Explicating the contextuality of corporate governance through ownership structure and family management: Evidence from an emerging economy

Abstract

Purpose - This research investigates the impact of family management and ownership structure, including foreign ownership and business group ownership, on corporate performance.

Design/methodology/approach - Employing an agency perspective and a quantitative research methodology, this study examines listed firms in Pakistan from 2009-2018.

Findings - The results suggest that family management and concentrated leadership constrain, while family leadership, foreign ownership and group ownership strengthen monitoring effectiveness and corporate performance. These findings imply that the shareholder governance logic offers optimal solutions in an emerging economy, as relational governance may activate agency problems.

Originality - Our findings are consistent with the relevance of relational governance mechanisms in the form of family leadership. However, the results suggest that emerging economies require a hybrid governance model to address their unique agency problems, thereby underlining context relevance in corporate governance scholarship. Furthermore, this research adopts a thick view of institutions to clarify institutional embeddedness and corporate governance contextuality in an emerging economy.

Keywords: Corporate governance, Family-owned business, Business group, Foreign ownership, Firm performance.

1. Introduction

Among developed economies, the principal-agency model underpins the raison d'être of corporate governance discourse (Bhatt and Bhatt, 2017; Clark and Wójcik, 2018; Jackling and Johl, 2009; Muntahanah *et al.*, 2021; Shleifer and Vishny, 1997; Young *et al.*, 2008). Scholars adopt a similar principal (owner) – agency (manager) conflict argument to investigate corporate governance complexities in emerging economies, while paying minimal attention to its unique governance structures and institutional contexts (Aguilera *et al.*, 2018). For instance, contractual arrangements and their enforcement in developed countries are routine. However, even where legal mechanisms are in place in emerging economies, their enforcement is unpredictable, inefficient, and costly due to institutional voids (Keasey *et al.*, 2005; Khanna and Palepu, 2000a; La Porta *et al.*, 1997). These innate contextual differences expose a weak and fluid institutional arrangement in these contexts that emasculate the robustness of agency and related theories to explain the link between corporate governance and firm performance.

Recently, management scholars have identified agency theory as a context-sensitive Western theory (Filatotchev et al., 2022; Hashemi *et al*., 2022; Passetti, 2021; Pourmansouri, 2022). Indeed, contextualizing the agency theory through an open-systems perspective in non-Western contexts can provoke key insights. The framework of open systems maintains that organizational survival is contingent upon its interrelationships with the external environment and its institutions (Kast and Rosenzweig, 1972; Scott and Davis, 2015). The organization obtains resources, including social legitimacy, processes its inputs and eventually provides the outputs to the outer world. The dependency and interaction between a business firm and its environment underline the relevance of an open-system perspective. The open-system perspective can facilitate management scholars to apprise the boundary conditions of the established theories like agency theory. In so doing, one needs to analyse both the institutional context and organizational actors to provide a thick view of institutions (George and Schillebeeckx, 2022; Süsi and Jaakson, 2020; Zattoni *et al.*, 2020). , There is a dearth of research that takes a thick view of institutions to contextualize the agency theory (Filatotchev *et al.*, 2022). This study fills this research gap by contextualizing agency theory in a non-Western setting – Pakistan.

A body of literature (Chiang and Lin, 2007; Fernández and Tejerina, 2020; Finegold *et al.*, 2007; Hillman and Dalziel, 2003; Klapper and Love, 2004; Lam and Lee, 2012; Maury, 2006; Nicholson and Kiel, 2007; Singh and Gaur, 2009) has explored the relationship between governance mechanisms including firm ownership structure, board attributes and composition, and corporate performance. However, pertinent questions regarding the roles of board composition and ownership structure in distinct institutional environments remain unaddressed (Ciftci *et al*., 2019). In fact, it has been proposed that future corporate governance research should take a thick view of institutions (Aguilera and Grøgaard, 2019; Zattoni *et al.*, 2020). This viewpoint can assist in emphasizing the interdependencies among national institutions and governance mechanisms in varieties of capitalism. These investigations can identify the extent of institutional embeddedness and context relevance in diverse institutional arrangements (Aguilera and Jackson, 2010; Zattoni *et al.*, 2020). This study responds to these calls by examining the relationships between institutional arrangements, governance practices, and firm performance in an emerging economy (Pakistan). In this regard, this research explores the roles of internal and external governance mechanisms in dealing with context-dependent performance challenges. With regard to the institutional environment in emerging economies, this research examines how family leadership, board composition, managerial ownership, foreign ownership, and business group ownership influence firm performance in a non-Western institutional setting. This investigation can further illuminate institutional convergences and divergences between developing and developed economies.

