***

10. Does your company employ a CFO?

☐ Yes ☐ No

If yes, please provide following details about CFO:

(Please provide details for first two columns and tick (√) yes or no for last three columns)

Academic or professional qualification of CFO	Working experience as CFO in years	Previous CFO of another company	CFO is also director	CFO, though not director, attends board meeting

		Yes	No	Yes	No	Yes	No

PART E: ***Internal Audit Department and Head of Internal Auditor (HIA)***

11. Does your company establish a separate internal audit department?
☐ Yes ☐ No
12. Does your company employ a HIA?
☐ Yes ☐ No

If yes, please provide following details about HIA:
(Please provide details for first two columns and tick (√) yes or no for last three columns)

Academic or professional qualification of HIA	Working experience as HIA in years	Previous HIA in another company		HIA is also director		HIA, not director, attends board meeting	
		Yes	No	Yes	No	Yes	No

13. Who does appoint and remove the HIA?

☐ Chairman of the Board ☐ CEO
☐ CFO ☐ Audit committee ☐ Board of Directors

14. To whom does the HIA report?

☐ Chairman of the Board ☐ CEO
☐ CFO ☐ Audit committee ☐ Board of Directors

PART F: ***External Auditor***

15. In your company, who does nominate the external auditor?
☐ Chairman of the Board ☐ CEO
☐ CFO ☐ Audit committee ☐ Board of Directors
16. Does your company purchase any non-audit services from your present external auditor?
☐ Yes ☐ No
If yes, what is the percentage of non-audit service fees to total auditor's fees in 2010?

Answer:………………….

17. Who does receive the external auditor's recommendation to management regarding accounting and audit practices?

☐ Chairman of the Board ☐ CEO ☐ CFO
☐ Audit committee ☐ Board of Directors ☐ Not applicable

18. A. Does your company last change the external audit firm within last three years?

☐ Yes ☐ No

B. what was the reason for changing the external auditor?

☐ To comply with SEC pronouncement about the rotation of auditor
☐ Auditor went out of business
☐ Disagreement over audit fees
☐ Disagreement over accounting policy
☐ Other reason (Please specify)…………………………………………

Details of Respondent:

(Only required to fill-in if you are interested to receive a copy of initial findings of this study)

Name of the Company: ....

Name of the Respondent: ....

Maximum Level of Education Achieved:...Discipline:...…..............

Designation: ....

Email:……………………………………………….

Experience in current position: ....years.....................months

Thank you very much