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**Corporate governance, compliance  
and performance nexus**

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A thesis  
submitted in partial fulfilment  
of the requirements for the Degree of  
Doctor of Philosophy in Accounting and Finance

at  
Lincoln University

by  
Muhammad Arslan

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Lincoln University

2019

*I dedicate this work to my parents, my brothers, my sister and my two cute nephews for all their love, support and encouragement.*

Abstract of a thesis submitted in partial fulfilment of the requirements for the Degree of  
Doctor of Philosophy in Accounting and Finance

**Corporate governance, compliance and performance nexus**

By

Muhammad Arslan

Economic globalization has encouraged debate on the differences and similarities among national corporate governance (CG) systems. However, in today's world, it is pivotal to study how (and to what extent) CG is shaped by institutional environments both at national and firm levels. Consequently, this study aims to explore the key institutional determinants of good CG practices in Pakistan. The study identifies the barriers and drivers of good CG practices in the distinct context of Pakistan. At the end, the study investigates the nexus between CG compliance (CGI) scores and firm performance among Pakistan Stock Exchange (PSX) listed firms. Drawing substantially on the lenses of agency and institutional theories, this study conceptualizes CG practices and structures as institutionally resolute and directed. This study adopts a mixed research (i.e. qualitative and quantitative) methodology and finds that CG models, particularly in emerging countries, are irrelevant if they are not institutionally grounded and explicated. Specifically, this study explores the extent to which certain underlying formal and informal institutional determinants, such as the political, legal and culture, values, voting, shareholders' awareness, auditing and board, play a determining role in CG system in Pakistan.

Using exploratory factor analysis (EFA), this study identified five major barriers, i.e. firm level barriers (lack of auditor independence, board ineffectiveness, lack of shareholders' awareness), external barriers (political and governmental interference in business activities, weak legal control and enforcement, high levels of corruption), social barriers (strong social ties among different stakeholders, interpersonal connections among boards of directors (BoDs), education and training barriers (lack of professional education and training among stakeholders) and legal barriers (fewer voting rights) which restrain good CG practices in Pakistan. In addition, this study identified four major drivers i.e. internal drivers (auditors' independence, board heterogeneity, board independence, initiation of training and educational programs to raise awareness), regulatory drivers (enhancing and empowering professional regulatory bodies), motivational drivers (encouraging participation in events and conferences related to corporate governance) and collaborative drivers (enhancing partnership with international bodies) which

can promote good CG practices in Pakistan. The findings of multiple hierarchical regression analysis reveal that the CGI score has a significant positive relationship with both return on assets (ROA) and return on equity (ROE). Hence, CG practices can increase firm performance of PSX listed firms. At the end, drawing on the findings of this study, a model of good CG practices in Pakistan is proposed which not only identifies institutional determinants but also identifies the most influential barriers hindering the implementation of CG practices and reforms in Pakistan. Most importantly, drivers that can promote CG practices and ultimately firm performance are also highlighted in the proposed model. This study emphasizes the necessity to revisit the foundation of institutional and agency theories in the environment of developing countries. It also suggests the reassessment of the implication of executives in agency theory literature concerning developing countries, relying on the general lack of knowledge by shareholders with respect to benefits of CG practices and their rights.

**Keywords:** Institutional; Determinants; Corporate Governance; Formal and Informal; Agency Theory; Institutional Theory; Barriers; Drivers; CG compliance; Performance; CG Model

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## **CHAPTER ONE**

### **INTRODUCTION TO THE THESIS**

#### **1.1 Introduction**

This chapter presents the overview of this thesis. Section 1.2 presents the background of the study, followed by the research problem in section 1.3. The research objectives and research questions are presented in sections 1.4 and 1.5 respectively. A brief summary of the methodology is presented in section 1.6 while section 1.7 presents the significance and implications of the study. At the end, section 1.8 presents the structure of the thesis and concludes this chapter.

#### **1.2 Background of the Study**

Across the globe, the economic crisis has amplified the significance of good corporate governance (CG) and increased regulation as complementary to the “over-liberated” freedom of modern capitalism (Claessens & Yurtoglu, 2013). On the other side, classic cases of corporate fraud such as WorldCom, Enron and Arthur Andersen, one of the top audit firms, have been ascribed to weak CG practices (Ntim & Danbolt, 2012) and triggered the need for stringent CG mechanisms. However, in most comparative CG research, it is assumed that national institutions determine firm-level CG practices (Aguilera & Jackson, 2003). Mallin (2007) and Iturriaga (2009) argued that CG codes have gained popularity due to these mega corporate failures and evolving investors’ awareness. Consequently, CG regulations and reforms have become a primacy agenda for market regulators and governments (Aguilera & Cuervo-Cazurra, 2009). Agency theory was prominent in fostering contemporary CG discussions. Nonetheless, researchers debated that CG is shaped by institutional factors, especially, in the international context (Creed, DeJordy, & Lok, 2010; Peng, Sun, Pinkham, & Chen, 2009; Williamson, 1989). Thus, the institutionalism based CG literature has advanced considerations beyond the boards of directors (BoDs) to the legal structure and financial markets, and to the broader cultural understanding about the role of the corporation in a modern society (Davis, 2005).

Researchers acknowledged that divergence in global CG practices is due to divergence in institutional environments across countries (Judge, Douglas, & Kutan, 2008). This has led to a growing appreciation of the institutional effects on CG in developed countries (Adegbite, Amaeshi, & Nakajima, 2013; Aguilera & Jackson, 2003; Aguilera, 2005; Lubatkin, Lane, Collin, & Very, 2007; Sauerwald & Peng, 2013), conversely, a comparative gap still exists in

the CG literature for developing countries that are usually characterized by weak institutions (Adegbite & Nakajima, 2011). Specifically, in the socio-economic environment of Asian developing countries, the corporate context is critically exaggerated through informal social relations (Hussainey & Al-Nodel, 2008) which are highly socially valued. The governance structure of any country can be determined by its *de facto* realities of the corporate environment (Khanna, Kogan, & Palepu, 2006), firms' articles of association and the legal and regulatory framework.

In this debate, the questions arise as to how the institutional environment affects CG practices and how local and international firms can, by themselves, promote good CG in weak institutional settings. Consequently, this study explores the key institutional determinants of good CG practices in Pakistan and also finds ways to promote good CG practices at the firm level. In addition, this study also identifies the barriers to good CG practices and, finally, examines the nexus between CG compliance (CGI) score and firm performance on a sample of Pakistan Stock Exchange (PSX) listed firms.

In Pakistan, the detailed provisions, regarding CG mechanisms, are provided by the Code of Corporate Governance (CCG) issued by the Security and Exchange Commission of Pakistan (SECP) in March 2002. However, in 2012, the SECP carried out a reform of CCG 2002 and made most of the provisions mandatory for the listed companies. All the listed companies need to comply with CCG 2012 to remain listed on PSX, consequently, many firms delisted from PSX. Besides all these efforts by SECP, the problem still exists regarding true compliance with the corporate governance code<sup>4</sup>. After the reform in CCG 2012, the CCG has many mandatory provisions related to auditing, board structure and disclosure for listed companies but there are still some voluntary provisions (SECP CCG, 2012). These provisions challenge the discretionary power of the state and families and have great impact on a company's management. Therefore, they are unwilling to regard the CG code in its true spirit and compliance with the CCG is in form not in substance. A recent study conducted by Khan (2014) documented that tick box practice is very common among PSX listed firms and CG provisions are not complied with in the true sense. He also documented that senior officers of SECP confirmed that the CCG is not complied in the true sense as many public listed firms are family owned (FOBs) in Pakistan. Therefore, in such firms, family members are elected as executive and non-executive directors. Additionally, these firms also appoint family members as

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<sup>4</sup> SECP introduced a new code of corporate governance in 2017, implemented from 2018, which is beyond the scope of this study.

independent directors with a few shares. Many FOBs have appointed their children as independent directors with a few shares to fulfill the requirement of the CCG 2012. He further concluded that “law in books” is not enough; it should be implemented to be considered as “law in action”. Similarly, Samza (2016) conducted a study in Pakistan to identify weaknesses of CG and explored opportunities for its improvement. She documented that many of the CCG provisions overlap with the Companies’ Ordinance 1984 which is problematic. She further documented that the SECP and the Pakistan Institute of Corporate Governance (PICG) should have a strategy to increase awareness about the benefits of adopting corporate governance.

Yakasai (2001) and Ahunwan (2002) argued that the weak institutional context makes self-regulatory initiatives impractical and corporate law enforcements naive. Hence, it is noticed that CG in developing countries faces several challenges (Berglöf & Claessens, 2006; Okpara, 2011; Reed, 2002) including weak institutional frameworks (Adegbite et al., 2013; Adegbite & Nakajima, 2012; Aguilera, 2005), inefficient adoption of Anglo-American models (Kraakman & Hansmann, 2017; West, 2006), various deviations in firm level governance (Klapper & Love, 2004; Okike, Adegbite, Nakpodia, & Adegbite, 2015) and principal-principal concerns (Chen & Young, 2010; Su, Xu, & Phan, 2008; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). Similarly, Rwegasira (2000) debated that the institutional environment needs to be accounted for before and during the establishment of CG systems in developing countries. Okpara (2011) reinforced this argument and documented that CG challenges during its development could be expounded by the quality of the underlying institutional environment in the developing economies. In addition, researchers debated that board effectiveness depends on the firm’s institutional environment (Gillan, 2006; Mangena, Tauringana, & Chamisa, 2012), consequently, governance theories may need reforms or improvement in order to achieve a robust CG system. According to a report of the World Bank (2013), emerging market firms are playing a compelling part in reforming the global industrialisation process. Therefore, it is critical to establish effective CG mechanisms in these emerging economies because the prevalence of a weak CG system in these economies could have global implications. Drawing substantially on agency and institutional theories, this study, therefore, explicitly contributes to CG literature in developing countries (Douglass, 1990; Scott, 2013; Zucker, 1987), especially in Pakistan.

### **1.3 Research Problem**

The East Asian crisis has injected fresh fuel into the promulgation of various CG codes in this part of the world. Nevertheless, low compliance and loose CG rules are blamed as the causes



of the crisis in 1997-1998 (Haniffa & Hudaib, 2006). On the other side of the world, failure of big companies such as Enron and WorldCom has been ascribed to weak CG practices (Ntim & Danbolt, 2012). Mallin (2007) and Iturriaga (2009) argued that globalization, corporate collapses and increased investors' awareness have prompted the diffusion and worldwide popularity of CG practices. Hence, around the globe, the evolving attention has made CG regulations and reforms a primacy topic for market regulators and governments. Similarly, Aguilera and Cuervo-Cazurra (2009) documented that corporate governance has received ample consideration from academics and policy makers due to the implications of CG reforms, specifically in the socio-economic environment of Asian developing countries where the corporate environment is affected by highly appreciated informal social relations (Hussainey & Al-Nodel, 2008). Most of the existing CG literature revolves around larger companies in developed countries; however, it is still emerging in developing countries. Baydoun, Maguire, Ryan, and Willett (2013) conducted a study in Arab countries and found high ownership concentration and family dominant firms. Consequently, interest is evolving in exploring the CG in the Islamic environment of Arab countries (Alsaeed, 2006; Baydoun et al., 2013). Islam provides comprehensive guidelines for all facets of the Muslim community including business and economic practices.

The Islamic principles profoundly guide daily life in Pakistani society, including economics, law, business and other areas. Additionally, the socio-economic factors of developing countries, particularly Pakistan, are quite different from developed countries in terms of legal, political and social systems. Thus, these imperative and distinct contextual, regulatory and institutional divergences can have substantial significance for the efficacy of accountability, CG disclosure and performance. In Pakistan, most firms are family owned and they usually recruit family members or close relatives and friends. In this context, merit is compromised in employing the employees. Mostly, employees are hired on the basis of personal relationships or social linkages with the owner of the firm. These appointments can have negative impacts on internal CG mechanisms like board structure, audit committee structure, internal auditors and corporate governance monitoring systems. In Pakistan, most of the public listed firms are dominated by politicians. Researchers also found that CG practices are greatly influenced by these political connections and appointments are made to corporate boards of firms (Hussainey & Al-Nodel, 2008). Correspondingly, all these have negative effects on the independence and composition of BoDs. In Pakistan, agency problems may be exaggerated due to the high ownership concentration (Javid & Iqbal, 2008b). This high ownership concentration may

influence the recruitment process in family firms. Baydoun et al. (2013) conducted a study among Arab countries but it is also applicable to the Pakistani environment. They suggested that high ownership concentration and dominance of family businesses in Arab countries have great influence on employees' recruitment in some listed firms and only close relatives and friends are appointed to corporate boards, so consequently, board independence is compromised in those firms. Besides these, poor CG practices may not only cause the loss of the domestic but also of the foreign shareholders. In addition, the weak corporate governance regime exacerbates information asymmetry in Pakistan and consequently has adverse effects on local and foreign investment in the country.

In Pakistan, few empirical studies have been conducted to examine the link between individual CG mechanisms and firm performance (Cheema, Bari, & Saddique, 2003; Humera, 2010; Ibrahim, 2006; Iqbal, 2006; Shaheen & Nishat, 2005). Existing literature reveals that several studies have been conducted to explore CG reforms, to find the determinants of CG disclosure and level of compliance with CG standards (Ashraf & Ghani, 2005; Hermes, Hooghiemstra, Van Der Laan, Postma, & Van Witteloostuijn, 2007; Javid & Iqbal, 2008b; Nadeem, Zongjun, & Shoaib, 2013; Tariq & Abbas, 2013). Nonetheless, the results of these few empirical studies are inconclusive. Additionally, existing empirical evidence reveals that poor quality regulations may not only increase the compliance cost but also cause uncertainty and complexity of regulatory obligations which moderate the capacity of government to achieve its objectives (OECD, 2008). There is emerging but still premature literature on exploring the relationship between CG compliance and performance (Rose, 2016; Talaulicar & Werder, 2008; Tariq & Abbas, 2013). In addition, in Pakistan, the relevant market pressures like market for corporate control and shareholder activism are either corrupt, non-vibrant or absent.

Nevertheless, these research problems provide an opportunity to conduct a comprehensive study in Pakistan, taking into account indigenous socio-economic conditions in order to explore the key institutional determinants of good CG practices in Pakistan. In addition, on the basis of these institutional determinants of CG practices, this study also identifies the most influential barriers and important drivers of good CG practices in Pakistan. At the end, this study examines the nexus between CCG compliance and firm performance and proposes a good CG model for PSX listed firms.

## 1.4 Research Objectives

On the basis of the above research problem, this study has the following research objectives:

- To explore the institutional determinants of good CG practices in Pakistan
- To explore the most influential barriers to good CG practices in Pakistan
- To explore the most important drivers of good CG practices in Pakistan
- To investigate the nexus between CG compliance and financial performance among PSX listed firms.

## 1.5 Research Questions

Considering above research objectives, the following research questions have been developed:

- What are the key institutional determinants of good CG practices in the Pakistan socio- economic context?
- What are the most influential barriers to good CG practices in Pakistan?
- What are the most important drivers of good CG practices in Pakistan?
- What is the nexus between CG compliance and financial performance among PSX listed firms?

## 1.6 Methodology

The research methodology is significantly influenced by the researcher's epistemological and ontological stand (Creswell & Creswell, 2017; Lincoln, Lynham, & Guba, 2011) and research objectives (Holden & Lynch, 2004). The engagement with research paradigms is discussed in chapter four of this thesis. Section 4.2 guided the researcher's preference for employing mixed research (i.e. qualitative and quantitative) methodology. The methodology of this study is divided into two phases. In phase I, qualitative research is applied, and semi-structured focus group interviews were conducted with the professionals and regulators of CG in Pakistan (*see section 4.5.2*) and an open-ended questionnaire was used. Consent was obtained before conducting the interview and an interview guide was followed to increase the validity and reliability of qualitative data. The semi-structured focus group interviews were transcribed and analyzed by using NVivo as a tool to explore the key institutional determinants of CG practices in Pakistan. A total of eight aggregate themes emerged with their sub themes.

In phase II, the quantitative research method was applied, and primary data related to demographic information, CG compliance, barriers and drivers of good CG practices in Pakistan were collected from respondents through the survey questionnaire (*see section 4.15*).

The validity and reliability of data were ensured, and Cronbach's alpha was calculated. The descriptive statistics, correlation analysis, exploratory factor analysis (EFA) and multiple hierarchical regressions were employed. The summary of the research methods is presented at the end of chapter four.

### **1.7 Significance and Implications of the Study**

In the contemporary corporate world, due to corporate scandals (e.g. Enron, WorldCom) and financial disasters, CG has become a considerably important issue. These incidents reflect the absence of CG, consequently companies with flimsy and futile CG frameworks are anticipated to face austere consequences. Even though, in Pakistan, the SECP introduced the CCG in 2002 and a reform in 2012, the CG compliance is still not up to the mark and researchers have identified ineffective CG practices and tick box practices among PSX listed firms (Khan, 2014; Samza, 2016). On the other side, researchers have highlighted the importance of institutional factors in the effectiveness of CG practices (Adegbite & Nakajima, 2011; Aguilera & Jackson, 2003; Young et al., 2008). Through addressing the embeddedness of corporations in a nexus of formal and informal rules, institutional theory supplements under socialized views of corporate governance (Douglass, 1990). In the literature, researchers debated that the efficacy of CG practice depends on its legitimacy within broader sets of institutions that vary over time and across societies (Dobbin, 1994; Fhgststein, 1990; Scott, 2004) and their fit with the task environment of the organization (Keasey, Thompson, & Wright, 1998). However, this improvement has generated a stream of categories and themes<sup>5</sup> intended to address central institutional concerns. This study explored eight distinct institutional determinants, divided into formal and informal institutional classifications, which could sufficiently expound the current state of CG practices and reforms in Pakistan. These institutional classifications are consistent with prior studies (see Nakpodia, Adegbite, Amaeshi, & Owolabi, 2018) and unveil the institutional environment in Pakistan. Regarding the theoretical contribution, it must be noted that agency theory is the starting point for CG research, while institutional theory serves as complementary theory in this regard. In addition, this study identifies the most influential barriers to good CG practices in Pakistan that hinder the implementation of good CG practices and effectiveness of CG reforms. The study identified different drivers that can promote CG practices in Pakistan and increase the CG compliance among PSX listed firms. This study proposes a model of good CG practices in Pakistan that emphasizes the need to increase the

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<sup>5</sup> (see Giddens, 1984; Hall & Taylor, 1996)

level of awareness among different stakeholders through motivation, subsidies, tax rebates and enhanced collaboration with international regulatory bodies.

At the end, this study finds positive relationship between CG compliance and firm performance. It is expected that firms are not complying the CCG 2012 in spirit. Hence, high CGI score does not indicate the actual compliance of CCG 2012. Thus, caution is need while evaluating the positive relationship between CG compliance and firm performance. The study highlights the need of more qualitative CG research aimed at developing new streams of CG frameworks and advancing existing governance theories. This study takes a step further in this matter by collecting data from multiple sources (i.e. interviews, survey and secondary data) which contextualized elucidation of good CG practices. Most of existing CG literature emphasized to employ qualitative research design (Zattoni, Douglas, & Judge, 2013), this study contributes to existing literature by offering more nuanced insight. The institutional effects on CG practices in Pakistan have abetted to shed more understanding on legitimacy, necessity, dynamics, applicability and effectiveness of certain CG mechanisms in weak institutional settings. Therefore, it is imperative that good CG models are not inhabited in seclusion of the rest of the institutional reinforcements (Adegbite & Nakajima, 2011; Nakpodia, Adegbite, et al., 2018; Nakpodia, Shrives, & Sorour, 2018). This study highlights the effectiveness of an institutional analysis in understanding firm behavior (Lau, Fan, Young, & Wu, 2007; Lu, Xu, & Liu, 2009) in weak institutional contexts (Adegbite, 2015). The findings have significance implications for CG reforms in emerging economies especially for Pakistan (Fatima, Mortimer, & Bilal, 2018; Osemeke & Adegbite, 2016; Siddiqui, 2010).

### **1.8 Structure of the Thesis**

As presented in Figure 1, this thesis consists of seven chapters. A brief synopsis of each chapter is presented below:

**Chapter One:** Chapter one offers the introduction of this study. It presents the background of the study, the research problem, research objectives and questions. In addition, this chapter also provides a brief outline of the adopted methodology and the rationale and significance of the study. At the end, the structure of the thesis is presented.

**Chapter Two:** This chapter aims to conduct a comprehensive literature review on CG. It presents theoretical deliberations of CG applicable to this study. The chapter also presents objectives of CG, types of CG structures, socio-economic factors, CG compliance in developed and developing countries and determinants of CG practices identified in prior literature. In

addition, the chapter presents the nexus between CG compliance and firm performance both from developed and developing countries. At the end, the summary of the chapter is presented.

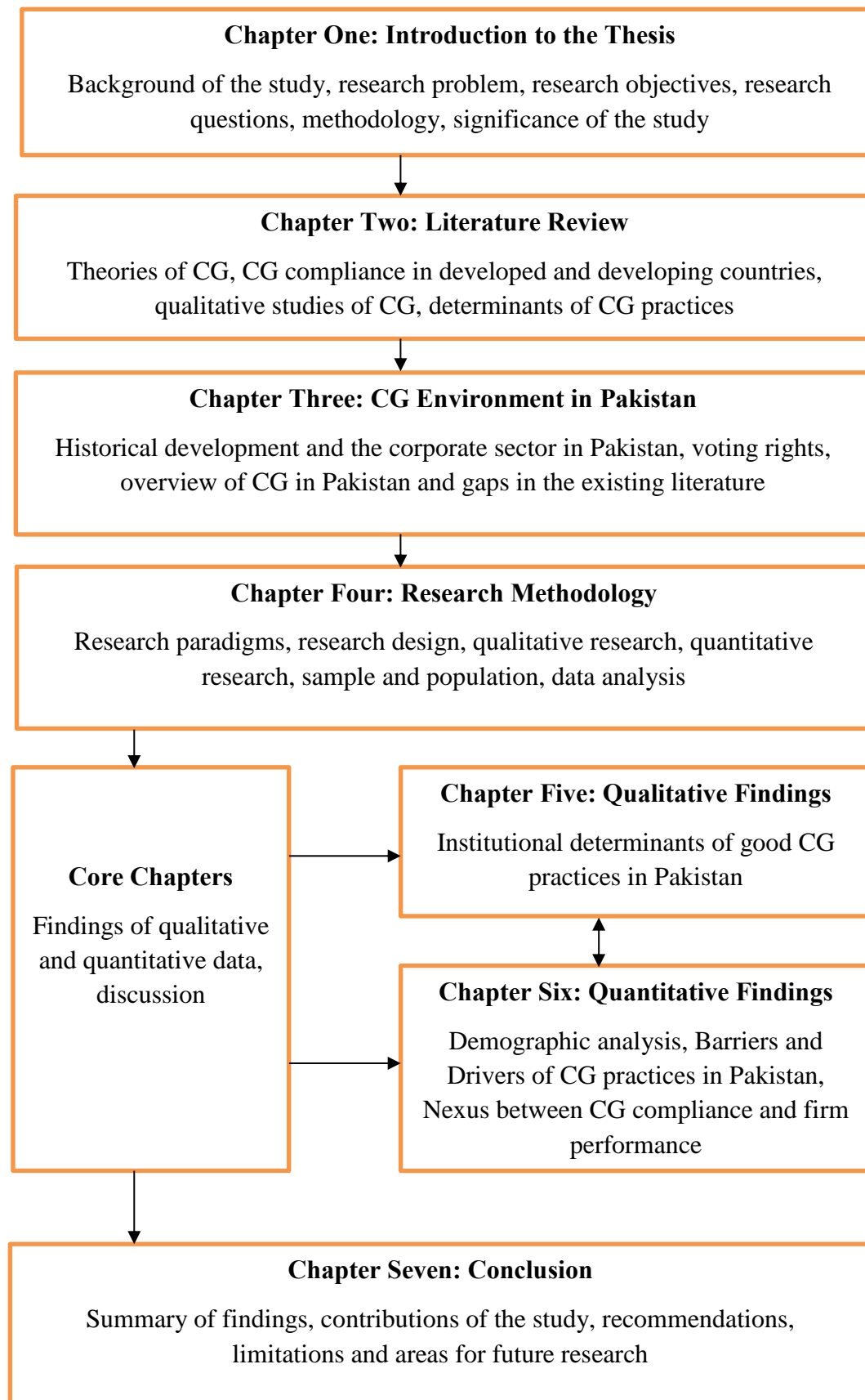
**Chapter Three:** This chapter presents the detailed CG environment in Pakistan. It presents the historical development and the corporate sector of Pakistan. In addition, this chapter also presents the voting rights, enforcement mechanism and literature gap addressed by this thesis.