Over time, the organizational form of public firms in developed (primarily in Anglophonic) economies has evolved from family/concentrated ownership and control to dispersed ownership with professional management controls (Clark and Wójcik, 2018; Shleifer and Vishny, 1997). In contrast, the organizational form of public firms in emerging economies has further cemented itself as one of relational/family/concentrated ownership and control, offering an organizational response to dysfunctional institutional arrangements or institutional voids (Jackling and Johl, 2009; Young *et al*., 2008). Unlike developed economies where corporate conflicts are modelled between the principal (dispersed ownership) and professional manager, firm conflicts in

emerging economies are primarily modelled between family owners/majority shareholders (family managers) and widely dispersed (minority) shareholders (Jackling and Johl, 2009; Young *et al*., 2008). Owing to distinct institutional arrangements between emerging and developed economies, we build our theoretical argument on the principal-principal framework (Young *et al.,* 2008). In the principal-principal framework, the family as owners (insiders) and managers safeguard private interests and govern through an alternative governance logic – family or relational corporate governance.

The corporate governance literature contends that founding families, business groups and networks possess substantial equity ownership in emerging economies like Pakistan (Ali and Khan, 2022; Fariha *et al*., 2021). This aspect adds a new dimension to principal-principal conflicts, and surprisingly, it is a relatively underexplored phenomenon in agency-grounded research. The complexity and opacity associated with family and network businesses in emerging economies trigger principal-principal conflicts. These conflicts suggest that researchers reconsider the fundamental theoretical assumptions of agency theory for developing and testing contextually relevant relationships (Arteaga, 2020; Scherer and Voegtlin, 2020). Hence, our research fulfils this imperative need. We conduct an in-depth analysis of how various aspects of institutions can influence corporate governance arrangements in a relatively understudied setting, i.e., Pakistan, thereby answering the urgent demand for more research on the subject. This investigation is in line with the open-systems perspective and aims to offer an unbiased, holistic, and unique understanding of corporate governance in a non-Western institutional context (Filatotchev *et al*., 2022; Scott and Davis, 2015).

This study employs a panel dataset comprising 138 nonfinancial firms listed on the Pakistan Stock Exchange for the period covering 2009-2018. Fixed effect regression analysis was used to examine the impact of family management and ownership structure on corporate performance. Our results reveal that family leadership and business group ownership strengthen firms' corporate governance system for improved corporate performance. These findings emphasize how institutional voids due to weak and fluid formal institutions in an emerging economy are filled by informal institutional arrangements to govern corporations through relational governance mechanisms.

This study makes the following significant contributions to the corporate governance contextuality literature. First, this study adds to the research on the relationship between corporate governance and firm performance by contextualizing agency theory in a non-Western institutional setting. Second, it provides a more comprehensive depiction of the impact of family management and ownership structure in the context of an emerging economy. Third, it extends the growing body of literature by employing a comprehensive set of market-based and accounting measures of firm performance, using data collected over a relatively long and recent timeframe. Fourth, the study explores the relevance of the principal-agency model in the institutional context of an emerging market where relational (family) governance logic dominates the institutional environment. Finally, this study investigates the relevance of agency theory by comparing the relational (family) governance logic with the shareholder governance logic. Our findings imply that the principal-agency framework is inadequate to fully explicate the link between corporate governance mechanisms and firm performance in a non-Western institutional context.

The rest of this paper is structured as follows. In the next section, we discuss the corporate governance structure in Pakistan, highlighting the key factors that have shaped the country's corporate governance landscape. Next, we present the theoretical underpinning of this research (agency theory) and establish six (6) hypotheses that help us address the corporate governance-firm performance nexus. The discussion of the study's methodology comes next, followed by a presentation of our findings and contributions to the extant literature. We conclude with the implications of our results for firms and policymakers.

2. Corporate Governance in Pakistan

The history of stock exchanges in Pakistan dates to 1949 with the incorporation of the Karachi Stock Exchange. This was followed by the establishment of two additional stock exchanges in 1970 (Lahore Stock Exchange) and 1989 (Islamabad Stock Exchange). These three exchanges had separate management, trading interfaces, and indices, and had no mutualized structure. However, in 2012, the Pakistani government promulgated the Stock Exchanges (Corporatization, Demutualization, and Integration) Act, which integrated the operations of the three exchanges effective January 11, 2016, under the new name 'Pakistan Stock Exchange Limited' (PSX) (PSX, 2022). Accordingly, 40% strategic shares were sold to a Chinese consortium comprising three stock exchanges - China Financial Futures Exchange Company Ltd (the lead bidder), Shanghai Stock Exchange and Shenzhen Stock Exchange. The remaining 60% is controlled by the general public, comprising initial shareholders, and local and foreign investors.

The history of corporate governance reforms and codes in Pakistan is fairly recent. The purpose of the codes was to ensure accountability, transparency, and protection of shareholder interests, similar to the Western model of corporate governance (Farooq *et al*., 2021; Shamsi *et al.*, 2013). The first code of corporate governance of Pakistan was issued in 2002 by the Securities and Exchange Commission of Pakistan (SECP), with support from the Institute of Chartered Accountants of Pakistan. The code was issued when the West was experiencing a series of corporate scandals, including the collapse of Enron, which prompted the enactment of the Sarbanes-Oxley Act 2002 (Romano, 2005). Like many countries across the globe, the Pakistani economy has had its share of corporate collapses (Farooq *et al*., 2021). Corporate scandals sensitize stakeholders to the importance of corporate governance for minimizing fiduciary abuses. In reaction to these corporate failures and following the effect of the global financial crisis, the SECP issued a revised version of the corporate governance code in 2012 (SECP, 2017). To further align the Pakistani corporate governance codes with international best practices, this revised code paid greater attention to board independence, diversity, and accountability. The latest code, issued in 2019, includes eight mandatory, twenty-two nonmandatory and four recommendatory provisions for publicly listed companies.

These consistent and recurring updates in the Pakistani code represent a deliberate transition toward shareholder governance logic from relational governance logic (Fainshmidt *et al*., 2018; Jackson and Deeg, 2008). The restructuring of the PSX in 2016 was also a step towards the shareholder governance logic. However, the World Bank reports that families, multinationals and the State dominate Pakistan’s corporate landscape (ROSC, 2018). Pakistani firms have a family-dominated ownership structure, which could lead to significant

concerns for minority shareholders, consistent with the principal-principal framework. Furthermore, Pakistan has a weak governance environment due to the absence of an effective and predictable rule of law (Hasan *et al.*, 2022). As a result, principal–principal conflicts can emerge as a critical corporate governance concern in emerging economies such as Pakistan (Young *et al.*, 2008). Against this backdrop, we examine the relationship between corporate governance mechanisms and firm performance among Pakistani firms to uncover the relevance of internal/relational and external governance mechanisms regarding firm performance. This investigation allows us to contextualize the agency theory in a non-Western context.

3. Theoretical Background and Research Hypotheses

Corporate governance aims to protect the interests of principals against agents' opportunistic behaviour to mitigate agency conflicts (Muntahanah *et al.*, 2021; Shleifer and Vishny, 1997). Unlike developed economies, formal institutional arrangements in emerging economies are not effective in safeguarding the interests of minority shareholders against insider expropriation (Clark and Wójcik, 2018; Jackling and Johl, 2009; Shleifer and Vishny, 1997; Young *et al.*, 2008). The question then arises - how do emerging economies protect minority shareholders in the wake of institutional voids? These institutional voids represent the inadequacy of corporate mechanisms that support markets to perform optimally (Khanna and Palepu, 2000a, 2000b, 2010). Usually, institutional voids in emerging economies manifest as ineffective governance mechanisms, weaker regulation of securities, inefficient product markets and a lack of market mechanisms for corporate control. These institutional voids can lead to increased transaction costs and jeopardize firm performance (Ma *et al.*, 2006).

Agency theory suggests that concentrated ownership can lead to better monitoring of agents, thereby minimizing principal-agent conflicts (Anderson and Reeb, 2003; Chen *et al.*, 2005; Miller *et al.*, 2007). In the context of emerging markets, ownership concentration can ensue through different ownership types, including family ownership, institutional ownership, foreign ownership, and state ownership (Young *et al.*, 2008). In the context of emerging economies, family members represent dominant ownership of firms and these family firms constitute a large proportion of firms in Pakistan (Ali *et al.*, 2021; ROSC, 2018). It is argued that family ownership can strengthen the corporate governance function as it can reduce principal-agent conflicts by minimizing the monitoring costs of owners, reducing the bonding costs of agents, and minimizing residual losses (Hillman and Dalziel, 2003). Conversely, a higher level of family ownership may endow the family with more influence and power to dominate board composition, corporate governance arrangements and strategic decision-making (Villalonga and Amit, 2006). Family ownership can result in a misappropriation of minority shareholders' value when these family-oriented manipulations are established through idiosyncratic family goals including socioemotional affluence (Barth *et al.*, 2005; Berrone *et al.*, 2020). Thus, principal-principal conflicts are likely to occur. Moreover, the conflicting motives can include unnecessary risk aversion to protect the socioemotional wealth of the family at the expense of minority shareholders over the longer term (Basco *et al.*, 2019; Miller *et al.*, 2007). Subsequently, the block-holding power of the family raises the principal-principal conflicts, which could have unintended consequences on the productivity, financial efficiency, and shareholder value of the firm

Contemporary corporate governance systems have two interdependent mechanisms to resolve these conflicts: internal/relational and external. Internal governance mechanisms include the board of directors and family members, while external mechanisms comprise the ownership structure, and market for corporate control, among others. Extant research (e.g., Ciftci *et al.*, 2019) supports the correlation between these mechanisms and the protection of outside investors' capital in many developed economies. However, due to the dysfunctional external institutional framework in emerging economies, the family/concentrated control organizational structure is considered an efficient alternative to fill these institutional voids (Berrone *et al.*, 2020; Murithi *et al.*, 2020; Luo and Chung, 2013). Due to the diversity of institutional contexts, this study stretches the existing notion of principal-agent conflicts for testing contextually relevant agency relationships in the setting of an emerging economy (Scherer and Voegtlin, 2020). As mentioned earlier, open systems perspective assists in reconsidering the fundamental theoretical assumptions of agency theory that appear to have an almost universal relevance in the West (Arteaga, 2020). Consequently, our research proposes the following hypotheses to examine how a unique institutional context and organizational actors in an emerging economy can influence corporate governance.