**Chapter Four:** This chapter presents the detailed qualitative and quantitative methodology, adopted in this thesis. It presents the research paradigms, research design, research questions and relevant chosen methodology, triangulation and possible challenges in implementation mixed research methods. Furthermore, the chapter also presents the detailed qualitative and quantitative research methods including validity, semi-structured interview, sampling technique, reliability and validity, ethical considerations and analyses of qualitative and quantitative data of the study.

**Chapter Five:** This chapter aims to explore the institutional determinants of CG practices in Pakistan and addresses the first research question of this study. Drawing on analysis of semi-structured focus groups, this chapter presents eight aggregate themes with their sub themes. The chapter also presents how these institutional determinants are affecting CG practices in Pakistan and presents the institutional determinants of CG practices in pictorial form. At the end, a summary of the chapter is presented.

**Chapter Six:** This chapter presents the analysis of the quantitative primary data which is collected thorough a survey questionnaire. The chapter presents the analyses that address the remaining three research questions of this thesis. Regarding the second research question, the chapter presents the demographic information of respondents followed by the most influential barriers to CG practices in Pakistan. Regarding the third research question, this chapter also presents the drivers of CG practices in Pakistan which can improve good corporate governance systems. At the end, this chapter presents the nexus between CG compliance and firm performance among PSX listed firms and addresses the last research question of this thesis. At the end of this chapter, the discussion, proposed CG model and chapter summary are presented.

**Chapter Seven:** This is the final chapter and presents a brief summary of the findings of this study. This chapter presents the contributions of the study, followed by recommendations. At the end, the limitations of the study and an area for future research are presented.

**Figure 1 Structure of the Thesis**

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

This chapter aims to review existing literature on CG and identifies the significance of this study. The chapter helps to identify the gaps in existing literature especially in the context of emerging economies. Section 2.2 presents the background of corporate governance while section 2.3 discusses the different theoretical approaches, mainly agency theory, institutional theory, resource dependence theory, managerial signaling theory, stewardship theory and stakeholders' theory. This section also provides implications of these theories in Pakistan, substantially focusing on agency and institutional theories. Section 2.4 presents objectives of CG regarding accountability and firm performance while section 2.5 discusses different types of CG structures with the help of existing literature. Section 2.6 presents the nexus between socio-economic perspectives and corporate governance while section 2.7 debates compliance with the CG code in developed and emerging economies. Section 2.8 identifies the determinants of CG in existing literature while section 2.9 presents the nexus between CG and firm performance. Section 2.10 presents qualitative studies on CG while section 2.11 presents a chapter summary and concludes this chapter.

#### 2.2 Corporate Governance

The word governance is a broad and general. The particular application of governance is called corporate governance (CG) and it has subsets like organizational, political and economic governance. CG is a division of governance which is related to governance within an organizational structure. It indicates two things. The first is power that is related to the decision-making process and the second is accountability that is related to the execution of this power and its subjectivity. CG is as old as the creation of early economic activities in history in the form of partnerships. However, it has gained the attention of policy makers in recent years due to serious financial crises in well governed jurisdictions (Ronald J. Gilson, 1996). CG can be defined both in narrow and broad senses. In the narrow sense, the emphasis is on the idea of shareholder values. Consequently, it is applied to ensure that the company is acting on behalf of its shareholders to increase their wealth. Shleifer and Vishny (1997, p. 1) defined CG in a narrow sense. They documented that “*Corporate governance is a set of mechanisms through which outside investors protect themselves from expropriation of insiders*”. In addition, Cadbury (1992) documented that CG mechanisms provide assurance of a return on money invested by investors either in the form of interest or dividend. The entire process of



accountability and decision making has ended up with profit maximizing and increasing the value of shares (Shleifer, Vishny, Porta, & Lopez-de-Silanes, 2000).

In the broader sense, it also includes interests of creditors, employees and the public at large besides directors and shareholders. CG has been explained in a broader sense by the OECD principles (2004) that define it as “*a set of relationships between management, board and stakeholders*”. The next section presents the theories of CG relevant to this thesis.

## **2.3 Theories of Corporate Governance**

Several theories have been presented by academics that are related to CG. The interests and power of relevant groups are given priority over others. These theories have been drawn from a range of subjects that include finance, accounting and economics (Durisin & Puzone, 2009). Different theories present different definitions of CG and accounting and finance scholars are not agreed upon these definitions. This section discusses CG with the help of different theories on one hand with the implications of these theories in the contextual setting of Pakistan on the other hand.

### **2.3.1 Agency Theory**

In CG literature, agency theory is the fundamental theory and mostly studies rely on it (Filatotchev & Boyd, 2009). The British economist, Adam Smith identified potential agency conflicts in modern organizations as separation of ownership and control (Smith, 1776, pp. 606-607) by saying that: “*The directors of companies who are also the managers of other people’s money cannot look out for others’ money as of their own. It is expected that negligence and cornucopia will prevail in management and affairs of the company*”.

Jensen and Meckling (1976) expounded the agency contract as agreement between agents and principals to operate firms in the best interest of shareholders. Agency theory was developed first by Jensen and Meckling (1976) and they suggested the possibility of conflicts between managers and owners. Agency theory tries to reduce the agency conflicts between agents and principals and prevent the expropriation of shareholders by aligning their interests. It is also found that executive directors exploit insider information in their best interest (Black, Jang, & Kim, 2006; Chalevas, 2011; Jensen & Meckling, 1976) and executive directors can take excess pay in the form of bonuses and salaries to exploit shareholders’ wealth (Bebchuk & Fried, 2003; Berle & Means, 1932; Ntim & Danbolt, 2012). Jensen and Meckling (1976) debated that company managers can also exploit shareholders’ wealth by taking more fringe benefits in the form of greater sectorial support and office space.

Researchers argued that CG mechanism can be introduced to minimize agency cost and mitigate managerial deviousness (Haniffa & Hudaib, 2006; Solomon, 2010). Agency theory helps with the establishment of legal contracts to monitor managers and advocates a reduction in executive BoDs which can increase the independence of the board (Chen, 2011; Solomon, 2010). Allegrini and Greco (2013) argued that audit, remuneration and nomination committees are crucial tools to monitor managerial behaviors. The internal control mechanism also helps in reducing the expropriation of shareholders' wealth (Renneboog & Szilagyi, 2011). Researchers also found that establishment of a managerial incentive system encourages managers to increase their performance (Li & Wang, 2016; Murphy & Sandino, 2010; Ntim, Lindop, Osei, & Thomas, 2014).

In Pakistan, the government has taken various steps regarding CG reforms within the country. The establishment of SECP in 1999, introduction of CCG in 2002 and recent CG reform in 2012 established the foundation of CG reforms in the country. By decreasing the conflicts between shareholders and directors, CCG 2012 expects an increase in accountability, transparency and responsibility. Due to prevalence of high ownership concentration in Pakistan, there are more chances of conflicts between minority and majority shareholders and majority shareholders can also exploit the rights of minority shareholders (Baydoun et al., 2013). Additionally, managers and directors can be appointed by majority shareholders or politically associated personalities regardless of their capability and experience (Boytsun, Deloof, & Matthyssens, 2011). These managers and directors may neglect the interests of all shareholder and only work in the best interest of majority shareholders. In short, the agency theory suggests that good governance can lead to decreasing the agency costs. While in Pakistan, mostly firms are family owned and consequently, provide a big hurdle in reforming the CG structure. BoDs are dominated by family members and they discourage any governance reform. There is a need to undermine family dominance in BoDs and comply with governance reforms in their true form.

### **2.3.2 Resource Dependent Theory**

The resource dependent theory suggested that BoDs are a vigorous connection between firm resources which are essential for the growth of firms (Pfeffer, 1972). Similarly, Chen and Roberts (2010) also documented that firms have to rely on the environment for survival as they are not self-sufficient. The crux of resource dependent theory is to focus on process of organizations to get dynamic resources which are needed for growth and survival (Chen & Roberts, 2010). Consequently, resource dependent theory relies on two assumptions.

According to the first assumption, besides the monitoring role, the BoDs also play a significant role by providing critical resources that include knowledge, business contracts and expertise (Bouwman, 2011; Chen, 2011; Hillman & Dalziel, 2003). As per the second assumption, they also represent the interests of different stakeholders (Hillman & Dalziel, 2003; Nicholson & Kiel, 2007). Researchers have also argued that BoDs can serve as a link between the firm and its environment to gain competitive advantage (Chen & Roberts, 2010).

This theory suggests that BoDs can play a significant role in acquiring capital and resources. In Pakistan, most of the firms are family owned and families utilize their own funds to sustain managerial control. Similarly, governments can help in acquiring more funding for firms with higher levels of government ownership. Consequently, firms need to build strong relations with all the stakeholders to easily fulfill their funding requirement.

### **2.3.3 Managerial Signaling Theory**

Managerial signaling theory expounds behavior when managers and shareholders have different information (Black et al., 2006; Connelly, Certo, Ireland, & Reutzel, 2011). Researchers documented it as an extension of agency theory (see Buskirk, 2012). This theory further expounds that information is critical and insiders (such as managers and directors) hold more information than outsiders (shareholders). Jensen and Meckling (1976) documented that those managers who are working as agents of principals can use this information for their personal benefit and exploit the interests of principals. Moreover, Conyon and He (2011) argued that weak ethics and the opportunistic behavior of modern organizations are the foundation of this. The information asymmetry and market uncertainty can be reduced by adopting good CG practices within organizations. Therefore, this reduction can provide high liquidity by providing more local and foreign investment, reducing agency problems and enhancing market control (Chung & Zhang, 2011; Klein, Shapiro, & Young, 2005; Sharma, 2013). The managerial signaling theory provides recommendations that those companies who publish corporate reporting have an advantage over other companies and financial institutions in that they are better as compared to others. Thus, they attract more investment and a better reputation as compared to their counterparts (Salman & Siddiqui, 2013).

The companies should disclose more information as per the requirements of law and regulations. In contrast, the less disclosure of information will itself be a negative sign. It is necessary for companies to pick disclosure over non-disclosure to flag themselves as superior compared to normal companies. The introduction of the CCG in 2002 by the SECP in Pakistan, was intended to improve transparency and disclosure to reduce asymmetry information. The

recent reform of CG in 2012 mandates all listing companies to reveal information regarding change in board and ownership structure, financial change and performance of business. Consequently, this CG compliance and disclosure may reduce asymmetric information which may increase external funding and reduce funding cost.

#### **2.3.4 Stewardship Theory**

The steward theory is contradictory to the prophecies of agency theory. The main theme of the theory is reliance on the motivation of managers through the objectives of principals not by individual interests (Davis, Schoorman, & Donaldson, 1997). Consequently, stewardship theory advocates that managers of firms are trustworthy (Siebels & Knyphausen-Aufseß, 2012). The researchers also argued that managers (agents) have access to information which provides ample support to take appropriate decisions for the welfare of the firm (Nicholson & Kiel, 2007). Hence, they also try to employ resources for maximization of the firm's value. This theory is based on some assumptions. The first assumption is about alignment of managers' interests and shareholders' interests (Davis et al., 1997). The second assumption is about CEO duality that advocates it as most appropriate system to run a company (Siebels & Knyphausen-Aufseß, 2012). This theory also implies that managers do not misconduct for the sake of their career and reputation (Conyon & He, 2011).

On the basis of the above discussion, stewardship theory is in divergence from agency theory as it suggests no agency conflicts exist (Nicholson & Kiel, 2007). In Pakistan, CCG 2012 also mandates appointing at least one independent director and the maximum number of executive directors cannot be more than 1/3 of total elected directors including the CEO (SECP CCG, 2012, p. 38). Moreover, the CEO and chairman cannot be the same person (SECP CCG, 2012, p. 39). The objective of CG is to make managers accountable by increasing supervision and monitoring. However, this is opposite to steward theory which suggests that managers are trustworthy and reliable. It can be applicable to the Pakistani corporate environment where family ownership is high, and relatives are appointed in these family firms and are expected to be trustworthy.

#### **2.3.5 Stakeholders' Theory**

Stakeholder theory offers a wider outlook on corporate governance. Stakeholders are defined as a broad range of groups and individuals who can affect corporate governance activities (Freeman, 1984). Contrary to agency theory, stakeholders' theory undertakes the notion that managers are held responsible to all the stakeholders (Friedman & Miles, 2006). Accordingly,

firm needs to protect the interests of different stakeholders (Clarke, 1998; Solomon, 2010). Conversely, the expectations of stakeholders differ from company to company. Employees expect a good salary, job security and fringe benefits while shareholders expect handsome returns. The expectation of creditors is related to the strong financial position of the company to secure their investment through minimizing risk. Additionally, policy makers expect that CG compliance should be increased and shareholders' rights should be protected. This theory emerged as a result of the shareholder model (Sternberg, 1997). Nonetheless, the stakeholder model is not much appreciated in those countries like US and UK where they provide more protection for shareholders by adopting Anglo-American orientation (Aguilera & Jackson, 2003; Ntim & Danbolt, 2012) while it is much appreciated and favored in countries (such as Germany, Sweden, Japan) that adopt the Continental European model (Letza & Kirkbride, 2004). Moreover, researchers also documented that a two tier board system is followed in these countries which usually comprises both supervisory and managing members (Clarke, 1998; Conyon & He, 2011). Sharma (2013) argued that firms protect the interests of different stakeholders by employing the Continental European-Asian governance model. There are some fundamental assumptions regarding stakeholder theory. The first assumption is about the financial benefits and interests of society. The owners should not operate firms only for their own benefits, but interests of the relevant broader society should also kept in consideration (Chen & Roberts, 2010). The second assumption is about the accountability of executive directors. The researcher argued that executive BoDs are answerable to all stakeholders (Clarke, 1998). The third assumption is about morality and corporate social responsibility in doing business (Westphal & Zajac, 2013). Although, this theory is extensively implanted in CG codes (Aguilera & Cuervo-Cazurra, 2009), the researcher criticized in two ways (Sternberg, 1997). First, the main objective of firms is to maximize the wealth of shareholders and is contrary to the assumption of stakeholders' theory. Second, it contradicts the agent principal relationship which advocates that managers are accountable only to shareholders. Consequently, it is incompatible with basic principles of corporate governance. However, researchers have still documented it as key CG theory (Chen & Roberts, 2010; Solomon, 2010).

### **2.3.6 Institutional Theory**

This theory is a dominant perspective in macro organization theory (Dacin et al., 2008), contributes to crucial fundamentals of economic theories (Zahra, 2007) and strengthens the application and knowledge of other theoretical approaches (Suddaby, 2010). Scott (2004) defined institutional theory as *"A theory on the deeper and more resilient aspects of social*

*structure*” (p.2). Researchers have linked the institutional theory with agency theory (Judge et al., 2008) and proposed that the institutional theory of CG was compelled by the lack of a framework to address underlying institutional elements of the agency model (Mitnick, 2006). The studies relating to institutions have evolved substantially over time due to growing concern over agency theory (Adegbite & Nakajima, 2011; Maguire & Hardy, 2009).

Researchers also argued that prevailing culture in emerging markets contributes to the weak CG practices in those countries (Rafiee & Sarabdeen, 2012) and suggests the adoption of cultural-cognitive system which may improve CG practices by harmonizing the key elements of normative and regulatory systems (Scott, 2013). It is also found that firms must understand and negotiate to different environmental influences, including politics and culture, for its survival (Patel & Xavier, 2005). DiMaggio and Powell (1983) argued that firms are similar to each other in different areas and this concept is called isomorphism. Firms can imitate the activities and operations of another firm in a certain environment to become similar (Dacin, 1997). The institutional isomorphism can be manifested in three forms (i.e. Mimetic, Normative and Coercive). In mimetic isomorphism, a firm deliberately tries to imitate the practices of established competitors in highly unpredictable environment for survival. While in normative isomorphism, there is no deliberate attempt of a firms to imitate its established competitors. Normative isomorphism emerges due to engagement of operatives and managers from its competitors. Coercive isomorphism is demand for change due to formal and informal pressure from societal culture and other organizations upon which firms depend (DiMaggio & Powell, 1983). This highlights the importance of institutional environment to CG. Similarly, Knack and Keefer (1995) utilized the robustness of institutional environments to expound countries into developing and developed. Consequently, the developed countries should have relatively strong corporate governance as compared to developing countries due to having sound institutional framework, however, the classic cases, such as Enron, highlights concern regarding corporate governance in developed countries (Holmstrom & Kaplan, 2003). It implies that though the institutional environment is critical to corporate governance discourse, key players in a business could equally affect the emergence of (negative) isomorphic tendencies in a business environment.

Since 1980s, the agency paradigm of corporate governance has been dominated in the existing literature (Brudney, 1985; Coffee, 1984), however, a number of recent CG studies emphasized on more holistic view and accounted the organizations’ nexus with society and different

stakeholders (DAVIS & USEEM, 2002). Aguilera and Jackson (2003) argued that the agency theory is an "under-socialized" approach which is impervious to how institutions share the interests and identities among actors in CG system. In addition, agency theory only focuses on managers and shareholders. Though different countries offer distinctive level of investor protection and therefore, effect the agency costs (Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998), the role of institutions is very restricted from agency perspective. Sociological strands of institutional theory offers an alternative justification for firm behavior in terms of "*understandings that organizational actors share, independent of their interests*" (DiMaggio & Powell, 1983, p. 3). Institutional theory does not make projections on based on self-interested actors with bounded rationality but ascertains the normative, regulative and cognitive mechanisms that shape the interests and identities broad range of stakeholders.

Aoki, Greif, and Milgrom (2001) argued that different stakeholders may adapt socially legitimate and institutionally accessible CG practices to build different coalitions. The firms have high ownership concentration in emerging markets (Fan & Wong, 2005) and state or a family holds most of the stake (Berglöf & Von Thadden, 1999). Jackson (2010) argued that different forms of agency conflicts take place across different countries due to different shareholders concentration and social identifies of block holders. Firms in emerging markets may have different organizational activities from firms in developed market(Wright, Filatotchev, Hoskisson, & Peng, 2005; Young et al., 2008), therefore, CG problems may differ in these emerging markets and require different solution from the one which generated from agency perspectives (Lubatkin, Lane, Collin, & Very, 2005). Another criticized is the notion of effectiveness within agency theory is too narrow to be applied to CG in very different settings. Similarly, Aguilera, Filatotchev, Gospel, and Jackson (2008) argued that effectiveness of different CG practices depends mainly on their fit to broader organizational context. Recent CG studies emphasized that CG systems are embedded in larger institutional and legal frameworks (DAVIS & USEEM, 2002) and how wider political, social and cultural factors shape the cross-national diversity of actors and settings in corporate governance (see Aguilera & Jackson, 2010).

Emerging markets have institutional differences from developed markets, and these should be integrated to CG policies while adapting the CG codes from developed markets. In addition, the policies designed for developed markets may be ineffective in emerging markets (Young et al., 2008) due to weak institutions (Gugler, Mueller, & Burcin Yurtoglu, 2003) and different capital market structure (Singh et al., 2005). Hence, the utilization of agency theory is

questioned. It is pivotal to see rich and comparative insights into institutions in order to understand CG systems worldwide (Filatotchev, Jackson, & Nakajima, 2013). Similarly, Mangena et al. (2012) and Filatotchev et al. (2013) argued that the institutional environment does affect board and ownership structures. Acemoglu, Johnson, Robinson, and Thaicharoen (2003) argued that it is critical to categorize the institutional differences between rich and poor countries. Hence, it is imperative to comprehend existing studies related to institutional influence on CG. In developing countries, like Pakistan, some individuals might exercise their power which provide an opportunity to those individuals to influence institutional elements to achieve personal objectives and interests. Consequently, it is critical to manage and develop this knowledge to promote CG in developing countries.

## **2.4 Objectives of Corporate Governance**

This section presents the objectives of CG. Two main perspectives of CG are discussed in this section. Section 2.4.1 discusses the firm performance perspective while section 2.4.2 talks about the accountability perspective. The delegation of power between shareholders and indicators of firm performance are also presented in this section.

### **2.4.1 Financial Performance**

In the extended literature, the debate about good governance on financial performance is unresolved. A number of indicators reflect the performance of stock exchanges and firms. The mostly documented indicators for firm performance are return of capital, stock prices and return on assets, while stock market indices are used for indicating stock market performance (Black et al., 2006; Drobetz, Schillhofer, & Zimmermann, 2004). Financial performance is considered as evidence for the success of firms and there is always found to be a link between good CG and financial performance. Nonetheless, it is problematic to find type and causality empirically. In existing literature, researchers found diverse relationships. Some scholars found a positive relationship between CG components and financial performance while others found negative (Brown & Caylor, 2006; Tariq & Abbas, 2013). Although the literature provides correlation of some specific governance measures with financial performance, the link with overall governance mechanisms is still unresolved (Aguilera, Florackis, & Kim, 2016). Moreover, the extent of the relationship of individual and specific governance features on financial performance is still challenging. Endogenous and exogenous forces may affect financial performance (Aguilera et al., 2016; Souha & Anis, 2016). In a similar vein, the share price of a firm may be affected by multiple factors that include but are not limited to economic,



political and security issues. Besides this, domestic and global incidents may affect the share price of firms that ultimately will have an impact on the market index. Such external variables that affect performance are exogenous factors (Connor & Korajczyk, 1986). The overall structure of the firm, the distribution of powers between directors and shareholders, statutory governance mechanism, and structure of BoDs come into the domain of endogenous forces. The separation of the effect of both exogenous and endogenous variables is also problematic and it is challenging to find a casual relation between overall governance components and financial performance (Bhagat & Bolton, 2008).

Researchers also documented that mostly investors are anxious about performance rather than compliance with good CG practices (MacNeil & Li, 2006b). Consequently, if firms are already performing well, investors may ignore compliance with good CG practices. It is also noteworthy that caution is required in the adaptation of such an approach in developing countries such as Pakistan. It is well acknowledged that performance is pivotal to investors and companies who are following good CG practices may establish an example for other companies. Therefore, it creates a culture of compliance with good CG practices that ultimately can attract more investment. The link between specific governance measures and performance cannot be demonstrated in developing countries like Pakistan. Therefore, compliance with good CG practices can help in endorsing and enhancing investors' confidence in the country. Additionally, it will provide incentives and attract investments for poorly performing firms which will ultimately help in boosting stock markets.

#### **2.4.2 Accountability**

This is linked to power. In contemporary companies, especially public companies, it is not viable to involve shareholders in every decision-making process. Thus, power is given to a certain people who are nominated by shareholders. BoDs must be accountable to shareholders when power is given to them as they are not the real owners of the company. The removal of non-performing directors is also a form of accountability. In the UK, there is an easy process for the removal of directors, although, directors have all the power. A simple resolution is needed to remove a director and accountability is linked to controlling shareholders as well. The controlling shareholders can also expropriate funds of a company for their own interests and benefits. They may approve a contract that is in favor of their own interest rather than in favor of the shareholders of the company (Companies Act 2006, s 168). Consequently, the whole concept of accountability revolves around the powers of shareholders to hold directors and controlling shareholders accountable. The CG code requires disclosure which helps

shareholders to take actions and also facilitates controlling rebellious shareholders. Therefore, accountability can occur outside the legal framework as codes make provisions that are not implemented in a formal legal way.

## **2.5 Types of Corporate Governance Structures**

This section presents the different types of CG structures. Section 2.5.1 presents dispersed ownership while section 2.5.2 presents concentration of ownership structures. The government ownership structure is presented in section 2.5.3, while family-based enterprises are presented at the end of this section. The section discusses different aspects of CG structures that helps in comprehending the contextual environment of the underway study.

### **2.5.1 Dispersed Ownership**

The structures in which shareholders are dispersed are called dispersed ownership structures. Hence, it is very difficult to gather, discuss and convince all shareholders if some quick action is needed. Additionally, more cost is involved and sometimes it is impossible to convince all shareholders. The elementary feature of this structure is problems of collective actions of shareholders and dispirited attitude as well (Gower, 1979). Consequently, it provides opportunity for managers to exploit shareholders and manipulate decision making. Moreover, they also control proxy mechanisms and agenda of meetings that ultimately weaken shareholders' control (Cubbin & Dennis Leech, 1983). Dispersed ownership does not prevail in many countries but is limited to the UK and the US (Silanes, La Porta, Shleifer, & Vishny, 1997) while concentrated ownership is dominant in the rest of the world especially in emerging economies. Mostly families, states and groups control the corporate sector. Conversely, dispersed ownership is not a substandard management monitoring system for the performance of managers (Demsetz & Lehn, 1985). Diverse types of governance systems are developed over time to monitor the performance of managers and making them accountable. Additionally, the role of the market cannot be neglected in this regard. The non-performing firms and managers can be punished in a developed and active markets. Minority rights, takeovers, institutional investors, strong regulators and enforcement mechanisms may act as powerful market features to monitor and protect shareholders' rights. Countries such as the US and the UK, have particularly different views on the development of such a system. In the US, dispersed ownership occurred through political forces and historical developments, not economic efficiency (Roe, 1991).

Silanes et al. (1997) documented that there is a positive connection between security of property rights and legal protection of investors. They further reported that such legal protection is directly associated with effective CG and is reflected in developed markets and dispersed ownership (Silanes et al., 1997). In contrast, Cheffins (2001) documented that law was not the main contributing factor in the evolution of a dispersed structure in the UK. He further argued that the main contributing factors were social and financial environments, independent and self-regulation, an impartial and professional judiciary, while alternative institutional structures also played their role in it (Brian R. Cheffins, 2000). The legal environment of a country can be the key driving force for effective CG in the absence of an institutional structure in the UK that provides confidence to investors. Moreover, the legal structure helps in the dispersion of investors' finance to different investments with confidence. This spectacle also inspires the development of the capital market. In contrast, if there is no or less legal protection for investors they will prefer block holdings and be reluctant to have minority shareholdings (John C. Coffee, 1999). In existing literature, a number of researchers documented diverse reasons for dispersed ownership, but legal protection is still the dominating reason. It is also noticed that market discipline also plays a pivotal role in prerogatives with dispersed shareholdings that can also be seen in the implementation of the UK Code of CG, although the code is attached in an annex to listing regulations and is not part of it. It is also not considered as part of the legal framework but only part of soft law. The code is based on either complying with or explaining principles and is self-regulated. Moreover, it is also applicable to premier companies that are listed on the London Stock Exchange (LSE). The companies are required to either comply with or explain in the case of non-compliance with the code. Conformance with the code is also required for listing on the LSE. The United Kingdom Listing Authority (UKLA) has some certain rules and regulations which require disclosure of certain information and, if the company is not disclosing that information, a fine, suspension and public censure may be sanctioned. Consequently, market monitors the CG compliance and also accept the valid justification for non-compliance. The market may punish companies for non-compliance by reducing their share price that ultimately leads towards an increase in the cost of capital.

### **2.5.2 Concentrated Ownership**

Shareholders control the firm through divergent techniques in concentrated ownership. They can control firms either by holding more than 50% of the share of a firm or by holding more voting rights. On the other side, they can control a firm by implementing pyramid structures

by holding fewer shares in a subsidiary company while holding more shares in a holding company (Javid & Iqbal, 2008b). Moreover, they may control firms through cross shareholdings and appoint different family members. Generally, cross shareholding is a subcategory of a pyramid structure. And few families can control the firms for their own benefits. Concentrated ownership is a general practice in Asia and Europe and in such a system, the financial institutions such as banks play a pivotal role (Fan & Wong, 2002; Javid & Iqbal, 2008b). Consequently, investors invest through financial intermediaries if they feel direct investments are not secure. If governance and legal systems do not provide protection to investors, then shareholders control firms by implementing concentrated ownership.

### **2.5.3 Government Ownership**

Governance structure is a subset of concentrated ownership in which the state or government controls the regulators and shareholders. Consequently, it is very hard for regulators to punish themselves thus making this system less efficient. In some underdeveloped and social economies including Pakistan, the majority of the economy is operated through state owned enterprises (SOEs). Additionally, politicians have direct or indirect control over most firms through state ownership or regulations. Moreover, they also have power and try to repel the reforms to maintain their status quo, which is not good (Milhaupt, 1998). In recent years, the financial crises in Asia, the failure of socialism and recession around the globe have prompted the attention of international bodies and host countries to enhance the governance structure of poorly performing countries. Consequently, international financial institutions also offered loans to emerging countries and compelled them to do necessary reforms. The corporatization of State Owned Enterprises was also included in the reform agenda (Metzger, 2003). Thus, these reforms reduced the control of states over those enterprises which were running bureaucratically.

### **2.5.4 Family Owned Businesses (FOBs)**

Another form of concentrated ownership structure is FOBs in which families hold most of the shares and control the key part of the economy. Nonetheless, they tailor governance structures for their own benefit. Lim (2001) documented examples of such structures from Japan and Korea that include Keiretsu and Chaebol, respectively. The families control their firms by applying different forms such as shareholder interlocking, pyramiding and shared ownership. These families monitor and manage the company which leads towards poor internal governance. Consequently, this type of structuring has a negative impact on CG practices. These path dependencies also create resistance to reform which can monitor their powers (Lee

& Park, 2008; Miyajima, 2005). It is the same in the case of Pakistan, where families control and hold firms. Moreover, these families also have connections with politicians and are sometimes directly involved in politics. In such firms, shareholders have control but not as per their proportion. They control management and the whole firm. Mostly, family members are appointed as directors in these firms. Although, there is no ideal system for corporate governance, concentrated ownership is regarded more attentive paralleled by dispersed ownership as managers may be held accountable by controlling shareholders (Cheffins, 2001). Nevertheless, managers have more opportunities in dispersed ownership to expropriate minority shareholders as they do not have enticements to monitor managers' behavior.

## **2.6 Socio-economic Perspective and Corporate Governance**

Usually, there is no connection between religion and the CG issue, but it can have an impact in an ideological country. Amir et al., (2005) and Bebchuk and Roe. (1999) documented that the ideology and culture of a country also determines governance mechanisms and choice of corporate law. Additionally, researchers argued that investor protection can vary due to the country's main religion (Stulz & Williamson, 2003). They found that creditor rights were strong in Protestant countries as compared to Catholic countries. Hilary and Hui (2009) conducted a study in the US and found that religiosity also matters in the decision-making process of firms. They found that firms with high religiosity show lower investment, less risk exposure and higher undiscounted profits. Researchers also found a negative association of religiosity with earnings management, option backdating and executive compensation in the US (Grullon, Kanatas, & Weston, 2009). Similarly, McGuire, Omer, and Sharp (2011) investigated the impact of religion in financial reporting. They found a negative relationship between religiosity and accrual-based earnings management. In prior literature, researchers documented that ethical norms and social commitments are key components of Islamic business within the framework of Sharia (Ahmad, 2000). Asyraf (2006) documented that Sharia embargoes intermingling of Islamic financial transactions for ethical and socially responsible reasons on one hand while prohibiting illegal activities on the other hand. Islam is viewed as a practical religion which defines and leads every field of life.

Islam is extended to the whole life of Muslims rather than limited to few rituals. It has also recognized the broad principles and ethics of doing business (Khan, 2014). Additionally, an Islamic economy provides honesty, fairness and justice which is also considered as its main characteristic. Pakistan is an Islamic country and its constitution is based on Islam. Therefore, religion is dominant in cultural, political, social and also in business affairs and Islam is

recognized as the state religion by the Constitution of Pakistan. Additionally, the Constitution of Pakistan also safeguards the Islamic spirit thorough bringing all existing laws in conformity within the embargoes of Islam as laid down by the Quran and Sunnah. Correspondingly, it also explains that no law shall be sanctioned that is obnoxious to such embargoes. Different institutions have been established to check conformity with the law and ensure compliance with the provisions of the constitution. Moreover, different steps are taken by the government to bring conformity with the embargoes of Islam under directions of these institutions. Being an Islamic state, Pakistan may drive its CG mechanisms from Islamic norms. But traditionally, this has endured only as a weak force. Due to colonial influence, Pakistan inherited its corporate laws from British rule, but historical status developed its corporate sector which differs from the British. However, Islamic norms in Pakistan and around the world can still play a pivotal role in the development of the corporate sector of Pakistan. Although researchers have tried to establish a link between religion and corporate governance, it is still emerging (Amir N. Licht et al., 2005; Asyraf, 2006; Bebchuk & Roe., 1999; Grullon et al., 2009; McGuire et al., 2011; Stulz & Williamson, 2003).

Culture is distinct (Ronen & Shenkar, 2013). As per the social identity theory (Tajfel, 1981), cultural norms affect individual behavior and persist within the environment. Religion and culture are positioned at the top and affect economic outcomes (Williamson, 2000). In a similar vein, Zheng, El Ghoul, Guedhami, and Kwok (2012) suggest that individuals' behavior and decision making are affected by informal constraints such as culture which ultimately influence economic outcomes. Roe (2000) documented that political and ideological conditions have an impact on the development of the CG system of a specific country. Besides this, a number of studies have also documented that country characteristics excluding state investor protection have substantial effects on the country level of the measure of corporate governance. Bushman, Piotroski, and Smith (2004) also support this argument. They documented that political environment physiognomies are pivotal for some types of financial disclosures. Hope (2003) conducted a study to investigate the impact of culture and legal origin on disclosure. He found that culture is important and provides explanatory power for disclosure. In a similar vein, Daniel, Cieslewicz, and Pourjalali (2012) conducted a study to investigate the impact of culture and institutional environment on corporate governance practices. They employed structural equation modeling and found that culture has an influence on corporate governance practices through the institutional environment. Keeping in view the above discussion, this thesis seeks to explore the effect of key institutions on good CG practices in Pakistan.

## **2.7 Compliance and Corporate Governance Disclosure**

In existing literature, researchers argued that the primary objective of a CG code is to enhance transparency, accountability and CG disclosure (Aguilera & Cuervo-Cazurra, 2009; Bouwman, 2011). Moreover, researchers also found that development in CG is still progressing as there are some cultural and regional differences which affect implementation and compliance with CG code (Bebchuk & Fried, 2003; Haniffa & Hudaib, 2006; Ntim & Danbolt, 2012). In some countries, compliance with a CG code is mandatory while in some it is comply or explain. According to the UK Cadbury Report (1992), compliance with the CG code is “comply or explain” while as per the US Sarbanes Oxley Act (2002), it is mandatory. Consequently, much attention has been given to measuring compliance with the CG code and its influence on the performance nexus (Bozec, Dia, & Bozec, 2010; MacNeil & Li, 2006a). This section seeks to explore the level of CG compliance in developed and developing countries and factors that affect CG compliance.

### **2.7.1 Level of CG Compliance and Disclosure**

It is evident from existing literature that CG compliance differs from country to country and firms have different levels of CG practices (MacNeil & Li, 2006a; Samaha, Dahawy, Hussainey, & Stapleton, 2012). Recently, many developed and developing countries have introduced different CG codes to increase CG practices among firms. Therefore, researchers have also given considerable attention to examine factors affecting CG disclosure (Allegrini & Greco, 2013).

#### **2.7.1.1 CG Compliance in Developed Countries**

The level of compliance is high in developed countries. Conyon (1994) found through his survey research that CG practices improved among firms after the introduction of the UK 1992 Cadbury Report. He further argued that there was great change among firms regarding separation of role of CEO and chairperson. The separation of CEO and chairperson was 57% before implementation of the code and increased to 77% among UK firms after implementation. Correspondingly, Conyon and Mallin (1997) conducted a literature review related to CG compliance and found that firms were adhering to the code by increasing the number of non-executive members on committees and boards. Werder, Talaulicar, and Kolat (2005) conducted a study among German firms to investigate the level of compliance. They found high levels of CG code compliance in the listed firms of the Frankfurt Stock Exchange. They used a sample of 408 German firms for the year 2003. Correspondingly, Cromme (2005) also conducted a study among German listed firms to investigate compliance with corporate

governance principles in 2003. He found that 3/4 of listed firms were complying with good CG principles. In 2010, researchers conducted a study among UK firms to investigate compliance with the 2003 Combined Code (Hegazy & Hegazy, 2010). They found that the average degree of CG compliance among UK firms was around 70%. They took samples of FTSE 100 firms and analyzed annual reports for the year 2008 by employing content analysis.

Hussainey and Al-Najjar (2012) conducted a study by taking a sample of non-financial listed firms of the UK. They took 130 firms as a sample of study over the years 2003 to 2009. The findings of their study showed high levels of compliance with the Corporate Governance Quotient (CGQ). On the basis of the above studies, it can be argued that UK firms are improving disclosure and governance practices by complying with the UK combined code. Allegrini and Greco (2013) conducted a study among Italian listed companies. They developed an index with 60 provisions of 2007 Italian CG code and documented that levels of governance practices and voluntary disclosure had increased among Italian listed companies. Correspondingly, Salterio, Conrod, and Schmidt (2013) conducted a study among Canadian listed firms, taking a sample of 742 Canadian listed firms, and used 16 CG recommendations. The study findings revealed that only 39% listed firms were fully complying while 82% were partially complying with CG codes. In conclusion, it can be argued that CG compliance is high in developed countries. Researchers also documented that robust economic, legal and cultural systems in these developed economies are effective in ensuring and ascertaining compliance with good CG practices (Aguilera & Cuervo-Cazurra, 2009; Salterio et al., 2013).

#### **2.7.1.2 CG Compliance in Developing Countries**

Researchers found extensive inequality with levels of compliance with CG disclosure among developing countries (Solomon, 2010). Existing empirical studies also expounded that the CG compliance differs due to the type of government at the country level (MacNeil & Li, 2006a; Samaha et al., 2012) and some studies found weak levels of compliance in developing countries. Researchers conducted a study to determine an overview of the Turkish CG system (Ararat & Ugur, 2003). They uncovered some weaknesses in the Turkish CG system and concluded that low compliance in Turkish listed firms is due to weak enforcement and supervision of regulatory authorities (Ararat & Ugur, 2003). Krambia-Kapardis and Psaros (2006) conducted a study by taking a sample of 160 Cyprus listed firms for the year 2002. They found that only a marginal number of firms were complying with the provisions of the CG code. The CG code introduced in 2002 in Cyprus and it may be a possible reason for the marginal number of listed companies. Furthermore, researchers also emphasized that time was



very short for the implementation of CG reform to improve CG practices (Renders, Gaeremynck, & Sercu, 2010). Tsamenyi, Enninful-Adu, and Onumah (2007) developed a CG index and took a sample of 22 Ghana listed firms over the year 2001 to 2002. The findings of their study show a 52 % average score for disclosure and transparency. Similarly, Samaha et al. (2012) conducted a study to determine the level of voluntary disclosure by taking a sample of 100 Egyptian listed firms for the year 2009. They used a disclosure index with 53 provisions of corporate governance. Researchers conducted a study to determine the degree of voluntary disclosure in the Brazilian stock market (Schiehl, Terra, & Victor, 2013). They examined the degree of disclosure with the Executive Stock Option plan (ESO) which was released in 2007. They used data of 68 publicly traded firms and the findings of their study reveal that Brazilian companies were not complying with all the recommended provisions. Companies were complying with only 10 provisions out of 23 and disclosing limited information about ESO plans.

In contrast, some studies found that CG compliance improved substantially in some developing countries after the introduction of the CG code. Researchers also conducted a study to determine levels of corporate disclosure in Portuguese firms (Alves & Mendes, 2004). They found a significant improvement after the publication of the Portuguese CG Code in 1999. The gradual increase was also found in the level of CG compliance among 54 listed firms of Kenya for the year 1999 after the development of corporate governance principles (Barako, Hancock, & Izan, 2006). Additionally, Chalevas (2011) conducted a study among Greek companies to determine the level of compliance with CG standards from the years 2000 to 2003. He found that the level of compliance improved among Greek companies for the investigated period. Similarly, Ntim and Danbolt (2012) conducted a study to determine the effect of King II report on CG practices by taking a sample listed firms of South Africa. They developed a CG index with 50 provisions. They found improvement in corporate governance standards after the release of the King II report in 2002; specifically the level of CG compliance reached 69% in 2006 from 47% in 2002.

Furthermore, there are some studies that focused on cross countries. In 2002, researchers conducted a study among 19 emerging markets to investigate compliance level. They took 354 firms over the period 1998 to 2000. They documented that South African and Asian markets have considerably higher levels of disclosure and transparency as compared to Eastern Europe, Latin America and Middle East markets. Furthermore, Klapper and Love (2004) employed a

CLSA index to find deviation in firms' levels of CG disclosures<sup>6</sup>. They drew sample from 14 developing countries for the year 2000 and found great variation in firms' levels of governance disclosures. In a nutshell, it can be summarized that variance in compliance with corporate governance standards is due to differences in the cultural, social and legal systems of countries (Haniffa & Hudaib, 2006; Ntim & Danbolt, 2012). It can also be concluded that compliance with corporate governance has been improved with the introduction of a code of good CG in some countries. Consequently, Bozec et al. (2010) documented that developing countries adopt good CG practices to attract more investors as they are already suffering from a weak legal system in the country.

After issuance of the CG code 2002, only limited number of studies have been conducted to investigate CG compliance in Pakistan (Javid & Iqbal, 2008a; Tariq & Abbas, 2013). These studies only took the CG code 2002 and examined the compliance with a few CG provisions. Javed and Iqbal (2007) examined the CG compliance by taking 50 KSE listed firms over the period of 2003 to 2005. They only constructed the CG index by taking 22 provisions and found possible improvement in levels of compliance and disclosure. These few provisions may not represent the level of compliance in a true form. Additionally, Javid and Iqbal (2008a) conducted a study to examine CG standards among 50 KSE listed companies over the period of 2003 to 2007. They found that CG compliance improved due to monitoring of SECP. Recently, Tariq and Abbas (2013) employed a weighted index consisting of 50 provisions for 119 PSX listed firms over the period of 2003 to 2010. They documented that although CG compliance has improved since issuance of the CG code in 2002 it is still minimal. The above studies have some limitations in the shape of fewer provisions, methodology and fewer observations<sup>7</sup>. Additionally, these studies only considered the CG code 2002. This study fills this gap by employing mixed methods and constructed CG compliance scores through a survey questionnaire.

### **2.7.2 Corporate Governance and Institutions in Emerging Economies**

Researchers have documented that institutions are predetermined and shaped by the distinct national system of the country (Douglass, 1990; Gustafsson, Knudsen, & Mäki, 2003). Gilson (1996) argued that the economic success of firms is also dependent on the institutions of a particular country in which they are expected to compete. Sorour and Howell (2012) conducted

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<sup>6</sup> CLSA index stands for Credit Lyonnais Securities Asia.

<sup>7</sup> These studies only focused on CG code 2002 and ignored the recent CG reform in 2012. In addition, the CG index is constructed from annual reports that may not be truly representative of CG compliance due to tick practices (see Khan, 2014).

a study in Egyptian banks and found that powerful agents drive the political process of CG. In a similar vein, Jizi, Salama, Dixon, and Stratling (2014) argued that powerful CEOs take liberal decisions which may not be in best interest of firms. Thus, it is evident that economic actors appear to endure more effect on the discretion of CG. Researchers also investigated the impact of low education on political institutions and found that well educated countries exhibit more stable democracies from those poorly educated countries (Hanushek & Wößmann, 2007; Jones, 2016; Karatnycky, 2002). These findings expounds the political institutions are more pertinent in educated countries as compared to their counterparts (Lipset, 1960). Cuervo (2002) examined the deficiencies in shareholders' protection in Anglo-Saxon and continental European systems of CG. He found that the enforceability issue in Continental Europe restricts the use of codes. The existing literature also provides evidence that the dominant religion (Hilary & Hui, 2009; McGuire et al., 2011) and prevailing culture (Haniffa & Cooke, 2002), for example, are vital for the effectiveness of CG codes. In addition, legal institutions can also be confronted by legitimacy issues that also emasculate their effectiveness. Judge et al. (2008) found three pillars (such as legal institutions, culture and particularly, corruption) of institutionalization which driving the perceptions of CG at the country level. In addition, global CG systems cannot be restricted to the Anglo Saxon or Continental European models (Judge et al., 2008).

Researchers also found issues of legal protection of minority shareholders in emerging economies (Hasan, Kobeissi, & Song, 2014; Klapper & Love, 2004) which raises the question about the role of legal institutions in those economies. Similarly, corruption is associated with societal elites in many weak institutional contexts. Despite the importance of the institutional framework, researchers have questioned its significance in creating a robust CG system (Adegbite et al., 2013; Johanson & Ostergren, 2010; Przeworski, 2004). Some researchers agreed that institutions matter (Adu-Amoah, Tsamenyi, & Mensah Onumah, 2008) while others documented that institutions do not matter absolutely (Przeworski, 2004). It is not possible to design an effective CG system without taking political and social factors into account (Adu-Amoah et al., 2008).

In a nutshell, it is documented that institutions do play a significant role in developing CG systems; however, it depends on the extent of institutional sophistication. However, the intuitional sophistication may be affected by the conditionalities which are intrinsic in a specific system. The effects of these conditions depend on economic development of particular country. Therefore, these conditions are flabbergasted by the robustness of existing institutions

in developed countries while it is divergent in emerging economies and affects the CG model adopted in emerging countries.

## **2.8 Determinants of Corporate Governance**

Existing literature reveals divergence in disclosure level among firms. Researchers also emphasized that corporate ownership and board characteristics are leading determinants for CG disclosure (Chalevas, 2011; Nadeem et al., 2013; Samaha et al., 2012). It is also evident from existing literature that most empirical studies were conducted in American firms till 1990s to examine corporate governance and voluntary disclosure (Bozec et al., 2010). Similarly, La Porta et al., (2002) conducted a number of studies to make international comparisons by making cross country studies and found that poor investors' protection is cause of lower valuation (Bebchuk & Weisbach, 2010). Consequently, keeping in view the limited literature in developing countries, particularly in Pakistan, this study adds to existing CG literature by exploring the key institutional determinants of good CG practices. There are some mechanisms needed for effective corporate governance. Jensen (1986) classified internal and external mechanisms as effective corporate governance mechanisms. Consequently, researchers documented ownership structure and BoDs as internal mechanisms of corporate governance. Moreover, the researcher also documented that external mechanisms are mainly connected to rules and regulations regarding control and operation of companies (Jensen, 1986).