3.1 Relational (Family) Corporate Governance

Family-controlled firms dominate the corporate landscape in emerging and developed economies (Miller *et al.*, 2013; Muntahanah *et al.*, 2021). Agency theory suggests that the key function of a corporate board is to monitor management's behaviour to protect shareholders' interests (Johl *et al.*, 2015). The empirical literature admits that family executives reduce the agency problem between the managers and shareholders (Anderson and Reeb, 2003). Arora and Sharma (2016) clarify that family boards help improve decision-making and enhance Indian firms' performance. These boards create value for firms and are more effective in monitoring their operations. Ciftci *et al.* (2019) also argue that family management is relatively efficient in weak institutional contexts, as these managers have substantial economic incentives to maximize firm performance and the influence to activate performance. Hidayat and Utama (2017) further suggest that the proportion of family members on Indonesian boards positively impacts firm performance as these directors bring specific knowledge and competitive advantage to the firm.

In contrast, family executives can use their power and knowledge to exploit less influential owners to benefit themselves at the firm's expense, thereby causing principal–principal conflicts (Barth *et al.*, 2005; Crisóstomo and Brandão, 2019). In this case, family managers may use the business to serve their personal interests through free riding and shirking behaviour. Maury (2006) suggests that family control is useful in legal systems that can better protect minority shareholders against family opportunism. Family managers may pursue actions that maximize their personal utility and lead to suboptimal allocation of resources, resulting in poor performance relative to nonfamily firms (Villalonga and Amit, 2006). Bhagat and Bolton (2009) also contend that family managers have a strong preference for control that may create an inefficient concentration of decision-making authority that prevents them from adopting productivity-enhancing strategies. In a study of Spanish firms, Basco *et al.* (2019) note that the proportion of family directors is negatively associated with

financial performance due to relationship-based and task-related fault-lines. In sum, the literature provides conflicting evidence on the relationship between firm performance and family management, creating further opportunities to explore this association. Consequently, we hypothesize a link between the proportion of family board members and firm performance as follows:

Hypothesis 1: The proportion of family board members is significantly related to firm performance.

To minimize agency conflicts, corporate boards hire, fire and design compensation structures for CEOs and other executives. It also delegates day-to-day management of operations to the CEO and works closely with it to set the business's strategic direction to maximize shareholders' wealth (Boesso *et al.*, 2017). Anderson and Reeb (2003) find that firms headed by family CEOs perform better than those led by outside (nonfamily) CEOs. In this regard, Ang *et al.* (2000) explain that agency costs are greater in firms with more outside managers than in those with insider managers. Jongjaroenkamol and Laux (2017) find that the CEO can misreport the firm's performance, noting that this effect is more intense if the CEO is an outsider. In contrast, another stream of research reports that firms managed by professional CEOs perform significantly better than firms with family CEOs (Allen and Panian, 1982; Bhagat and Bolton, 2009). Empirical evidence suggests that family-managed firms may have trouble raising capital and are less likely to welcome new ideas and commit to innovation, adversely impacting firm value (Bennedsen *et al.*, 2007; Gallo *et al.*, 2004).

As mentioned earlier, families dominate the ownership structure and control of firms in Pakistan, similar to most emerging economies. This is viewed as an efficient governance arrangement given their inefficient external markets for factors of production such as managerial labour and capital (Young *et al.*, 2008). The literature reports a positive link between family CEOs and firm performance in Indian and Taiwanese settings (Jackling and Johl, 2009; Kuan *et al.*, 2011). On the other hand, the presence of family CEOs in these firms can trigger principal–principal conflicts owing to the prevalence of institutional voids (Luo and Chung, 2013; Murithi *et al.*, 2020). Therefore, firms headed by family CEOs influence firm performance differently (negatively) than firms run by outsiders (Jongjaroenkamol and Laux, 2017; Miller *et al.*, 2013). Based on these inconclusive results, the following hypothesis proposes a relationship between family CEOs and firm performance.

Hypothesis 2: The presence of a family CEO is significantly related to firm performance.

The CEO can influence the effectiveness of corporate boards, and agency conflicts can be reduced by separating the roles of CEOs and the board chairperson (Duru *et al.*, 2016). The weakening of the CEO's influence can allow the board to check their self-dealing behaviour, including financial reporting irregularities. Ali *et al.* (2021) argue that separating the role of CEO and chairperson can improve board independence and effectiveness. The leading role of contemporary corporate boards is to monitor the behaviour of CEOs. In a firm where CEO also serves as board chair, the information meant for outsiders (board) flows through the insider's path (CEO), thereby compromising the fiduciary and control functions of the board (Yermack, 1996). However, the research linking CEO duality and firm performance remains inconsistent.

Coles et al. (2001) report a significant positive link between CEO duality and performance. Kuan *et al.* (2011) advocate that financial performance is stronger for firms where family members are CEOs, chairpersons, and top managers. Conversely, Worrell *et al.* (1997) examine the market reaction around CEO duality and find negative effects on shareholder wealth. Hermalin and Weisbach (2003) find that CEO duality is negatively related to ROA (accounting measure) but positively associated with Tobin's Q (market measure). Duru *et al.* (2016) and Tang (2017) also find that CEO duality negatively influences firm performance.

As noted, the dominant form of corporate structure in Pakistan is that of concentrated/family ownership and family management (ROSC, 2018). From the agency perspective, it may trigger severe corporate governance concerns if the same person holds the CEO and board chair roles (Ali *et al.*, 2021). This concentration of power can provoke principal–principal conflicts due to weak regulatory and governance structures in emerging economies. Thus, it would be critical to investigate the relevance of role duality, which inhibits firm monitoring. Relying on the foregoing empirical arguments, we hypothesize a negative relationship between CEO duality and firm performance as follows:

Hypothesis 3: CEO duality is negatively related to firm performance.

3.2 External Corporate Governance

Ownership structure is a critical external governance factor in explaining firm performance (Teng *et al.*, 2021; Weir *et al*., 2002). Business groups and families have a predominant ownership stake in many countries, particularly in emerging economies (Hermuningsih *et al.*, 2020). These investors have access to more extensive networks and resources, which can be harnessed to optimize performance. Associated ownership (the percentage of total shares held by the associated companies, undertakings, and related parties) offers optimal corporate governance arrangements in contexts with weak regulatory institutions, insufficient information disclosures and uncertain political systems (Ciftci *et al.*, 2019). It creates value by effectively allocating capital and managerial resources among firms in environments with immature external capital and labour markets. Abdullah *et al.* (2012) argue that associated ownership is more long-term, resulting in efficient strategic decisions and superior firm performance. Ma *et al.* (2006) advocate that it develops the operating synergy of group firms through shared resources, including finance, technology, and the supply chain.

The agency perspective suggests that higher associated ownership reduces agency conflicts between shareholders and managers. However, it may also create a severe conflict of interest between majority insiders and minority outsiders (principal-principal conflicts). Zhang (2021) contends that associated ownership negatively impacts firm performance because the complex structure of business groups provokes self-dealing behaviour through related party transactions at the expense of minority shareholders. Moreover, the purpose of group ownership in a firm is to manoeuvre its operating, investing, and financing activities rather than to earn a fair return (Ciftci *et al.*, 2019). Pakistan's large commercial and industrial families have capitalized on the current political structure and regulatory framework to strengthen their control (Abdullah *et al*., 2012). Based on the above empirical debate, the following hypothesis proposes a link between associated ownership and firm performance.

Hypothesis 4: Associated ownership is significantly related to firm performance.

The World Bank reports that foreign investors are one of the largest set of owners in Pakistan other than families and the State (ROSC, 2018). The empirical literature suggests that foreign investors have stronger incentives and superior expertise in monitoring corporate activities (Zhang, 2021). Therefore, foreign ownership has a positive impact on the valuation and performance of firms. Ali *et al.* (2021) argue that foreign shareholders are effective external monitors of managerial actions since they are less likely to be related to controlling shareholders. Kao *et al.* (2019) find that foreign investors can resolve information asymmetry and agency conflicts by aligning all stakeholders' interests.

Ciftci *et al*. (2019) advocate that foreign ownership improves corporate governance practices that strengthen operating performance. Kao *et al.* (2019) argue that higher levels of foreign shareholding induce management to improve corporate transparency, prompting better financial performance. Ciftci *et al.* (2019) contend that foreign investors can evaluate the risks and returns of their investment decision more effectively owing to their international business experiences. Jusoh (2016) provides that foreign equity ownership is critical for enhancing firm performance because of access to superior technical and managerial expertise along with organizational and financial resources.

Despite the widely reported positive effects of foreign ownership on firm performance, Miyajima *et al.* (2016) submit contradictory opinions on the role of foreign investors in corporate governance. The optimistic opinion is that foreign ownership boosts the oversight capacity of corporate boards and consolidates the corporate governance system leading to enhanced firm performance. On the other hand, the pessimistic opinion is that these investors have a severe prejudice towards their own investment plans and are less loyal to a particular firm. Yoo and Koh (2014) argue that foreign ownership is an effective governance mechanism to control principal-principal conflicts in the Asian context. Given that the generality of the literature points to a positive link between foreign ownership and firm performance, we articulate the next hypothesis on the dominant scholarly position as follows:

Hypothesis 5: Foreign ownership is positively related to firm performance.