### **2.8.1 Ownership Structure and CG Disclosure**

Existing studies revealed that ownership structure is a pivotal determinant of good CG practices (Bozec & Bozec, 2007; Konijn, Kraussl, & Lucas, 2011; La Porta, Lopez-de-Silanes, & Shleifer, 1999). It is expected theoretically that large shareholders can manage and control managers that can enhance disclosure and CG practices (Edmans & Manso, 2011; Jensen & Meckling, 1976). Consequently, researchers emphasized that institutional ownership attracts foreign investors by improving disclosure and CG practices (Cornett, Marcus, Saunders, & Tehranian, 2007; Kansil & Singh, 2018; Nashier & Gupta, 2016). However, empirical evidence on exploring the nexus between disclosure and ownership structure are still inconclusive (Bebchuk & Weisbach, 2010).

#### **2.8.1.1 Government Ownership and CG Disclosure**

It is documented that government ownership is a key factor in emerging countries that can influence corporate governance disclosure as concentrated ownership is extensive among these countries (Cornett, Guo, Khaksari, & Tehranian, 2010). Researchers also acknowledged that

the agency problem arises in government ownership (Eng & Mak, 2003). Additionally, researchers also recognized that poor corporate governance structure in firms is caused by the intervention of government in operating firms (Konijn et al., 2011). Some researchers documented that government can use its power to appoint CEOs and directors irrespective of their qualifications and experience (Cornett et al., 2010). From the stewardship theory perspective, executive directors and CEOs may not be affected by government ownership due to alignment of their interests with corporate owners (Davis et al., 1997). Consequently, CEOs have to improve firm performance in order to protect their reputation and career growth (Conyon & He, 2011). Similarly, resource dependence theory supports the argument that government ownership may grant tax subsidies and government contracts that ultimately improve disclosure and performance (Bauwhede & Willekens, 2008; Hermalin & Weisbach, 2012). The empirical literature on the relationship between government ownership and CG disclosure is still emerging (Eng & Mak, 2003; Ntim & Danbolt, 2012) and it provides an opportunity to make contributions internationally. Eng and Mak (2003) took a sample of 158 listed firms of Singapore for the year 1995 to examine relationship between government ownership and voluntary disclosure and found a positive relationship. Additionally, Conyon and He (2011) examined the relationship between government ownership and corporate governance practices. They took a sample of 1342 Chinese firms over the years 2001 to 2005 and documented a positive relationship between them. In a similar vein, Ntim and Danbolt (2012) conducted a study in South African listed firms and found a positive link between government ownership and voluntary CG disclosure. Al-Matari, Al-Swidi, and Fadzil (2012) conducted a study in Saudi listed firms to explore the effect of government ownership on corporate disclosure. They employed a corporate governance index consisting of nine provisions with a sample of 42 listed firms. They found a positive effect of government ownership on corporate governance disclosure.

### **2.8.1.2 Institutional Ownership and CG Disclosure**

Institutional investors are more proficient in monitoring and improving corporate governance disclosure (Barako et al., 2006). Jensen and Meckling (1976) acknowledged that monitoring helps in mitigating the conflicts between investors and directors (Solomon, 2010). Additionally, the institutional investors have greater spurs to protect investment particularly when existence for firms is costly (Chung & Zhang, 2011). Therefore, they also ensure high levels of accountability between top management and shareholders (Aggarwal, Erel, Ferreira, & Matos, 2011; Haniffa & Hudaib, 2006). Existing studies reveal that institutional ownership

can mitigate agency cost through monitoring the behaviors of managers. Healy and Palepu (2001) suggested that improvement in corporate governance disclosure may lead towards high share prices that ultimately increase firm value. In a similar vein, Ntim and Danbolt (2012) also provided similar suggestions. It is evident that institutional shareholders can help in reducing information asymmetry (Aggarwal et al., 2011). These findings are also consistent with the argument of Chung and Zhang (2011) that institutional shareholding increases the quality of CG among firms. On the other hand, Ruiz-Mallorquí and Santana-Martín (2011) also documented that it is not necessary that institutional investors will perform as leading element in improving the level of transparency and disclosure. They can also play a weak role in motivating good CG practices in order to get short term benefits. A number of empirical studies documented a positive relationship between institutional ownership and corporate disclosure (Aggarwal et al., 2011; Chung & Zhang, 2011; Ntim & Danbolt, 2012). Barako et al. (2006) conducted a study by taking a sample of 53 Kenyan listed firms and found a significant positive relationship between institutional ownership and transparency. In a similar vein, Bushee, Carter, and Gerakos (2013) conducted a study and found a positive relationship between institutional ownership and corporate governance practices. Chung and Zhang (2011) conducted a study by employing a large sample of 12093 firm year observations for the years 2001 to 2006 in the US financial market. They found a positive relationship between the level of corporate governance compliance and institutional investors. It is evident from developed and emerging economies that institutional ownership has a positive association with corporate disclosure (Barako et al., 2006; Hussainey & Al-Najjar, 2012).

### **2.8.1.3 Block holders Ownership and CG Disclosure**

The stakeholders' theory suggests that block holders have a dominant effect on CG disclosure (Edmans, 2014; Konijn et al., 2011; Yermack, 2017). Researchers also argue that outside block holders have considerable power and consequently they have power to limit excessive compensation (Conyon & He, 2011; Konijn et al., 2011). Additionally, Shleifer and Vishny (1997) expounded that block holders have power to control opportunistic behavior of managers as compared to small shareholders that ultimately reduces agency cost. Correspondingly, Konijn et al. (2011) suggested that large shareholders take more interest in monitoring the performance of managers and reduce the problem of free riders. In addition, block holders have more funds to support a firm financially and can improve firm performance (Chen, Chen, & Wei, 2009). On the other side, large shareholders can expropriate corporate resources and small shareholders by conspiring with managers (Ntim, Lindop, Osei, & Thomas, 2015). In literature,

the empirical studies documented a negative or no association of block holder ownership with level of corporate governance disclosure. Barako et al. (2006) found a negative association between block holder ownership and voluntary disclosure. Similarly, Al-Bassam, Ntim, Opong, and Downs (2018) also found a negative relationship between them which is also consistent with findings of Ntim and Soobaroyen (2013). In contrast, Konijn et al. (2011) found no link between shareholders rights and block holders among US firms. Researchers argued that this deviation in findings may be due to different contextual settings (Robertson, Diyab, & Al-Kahtani, 2013). Emerging countries suffer weak legal systems (Adegbite et al., 2013; Bauwhede & Willekens, 2008; Judge et al., 2008) while developed countries have efficient external CG mechanism that ultimately helps with improvement in CG disclosure (Haniffa & Hudaib, 2006).

#### **2.8.1.4 Director Ownership and CG Disclosure**

The board of directors play a significant role in CG disclosure policies (Chalevas, 2011; Eng & Mak, 2003; Jensen & Meckling, 1976). Keeping in view the agency perspective, the nexus between CG disclosure and director ownership is still inconclusive (Haniffa & Hudaib, 2006). Moreover, if directors need some information to maximize their own wealth, they will seek that information for themselves not for the firm (McConnell & Servaes, 1990). In contrast, low director ownership can cause low performance due to lower CG disclosure (Eng & Mak, 2003). Jensen and Meckling (1976) documented that agency problems can be mitigated if shareholders monitor the board's behavior and ultimately this increases the monitoring costs. Therefore, CG disclosure can enhance monitoring mechanisms of directors and CG practices (Aguilera & Jackson, 2003; Eng & Mak, 2003). On the other hand, director ownership affects the outside shareholders and directors (Jensen & Meckling, 1976). Additionally, if the interests of shareholders and directors are aligned, directors seek to improve transparency and disclosure.

Existing empirical literature suggests a negative link between CG disclosure and director ownership. Bauwhede and Willekens (2008) conducted a cross country study of 14 countries by taking 130 firms for the year 2000. They documented a negative association between closely held shares of insiders with corporate governance practices. Moreover, Samaha et al. (2012) conducted a study among 100 Egyptian listed firms to examine the association of board ownership and disclosure. The findings of their studies do not support a positive association between board ownership and CG disclosure. Similarly, some scholars also found a negative relationship among UK firms (see Hussainey & Al-Najjar, 2012).

## **2.8.2 Board of Directors (BoDs)**

BoDs are pivotal in examining CG disclosure (Allegrini & Greco, 2013). The following sections review related literature.

### **2.8.2.1 Independent BoDs and CG Disclosure**

Independent directors have gained significant consideration from academic research and CG regulations (Chen, 2011; Johanson & Ostergren, 2010). Moreover, independent directors have a great capacity to limit managerial opportunism behavior as suggested by agency theory (Allegrini & Greco, 2013; Jensen & Meckling, 1976). Chalevas (2011) documented that an independent board has the capability to reduce agency costs and protect shareholders. Consequently, agency theory also predicts that information asymmetry can be reduced in the presence of independent directors (La Porta et al., 2002). Additionally, independent directors can provide support and guidance to committees and boards through their experience and knowledge (Barako et al., 2006). Hence, they are very important resource for firms. Haniffa and Cooke (2002) conducted a study in Malaysia by taking a sample of 167 listed firms over the year 1995. The findings of their study revealed that accountability and transparency were improved in the presence of independent directors. In a similar vein, García-Meca and Sánchez-Ballesta (2010) conducted the literature review by applying a meta-analysis. They found that board independence protects the rights of shareholders. Chau and Gray (2010) conducted a study to investigate the association of board independence and corporate governance disclosure and found that independent chairman and BoDs can reduce exploitation. Samaha et al. (2012) conducted a study among 100 Egyptian listed firms and documented a significant association between disclosure and a higher proportion of independent directors. Most of existing literature found significant association between independent BoDs and CG disclosure. Hussainey and Al-Najjar (2012) also documented similar results by conducting a study among 130 UK listed firms over the period 2003 to 2009. Their findings reveal the association of an independent board of directors and corporate disclosure. In contrast, some researchers did not find any relationship between board independence and CG practices. Allegrini and Greco (2013) conducted a study among Italian listed firms to examine the association of board independence and CG disclosure. They did not find any relationship between board independence and CG disclosure. Using the self-constructed index of corporate governance, Al-Matari et al. (2012) found positive relationship between the presence of independent directors and CG. In a nutshell, many existing studies documented a positive relationship between board independence and CG disclosure.



### **2.8.2.2 Corporate Governance Committee and Corporate Disclosure**

Several CG codes and reforms have made recommendations about the existence of CG committees. The focal purpose of a CG committee is to provide support in the implementation of CG standards that ultimately increase CG disclosure (Ntim & Danbolt, 2012). The stakeholder theory defines that the role of CG is to provide equal protection to shareholders and stakeholders (Solomon, 2010). Consequently, the presence of a CG committee is to provide further protection to stakeholders' rights. Additionally, corporate governance also helps in the reduction of variation in information and sends signals to markets about firms' commitments towards good corporate governance practices (Akhtaruddin, Hossain, Hossain, & Yao, 2009). Nonetheless, only a few empirical studies documented the association between the presence of CG committee and CG disclosure (Ntim & Danbolt, 2012).

### **2.8.2.3 Board Size and Corporate Disclosure**

Keeping in view the agency perspective, researchers documented that shareholders select BoDs to represent their interests and anticipate high disclosure from BoDs (Davidson, Nemec, & Worrell, 1996). Board size is a decisive factor in monitoring management behavior as advised by agency theory (Allegrini & Greco, 2013). Moreover, researchers also documented that increased managerial monitoring has a positive influence on voluntary disclosure (Ntim & Soobaroyen, 2013). In the literature, researchers also documented that knowledgeable, experienced and independent directors are related to board size (Haniffa & Cooke, 2002). Consequently, it can be argued that large firms are more likely to have larger board size due to complexity of activities (Coles, Daniel, & Naveen, 2008). On the other hand, large board size may lead to co-ordination, communication and interaction problems among directors and consequently, it can have disastrous effects on the accountability of management and directors. Akhtaruddin et al. (2009) conducted a study in Malaysia to examine the extent of disclosure. They used an already developed corporate governance index and took data (i.e. year 2002) from 94 Malaysian listed firms. They found that board size is linked with CG disclosure. The limitation of their study was to employ an adopted index that was developed by Meek, Roberts, and Gray (1995). This index was developed for developed countries rather than emerging countries. Subsequently, some scholars could not consider contextual differences like legal, cultural and economic systems among developed and developing countries (Akhtaruddin et al., 2009; Haniffa & Cooke, 2002; Haniffa & Hudaib, 2006; Robertson et al., 2013). Researchers also documented that board size is a core determinant of corporate governance disclosure (Ntim & Danbolt, 2012). Ntim and Danbolt (2012) conducted a study among 169 South African firms

to determine association of board size and corporate disclosure and found a significant positive relationship between them. In a similar vein, Samaha et al. (2012) also documented that firms with larger boards tend to disclose more CG information as compared to their smaller counterparts. Schiehl et al. (2013) conducted a study among Brazilian listed firms on the Sao Paulo Stock Exchange to examine the association of board size and executive stock options plans. By employing a sample of 68 companies, they found a positive association between CG disclosure practice and board size. On the other hand, Hussainey and Al-Najjar (2012) conducted a study among 130 listed firms of the UK and found no significant association between board size and CG disclosure. While Samaha, Khelif, and Hussainey (2015) also found that board composition, size and audit committees have significant positive relationship on voluntary disclosure.

#### **2.8.2.4 Board Gender Diversity and Corporate Disclosure**

As per agency and resource dependence theories, diversity enhances the level of CG compliance and disclosure (Bear, Rahman, & Post, 2010). Agency theory emphasized on the role of BoDs in monitoring managers to protect shareholders' interests (Eisenhardt, 1989). Consequently, the experiences and capabilities of BoDs provide additional support to them to manage and evaluate strategies which may enhance the CG disclosure of firm. Resource dependence theory also emphasizes the significance of a board's role in ensuring the provision of resources (Pfeffer & Salancik, 2003). In a similar vein, Hillman and Dalziel (2003) argued that the BoDs work as a source of information among executive members and shareholders which is likely to boost CG disclosure. Prior studies examined the nexus between different types of diversity on boards and different corporate decisions (Dezsö & Ross, 2012; Rose, 2007). Some scholars found that female directors have influence on firms' boards (Carter, D'Souza, Simkins, & Simpson, 2010; Yu, Lord, Peni, & Vähämaa, 2010) while others argued that gender diversity can boost CG disclosure due to unique methods to information disclosure (Terjesen, Sealy, & Singh, 2009).

#### **2.8.2.5 Audit Firm Size and Corporate Disclosure**

From stakeholder and agency theories' perspectives, audit firms can have impact on the quality and level of CG disclosure (Barako et al., 2006). It is evident from existing literature that audit firms are external CG mechanisms that are pivotal in overseeing managers through investigating disclosure and firm performance. Therefore, audit firms can have significant implications for disclosure. Haniffa and Cooke (2002) documented that audit firms can assist in reducing agency conflicts by limiting agents' opportunistic behavior. Additionally, CG

practices can be enhanced through external auditing (Eng & Mak, 2003). In a similar vein, Alsaeed (2006) argued that the big four audit firms have better auditing standards as compared to other audit firms. In support of this argument, Barako et al. (2006) highlighted that big audit firms have more qualified, trained and experienced teams as compared to small audit firms which helps in conducting rigorous audits. Moreover, the big four audit firms also try to protect their reputation by providing high levels of disclosure. On the other side, small audit firms may have weaker capacity to negotiate for high quality disclosure due to financial constraints as compared to their larger counterparts (Alsaeed, 2006). Ntim and Danbolt (2012) documented a positive relationship between the level of CG disclosure and audit firm size among South African firms. In a similar vein, Schiehl et al. (2013) documented that the big four audit firms tended to increase executive stock option disclosure among Brazilian firms. Alsaeed (2006) conducted a study among Saudi firms and found no significance effect of audit firms on CG disclosure.

## **2.9 Corporate Governance and Financial Performance**

In recent decades, plenty of studies have been conducted to investigate the impact of CG on financial performance but a comprehensive literature review reveals a lack of consensus among researchers (Bhagat & Black, 2001; Bozec, 2005; Davidson et al., 1996; Eisenberg, Sundgren, & Wells, 1998; Haniffa & Hudaib, 2006; Iqbal, 2006). Some studies reported a significant positive effect of CG on financial performance while others not. Drobetz et al. (2004) conducted a study among German firms to investigate the relationship between CG and firms. They documented that firms' values such as Tobin's Q and market to book value are significantly related to good CG practices. In similar vein, Brown and Caylor (2006) constructed a CG index with 51 external and internal attributes and found a significant positive association between Tobin's Q and constructed CGI. Additionally, Mohanty (2003) also documents a significant positive relationship between CG practices and financial performance in the context of developing economies. He employed Tobin's Q and excess stock return as a measure of financial performance among Indian firms. Black et al. (2006) conducted a study among Korean public companies to investigate the association of overall CGI with market value. They documented that stronger CG predicts higher market values. Moreover, they also documented that investors appreciate better CG and ultimately it leads towards a reduction in the cost of capital. Besides these, Ehikioya (2009) conducted a study to examine links between CG structure and firm performance by taking a sample of 107 Nigerian listed firms. He documented a positive relationship between ownership concentration and firm performance on

one hand while on other hand, no association was found between board composition and firm performance. He further documented that concentrated ownership protects interests of stakeholders and investors. Huang (2010) conducted a study to investigate the relationship between board, ownership and performance of banks in Taiwan. The findings provide evidence of a positive influence of board size, number of outside directors and family owned share on the performance of banks. This is consistent with the findings of Varshney, Kaul, and Vasal (2012), who documented that good CG has a positive effect on firm performance as measured by economic value added. Nonetheless, this relationship becomes invalidated when traditional performance measurements like return on capital, Tobin's Q and return on assets are employed. Though, marvelous efforts have been made by the OECD to improve the linkage between CG best practice and firm performance, this association is still not clear in both emerging and transition economies. Consequently, Aboagye and Otioku (2010) conducted a study among rural and community banks of Ghana and found no association between CG and financial performance. In contrast, Hassan Al-Tamimi (2012) conducted a study among UAE national banks and documented an insignificant positive relationship between CG practices and performance level. In a similar vein, Elsayed (2007) conducted a study among Egyptian firms to investigate the relationship between CEO duality and corporate performance. By taking 92 firms for the period from 2000 to 2004, he found no evidence regarding the impact of CEO duality on corporate performance. Nevertheless, a significant positive effect can be noted in the presence of low corporate performance.

Omran, Bolbol, and Fatheldin (2008) took a sample of 304 firms from Arab equity markets including Jordan, Oman, Egypt and Tunisia to investigate the association between ownership structure and corporate performance. They documented no significant impact of ownership concentration on firm performance. In contrast to agency theory and stewardship theory, Elsayed (2010) expounds that appropriateness of board leadership structure depends upon the age, size and ownership structure of the firm. Furthermore, he also documented that board size has a positive association with corporate performance in the absence of CEO duality while this association becomes negative in presence of CEO duality (Elsayed, 2011). In a similar vein, Wahba (2015) documented that an increase in the proportion of non-executive directors has a negative effect on firm financial performance in the presence of CEO duality.

## **2.10 Qualitative Studies in Corporate Governance**

The research in the area of CG has been growing and evolving since classic corporate collapses. O'Higgins (2002) conducted a study to analyze the selection of non-executive BoDs in Ireland.

They conducted interviews from 26 prominent directors and chairpersons. They found that incisive thinking, beneficial contributions and practical business experience were pivotal in the selection of non-executive BoDs. In a similar vein, Roberts, McNulty, and Stiles (2005) conducted a study to examine the effectiveness of BoDs. They conducted interviews with 40 directors who were commissioned for Higgs Review. They documented that live experiences of non-executive and other BoDs are quite divergent from traditional agency theory and stewardship. Parker (2007) conducted an observational study by involving 80% in all board meetings along with sub committees. He argued that boardroom culture is a compelling factor in the internal corporate governance process. Correspondingly, Brundin and Nordqvist (2008) conducted a study to explore the effect of emotions in board meetings and tasks performance. They observed emotion in real time over a period of 18 months. They found that emotions matter in board meetings and tasks performance of board members. Additionally, Soobaroyen and Mahadeo (2012) conducted a study in an emerging economy (Mauritius) which may also be applicable in Pakistan. They investigated the effect of corporate governance provisions on the accountability of boards of directors of companies. They conducted 24 semi structured interviews from BoDs of listed and non-listed firms. They found substantial change in BoDs and noted empowered maximalist boards.

On the other hand, some researchers conducted qualitative studies to investigate the effect of corporate governance on audit committees. Cohen, Krishnamoorthy, and Wright (2002) conducted a study to examine CG factors on the audit process. They conducted 36 semi-structured interviews with 36 practicing auditors. They documented that audit committees lack sufficient power and strong governance mechanisms in the view of auditors. The reasons for this were inexperienced audit committee members and power to take decisions. On the other hand, Gendron, Bedard, and Gosselin (2004) conducted a field study to determine the effectiveness of audit committees. They conducted a field study in three Canadian public corporations. They documented that audit members were responsible and aware of their responsibilities. During their interviews, they found that audit committee members placed significant attention on a few matters and assessed the responses of managers by cross questioning during meetings. Although the trend of adopting qualitative methodology is increasing in recent decades, there is still a dire need to blend qualitative and quantitative methods to explore the CG mechanisms further.

## 2.11 Chapter Summary

The chapter presents a theoretical and empirical review of literature regarding corporate governance, compliance and performance nexus. The chapter was divided into ten main sections. The first section presented the introduction to the chapter while the second section defined the corporate governance. The third section discussed the most relevant theories that underlie CG disclosure in the context of Pakistan. Consequently, the study adopted a multiple theoretical approach, including different CG theories and substantially focusing on agency theory and institutional theory. The applicability of these theories in the Pakistani context was also presented in this section. Section 4 presented the objectives of corporate governance. In this regard, two perspectives are discussed i.e. financial performance and accountability. The fifth section presented different types of ownership structure and assisted in understanding the contextual environment of the study underway. The sixth section presented the nexus between the socio-economic perspective and corporate governance. Section seven reviewed the literature regarding CG compliance and disclosure with corporate governance codes. This section discussed the level of compliance both in developed and developing countries with particular focus on Pakistan. The literature suggested divergence in the level of compliance in both developed and developing countries and suggested that this difference in the level of compliance may be attributed to socio economic factors. The nexus between institutions and CG mechanism was also presented in this section. Section eight presented the determinants of CG with an extensive literature review. This section identified ownership structure, board and audit characteristics as the main determinants of corporate governance. The ownership structure is made up of director, institution, government and block holders while board and audit characteristics are made up of independent directors, audit committees and size. The nexus between CG and financial performance is presented in section nine. At the end, the qualitative studies related to CG were presented in section ten.

This chapter was mainly related to theories and the literature review of CG while the next chapter presents the overview of the corporate sector of Pakistan. The next chapter assists in understanding the CG environment in Pakistan and laws that are related to it.

## CHAPTER THREE

### CG ENVIRONMENT IN PAKISTAN

#### 3.1 Introduction

This chapter presents the overview of the CG environment in Pakistan. Section 3.2 presents the historical development of the corporate sector of Pakistan while the nature of the corporate sector of Pakistan is presented in section 3.3. The voting rights in the corporate law of Pakistan are presented in section 3.4 and section 3.5 presents enforcement mechanisms in Pakistan. The overview of CG in Pakistan is presented in section 3.6. Section 3.7 presents gaps in the existing literature which are addressed by this thesis while a chapter summary concludes this chapter.

#### 3.2 Corporate Sector of Pakistan: History and Development

The British rulers introduced company law which is the foundation of Pakistan company law. After independence in 1947, Pakistan adopted the Indian Companies Act 1913 (amended in 1936) with necessary amendments. The former Companies Ordinance 1984 which was introduced on 8 October 1984 by imitating the Indian Companies Act 1913, was replaced by the Companies Act 2017<sup>8</sup>. Consequently, the companies are supposed to register under ordinance if they want to operate their headquarters in Pakistan. The scholars conducted a study and discussed the historical development of the corporate sector in Pakistan (Cheema et al., 2003). They highlighted the private sector as the main contributing factor of industrialization in Pakistan. Moreover, Amjad (2008) also documented that some specific families (44 monopoly houses) were controlling 48% of gross fixed assets of the large scale manufacturing sector in 1970. These families were also receiving benefits from cheap imports of capital goods and generous fiscal incentives. Additionally, these monopoly houses were controlled by the same person and hence there was a lack of separation and ownership. In mid-1972, the democratic government implemented policies that reduced the industrial concentration in the private sector. It also nationalized a number of industrial units which led to a 50% reduction in assets of 11 monopoly houses. Therefore, the investment in the public sector increased from 13% to 78% from 1972-73 to 1976-77. By nationalizing the banking sector of Pakistan, the government created political control over the entire financial sector (State Bank of Pakistan, 1974). Moreover, several governments rejuvenated the role of the private sector during the

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<sup>8</sup> The Companies Act, 2017 came into effect on 30th May 2017, except for a section dealing with real estate companies, the enforcement of which has been deferred for the time being. The Companies Ordinance, 1984 has simultaneously been repealed except for certain sections concerning non-banking finance companies.

1980s and 1990s. However, state and family control are still dominant in the corporate sector of Pakistan.

As the Ordinance aped the Companies Act 1913, provisions of minority rights were retained in Ordinance. The minority protection provisions failed to create dispersed ownership and ultimately capital markets (Shleifer et al., 2000). Due to the specific cultural, social, political and economic conditions, concentration of ownership created and led to underdeveloped capital markets. Moreover, institutions remained underdeveloped due to corruption, weak enforcement and bad rule of law. Since 1990s, the corporatization and privatization of institutions have been the focal agenda of the Government of Pakistan (GOP). The main contributing factors in endorsing corporate governance included but were not limited to international financial institutions, globalization, foreign investors and overseas listings which resulted in major reforms in the corporate sector (Hasan et al., 2014). The main motive of these reforms was restructuring of regulators and stock exchanges. The GOP has privatized a number of state-owned enterprises with agreement from the International Monetary Fund (IMF) since 1990 but the rapid privatization has been hindered by corruption. Moreover, the Supreme Court of Pakistan cancelled some key privatization processes, including steel mills, due to corruption and irregularities. Presently, the GOP is planning to privatize its power supply companies and Pakistan International Airline (Mehreen, 2016). Regardless of these privatization processes, families are still dominant in family owned companies while the state is dominant in state owned. Although researchers conducted qualitative studies, these studies are limited to relationships between corporate governance, audit committee, BoDs and management (Cohen et al., 2002; Gendron et al., 2004; O'Higgins, 2002; Roberts et al., 2005; Soobaroyen & Mahadeo, 2012). There are limited studies exploring the institutional effect on CG compliance and mechanisms. There is a dire need to conduct a comprehensive study to explore the key institutional determinants that shape the CG system in Pakistan. This thesis seeks to fill this gap by exploring the key institutional determinants of CG in the first part and barriers and drivers of good CG practices in Pakistan in the second part. Finally, this thesis examines the nexus between CG compliance score and financial performance and proposes a model of good CG practices in Pakistan.

### **3.3 The Corporate Sector in Pakistan**

Pakistan adapted the Anglo-Saxon model of CG while the nature of the corporate sector of Pakistan is the reverse and ownership concentration is high. The corporate sector is controlled by government and family ownerships and mostly private and public firms are controlled by



family members or politicians. It is also a matter of concern that more than 50% of private firms are controlled by husbands and wives who just fulfilled the minimum requirements of the companies' ordinance 1984. Moreover, these groups or families also own 75% or more shares in listed firms to control decision making and avoid any minority representation on the BoDs. These families and groups use several tools and techniques that include direct shareholding, pyramid structure and interlocking management. Consequently, these tools also create liquidity problems in the market on one hand. On the other hand, the understanding of these pyramid structures and interlocking management is a complex phenomenon for investors. These families also appoint their trustworthy family members as executive and non-executive members of the board regardless of their prerequisite qualifications and experience. These all help families to control decision making, cash flows and taking private benefits by utilizing the company's resources. Additionally, decisions are made without calling formal board meetings. The state-owned companies are the second largest stakeholder in Pakistan. These include incorporated and unincorporated companies.

During recent decades, the Government of Pakistan corporatized a number of SOEs while others are on the agenda. Every time, newly elected government takes control of top listed SOEs after coming into power. The political influence is remarkable in these SOEs. The board of directors and management of companies remain in their positions at the pleasure of the state. The appointments are made purely on the basis of political affiliation rather than qualifications and experience (Boytsun et al., 2011). However, these families and state owned corporations are the main sources of corporate growth and development of capital markets in Pakistan and these growth and developments are discouraged by control maximization (Cheema et al., 2003).

It is also observed that many FOBs in Pakistan do not have awareness of the underlying rewards of incorporating CG practices (Khan, 2014). As a result, this unawareness creates a tepid response towards governance reforms on one hand with strong family and government control of public listed firms on the other hand. Additionally, these companies resist governance reforms and sometimes go for delisting of their companies (Metzger, 2003; Milhaupt, 1998). In a similar vein, there was extensive delisting after announcement of the CCG in 2002 and the recent reform in 2012 (Pakistan Stock Exchange, n.d). As the multinational companies are entering financial markets, they are in the position of playing a significant role in the equity market of Pakistan. Most of these multinational companies are from the US and UK where

there is a strict requirement to comply with the corporate governance code. Henceforth these firms can set a good illustration for domestic firms by incorporating a code of CG.

### **3.4 Voting Rights in the Corporate Law of Pakistan**

According to the Companies Act 2017, the default voting rule is ‘one share’ one vote (Roland, 2016, p. 268), while firms can issue shares with more voting rights and shares without any voting right as per Companies Share Capital Rules 2000. Consequently, this provides an opportunity to family members to control management and board by having more voting rights. Although, the differential voting rights technique is considered legal, most of the stakeholders do not consider it good. In some countries like the UK, the companies are allowed to issue differential voting rights, but they do not do it, while companies do this in Pakistan which might dilute the voting rights of minority shareholders.

### **3.5 Enforcement Mechanisms in Pakistan**

In prior literature, researchers documented the rights of shareholders as a pivotal determinant for good corporate governance and development of capital markets (La Porta et al., 1997) while the rights of minority shareholders are not protected in Pakistan. The corporate law of Pakistan provides protection for some shareholders’ rights but the main problem is its enforcement (Javid & Iqbal, 2010). Additionally, the rights of minority shareholders are only on paper not in reality (Bari, Cheema, & Siddique, 2003). The judiciary is not able to enforce these laws due to corruption, inefficiency and lack of skill. Moreover, politicians have great impact on judiciary which is also a key contributing factor towards futile enforcement of these laws.

### **3.6 Overview of Corporate Governance in Pakistan**

It is well supported from literature that effective governance mechanisms retain investors’ confidence. The good CG regulations and rules persuade prospect investors to make investment decisions both in local and international equity markets. As evident from the law of demand, capital markets compete with each other to attract more local and international capital to meet contemporary financial needs. Consequently, corporate characteristics have importance to a large extent. Therefore, Pakistan has to comply and raise governance standards in order to compete in the global financial sector by obtaining equity financing and attracting more foreign direct investment. The protection of minority shareholders, transparency of capital markets and financial disclosure are considered as prerequisite of such governance structures (SECP Code, 2002). Additionally, in March 2002, SECP provided the detailed provisions regarding governance mechanisms in Pakistan. The CCG 2012 provides detailed guidelines and

provisions regarding boards of directors, financial reporting, governance structure and responsibilities of all stakeholders. It is also acknowledged that CG practices have numerous benefits both for developed and emerging countries like Pakistan. Consequently, these practices also provide support to emerging economies in getting sustainable and higher growth rates. Furthermore, these are also supportive in mobilizing savings and increasing the ability of capital markets to enhance investors' confidence in the national economy of the country. These also help in raising investment rates and encourage growth by protecting rights of both small and larger investors (Javid & Iqbal, 2008b; Rwegasira, 2000). In Pakistan, the Companies Act 2017 sets rules and regulations for governing companies and other associations which are based on common law.

The financial institutions such as Banks are regulated by regulations of the State Bank of Pakistan (SBP) and Banking Company Ordinance 1962. The Security and Exchange Ordinance 1969, the Security and Exchange Commission Act 1997 and the Companies Act 2017 are fundamental bodies of corporate governance and SECP is stabled under Security and Exchange Ordinance Act 1997 as principal regulator of listed companies, non-listed companies, banks and security markets such PSX. The major role of Security and Exchange Ordinance 1969 and Companies Act 2017 is to provide security delisting, fraud prevention and protection of investors. Additionally, the listed Companies Ordinance 2002 establishes ownership disclosure rules and takeovers. Listing rules also have special regulations regarding transfer pricing and listed companies are obliged to inform PSX about their change in BoDs, dividends, change in capital and annual general meetings (AGMs). In Pakistan, the code of CG is introduced by mutual efforts of SECP the Chartered Accountants of Pakistan in collaboration with the Cost and Management Accountants of Pakistan (ICMAP) and PSX. The CCG has numerous recommendations align with international CG standards. The key contributions of CCG include but are not limited to improving external and internal audits, reforms of better disclosure of information and BoDs in order to make companies responsible to all shareholders. However, the CCG has voluntary provisions regarding independence of BoDs and question the risk management. Consequently, SECP revises its CCG 2002 in 2012 through a reform and made most of provisions mandatory for listed companies. In recent reform of CCG 2012, SECP has given significant attention to transparency and disclosure and remuneration of BoDs. In addition, SBP mandated compliance of CCG 2012 for all listed and non-listed banking including development finance institutions and this requirement has made significant improvement in baking systems. SECP also issued a separate CG code for insurance companies

In addition, international bodies, such as the International Monetary Fund (IMF), the World Bank (WB) and the Organization for Economic Co-operation and Development (OECD) usually encourage emerging countries to make CG a priority agenda, including facilitating the introduction of codes of good CG practices (Clarke, 2004; Rwegasira, 2000).

The main problem is the compliance with CG codes. After reform in 2012, the Code of Corporate Governance (CCG) has many mandatory provisions related to auditing, board structure and disclosure for listed companies, but there are still some voluntary provisions (SECP CCG, 2012). These provisions challenge the discretionary power of state and families' influence on companies' management. Consequently, they show hesitant to perceive the CG Code in its true spirit. The compliance with CCG is in form not in substance. A recent study conducted by Khan (2014), documented that most of provisions are ticked in a box not in a true sense. He also documented that senior officers of SECP confirmed that CCG is not implemented in a true sense as most public listed firms are family owned in Pakistan. The family members are elected as executive and non-executive directors. Moreover, the firms also appoint family members as independent directors with a few shares. Most family firms are appointing their children as independent directors with a few shares to fulfill the requirement of CCG. He further concluded that "law in books" is not enough; it should be implemented to be considered as "law in action". In a similar vein, Samza (2016) conducted a study in Pakistan to identify weaknesses of corporate governance and explore opportunities for its improvement. She documented that many of SECP CCG provisions overlap with the Companies' Ordinance 1984<sup>9</sup> which is problematic. She further documented that SECP and PICG should make a strategy to increase awareness about the benefits of adopting corporate governance.

Although some researchers established the relationship between CG and firm performance by conducting quantitative studies, while others documented no relationship between CG and financial performance (Aboagye & Otioku, 2010; Javid & Iqbal, 2008b; Renders et al., 2010; Tariq & Abbas, 2013). In short, the opinion is mixed about CG and firm performance. These diverse outcomes invite scholars to further explore the relationship between CG and financial performance. The existing qualitative studies also tried to explore the ways to improve CG mechanisms in Pakistan but these studies have their limitations (Khan, 2014; Samza, 2016). These studies only adopt one method to identify weaknesses in the CG system and explore opportunities for its improvement. Khan (2014) recommended that further research is needed

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<sup>9</sup> See note 5.

to adjacent to a Western CG system inside the boundaries of Islam. Aguilera et al. (2016) recommended that future researchers can adopt mixed methodology while Samza (2016) recommended the use of structured or semi-structured interviews.

### **3.7 Gap in the Literature addressed by this thesis**

This section highlights the research gap in existing literature that are addressed by this thesis. Existing literature is critically reviewed which not only yields significant understanding, but also validates the aims and objectives of the study. After conducting a literature review, it is confirmed that it is worthwhile to investigate topics which specifically impact on CG and firm performance while country in general. The following paragraphs provide gaps in existing literature which are addressed in this study related to each research question.

Although a number of studies advocate the importance of a CG code for better performance, only few studies are conducted mainly in the Pakistani context. Existing studies talk about the old version of CG code 2002 except Samza (2016) who analyzed CG code 2012 for the first time. However, she employed only content analysis and recommended the use of interviews in her study (Samza, 2016). This study addresses this gap by incorporating both qualitative and quantitative methods and also analyses the CG code 2012. This the first study which is employing mixed methodology in the Pakistani context. This thesis fills the gap by exploring the key institutional determinants of CG in the first part and barriers and drivers of good CG practices in Pakistan in the second part. At the end, this thesis investigates the nexus between CG compliance score and financial performance and proposes a model of good CG practices in Pakistan.

Existing literature has emphasized the issue of proper compliance with CG and enforcement of CG principles. A few studies have been conducted and confirm the weak enforcement mechanisms in Pakistan without providing any solution and measures to improve CG compliance. This study provides solutions and measures to address those weakness and issues in CG compliance. Prior studies have small sample size and short time span (Javid & Iqbal, 2008a; Tariq & Abbas, 2013). In contrast, this study first conducted focus group interviews with participants and second, it gathered the primary data from PSX listed firms. Moreover, the prior studies used the CG index by considering a few provisions of CG code 2002 which may not present the true level of compliance with the CG code.

Distinctively, this study employs the five-point Likert scale for construction of corporate governance compliance scores (CGI) with provisions from the CG code 2012. The use of the

five-point Likert scale questionnaire provides more validity in determining levels of CG compliance<sup>10</sup>. Researchers found that firm ownership structure and characteristics of boards of directors are the key determinants of CG disclosure (Haniffa & Hudaib, 2006; Ntim & Soobaroyen, 2013; Samaha et al., 2012). This study explores the key institutional determinants of good CG practices in Pakistan. It is pivotal to explore those institutional determinants that shape the CG practices in a country. In addition, according to the researcher's best knowledge, this is the first study which identifies the most influential barriers of good CG practices in the unique context of Pakistan. The study also recommends the ways to improve good CG practices in Pakistan through identifying the most important drivers of CG practices. At the end, the study investigates the nexus between CG compliance and firm performance of the sampled firms and proposes a model for good CG practices in Pakistan.

### **3.8 Chapter Summary**

This chapter provides the overview of the CG environment in Pakistan. The history and development of the corporate sector in Pakistan are expounded in this chapter. Pakistan recently introduced the Companies Act 2017, formerly known as the Companies Ordinance 1984. In addition, Pakistan followed the Anglo-Saxon model of CG while ownership concentration is high. SECP introduced the CCG in 2002 in Pakistan with voluntary provisions while in the recent reform of CCG 2012, SECP has made CG provisions mandatory. There is also a lack of minority shareholders' protection and shareholders do not have enough voting rights. The chapter also expounded the enforcement mechanisms in Pakistan and identified the gap in existing literature.

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<sup>10</sup> Researchers documented that tick box practice is common regarding compliance with the CG code (see (Khan, 2014; Samza, 2016). Hence the five-point Likert scale questionnaire (rating) provides more validity through going beyond binary coding (0, 1).

## CHAPTER FOUR

### METHODOLOGY

#### 4.1 Introduction

The suitable method is pivotal in completion of a research study. Section 4.2 explores the philosophical assumptions of research paradigms and approaches underlying each paradigm. Section 4.3 presents the appropriateness of the employed research method, while section 4.4 expounds the challenges in employing a mixed methods research design followed by phase I (qualitative research design) and phase II (quantitative research design). The chapter summary is provided at the end of chapter in section 4.20.

#### 4.2 Research Paradigms

This section presents the motivation of using two research paradigms i.e. interpretivism and positivism and use of the mixed research approach by combining an inductive (qualitative) and a deductive (quantitative) approach. The extensive literature review has shown a lack of CG research in Pakistan by employing quantitative and qualitative research (mixed) methodology. The development of a conceptual model and qualitative analysis suggests that resulting interpretations can be applied by employing an inductive research approach (Bernard & Bernard, 2012). Additionally, Smith, Thorpe, and Jackson (2012) documented that the appropriateness of different research philosophies mainly depends on their application to the development, extensions and refinement of theories. They further documented that research design and processes are influenced by research philosophies. Saunders (2011) documented that research philosophies rely on perception, analysis and infer meaning from data for development of knowledge. These features are also extended into three distinctive philosophical perspectives i.e. interpretivism, positivism and realism (Saunders, 2011) and interpretivism and positivism are mainly used in management research (Bryman & Bell, 2015). Interpretivists explore the social phenomena and rely on idealism while positivists document that knowledge is founded on pragmatism. The use of interpretivist philosophy is justified through the literature review and development of the conceptual model while positivism is justified by testing of the proposed model.

Neuman and Robson (2014) defined interpretivism as *“the systematic analysis of socially meaningful action through the direct detailed observation of people in natural settings in order to arrive at understandings and interpretations of how people create and maintain their social worlds”* (p. 86). While Saunders (2011) documented interpretivism as an alternative to the orthodoxy of positivism, researchers also identified problems of overdependence and

unidirectional inferences by employing a single research philosophy (Bryman & Bell, 2015). Consequently, a combination of interpretivism and positivism is employed in this study to reduce overdependence and avoid data biases. Drawing on interpretivism methodology, semi structured focus group interviews are employed to explore the key institutional determinants of good CG practices in Pakistan, followed by statistical analysis of quantitative data which helps in comparing (Saunders, 2011) and developing a deep understanding of the results (Boyd, Franco Santos, & Shen, 2012).

In order to understand the notion of CG and development of a CG framework, it is necessary to discuss them with professionals, practitioners, managers and decision makers. Positivism presents not only provable, testable causalities but also expounds this causal relationship among variables that helps in theory building from results (Saunders, 2011; Smith et al., 2012). Consequently, positivism generates objective facts similar to experimental research while interpretivism generates values and meanings without offering a direct nexus between subjects and objects (May & Williams, 2002). The positivist paradigm is employed in this study to identify barriers and drivers of good CG practices in Pakistan and to examine the empirical nexus between CG compliance and firm performance.

The research philosophies of interpretivism and positivism are closely aligned to inductive and deductive research approaches. Trochim (2006) mentioned these “*broad methods of reasoning as the inductive and deductive approaches*” (p.1). Trochim (2006) documented that moving from specific to general is called the inductive approach, whereas moving from general to specific is referred to as the deductive approach. He also documented that arguments which are based on observation and experience can be best articulated inductively whereas arguments which are based on rules and regulations are best articulated deductively. Creswell and Clark (2011) documented inductive and deductive approaches as bottom up and top down approaches. They argued that deductive researchers start from a theory to hypotheses to add to or contradict the theory. In contrast, inductive researchers start from participants’ views to build broader themes and develop a theory by integrating those themes. Table 1 presents the assumptions of interpretivism and positivism paradigms.



**Table 1 Assumption of Interpretivism and Positivism Paradigms**

<b>Assumptions</b>	<b>Concept</b>	<b>Interpretivism</b>	<b>Positivism</b>
<b>Ontological</b>	Nature of reality	Reality is subjective, socially constructed and may change.	Reality is objective and external
<b>Epistemological</b>	Relationship of researcher with that being researched	Researcher interacts with that under research	Researcher is independent
<b>Axiological</b>	Role of values in research	Research is value laden and biased	Research is value free
<b>Rhetorical</b>	Language of research	Informal style and personal voice	Formal style and passive voice
<b>Methodological</b>	Process of research	Inductive, small sample, in-depth, context bound	Deductive, large sample, highly structured, large sample, context free

Source: (Creswell & Creswell, 2017)

This study is conducted in the socio-economic environment of Pakistan that contains regulators, stakeholders and firms. One aspect of the study is to explore the key institutional determinants of good CG practices in Pakistan; hence, a qualitative approach is applied. In contrast, CG compliance is determined in PSX listed firms, thus, a quantitative approach is applied to find a nexus between CG compliance and financial performance. Additionally, this study also identifies the most influential barriers to good CG practices in Pakistan and also provides recommendations to promote CG practices by identifying the most important drivers of good CG practices in Pakistan. This implies multiple perspectives. Epistemological research investigates the nexus among scholar and what is being explored. Interpretivism confines the distance among researcher and that under research (Collis & Hussey, 2013) while positivism reduces the biases by the appropriate sampling method. Therefore, qualitative research differs from quantitative research because it allows the observing of social phenomena (Collis & Hussey, 2013). Therefore, interpretivism suggests interacting with practitioners and conducting semi-structured focus group interviews to explore institutional determinants of CG practices in Pakistan. In contrast, barriers and drivers of good CG practice and the nexus between CG compliance and financial performance are investigated empirically by using primary data, collected from survey questionnaire and annual reports and enable the scholar to remain independent of what is being explored.

The axiological assumption reinforces the role of values in this research. Thus, qualitative research deliberates more research ethics and value-laden and deliberates compared to quantitative research. The institutional determinants of good CG practices are not measured quantitatively but through a descriptive assessment of interviewees. In contrast, this study constructed a CG index to determine CG compliance and nexus with the financial performance of PSX listed firms. The rhetorical assumption emphasizes on the use of language in the study. Interpretivism prefers an informal writing style and reflects the immediacy of research (Collis & Hussey, 2013) while positivism is showed in formal and impersonal language grounded on acknowledged positions (Creswell, 1994). The methodological assumption is related to the process of undertaking the research. This study employs an inductive approach to explore the institutional determinants of CG practices in Pakistan while employing a deductive approach to explore CG compliance and identify barriers and drivers of good CG practices. Semi-structured focus group interviews are the most appropriate method in an inductive approach which helps in exploring the institutional determinants of CG practices in the distinct context of Pakistan, On the other hand, the deductive approach helps in identifying barriers and drivers of good CG practices and investigating the nexus between CG compliance and firm performance.

### **4.3 Research Design**

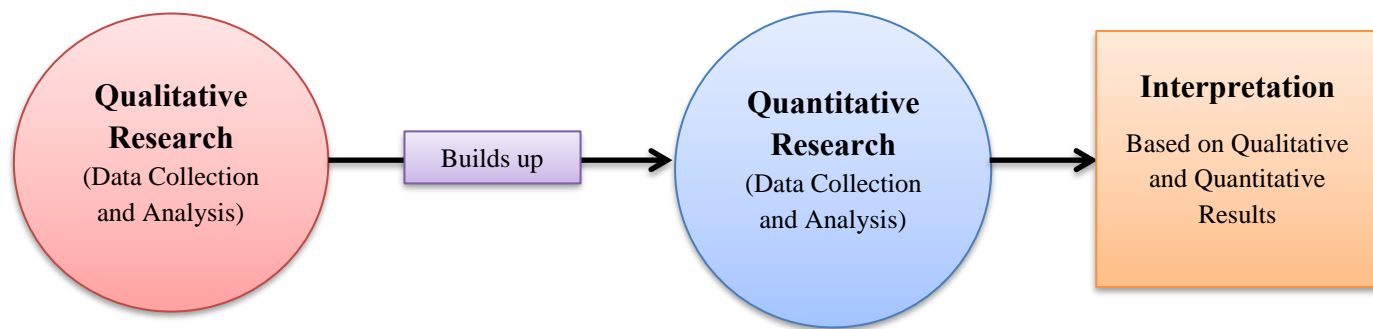
This section expounds mixed research method i.e. qualitative and quantitative methods with respect to the research objectives and questions of the study. This section also presents the appropriateness of mixed methodology for this study.