Separation of ownership and control creates agency problems between managers and shareholders. Managerial ownership is a mechanism that aligns ownership and control through stock ownership (Maury, 2006; Short and Keasey, 1999). It provides a direct economic incentive for managers to actively monitor and mitigate agency problems. Abdullah *et al.* (2012) argue that managerial stock ownership positively impacts the financial performance of Pakistani firms. Bhagat and Bolton (2009) investigate this association for large US firms and report that managerial ownership positively impacts corporate performance. Kao *et al*. (2019) contend that managerial ownership in Taiwan is considered a corporate governance mechanism that constrains opportunistic behaviours of managers and improves the efficiency of firms' operations.

Alternatively, Shan (2019) argues that board equity ownership leads to insider entrenchment, thus limiting firm performance and sparking principal-principal conflicts. Barth *et al.* (2005) find that managerial ownership negatively influences a firm's financial performance and the strength of its corporate governance

structure. Likewise, Villalonga and Amit (2006) advocate that managerial ownership coupled with a lack of market discipline results in wealth confiscation among firms in pursuit of personal objectives. Zhang (2021) documents that firms with a higher level of managerial equity ownership are more likely to report poor performance because these companies are less subject to effective governance by corporate boards. As the literature shows, there is no consensus regarding the impact of managerial ownership on financial reporting quality. Therefore, we propose that managerial ownership is related to firm performance in the following hypothesis:

Hypothesis 6: Managerial ownership is significantly related to firm performance.

4. Research Methodology

Our research examines the association between corporate governance mechanisms and firm performance for a sample of firms listed on the Pakistan Stock Exchange (PSX). Following Abdullah *et al.* (2012) and Ciftci *et al.* (2019), financial firms are excluded due to their different financial reporting standards. Data availability restricted our time horizon to 10 years from 2009 to 2018 and a final sample of 138 firms. This investigation focused on the pre-COVID period from 2009 to 2018 as firms were forced to adopt new managerial strategies to survive in difficult conditions during this pandemic (Koutoupis *et al*., 2021). Besides, this timeframe is important as the global economic crisis deepened worldwide at this time. This period also coincides with the integration of the country's three stock exchanges. It is also important to note that a number of revisions were made to the corporate codes during the referenced timeframe.

The study data are collected from the annual reports available on the websites of the selected firms over ten years (2009 to 2018). We employ panel data to estimate the models and test the established hypotheses. Panel data offer several advantages over other forms of data, including increased sample size and a clear explanation of dilemmatic models (Greene, 2018; Hasan *et al*., 2022). In addition, by combining both cross-sectional and time-series observations, panel data presents a more comprehensive and beneficial way to capture time varying determinants among cross sections and over time (Ciftci *et al*., 2019; Gujarati *et al.*, 2012).

It is important to consider the problem of endogeneity which is well documented in empirical research examining the association between corporate governance mechanisms and firm performance (Barth *et al.*, 2005; Bhagat and Bolton, 2009). The endogeneity stems from the omission of explanatory variables, which makes the illustrative variables correlate with the residuals of the estimated model. The fixed-effects estimator can handle the issue of omitted variables and eliminates the influence of time-invariant characteristics from the regressor variables (Arora and Sharma, 2016; Greene, 2018; Miller *et al*., 2013). Therefore, the study employs a fixed effects model to ensure that the underlying associations are not subject to any endogeneity related to the dataset. The specification test proposed by Hausman is a generally accepted procedure for identifying which test to employ in panel data analysis (Gujarati *et al.*, 2012; Hausman, 1978; Miller *et al*., 2013). Its results also confirm the superiority of the fixed effect over the random effect for all three models.

The following equation has been estimated to test our hypotheses:

$$FP_it = \beta_0 + \beta_1\ BFAM_it + \beta_2\ FCEO_it + \beta_3\ dCEO_it + \beta_4\ BMEET_it + \beta_5\ FOWN_it + \beta_6\ AOWN_it + \beta_7\ BIG4_it + \beta_8\ SIZE_it + \beta_9\ LEV_it + \beta_10\ AGE_it + \varepsilon_it \quad (1)$$

In the equation above, firm performance is the dependent variable, measured by Tobin's Q (TOBIN), market to book ratio (MTB), return on assets (ROA) and return on equity (ROE). TOBIN and MTB are market-based firm performance measures, while ROA and ROE are accounting-based firm performance metrics. The independent variables include family board membership (BFAM), family CEO (FCEO), CEO duality (dCEO), board meetings (BMEET), foreign ownership (FOWN) and associated ownership (AOWN). The control variables for this study include Big 4 audit firms (BIG4), firm size (SIZE), firm leverage (LEV) and firm age (AGE). The definitions and measures of all these variables are given in Table I.