#### **4.3.1 Mixed Methods Research Design**

The use of both qualitative and quantitative data in one research is called mixed methods (Saunders, 2011) and these can be used one after the other (sequential) or at the same time (parallel). The mixed methods studies have gained attention around the world due to integration of qualitative and quantitative data (Boyd et al., 2012) and also provides profound understanding of CG reforms (Molina-Azorin, 2012; Zattoni et al., 2013). Moreover, the mixed method supports in overcoming the insufficiencies in a research which arise by using a quantitative or qualitative approach (Creswell & Clark, 2011). The exploratory sequential design is used in this research (Figure 2)<sup>11</sup>.

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<sup>11</sup> (see Creswell & Clark, 2011)

**Figure 2 Exploratory Sequential Research Design**

Source: (Creswell & Clark, 2007, p. 73)

This design is useful especially when the scholar needs to identify and test unknown variables quantitatively (Creswell & Clark, 2007). Moreover, scholars identify the unknown variables from the qualitative phase or stating the propositions for a test based on a framework. Consequently, this connects the qualitative phase to the subsequent quantitative phase and more emphasis is given to the qualitative phase. This study primarily employs the qualitative phase to explore the variables to test during the quantitative phase. The data is analyzed separately for both stages i.e. qualitative and quantitative, thus, two sets of results are merged during discussion and interpretation phases of this study. The following paragraph expounds the justification for choosing a mixed methods research design (i.e. qualitative and quantitative research approaches) in the Pakistani CG context.

It is evident that qualitative research approaches have gained attention and popularity among scholars over time (Morgan & Smircich, 1980). The evolving use of qualitative research in recent years is due to study of human behavior (Atieno, 2009; De Lisle, 2011; Gilbert, 2008; Hesse-Biber & Leavy, 2011). Consequently, both qualitative and quantitative techniques provide a unique opportunity to expound and understand the exact phenomena in a study. The literature also provides support for using interviews to conduct exploratory studies (Haniffa & Hudaib, 2006). Additionally, the reason for using a mixed methodology approach is its scope and appreciation by scholars (Molina-Azorin, 2012).

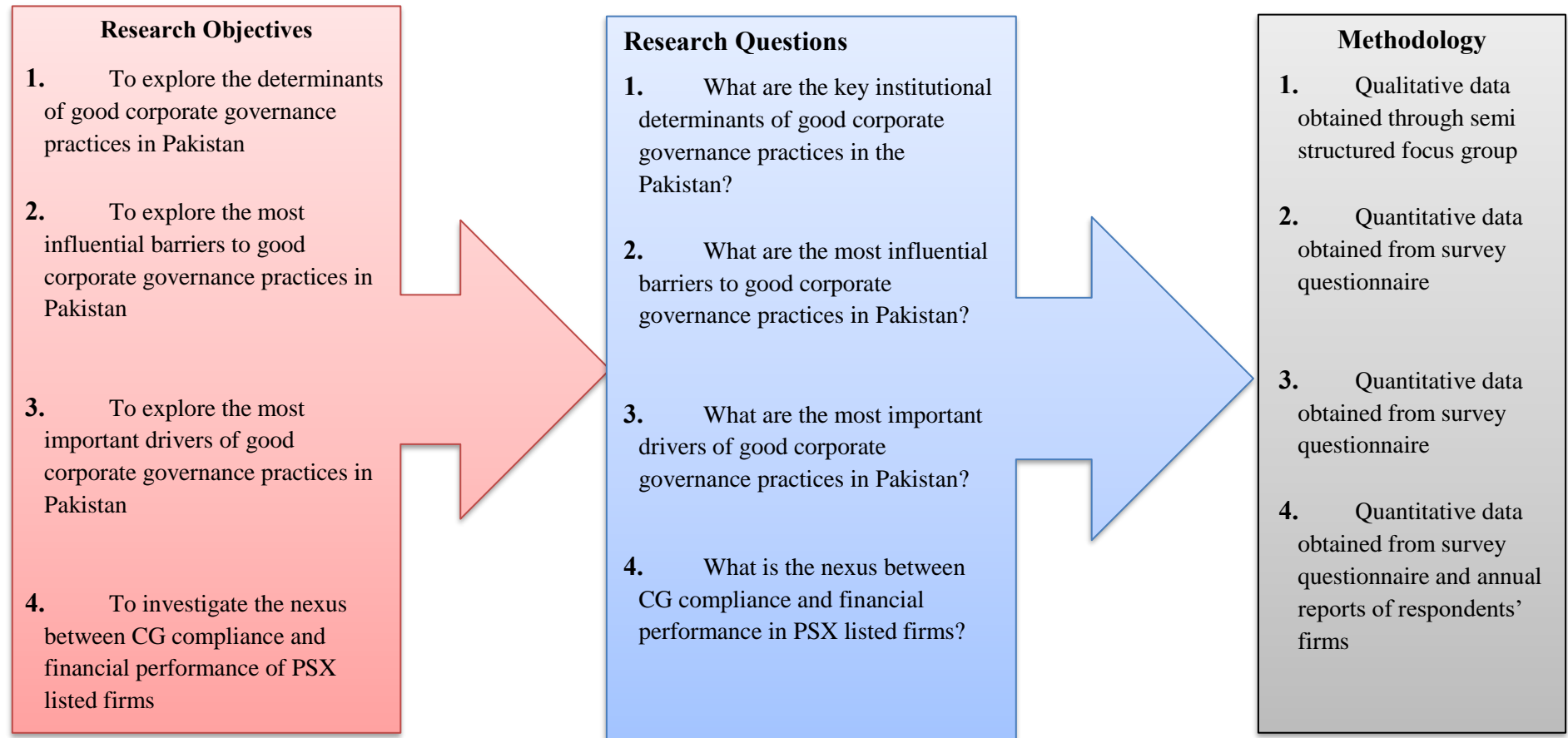
In the extended literature, mixed methods have gained attention of management scholars (Baydoun et al., 2013; Creswell & Clark, 2011; Zattoni et al., 2013) due to unwarranted consideration given to firms' and individuals' behaviors (Clarke, 1998). Furthermore, Boyd et al. (2012) acknowledged that mixed methods studies provide more credible and reliable results as compared to single method studies. In a similar vein, Molina-Azorin (2012) found that the tendency for citation of mixed methods studies are more compared to single method studies. It

shows that mixed methods studies are more acknowledged by scholars, consequently, due to employing mixed methods, this study adds a significant contribution to existing studies on emerging economies and CG literature. Furthermore, Tariq and Abbas (2013) documented that mandatory compliance with the code beyond certain levels does not contribute to improvement in the financial performance of Pakistani firms. They also documented that high scores on the CG compliance index are not a true indicator that firms are complying with the code of CG in a true spirit. Similarly, Khan (2014) also found that code compliance is in form not in substance. These findings indicate an alarming sign for regulators and policy makers.

A lack of understanding with regard to the code is also found in the Pakistani context. Consequently, the need arises to conduct a comprehensive study implementing an integrated research design to explore more deeply and provide profound guidelines in the best interests of policy makers and practitioners. In this regard, the integrated research design provides more room for comprehending the effect of CG reforms, compliance and performance nexus among PSX listed firms. Additionally, these approaches enable the researcher to find more perspectives and development of propositions through triangulation and extensive exploration (Bryman & Bell, 2015; Smith et al., 2012). Therefore, a mixed methods design is more suitable to address the research objectives and questions of this study as discussed in Figure 3.

Figure 3 reveals that this study seeks to achieve several research objectives to explore CG practices and reforms in Pakistan. This study aims to explore the key institutional determinants of good CG practices in Pakistan. Therefore, the study conducted semi-structured focus group interviews with key stakeholders to achieve this objective. Based on identified determinants of good CG practices, the study also explores different barriers and drivers of CG practices in Pakistan. At the end, the study examines the nexus between CG compliance and financial performance and proposes a model for good CG practices in Pakistan.

**Figure 3 Nexus between Research Objectives, Questions and Chosen Methodology**



#### **4.3.2 Research Questions and Chosen Methodology**

As included in Figure 3, the first research question is: What are the key institutional determinants of good CG practices in Pakistan? A triangulation approach (including literature reviews and semi structured focus group interviews) is employed to explore the key institutional determinants of good CG practices in Pakistan. The literature suggested board characteristics and ownership structure as main determinants of CG practices (Javid & Iqbal, 2008b; Lee & Park, 2008; Mallin & Ow-Yong, 2012; Samaha et al., 2012; Schiehl et al., 2013; Soobaroyen & Mahadeo, 2012) and this study explores new institutional determinants of CG best practices besides these determinants by conducting semi-structured focus group interviews with professionals and regulators. In addition, this research question helps in exploring and comprehending CG reforms in more detail by highlighting the level of CG awareness. The existing empirical CG studies (e.g. (Cohen et al., 2002; Khan, 2014; Samza, 2016; Tariq & Abbas, 2013) recommended the use of interview method to investigate the effectiveness of CG practices and reforms in Pakistan.

The second question of the study is: What are the most influential barriers to good CG practices in Pakistan? Based on identified determinants, the different barriers are identified and tested quantitatively through the survey questionnaire to highlight the most influential barriers to CG practices in Pakistan which restrain the implementation of a good CG system. The third question of the study which is: What are the most important drivers of good CG practices in Pakistan? Based on identified determinants, the different drivers are identified and tested quantitatively through the survey questionnaire to highlight the most important drivers of CG practices in Pakistan which can play a pivotal role in promoting CG practices.

Finally, the fourth question (i.e. What is the nexus between CG compliance and financial performance among PSX listed firms?) is explored via a self-constructed CG compliance index which is developed from the provisions of SECP CCG 2012 on a five point Likert scale, as evident from the recent CG studies (Ammann, Oesch, & Schmid, 2013; Michelberger, 2017; Nadeem et al., 2013; Tariq & Abbas, 2013; Varshney et al., 2012), and a CG compliance score is constructed to answer this question.

#### **4.3.3 Triangulation**

The concept of triangulation is often used by surveyors; however, social scientists use this notion for the reduction of methodological errors (Robson & McCartan, 2016) and the validation process of assessing the veracity of research results (Mertens & Hesse-Biber, 2012). The application of triangulation is to identify and minimize errors by employing multiple

theoretical, methodological and analytical lenses across the entire research process (Bryman & Bell, 2015). Therefore, triangulation not only increases the validity of findings and recommendations but also the contribution and application of the research (Miles, Huberman, & Saldana, 2013). In addition, triangulation is a partnership among different methods in data collection and confirming of results in one study. This study applies the following four types of triangulation as proposed by Miles et al. (2013).

*Theoretical triangulation:* This is the use of multiple theories or hypotheses to examine a phenomenon (Denzin, 2017). The intent is to conduct the study through multiple lenses and questions in mind to refute findings. This triangulation is applied in this study by considering greater possible variables from literature and qualitative and quantitative categories in the Pakistan context.

*Methodological Triangulation:* This is commonly referred to as multi method triangulation. It is used to refer to the combination of qualitative and quantitative methods and is a process of gathering information pertaining to the same phenomenon through more than one method to identify convergence and increase the validity of research findings (Kopinak, 1999). It involves the use of multiple methods (i.e. qualitative and/or quantitative) to investigate the phenomenon. For example, the results of interviews, focus group, and quantitative data could be compared, and validity is established if conclusions are same from each method. This triangulation is applied by using both inductive and deductive approaches.

*Data Triangulation:* It involves using different sources (i.e. stakeholders) of information to increase the validity of the study (Miles & Huberman, 1994). In the analysis stage, the feedback from stakeholders would be compared to determine the area of agreement and divergence. This triangulation is applied by collecting primary data through semi-structured focus group interviews and survey questionnaires from stakeholders in addition to secondary data from annual reports of PSX listed firms.

*Data Analysis Triangulation:* The method of data analysis is very important. Smaling (1987) described three approaches (i.e. intuitive, procedural and intersubjective approaches) of analysis of qualitative data. This study employs the procedural approach by documenting each step to make it transparent and replicable. Moreover, the study employs multiple analyses and evidences to test the hypotheses, including literature review, thematic analysis on qualitative primary data and other statistical techniques on quantitative primary and secondary data.

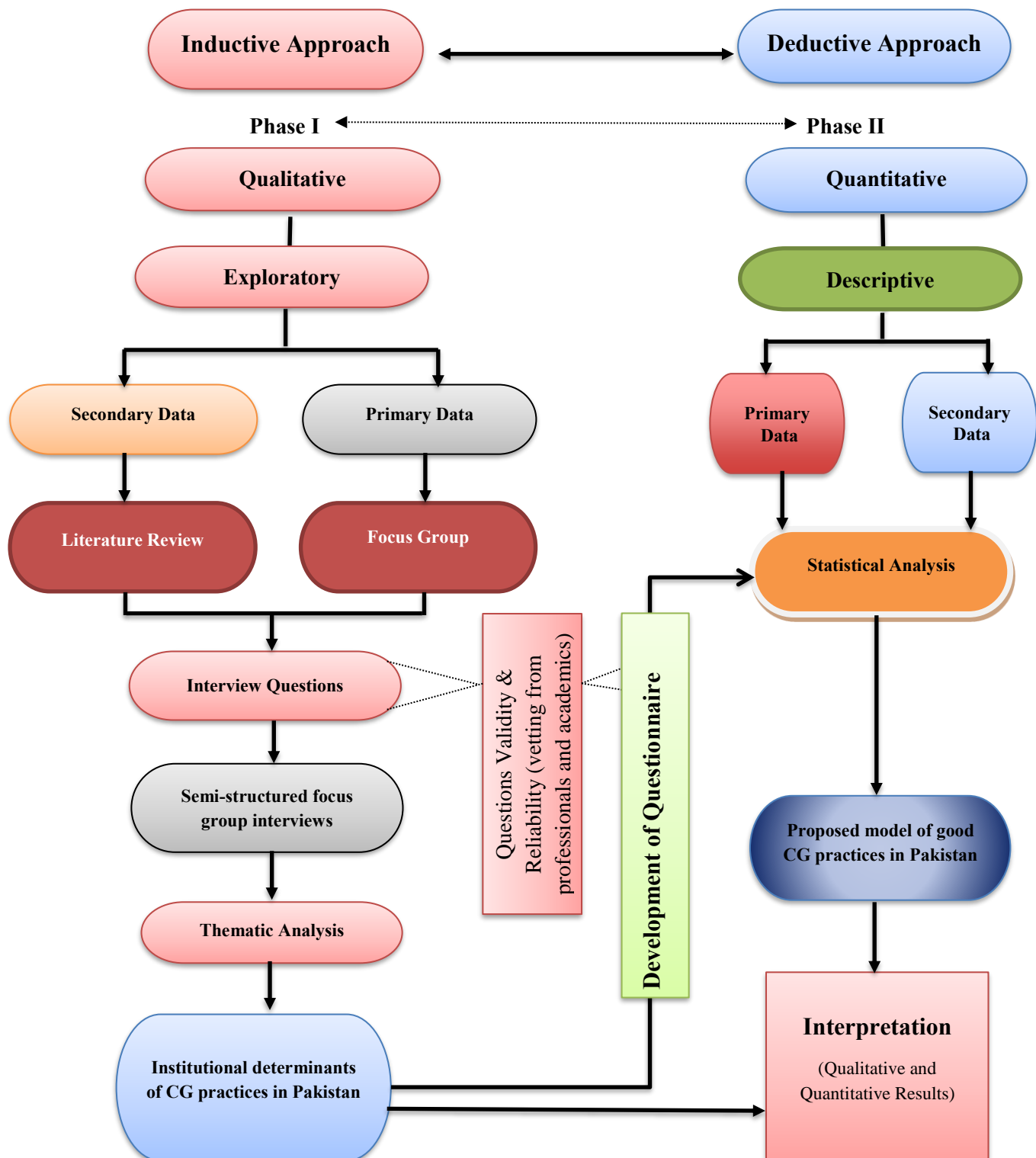
#### **4.4 Challenges in the Implementation of a Mixed Methods Research Design**

This section expounds the challenges in applying qualitative and quantitative research. Although the mixed method has gained attention over recent years, it may not overcome all the research problems (Creswell & Clark, 2011). Some scholars debate issues related to incompatibility of both quantitative and qualitative research (Foss & Ellefsen, 2002) while others debate that mixed methods provide a better picture of the study (Begley, 1996). Nevertheless, they all agree that mixed methods increase the robustness and accuracy of the research results (Begley, 1996; Creswell & Clark, 2011; Foss & Ellefsen, 2002; Saunders, 2011; Sekaran, 2003). In general, it is not easy to combine qualitative and quantitative methods due to their having different epistemological and philosophical frameworks (Creswell & Clark, 2011; Morgan, 1998). A challenging issue may arise if the results of one method contradict the findings of other (Foss & Ellefsen, 2002). Another challenge is the lack of commonality in mixed research methods.

Some scholars believe that mixed methods serve a quantitative paradigm (Howe, 2004) while giving auxiliary status to qualitative methods (Creswell, Shope, Plano Clark, & Green, 2006). In addition, researchers have argued that the mixed methods studies collide due to inability of researchers and gaps in the literature to integrate qualitative and quantitative results (Bryman & Bell, 2015; Creswell & Clark, 2011; Greene, Caracelli, & Graham, 1989). At the end, the cost of collecting qualitative data is another problem. Researchers may need to travel from one place to another to conduct the interviews which may be costly while quantitative data collection is easy and convenient. In sum, a researcher should keep all these issues in mind before choosing mixed research methods. As discussed in section 4.3.1, this study employed the sequential research design which is divided into two phases as shown in Figure 4. The phase I presents the inductive/qualitative approach while phase II presents the deductive/quantitative approach. The next section presents the detailed explanation of the sequential research design of this study.



Figure 4 Sequential Research Design of this Study



Developed by the researcher

## **PHASE I**

### **4.5 Introduction**

This section presents the qualitative research which is employed to address the first research question i.e. exploring the key institutional determinants of CG practices in Pakistan. Moreover, these qualitative findings help in the development of tool for phase II and integration of the qualitative and quantitative results of the study. This section presents the theoretical framework of qualitative research, the validity and reliability of qualitative research and the interview process, followed by ethical considerations and finally this section expounds an analysis qualitative data.

### **4.6 Qualitative Research**

In recent years, qualitative research has received great attention in CG literature as well in social sciences (Saunders, 2011; Soobaroyen & Mahadeo, 2012). In a similar vein, Zattoni et al. (2013) argued that mixed conclusions in CG studies have served as enthusiasm for researchers to use qualitative methods. Therefore, in this situation, a qualitative study is more desirable in exploring the key institutional determinants of good CG practices in Pakistan. Additionally, Mengoli, Pazzaglia, and Sapienza (2009) argued that the robustness of results increases by integrating the qualitative and quantitative findings.

In recent years, qualitative research has become common among social science researchers (Scott & Garner, 2013) due to close studying of human behavior (Lichtman, 2013) and it discovers in-depth social reality (Collis & Hussey, 2013). Consequently, qualitative research is a holistic approach, generates knowledge from various viewpoints (Scott & Garner, 2013) and aims to provide more robust results (Creswell & Clark, 2011). Corbin and Strauss (2008) documented three objectives to conduct qualitative research, i.e. (1) it offers a detailed explanation of social life and, (2) it explores social reality and (3) it expounds social phenomena while Becker, Bryman, and Ferguson (2012) suggested three key steps to conduct qualitative research. First, the researcher needs to determine the research problem and questions. The next step is to select suitable methods while the last step is analyzing and interpreting the data. Researchers documented that a few points need to be considered to conduct qualitative research (Bryman & Bell, 2015). First, qualitative research uses an inductive approach, thus, it does not develop hypotheses. Secondly, it is a flexible approach (Silverman, 2015), hence, there is no single method which fits into every research (Bryman & Bell, 2015). It explores the phenomena in detail; hence, it focuses on a limited number of

themes and sample size. The next section expounds the validity and reliability of qualitative research.

#### **4.6.1 Validity and Reliability of Qualitative Research**

Researchers have argued that validity and reliability are pivotal in qualitative research (Bryman & Bell, 2015) and heavily dependent on data gathering and analysis procedure (Creswell & Creswell, 2017; Hesse-Biber & Leavy, 2011). Therefore, no such tests exist which can determine the reliability and validity of qualitative research. Reliability denotes to the prospect of replicating the same results in repetitive research (Collis & Hussey, 2013) while validity means interpretation of results to reflect the phenomenon. Silverman (2015) suggested three ways to increase the reliability of interviews: (1) development of an interview guide), (2) accurate recording and transcription to make more reliable findings, and (3) maintaining inter-coding reliability. Additionally, the validity of interviews can be determined through selection and willingness of respondents to provide knowledgeable data (Louise Barriball & While, 1994). Researchers argued that qualitative validity depends on the accuracy of findings through explicit procedures while qualitative reliability implies the consistency of the researcher's approach through various projects (Creswell & Clark, 2011; Gibbs, 2018). Similarly, Creswell and Clark (2007) documented that validity is a strength in qualitative research and can be ensured through applying different validity strategies including triangulation, member checking and clarifying the researcher's bias. Hence, triangulation, member checking and researcher bias are applied in exploring the questions and verifying the results.

It can be concluded from the above discussion that both reliability and validity depend on data collection and the interview process and no such tests exist to measure validity and reliability in qualitative research (Gibbs, 2018).

#### **4.7 Interviews**

Researchers have emphasized the importance and use of interviews within qualitative research (Bryman & Bell, 2015). Interview is an research technique to gather data via perceptions and life experiences of individuals (Scott & Garner, 2013) and it provides flexibility in data collection and analysis (Bryman & Bell, 2015). Interviews have three main types i.e. structured interviews, unstructured interviews and semi-structured interviews (Silverman, 2015). The structured interviews depend on particular answers (Scott & Garner, 2013) and are frequently used in quantitative research, while semi-structured interviews provide liberty to diversify and

ask questions according to given answers (Haniffa & Hudaib, 2006). Semi-structured interviews are generally in depth and informal (Robson, 2002), thereby allowing the researcher to explore other areas of interest. In semi-structured interviews, the researcher develops an interview guide which guides the discussion about all issues (Bryman & Bell, 2015). The next section expounds the semi-structured focus groups that are employed in this study.

#### **4.7.1 Semi Structured Focus Group**

A focus group is a interview that is conducted with a small group of people on a particular topic (Patton, 2002) and has been widely used in social science research for qualitative data collection (Morgan, 1998). Focus groups are useful in exploring, clarifying and reacting to ideas (Krueger, 2014). They are an informal discussion among a group of selected individuals about a topic (Wilkinson & Silverman, 2004) and usually consist of 6 to 10 participants and a moderator (Howell, 2012). The rationale of this group size is to ensure information diversity. In addition, the focus group also offers a collective set of observations, experiences and values which are interpreted in the context. Moreover, it is a qualitative research instrument that demonstrates the essential bias for systematic attention to specify additional solid ground (Morgan, 1998). In addition, it is particularly helpful in obtaining and discovering new information on the same topic (Krueger, 2014) and is more economical.

Though there are benefits in using a focus group, it has some limitations as well<sup>12</sup>. Compared to one on one interviews, a focus group may not explore more in-depth information. In addition, participants may not be as cozy as in one-on-one interviews and may not expose sensitive information. Researchers generally need quite high levels of interviewing expertise to conduct focus group interviews. For instance, they require ‘gatekeeping’ skills to help avoid ‘group think’ outcomes and preventing any individuals from dominating conversations as well as teasing contributions from quieter members. That said, where the focus group does not present any of these dilemmas the researchers should be mostly anonymous, often only needing to contribute to commence, prompt occasionally and finalize the session.

To overcome the limitations of the focus group, this study employed a semi-structured focus group in which interviews are conducted individually (one-on-one), following the interview protocol and guide to keep the same context and ensure validity and reliability.

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<sup>12</sup> (see Creswell & Creswell, 2017; Zikmund, Babin, Carr, & Griffin, 2013)

#### **4.7.2 Selection of Interviewees and Interview Instrument**

Researchers have argued that the data quality determines the quality of findings (Saunders, 2011) and it is critical to develop a criteria for the selection of interviewees. This study employed a purposive sampling technique and only those respondents were considered who had the required experience of corporate governance in Pakistan to obtain informed opinions (see Bailey & Peck, 2013). In line with other studies, this study carefully recruited interviewees and focused on quality of data rather than quantity (see Haniffa & Hudaib, 2006). Consequently, this enhanced the reliability of the data.

After identifying the targeted respondents, the researcher invited them to participate in the study through email and/or telephonic invitations and provided them with a research information sheet, detailing the objectives of the study, time required for interview and processing to ensure their confidentiality and anonymity. These procedures increase creditability and encourage respondents to contribute to the study (Creswell & Creswell, 2017). After using these techniques, a focus group was identified consisting of eight participants. The first interview package – including an initial invitation email, a follow up email and/or phone call, a consent form and an interview guide – was prepared for conducting interviews with the agreed participants.

#### **4.7.3 Interview Protocol**

Table 2 presents the interview protocol. It can be seen that the duration of interviews ranged from 28 minutes to 43 minutes and interviews were conducted with directors/CEO or CG experts and/or consultants. A total of eight semi-structured focus group interviews were conducted, however, two participants did not allow recording of the interview. After getting approval from the Human Ethics Committee (HEC) of the concerned university, written permission (consent form) was taken from participants before starting the interview<sup>13</sup>.

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<sup>13</sup> The whole process took eight months starting from taking HEC approval to conducting interviews.

**Table 2 Interview Protocol**

<b>Interview Type</b>	Semi-structured focus group
<b>Duration of Interview</b>	28 - 43 minutes
<b>Level of interviewees</b>	Director/CEO/ CG experts or consultants
<b>No. in semi-structured focus group</b>	8
<b>Purpose and style</b>	Information extraction and exploration
<b>Interview Place</b>	Online or office
<b>Language</b>	English
<b>Confidentiality</b>	High
<b>Morality and Ethics</b>	Took Human Ethics committee approval from relevant university. Written consent is taken from participants
<b>Recording responses</b>	At the start of interview, interviewer told respondents that it will be recorded, and recording is started after their approval.
<b>Information exchange</b>	Detailed information was provided about the project and process. Preliminary questions were addressed in advance.
<b>Question Types</b>	Open ended (see Appendix B)

#### **4.7.3.1 Interview guide**

A interview guide is employed to guide the discussion and extract the information from participants (Smith, 2015). Similarly, Bryman and Bell (2015) suggested that the interview guide needs to be comprised of questions that address the underlying research problem to conduct a semi-structured focus group. Hence, an interview guide, consisting of brief questions, is used to conduct the semi-structured focus group (see Appendix C).

#### **4.8 Final Interviews**

The initial contacts were made through email invitation, followed up by email and or/ telephone. As only eight participants agreed to participate in the research, the interviews were conducted face to face and/or over skype, following the same interview protocol to ensure consistency among interviewees; however, different probes and prompts were used to gather as much as possible in-depth information from each interviewee. In addition to audio recording of interviews, notes were taken as back up.

#### 4.9 Ethical Considerations

In qualitative research, it is pivotal to consider ethical issues (Bryman & Bell, 2015). The research ethics are considered in three stages including before, conducting interviews and collection (Saunders, 2011). Similarly, Bryman and Bell (2015) suggested that interviewees should know about the purpose, the nature of the study and their rights of withdrawal from the interview. The research ethics are considered during data analysis and reporting of findings by keeping the confidentiality of interviewees. Similarly, Linck and Netter (2008) argued that interviewees' information should be treated confidentially and the interviewees' privacy ensured at every stage (Bryman & Bell, 2015). In addition, Lichtman (2013) argued that the researcher should ask appropriate questions and avoid questions about personal lives of interviewees. This research study is approved by the Human Ethics Committee of Lincoln University, New Zealand (see Appendix A).

#### 4.10 Analysis of the Semi Structured Focus Group

All the semi structured focus group interviews were transcribed verbatim into Microsoft Word. Only the researcher was involved in the transcription process in order to achieve the highest level of familiarity with the data before commencing analysis. Each respondent was assigned a pseudonym to hide their identity. Table 3 presents the summary of all the interviews:

**Table 3 Summary of Interviewees**

<b>Pseudonym</b>	<b>Experience</b>	<b>Position</b>	<b>Interview Status</b>
R1	20 years	Director	Recorded and notes were taken
R2	11 years	Consultant- Corporate Governance	Recorded and notes were taken
R3	9 years	Director	Recorded and notes were taken
R4	8 years	Director	Recorded and notes were taken
R5	17 years	Director	Recorded and notes were taken
R6	14 years	Head of CG Compliance	Recorded and notes were taken
R7	9 years	Legal Consultant-Corporate Governance	Not recorded- only notes were taken
R8	16 years	Senior Manager – Corporate Governance	Not recorded- only notes were taken

The transcribed data were transferred to a qualitative software package called NVivo for analysis. The use of software reduces the chances of making mistakes, analyzes the data more effectively and avoids missing key concepts (Quinlan, 2011). NVivo data analysis involved summarizing data into different categories based on concepts and themes (Neuman & Robson, 2014; Sekaran & Bougie, 2016). The study employed a coding process, consisting of three stages. Open coding is the first stage where the researcher goes through the transcribed interview to abridge the data into codes based on research interests. This stage creates numerous codes considered as sub-categories. Axial coding is the next phase, where the researcher finds common and repeating ideas by looking for the relationships and links among the sub-categories. This stage creates fundamental categories from the previous stage sub-categories (codes). Selective coding is the final stage in the coding of qualitative data where the researcher discovers the aggregate themes by looking into all the categories and sub categories. These new generated themes are called core themes (Creswell & Clark, 2011; Neuman & Robson, 2014; Quinlan, 2011) and directly related to the research questions.

The first stage of the coding process generated 131 open codes. In the second stage, the primary codes were revised by grouping similar codes with the same ideas in order to produce axial codes. This stage resulted in 11 key codes and 41 sub-codes/themes. The researcher then scanned all generated codes and sub-codes to develop the final core codes. This final coding stage resulted in eight core codes (themes) aligned with the research question (Table 4).



**Table 4 Semi Structured Focus Group – Themes and Codes**

<p><b>1. Auditing</b></p> <p>Auditor Independence</p> <p>Audit Committee</p> <p>Risk Management</p> <p><b>2. Political</b></p> <p>Political System</p> <p>Political Influences</p> <p>Corruption</p> <p><b>3. Legal</b></p> <p>Compliance</p> <p>Enforcement</p> <p>Regulators</p> <p><b>4. Board</b></p> <p>Board Independence</p> <p>Board Heterogeneity</p> <p>Nepotism/Kinship</p> <p><b>5. Shareholders' awareness</b></p> <p>Shareholders' Rights Protection</p> <p>Education and Training</p> <p><b>6. Values</b></p> <p>Family System</p> <p>Interpersonal Connections</p> <p><b>7. Culture</b></p> <p>Institutional Culture</p> <p>Organizational Whistle-Blowers</p> <p><b>8. Voting</b></p> <p>AGM participation</p>
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## **PHASE II**

### **4.11 Introduction**

This section presents the phase II of the research methodology used in this thesis. First of all, this section expounds the quantitative research followed by population, sample size and data collection including primary and secondary data through the survey questionnaire and annual reports. Second, the section presents the question design and development of the questionnaire. Secondly, the section also presents the procedure of development of the survey questionnaire. This section also provides the pilot study and Cronbach's Alpha to check reliability and validity. At the end, this section also presents the models used in data analysis of the quantitative data.

### **4.12 Quantitative Research**

This study adopted deductive approach and positivist paradigm. Quantitative research was more suitable in achieving the objectives of this study. A positivist research paradigm and deductive approach have been adopted and quantitative research is necessary to achieve the aims and research questions of the study. Quantitative research can be explanatory, predictive and confirmative in nature. Survey is a famous type of quantitative method which offers information on what people perceive (Nardi, 2018; Neuman & Robson, 2014).

### **4.13 Population and Sample**

A population is an entire set of individuals, events or subjects of interest that the researcher wishes to investigate (Mugenda, 2003; Sekaran, 2003) and it is pivotal to define the population and sample to ensure that the sample is an accurate representation of the population. The population of study consists of all the 579 firms listed on the Pakistan Stock Exchange (PSX) and the sample should be drawn carefully to represent the whole population. However, researchers also documented some determinants such as research objectives, time and cost, proposed analysis and size of population that may affect decisions regarding selection of the sample size (Sekaran & Bougie, 2016; Veal, 2005). In addition, Kothari (2004) suggested that the sample size should not be too large nor too small. Consequently, this research used a purposive sampling technique to recruit the sample. This technique has been widely used in the existing studies on CG in different countries (Anis, 2013; Fuzuli, Pahala, & Murdayanti, 2013; Mariri & Chipunza, 2011; Nur'ainy, Nurcahyo, Sri Kurniasih, & Sugiharti, 2013). This is a type of non-probability sampling technique in which the sample is selected in view of the purpose and defined criteria (Zikmund et al., 2013). This research excluded the financial

companies from the sample due to their different CG structure. In a similar vein, Neuman and Robson (2014) argued that a purposive sampling technique is appropriate when researcher aims to attain the profound understanding of underlying research theme and have already selected their sample. The sample is recruited on two basic criteria. First, only those companies were contacted which had recent annual reports available (2017 or 2018)<sup>14</sup> because the study used the performance data from annual reports of the companies. Second, the survey was conducted from different respondents including managers, accountants, auditors or other members of organizations who were involved in the preparation of CG reports. Based on the above criteria, the questionnaire was distributed to 350 respondents<sup>15</sup>, however, only 120 questionnaires were received. Out of 120 filled questionnaires, 15 questionnaires were incomplete, hence, making a final sample of 105 respondents.

#### **4.14 Questionnaire Survey**

The study used the questionnaire survey to collect the primary data from respondents. Collis and Hussey (2013) documented that a questionnaire is a list of carefully chosen structured questions that are executed after considerable testing to elicit responses from respondents. In a similar vein, Sekaran (2003) argued that a questionnaire is a written set of questions to record respondents' answers. In addition, Zikmund et al. (2013) documented that the questionnaire method is very helpful in getting information from respondents related to the research problem and helps decision makers to address the problem. Existing literature also provides the evidence that a survey questionnaire is commonly used in the area of social sciences and all respondents were asked to answer the same questions in same circumstances (Easterby-Smith, Thorpe, & Jackson, 2012).

In line with the views of Oppenheim (1992) and Foddy and Foddy (1994), this study used a survey questionnaire for several reasons. It is the most commonly used method for data collection and ensures the anonymity of respondents; consequently, respondents respond in a more free and convenient manner. Hence, the credibility of data and research is increased. It is appropriate for individual researchers who have shorter time span and limited resources. Survey questionnaire can easily disseminate to a larger sample which increases the credibility of data and generalizability of results. In addition, researchers also documented that a survey questionnaire is the best method of gathering data because CG studies are descriptive in nature

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<sup>14</sup> In Pakistan, some companies have their year ending in June while some have December.

<sup>15</sup> There is a total of 579 PSX listed firms in Pakistan, however, only 365 firms fulfilled the set criteria. Out of 365 companies, 15 companies were further excluded and were used in the pilot study (*see section 4.16*).

(Alleyne, Howard, & Greenidge, 2006; Denscombe, 2014; Jones, Baxter, & Khanduja, 2013; Paape, Scheffe, & Snoep, 2003). There are two types of questionnaires as documented by Oppenheim (1992) and Bryman and Bell (2015). First is the self-administered questionnaire which can be conducted into three ways i.e. postal, internet mediated and hand delivered and collected (Jones et al., 2013). Second type is interviewer administered questionnaire which is classified into two types i.e. the structured interview and telephone questionnaire (Jones et al., 2013). Additionally, researchers also documented that the choice of questionnaire depends on many factors including sample size, respondents' characteristics, purpose of data gathering and number of questions (Saunders, 2011).

Keeping in view the objectives of the study, the self-administrated questionnaire was suitable and employed for several reasons. It was more appropriate in the Pakistani context due to authenticity<sup>16</sup>, time savings, being easy to distribute, cheaper and kept anonymity that encouraged respondents and increased the response rate. In addition, existing studies on CG have already utilized this method (Goodwin & Seow, 2002; Hussain & Mallin, 2003; Solomon, Lin, Norton, & Solomon, 2003). Though the self-administrated questionnaire can be distributed through the post, internet and hand delivery, researchers argued that hand delivery method is the most appropriate for several reasons (Jones et al., 2013; Sekaran, 2003). It provides an opportunity to the researcher to motivate respondents to answer truly through providing a brief introduction about the research topic. Moreover, the researcher can collect responses in a shorter time and can clarify any ambiguity of respondents about questions. In addition, the questionnaire can be distributed to a large sample in a less expensive way as compared to interview and requires less skills. The researcher hired two research assistants to distribute the questionnaire to respondents to save time and cost<sup>17</sup>. The distribution and collection of questionnaires took two months.

#### **4.15 Questionnaire Design**

Researchers have argued that the questionnaire design is a very complex process and guidelines need to be followed (Collis & Hussey, 2013). The questionnaire needs to be in simple and concise language to ensure the respondents understand the meaning of questions in the same

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<sup>16</sup> Due to many fraudulent emails and links, respondents are not comfortable with filling the questionnaires online which may reduce response rate. In addition, sometimes, emails go to a spam folder to protect from fraudulent activities.

<sup>17</sup> The researcher was based in New Zealand and it was not possible for the researcher to go back to Pakistan to collect survey data due to time and huge travelling costs. Therefore, two research assistants were hired who have relevant qualifications and experience to save time and cost. In addition, a pilot study was conducted which helped in training the research assistant *see (Connelly, 2008)*. The survey was completed in six weeks.

way. Moreover, questions need to be specific so that respondents do not give several answers. The questionnaire was formulated from multiple sources<sup>18</sup> to ensure validity (Brace, 2018; Jann & Hinz, 2016; Perkins & Peterson, 2005). The survey questionnaire employed several kinds of questions such as Likert scale and multiple-choice questions. As seen in Annexure D, the questionnaire consists of four parts including demographic information to increase participants' confidence (Kelley, Clark, Brown, & Sitzia, 2003). The first part comprises the questions linked to the level of CG compliance, measured through a five-point Likert scale ranging from (1) strongly disagree to (5) strongly agree. The first part consisted of 48 CCG 2012 provisions, divided into seven sub sections i.e. Auditing, BoDs, Charters/laws, Directors' Education, Executive Director Compensation, Ownership and Progressive Practice. This section represents the independent variable of the study and is used to compute the CG index (CGI) score.

The second and third parts comprise barriers and drivers of good CG practices in Pakistan, respectively, which are also measured through a five-point Likert scale ranging from (1) strongly disagree to (5) strongly agree. The part two (barriers) consists of seventeen items; (1) Lack of Auditors' Independence, (2) Board Ineffectiveness, (3) Institutional Culture of Pakistan, (4) Political and Governmental Interference in Business Activities, (5) Weak Legal Control and Enforcement, (6) Lack of Shareholders' Awareness, (7) Lack of Resources for CG Compliance, (8) Lack of Shareholders' Rights Protection especially Minority Shareholders, (9) Lack of Protection for Whistle Blowers, (10) Lack of Professional Education and Training among Stakeholders, (11) Fewer Voting Rights, (12) Low AGM Participation, (13) High Level of Corruption, (14) Nepotism or Kinship Culture, (15) Wobbly/unstable Economy of Pakistan, (16) Strong Social Ties among Different Stakeholders, and (17) Interpersonal Connections among BoDs while part three (drivers) consists of twelve items; (1) Auditors Independence, (2) Internal Control and Risk Management, (3) Provide Protection to Whistle Blowers, (4) Enhancing and Empowering Professional Regulatory Bodies, (5) Board Heterogeneity, (6) Board Independence, (7) Encouraging Participation in Events and Conferences related to Corporate Governance), (8) Enhancing Partnership with International Regulatory Bodies i.e. OECD, IFC to Promote CG in Pakistan, (9) Provide Accounting and Auditing Education to Internal Stakeholders, (10) Initiation of Training Programs for Directors, raise Awareness and Education for CEOs, Directors, Shareholders and Board Members, (11) Establish Corporate

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<sup>18</sup> The questionnaire is developed based on provisions of CCG 2012 and findings of the qualitative study (see chapter five).

Governance Education Programs at Universities, and (12) Promote CG Research in Pakistan. Finally, part four comprises respondents' demographic information including age, position within organization, qualification, specialization and experience within job.

#### 4.16 Pilot Study

A pilot study is widely used by researchers to reduce errors at very minimal costs. After designing the questionnaire, a pilot test was conducted to ensure validity and reliability of the instruments and procedure for data collection. The purpose of conducting a pilot study is manifold. It helps in developing and testing the adequacy of the research instrument, designing and testing protocols for study, collecting preliminary data and training of research assistants (Connelly, 2008). In addition, the participants in a pilot study are not included in the final sample to avoid response bias. Connelly (2008) stresses that a pilot study sample should be at least 10% of the total sample size of the study. Hence, this research conducted a pilot study from 15 respondents to fulfil the aforementioned objectives.

#### 4.17 Validity and Reliability

The instruments were pre-tested to ensure the content and face validity by analyzing consistency and interpretation. For this purpose, the questionnaire was sent to experts in the field of CG to eliminate ambiguity and inadequacy. Simple words and language were used to ensure validity. Moreover, redundant and complicated terminologies were eliminated. The items were tested for their reliability through Cronbach Alpha with the help of Statistical Package for Social Sciences (SPSS) 24. The Cronbach alpha indicates how well items in a set are positively correlated to each other and Cronbach alpha is determined for the items. The results of Cronbach Alpha are presented below (Table 5):

**Table 5 Cronbach Alpha Value of Instrument**

<b>Parts</b>	<b>Variables</b>	<b>Number of total Items</b>	<b>Cronbach Alpha</b>
1	Level of Corporate Governance Compliance	48	0.892
2	Barriers to Good Governance Practices	17	0.854
3	Drivers of Good Governance Practices	12	0.845

As seen in Table 5, the Cronbach Alphas for all three parts were above 0.70. The coefficient of Cronbach Alpha ranges between zero to one and above 0.7 are considered as highly reliable (Sekaran & Bougie, 2016).

#### 4.18 Data Collection

In addition to primary data, this research also used secondary data for analysis. The primary data is gathered via a survey questionnaire as discussed in the section 4.15. Secondary data has some advantages over primary data due to its time and cost effectiveness (Saunders, 2011; Sekaran & Bougie, 2016). Similarly, Ghauri and Grønhaug (2005) documented that it is desirable to use secondary data over primary data to answer the research questions if it is available. Consequently, this study also used secondary data to measure firm performance such as return of assets (ROA), return on equity (ROE) which is collected from recent annual reports of sampled firms<sup>19</sup>.

#### 4.19 Data Analysis and Presentation

A research study produces massive raw data and it is necessary to organize and score data systematically for data analysis (Collins, 2003). In this research, the data is gathered from PSX listed firms through self-administrated questionnaires. The data analysis is fascinating, creative and time consuming process (Marshall & Rossman, 2014). This research used descriptive statistics, exploratory factor analysis (EFA), correlation and regression analysis to achieve the research objectives and SPSS 24 was used as a tool for data analysis. First, this research employed explanatory factor analysis (EFA) which is an interdependence method for classifying the most influential barriers and drivers of good CG practices in Pakistan. The factor analysis investigates the inter-correlations between the items and reduces them into small groups. The factors within a group are quite similar in meaning and represent the same meaning. This technique allows the researcher to determine underlying factors or dimensions that exist in a given data set. This technique is useful in academic and managerial research in reducing the items into discrete dimensions that can be further aggregated. Second this research estimated a hierarchical multiple linear regression model for the study which is mentioned below:

$$\text{Firm Performance: } \beta_0 + \beta_1 \text{Demographic variables} + \beta_2 \text{CGI Score}_2 + \varepsilon$$

Where

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<sup>19</sup> Data is collected only for those firms, who filled in the survey questionnaire.

$\beta_0$  = Constant

Demographic variables: Age, Qualification, Specialization, Experience which is collected from the survey questionnaire

Firm Performance: ROA and ROE from annual reports

ROA = Net Income / Total Assets

ROE = Net Income / Total Shareholders' Equity

CGI Score: Corporate Governance index (CGI) Score which is calculated from the survey questionnaire

$\epsilon$ : Error term

#### **4.20 Chapter Summary**

This chapter discusses the methodology used in this study to explore key institutional determinants of CG practices in Pakistan. First, the chapter discussed the research paradigm (interpretivism and positivism) used in this study. The appropriateness of these research paradigms and their use in the study are also discussed in this chapter. The use of inductive and deductive approaches and their application in the context of study are also discussed. Second, the chapter presents a mixed methods research design and an explanation for choosing this design in the study. The chapter also highlights the strengths of a mixed methods research design and also discusses the nexus between the research objectives and questions with a mixed methods research design. The chapter provides justification for using qualitative and quantitative research related to each research question. Third, the chapter presents the benefits of triangulation in mixed methods studies. In phase I, a qualitative research design is employed. Semi-structured focus group interviews were conducted with professionals and regulators to explore the key institutional determinants of good CG practices in Pakistan. In addition, an interview guide is used to conduct the interviews which were recorded, and notes were taken. The qualitative data is transcribed into verbatim words and NVivo software is used as a tool to analyze the qualitative data. Eight themes (presented in Table 4) were explored i.e. (1) Auditing, (2) Political, (3) Legal, (4) Board, (5) Shareholders' awareness, (6) Voting, (7) Culture and (8) Values which are discussed in detail in chapter five.

In phase II, the quantitative research design is employed. The quantitative data is collected from 105 PSX listed firms using a purposive sampling technique through five-point Likert scale survey questionnaires. The survey questionnaire consists of four parts. The first part presents the CG compliance and consists of forty-eight provisions from SECP CCG 2012. The second part is consisting of potential barriers to good CG practices in Pakistan and consists of



seventeen items. The barriers are identified from qualitative data analysis. Furthermore, the third part consists of drivers of good CG practices in Pakistan and consists of twelve items. These items are also extracted from qualitative analysis. Regarding firm performance, the secondary data is collected from annual reports of sampled firms. Descriptive statistics and correlation analysis are conducted in phase II. In addition, EFA is employed to identify the most influential barriers of good CG practices in Pakistan which prevent the best CG practices in Pakistan. Moreover, the most important drivers are also identified which can promote good CG practice in Pakistan by employing EFA. Finally, the multiple hierarchical regression analyses were conducted to investigate the nexus between CG compliance score and firm performance among PSX listed firms.

## CHAPTER FIVE

### FINDINGS OF THE QUALITATIVE PHASE

#### 5.1 Introduction

This chapter presents the analysis of the focus group. The chapter expounds the themes which are identified by focus group interviews. Eight themes emerged as the result of the focus group interviews. These themes are; (1) Auditing, (2) Political, (3) Legal, (4) Board, (5) Shareholders' awareness, (6) Voting, (7) Culture and (8) Values and they were discussed by the participants of the focus group. These themes are key institutional determinants of good CG practices in Pakistan and fulfill the first objective. A chapter summary is presented at the end.