Insert Table I here

5. Findings and Discussion

5.1 Descriptive Statistics

Table II reports descriptive statistics of variables used in the study to assess the trend and spread of the data employed. The summary statistics of all the variables include the number of observations, mean, median, standard deviation, and minimum and maximum values. The average value of Tobin's q for the sample firms is 0.926, which suggests that the listed firms in Pakistan are generally undervalued (Ali *et al*., 2021). The mean market-to-book ratio is 2.26, implying that the investors have a positive perception of how firms invest their capital (Chen *et al.*, 2005). The return on assets is 8.5% on average, and the mean return on equity is 18% indicating that the firms are profitable on average during the sampling period, which is another reason for the higher MTB (Arora and Sharma, 2016).

Insert Table II here

In addition, the proportion of family members on the corporate boards is 35%, and family CEOs represent 53% of the sample firms, suggesting that family management has a dominant role among Pakistani businesses. Table II shows that 15.8% of the firms have no role separation between the CEO and board chair. The percentage of total shares held by group companies is 36% on average, indicating that associated firms have a vital role in shaping firm performance. The mean foreign ownership in sample firms is 19%, and the proportion of company shares held by its board of directors is also 19% on average, which implies robust monitoring by these shareholders in firms owing to their significant stake. This also indicates that Pakistani firms embrace multiple shareholder control.

5.2 Correlation Analysis

Table III presents the correlation matrix to assess the linear relationship between two variables. The results indicate that market-based and accounting measures are positively correlated, establishing that these measures can be used to evaluate firm performance. According to Table III, all the firm performance measures have a significant and negative pairwise correlation with family board membership, family CEO and CEO duality.

However, all these performance measures are positively and significantly correlated with associated ownership and foreign ownership. On the other hand, the firm performance measures have a negative and significant correlation with managerial ownership. Overall, the pairwise correlations do not appear to present any serious multicollinearity problems for the regression analysis. Gujarati *et al.* (2012) recommend that statistical problems created by collinearity and singularity occur at a higher bivariate correlation of 0.90 and above. Moreover, variance inflation factors (VIFs) and tolerance values for each variable are computed and shown in Table III. The tolerance values are greater than 0.10, and the VIFs are less than 10, which suggests that the issue of multicollinearity in models is not a concern in this study (Greene, 2018).

Insert Table III here

5.3 Regression Analysis

Table IV presents the fixed effect regression results, utilizing four measures of firm performance (dependent variable), i.e., Tobin's Q, MTB, ROA, and ROE. The results show that family board membership has a significant and negative impact on the sample firms' market performance (Tobin's Q, MTB). Evidence suggests that family directors pursue actions that maximize their personal utility and lead to suboptimal allocation of resources resulting in principal-principal conflicts and poor firm performance (Bhagat and Bolton, 2009; Villalonga and Amit, 2006). Family-managed firms have a strong preference for control, which highlights these firms' internal corporate governance weakness. The results reveal that family board membership is negatively but insignificantly related to accounting-based performance measures (ROA, ROE).

On the other hand, the presence of a family CEO is positively and significantly associated with three of the four firm performance measures, contributing strong support for hypothesis H2. The reason is that a family CEO has an intimate knowledge of the firm operations and its unwritten rules, which is impossible for a nonfamily executive to possess (Miller *et al.*, 2013). The tacit knowledge of the corporation also reduces owner-manager information asymmetries, which may incur agency costs (Jongjaroenkamol and Laux, 2017). These findings suggest that family directors constrain, while family leadership strengthens monitoring effectiveness and corporate performance.

Insert Table IV here

The Pakistan Code of Corporate Governance (SECP, 2017) recommends that the chair and CEO be separate persons. However, the descriptive statistics shown in Table I indicate that CEO duality is still prevalent (15.8%) in Pakistan. The regression results indicate that CEO duality is negatively related to all four FP measures, and three of these measures are significant. These results are consistent with hypothesis H3 and prior studies (Ali *et al.*, 2021; Duru *et al.*, 2016; Tang, 2017). From the agency theory perspective, the CEO of a firm and the chair of its board should be separate persons as duality may impair board independence and its fiduciary function (Yermack, 1996). The findings suggest that concentrated management in the form of family board membership and concentrated leadership in the form of CEO duality signal internal governance weakness, hamper corporate performance and trigger principal-principal conflicts.

Table IV further reveals that associated ownership as an external governance mechanism has a highly significant and positive influence on the accounting and market-based firm performance metrics ($p < 0.01$). These results confirm the acceptance of this research's fourth hypothesis (H4). The empirical literature suggests that associated ownership develops the operating synergy of group firms through mutual resources (Hermuningsih *et al.*, 2020; Ma *et al.*, 2006). It also offers the most favourable corporate governance arrangement in weak regulatory institutional settings, exposed to insufficient information disclosures and uncertain political systems (Abdullah *et al.*, 2012; Ciftci *et al.*, 2019). The results also indicate that the regression coefficients of FOWN are positive and statistically significant for three out of four FP measures, which validates hypothesis H5, indicating that foreign ownership is positively related to firm performance. These findings are consistent with the principal-principal perspective suggesting that foreign investors can resolve information asymmetry and principal-principal conflicts by aligning all stakeholders' interests (Kao *et al.*, 2019). The extant literature advocates that foreign ownership strengthens the monitoring capacity of corporate boards and consolidates the corporate governance system leading to enhanced firm performance (Ali *et al.*, 2021; Miyajima *et al.*, 2016).

The results further suggest that the performance effects of managerial ownership are mixed as regression coefficients of MOWN are not statistically significant with any of the market-based measures. However, it is positively linked to one of the accounting measures (ROA). The dominant form of corporate structure in Pakistan is family-managed firms. Therefore, managerial ownership provides an effective mechanism to align ownership and control through stock ownership, improving firms' operations' efficiency (Abdullah *et al.*, 2012). However, managerial ownership coupled with a lack of market discipline may provoke insider entrenchment to pursue personal objectives (Shan, 2019; Villalonga and Amit, 2006).

Table IV also reveals that the engagement of the big four auditors negatively influences the accounting performance of Pakistani firms. Prior studies on corporate performance provide empirical support for these findings (Buallay *et al.*, 2017; Detthamrong *et al.*, 2017). The results also indicate that firm size has a positive impact on firms' market performance, which is consistent with prior studies in Indian and Chinese settings (Arora and Sharma, 2016; Zhang, 2021). Likewise, regression coefficients of firm leverage (LEV) are negatively associated with three of the four firm performance measures at a 1% significance level and are consistent with the previous studies in the Turkish and Italian contexts (Ciftci *et al.*, 2019; Miller *et al.*, 2013). Table IV further demonstrates that firm age positively impacts firms' market-based and accounting performance measures. These results align with earlier studies investigating Saudi Arabia and Indonesia (Buallay *et al.*, 2017; Hermuningsih *et al.*, 2020).

6. Conclusion

This study suggests that family management (BFAM) and concentrated leadership (dCEO) constrain, while family leadership (FCEO), group ownership (AOWN) and foreign ownership (FOWN) strengthen monitoring effectiveness and corporate performance. We ascertain the relevance of shareholder governance logic through corporate governance measures, namely group ownership, foreign ownership, and managerial ownership over

internal or relational corporate controls via family board membership and CEO duality. The results imply that optimal governance solutions are offered in emerging economies through a hybrid of shareholder and relational governance logics. The prevalence of institutional voids in an emerging economy due to weak and fluid external governance mechanisms is complemented by relational governance mechanisms. The corporate governance literature has recently acknowledged the relevance of hybrid governance models in addressing unique agency problems (Aguilera *et al.*, 2018). Similarly, this study's findings demonstrate the relevance of relational and shareholder governance mechanisms in the Pakistani context. Our results emphasize the complex reality of corporate governance, and the thick view of institutions can explain corporate governance's contextuality. Corporate governance in emerging economies recognizes interdependencies between relational governance mechanisms and shareholder governance mechanisms (Fainshmidt *et al*., 2018; Jackson and Deeg, 2008). This thick view of corporate governance in Pakistan emphasizes actor-centred relationships through relational (family) governance mechanisms.

Our study provides implications for both policymakers and businesses. The findings of this research urge policymakers to resolve the unique problems of corporate governance through context-sensitive solutions rather than borrowing the less relevant solutions from other contexts. Currently, the corporate governance codes in Pakistan are biased toward shareholder governance logic. However, our findings emphasize the relevance of a hybrid governance model to address the unique agency problems in the context of Pakistan. It implies that the problems of corporate governance in Pakistan require a hybrid governance model comprising of both relational and shareholder governance mechanisms. To accomplish this goal, Pakistani regulators need to directly engage with local business associations and communities while understanding the diverse corporate governance requirements of Pakistani businesses. Policymaking can be facilitated through a robust interaction and consultation among local policymakers, supranational institutions of corporate governance and businesses in the country. For corporate managers, these findings should be interpreted with caution. The increased pace of economic growth and globalization of capital markets may require conventional/shareholder-oriented corporate governance mechanisms rather than relational-based unconventional controls. For an optimal governance solution in an emerging economy, due attention should be given to context-sensitive policy initiatives, comprising elements of relational governance and external governance mechanisms (Aguilera *et al.*, 2018; Jackling and Johl, 2009; Young *et al.*, 2008).

Finally, we identify some limitations of this research. First, our study was limited to publicly listed firms in Pakistan. Another limitation is its empirical model and variable measurements. We have not accounted for other important corporate governance practices, such as the qualification and experience levels of board and committee members, the level of board interlocking, and the existence and characteristics of other board committees. This study has demonstrated the greater influence of family leadership, group, and foreign ownership than other corporate governance practices. These attributes of the Pakistani market warrant future investigations for advancing corporate governance scholarship in emerging economies. Additionally, conducting a similar study in the post-COVID period would be worthwhile. Researchers may explore this relationship by undertaking a comparative analysis of emerging and developed economies. A deeper insight into corporate governance structures and links with firm performance can assist policymakers and practitioners,

both local and foreign, to gain from synergies inherent in shareholder governance and relational governance logic in emerging economies.

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