#### 5.2 Auditing

Auditing is a self-regulatory element of CG and creates appropriate links of information, governance and incentives between investors and managers. It encompasses a broad group of intermediaries i.e. financial analysts, investors, ratings agencies, corporate boards (internal governance agents), and auditors (internal and external) (Healy & Palepu, 2003). Researchers have documented the importance of auditing for improving CG practices. Preston, Cooper, Scarbrough, and Chilton (1995) argued that the audit process is profoundly convoluted in the development of professional codes of ethics and rules on independence through formal procedural knowledge. In addition, Grabosky (1995) documented that reputational intermediaries work as gatekeepers by ensuring quality information and compliance with regulations. However, these intermediaries may have their own set of incentives and problems, thus, they are regulated by different state agencies and certified professional bodies. As compared to board structure and shareholder activism, auditing issues have received less attention in CG debate because these are considered straightforward and technical in nature.

In Pakistan, the auditing process is not effective and auditors lack independence (Samza, 2016). The focus group analysis reveals that auditors have links with management and owners of firms and sign off practice is quite common. However, researchers argued that the purpose of audits is to identify fraud, and auditors provide a judgement on the financial statements with reference to the concept of fairness or a 'true and fair' view (Humphrey & Moizer, 1990; Humphrey, Moizer, & Turley, 1992). In Pakistan, the situation is contradictory and lacks transparency and fairness because auditors are not independent and audit committees are mostly comprised of family members or relatives who are serving as independent directors (Khan, 2014). The following sections expound evidence on three categories (1) auditor independence, (2) audit committee and (3) risk management that are classified together as auditing.

### 5.2.1 Auditor Independence

Auditor's effectiveness depends on the capability to perform independently as a gatekeeper. The auditor independence is pivotal for ensuring transparency and disclosure. However, focus group analysis reveals that an auditor's independence is compromised in the PSX listed firms. Similarly, DeFond, Raghunandan, and Subramanyam (2002) argued that auditors behave with relatively greater independence towards those clients who pay higher audit fees. Additionally, Ashbaugh, LaFond, and Mayhew (2003) found no relationship between discretionary accruals and audit fees after controlling for firm performance. These findings support the argument that market based incentives such as litigation cost and reputational loss (Coffee Jr, 2003) override the benefits received by auditors due to compromising their independence (Reynolds & Francis, 2000). A focus group participant informed that auditors do not verify the statements and there is sign off practice. This practice can be due to lack of expertise or high compensation. The focus group participant commented that:

*“One is a general statement of compliance which gets put with the audited accounts and that the external auditor has to sign off. Having said that I have questioned many times on various boards whether the external auditor actually verifies the statement of compliance and they do not (participant – II)”*

In addition, Ascioglu, Hegde, and McDermott (2005) maintained the argument that auditor compensation lowers market liquidity and disclosure quality of the firm. In a similar vein, Johnson, Nelson, and Frankel (2002) documented that large audit and consulting fees influence the auditor's independence. Dee, Lulseged, and Nowlin (2002) also support these findings and document that auditors are less conscientious in restraining earning management for those client firms which gave them a high proportion of non-audit fees. It is evident that auditor independence is very pivotal for good CG practices, transparency and fairness in Pakistan; however, the current practices are different. A focus group participant also mentioned that efficacy of the internal auditing function depends on the independence of the auditor. The focus group participant highlighted that:

*“Having his own internal systems of control and that is where the internal auditor... internal auditing function is important and depending very much on how efficient, effective, independent the internal auditor function is within the company. The compliance can vary from company to company so... (participant – II)”*

Hence, it can be interpreted that the nexus between auditor independence and their fees may depend on the CG context of the client firms themselves. Larcker and Richardson (2003) documented that the provision of non-audit services is possibly problematic for some firms that are controlled by management. In addition, Causey (2008) debated that there should be strong internal control and audit function to implement good CG practices. The firms lack transparency, fairness and disclosure due to lack of auditors' independence in Pakistan. The auditors are not fulfilling their duties in the true spirit and the quality of information is compromised. Moreover, the family dominated firms may have close links with auditing firms and pay them higher fees that lead towards poor disclosure quality.

### **5.2.2 Audit Committee**

Most of the listed firms around the globe have pursued tackling the problem of auditor independence mostly by having active audit committees within the BoDs and supervision of external auditors. Audit committee is responsible to ensure the independence of external auditors from CEO and firm, in general, and close supervision by independent outside directors. In addition, researchers and governmental bodies have aired distrust about the effectiveness of audit committees and frauds such as at Enron have vindicated those doubts. A UK based qualitative study in which interviews were conducted from audit committees documented that the ceremonial function of audit committees is to give shared declaration and relaxation to outsiders, rather than intervention in and verification of company information (Spira, 1999a; Spira, 1999b).

The analysis of the focus group reveals that the existence of an auditing committee is necessary to protect shareholders' interests especially minority shareholders. Moreover, the focus group analysis also highlighted that audit committees should be comprised of independent directors. A focus group participant highlighted the importance of audit committees in the listed firms of Pakistan:

*“at a minimum the board audit committee is essential and that should primarily be composed of independent directors, if there is one or two at least it should be chaired by an independent director so that there is some level of independent discourse vis a vis the financials (Participant-II)”*

Cohen et al. (2002) argued that audit committee members may lack expertise, knowledge and independence in supervision. Similarly, Felo, Krishnamurthy, and Solieri (2003) found that a

positive association between financial reporting and the percentage of audit committee members having a financial background. Serious issues emerged at Enron about the independence of committee members despite the presence of the audit committee. Gillan and Martin (2002) found strong financial ties among directors at Enron, consequently, directors took individual benefits in the form of consultancy fees, group donations and transactions with entities in which directors played a key role. In addition, researchers documented that the level of interaction between the audit committee and auditors is highly variable (DeZoort, 1998), hence, it is pivotal to know how audit committees operate and fulfill their responsibilities (Kalbers & Fogarty, 1998). Reinstein and Weirich (1996) found that selection and retention of audit companies were influenced by relationships between the audit firms and the companies of the committee members. A similar type of situation exists in Pakistan. The analysis of the focus group reveals that audit committees are usually comprised of non-independent directors or family members and decisions are made in best interests of the controlling family. A focus group participant highlighted that:

*the board so that what happens sometimes in family dominated companies is that they staff these sub committees with people whom they are comfortable with including primarily the audit committee with non-executive or family members and most of their decisions vis a vis the budget, vis a vis other issues (Participant-II)''*

The audit committee does not have the expertise and power to confront management in the listed firms of Pakistan and does not play an effective role in improving the quality of financial reports. It is important to have an audit committee with independent directors with relevant experience and literacy.

### **5.2.3 Risk Management**

Researchers documented that BoDs are responsible for managing internal control and risks. (Turnbull, 1999). Despite the increasing interest in studying risk management and internal control, limited evidence is found to expound the nexus between internal control and good CG practices (Solomon, Solomon, Norton, & Joseph, 2000). BoDs must ensure that all types of risks are considered and fully entrenched in the firm's culture. The analysis of the focus group reveals that risk should be managed by BoDs in the PSX listed firms that will help in improving CG practices. The risk is not limited to financial and regulatory/legal compliance risks, but also strategic, ethical and operational risk (Waite, 2001). Ethical risks include failure to have ethical standards in doing business and contracts are obtained through personal relations and unethical

means (Cooke, 1991). Consequently, this could also cross over into financial risks through accounting irregularities and vulnerability to fraud. Cannella Jr, Fraser, and Lee (1995) mentioned that there is particular reputation risk among BoDs if performance is poor. A focus group participant also mentioned that BoDs should emphasize internal control and risk management:

*“at least a good number of independent directors, sufficient independence, diversity of skills because for me corporate governance board’s role is really the center piece of corporate governance and then of course better oversight in terms of having internal controls and risk management under the board’s oversight I think that can contribute tremendously towards improving the overall corporate governance framework in companies in Pakistan (Participant – III)”*

It is concluded that auditing function is not reliable in Pakistan and auditors’ independence is questioned. However, as per agency theory, principals hire independent external experts (auditors) due to lack of trust in agents and reliability of information. Agents (directors or auditors) may be trustworthy and there is no need to increase the regulatory mechanism, however, a simple agency model suggests that agents are untrustworthy. The independence of auditors has great importance in delivering high-quality disclosure; however, auditors work closely with BoDs of firms that may question the independence of auditors and demand strict regulations and control.

### **5.3 Political**

Researchers have argued that the institutional environment of developing countries not only differs from developed countries but each developing country has its own institutional conditions that vary from other developing countries (Singh & Newberry, 2008). However, some scholars have also emphasized the similarities between developing countries in terms of political corruption, ownership structure, legal origin, size of capital markets and investor protection. Consequently, the politics can influence the culture, profitability, ownership, operations and firm size (Roe, 2003). The same situation is prevailing in the listed firms of Pakistan. Being a developing country, Pakistan has a high level of political risk and political interference is common in daily business life. Moreover, the political situation is unstable in the country and corruption is high. The capital markets of developing countries lack necessary resources to support entrepreneurs (Domadenik, Prašnikar, & Svejnar, 2014) and after following strict regulations (Desai & Olofsgård, 2011), business owners still face difficulties

in getting access to resources such as land, services and bank finance. Consequently, politicians take advantage of this and show interest in corporate organizations to take bribes and benefits (Wu, 2005).

The focus group analysis reveals that firms use political contacts to take advantage and expedite the process of acquiring resources in Pakistan. Moreover, the appointments are made on political connections rather than merit, consequently, sometimes people in higher positions lack expertise and relevant knowledge. The following sections expound evidence on three categories (1) political system, (2) political influence and (3) corruption that are classified together as political.

### **5.3.1 Political System**

Existing studies reveal that the political system of a country can have pivotal significance for the political system and ultimately corporate governance (Doidge, Karolyi, & Stulz, 2007). In a similar vein, researchers documented that the political system of a country is reflected in the corporate governance (Adegbite et al., 2013) and political influence can be manifest in the business environment (Adegbite, 2012). The analysis of the focus group reveals that corporate standards and performance are dependent on the economy and the economy is dependent on political stability. If the political situation is unstable, it will have negative consequences on the economic condition of the country and the firm level as well. A focus group participant asserted that:

*“On top of the issues I will say economic stability and political stability, these are the macro level issues. If they are persistent overall the performance of the company and the financial performance of the company as well as the corporate standards will definitely rise to a significant level. Uncertainty of politics and economics these are the barriers.... The market is dependent on the economy and the economy is dependent on political stability so that’s why we are on a downward spiral (Participant – IV)”*

Nahavandi (2006) also documented that leaders can influence their followers and their actions may be inconsistent with an organization’s objectives. Hence, this power inequality emasculates the ability of existing corporate mechanisms to meritoriously monitor behavior (Lessing, 2009). In Pakistan, the State Bank of Pakistan (SBP) has a poor CG system, consequently, the financial sector is abused by politically influential elites (Khan & Bhatti, 2008). In a similar vein, Saeed (2013) conducted a study in Pakistan to examine the effect of

political connectedness on firm leverage and performance. He found positive effect of political connectedness on a firm's leverage while a negative effect on firm performance. He also documented that politically connected firms enjoy the benefits of preferential lending as compared to non-politically connected firms. It is evident from the focus group that political issues are a major concern in the implementation of CG practices in Pakistan. Ali, Tao, Shaikh, and Sajid (2017) also documented that politics and leadership have an impact on corporate governance practices in Pakistan.

### 5.3.2 Political Influence

Political influence includes the connections of different stakeholders (Aplin & Hegarty, 1980) having restricted control over the rewards of political actors. Bushman et al. (2004) claim that private mechanisms for the enforcement of contracts and relationship-based arrangements emerge in countries with weak law enforcement. The parties of contracts develop informal ties with each other due to weak enforcement mechanisms and these informal ties perform as an auxiliary for the strong enforcement of contracts. They further argued that, in return for bribes, political support and nepotism, politically powerful elites favor their acquaintances. The analysis of the focus group also portrays a similar situation among listed firms of Pakistan. The analysis reveals that political appointments are made in listed firms of Pakistan which lead towards low transparency and disclosure. The analysis also reveals that SECP “that works as regulatory body of CG practices” is also under the influence of politics and unable to perform well. A focus group participant also mentioned the political appointments on the board at State Owned Enterprises (SEOs).

*“Because of that which I have told you the chronic illness of state-owned enterprises in Pakistan, which is they appoint, they have political appointees on their board (Participant -I)”*

Leuz and Oberholzer-Gee (2006) also argued that economic transactions are made on the basis of political and personal ties in weak law enforcement countries, hence, the political influence has an important role in shaping CG systems in those countries. Similarly, BoDs have political connections and CG practices do not exist in the true spirit among the listed firms of Pakistan. A focus group participant also highlighted that:

*“But sometimes SECP autonomy is compromised due to political interference and government line industries as you know. And because of this political interference SECP has been very bleak in ensuring corporate governance, enforcements in listed companies lease and because*



*SECP is the main body which is responsible for ensuring corporate governance in public sector companies..... they [SECP] are monitoring the progress of the companies but their hands are tied, they cannot basically, they till the implication which additional directors and associate directors can't do in the true spirit because of political influences through the commissioner and through the chair (Participant -I)''*

Similarly, researchers have argued that it is easy to maintain political relationships in family firms through networking and kinship (Bertrand & Schoar, 2006) especially in developing countries, consequently, these politically influential people can affect the development and implementation of regulations and laws in developing countries (Berglöf & Von Thadden, 1999). Focus group analysis reveals that almost all firms have political influence and it has disastrous effects on company performance and CG practices. The focus group participant stressed that politics should be separate from business to improve company governance. The focus group participant informed that:

*“Politics should be separated from the company's business, from the company's governance.... they are basically politically proof. They are prudent and politically proof and their corporate governance practices have never been the government stake.... This is the main chronic factor which is basically hurting the Pakistan economy and hurting the performance of the company in Pakistan.... But the reality is the political interference is so much. (Participant -I)''*

In sum, PSX listed firms have great political influence that is affecting their day to day operations and CG practices. The regulatory authorities are unable to enforce the regulations due to political influence and political connectedness. Politics should be separated from firm's operations in order to promote CG practices.

### **5.3.3 Corruption**

Corruption is the biggest challenge for many developing countries including Pakistan<sup>20</sup>. Political connectedness is also linked to the corruption level within the country (Bertrand & Schoar, 2006; Faccio, 2006; Goldman, Rocholl, & So, 2008). Similarly, political connectedness is more dominant in countries with weak legal systems and high levels of corruption (Faccio & Parsley, 2009). Fisman (2001) documented that high levels of corruption

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<sup>20</sup> Pakistan ranked 117 out of 180 most corrupted countries. The higher number indicates a high corruption level. See <https://www.transparency.org/country/PAK>

might imply the existence of political connectedness and high political corruption in developing countries such as Pakistan, India, Bangladesh and China. In addition, Faccio (2006) and Boubakri, Cosset, and Saffar (2008) documented that the political connectedness of firms is prevalent in countries with lower judicial independence. The analysis of the focus group reveals that corruption is high in Pakistan especially in the corporate sector. The participant (s) stressed the introduction of anti-corruption reforms. They mentioned that firms hide information due to corruption and wrong doing. A focus group participant informed that:

*“also another factor which is corruption, corruption is the cause of concern, the corruption is basically, anti-corruption movements are basically not implemented through in Pakistan... anti-corruption reforms should be retrospect, they should be implemented in all corporate governance and also stake holders and those which are involved in for example the State Bank of Pakistan, SECP... if you are hiding your reports (disclosure statement) that means there is corruption involved in it. (Participant -I)”*

It is becoming increasingly acknowledged that politics shape corporate governance (Roe, 1991), particularly taking more complex dimensions in developing countries like Pakistan. Similarly, Roe (2003) argued that politics interferes with firms’ ownership structures and boardrooms’ behavior. Moreover, politics influences the firm in several ways, given that it defines who owns it determines firm’s capacity to acquire external financing. In addition, it defines its growth and profitability potentials and ultimately reveals the dissemination of authority and power within the firm (Roe, 2003). In Pakistan, it is found that politicians hold major stakes either directly or indirectly in many firms, which provides them the opportunity to hire their favorite BoDs and management. Consequently, these politicians use their influence to control the firm for their personal interests and benefits. On the other side, multinationals compromise their ethical standard to get more business in such political and corrupt environment. Consequently, the need arises to comprehend relationship between institutions and CG system in such endemic corruption.

#### **5.4 Legal**

The legal and regulatory systems of a country instigated the CG provisions. In Pakistan, the SECP have been taken enormous steps in issuing and resolving CG issues in Pakistan. Nevertheless, different issues have constrained the efficacy of CG regulations despite the government and regulatory bodies’ intervention. The critical factors underlying this challenge remain the economic, legal and corporate environment of the country (Siddique, 2013).

Similarly, it is considerably essential that an appropriate, efficient and reliable regulatory, legal and institutional framework should be established in order to ascertain best CG practices (OECD, 2004). The business community has identified different key barriers; (1) lack of resources (i.e. qualified workforce), (2) insufficient benefits of CG compliance; and (3) problems regarding disclosure of proprietary information to competitors (International Finance Corporation, 2007) in effective implementation of CG in Pakistan. The analysis of the focus group reveals that firms are not complying with CG practice in the true spirit rather they are doing tick box practice. One reason for this may be lack of resources. Moreover, the analysis shows that enforcement lags behind due to the weak and long process of the judicial system. The analysis of the focus group also reveals that regulators are not competent enough and do not have enough power to exercise to enhance CG practices. Following sections expound the evidence on three categories (1) compliance, (2) enforcement and (3) regulators that are classified together as legal.

#### **5.4.1 Compliance**

Compliance is very important in achieving the CG objectives and many countries have adopted legal mechanisms to establish CG systems in particular context (La Porta et al., 2002), however, poor compliance has disastrous effects on good CG systems especially in emerging countries (Berglöf & Claessens, 2006; Okpara, 2011). Evidence reveals that CG codes do not take into account the local specificities (Aguilera & Jackson, 2003; Judge et al., 2008), consequently, impair the desire and motivation to comply with the CG codes (Adegbite & Nakajima, 2012). Similarly, the analysis reveals that compliance is lacking among the listed firms of Pakistan due to fewer resources or lack of motivation. One focus group participant informed that:

*“I think compliance is what lacks behind and that is the difference between complying in the letter and complying in spirit. You can have a statement of compliance saying and do a box ticking exercise that we are in compliance with all the provisions but it’s really not in spirit.... so I think compliance is far behind the written rules and regulations (participant – II)”*

In a similar vein, Hamid and Kozhich (2007) highlighted that, after the introduction of CG code in 2002, many firms delisted from the Karachi Stock Exchange (KSE) due to increased cost to fulfill the requirements of the CG code. Many firms perceive that appointment of qualified CG experts, publishing and printing of financial statements and CG disclosure are extra financial burdens on them. Another focus group participant highlighted that:

*“You don’t have enough resources to implement, to comply with the corporate governance practices. Maybe we think that it will create, it will increase your cost (Participant – I)”*

In Pakistan, ownership concentration is high and most of firms are owned and controlled by family members, hence, firms prefer not to comply with strict regulation intended at protecting the rights of minority shareholders (Khan, 2014). In a similar vein, Adu-Amoah et al. (2008) documented that this raises the concerns regarding the application of corporate governance codes, in emerging countries, developed by the Western world. For instance, in developed countries, CG compliance is effective due to the robustness of their institutional frameworks and replication of akin strategies in developing economies, i.e. Pakistan might not generate the same results due to weak institutional environment.

#### **5.4.2 Enforcement**

Researchers documented that enforcement is pivotal in creating good governance practices and an effective business environment, especially in a developing country like Pakistan (Ashraf & Ghani, 2005; Berglöf & Claessens, 2006). Anwar (2006) argued that enforcement is the main impediment to good corporate governance practices in Pakistan due to high levels of political corruption (Easterly, 2001). Similarly, researchers found that relationship -based arrangements emerge for enforcement in countries with weak law enforcement (Bushman et al., 2004). On the other hand, Inyang (2009) debated that enforcement is crucial to attain a good corporate governance system. Pakistan has a small concentrated capital market, characterized by weak law enforcement, and mostly, firms rely on banks for financing rather than equity financing (Ashraf & Ghani, 2005). Therefore, the Pakistan stock market is volatile and highly concentrated (Iqbal, 2012; Nawazish & Sara, 2012). In a similar vein, Siddiqui (2010) expounded that developing countries have less developed and more highly concentrated stock markets than the developed countries and the Anglo-Saxon model is more suitable for countries with low concentration and developed markets. Despite this fact, many developing countries including Pakistan have adopted this model due to the sway and guidance of international financial agencies. Pakistan also receives guidance from the Asian Development Bank (ADB) and the World Bank (WB) for effective enforcement of the CG system and development and training of staff (Javid & Iqbal, 2010). Another reason regarding regulations is related to the failure of courts to address legal disagreements economically, in a timely manner and fairly (Kessler, 2011). A focus group participant highlighted this issue:

*“We have very good laws everything is on paper I mean if you go through any legal penal structure, it is all there. Where we lack is implementation and here the judicial system... the role of the judicial system also comes into play because as you know if something goes to court in Pakistan you can just forget about it, it takes years and years for it to reach a conclusion if at all, so the many loopholes that exist in the implementation of the laws is what has held us behind (Participant -II)”*

This highlights the weak judicial system and powerful political class. Additionally, prevalent corrupt practices have infiltrated and boosted this problem. Recently in Pakistan, corporate executives, public office holders and politicians have been sentenced for governance-related infringements, nonetheless these sentences have been believed to be very compassionate. Additional reason is the length of proceedings in courts and expenses. Another focus group participant highlighted that:

*“So that was first hurdle but then the process itself, it was the court sanction process, so you had to petition the high court of the province. I have looked at different rulings that were issued under those provisions and in most cases I would say because of the process... the nature of the process being very contentious and laborious.... because courts are sometimes not as proficient or as efficient (participant – III)”*

Participants also discussed the duplication of regulations and role of regulators in enforcement of and compliance with good governance practices in Pakistan. In addition, complying with or explaining the nature of corporate governance regulations presents an additional challenge regarding enforcement<sup>21</sup>. Due to lack of enforcement, the objective of good CG practices is not fulfilled, and CG reforms become ineffective in Pakistan.

#### **5.4.3 Regulators**

It is noted that regulations are pivotal for the entrenchment of a sound CG system, but regulators are also most important because their responsibility is to ensure compliance with regulations. In Pakistan, it is advised that poor compliance and weak enforcement are affected by unprofessional CG regulators. SECP is the principal regulatory body for corporate sector regulations in Pakistan. Researchers have argued that good corporate governance practices cannot be achieved in Pakistan as regulators lack the required authorization to force compliance

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<sup>21</sup> SECP introduced the CG code in 2002 with comply or explain and made it mandatory to comply with most of the CG code provisions in the 2012 reform, however, there are still voluntary provisions.

(Khan, 2017). The analysis of the focus group reveals that regulators lack resources to ensure implementation of CG practices. The analysis also reveals that regulators do not have enough power to exercise it. A focus group participant also informed that:

*“If we talk about SECP they have the limited resources they can't go beyond that. So the true letter cannot be implemented but in the background of those limited resources there is political influence. So, they can't go there, this is an implication with the regulator. If the regulator is not performing at all fully then how can you, how can you basically say that company will do it.... As I told you, what the regulator is doing basically, the legal implication is there and SECP is an autonomous body, okay, but sometimes SECP autonomy is compromised due to political interference and government line industries as you know.... there is no serious corporate governance in public sector entities, even though the regulator is there, SECP is there, even though, even though the rules are there, even though ICAP is basically the Institute of Chartered Accountants of Pakistan are basically voicing and influencing, influencing and that these rules should be implemented into letter spirit but they are not basically implemented so far. (participant -I)”*

Another focus group participant informed that:

*“The regulators do not have enough power. Sometimes, they do not do their job and are active politically (Participant-VI)”*

Another focus group participant highlighted that:

*“So as far as regulations and laws are concerned I think it's pretty good it's the implementation which lacks and I think that's what you need to focus on because despite the best of laws and best of regulations they are unable to get them to be implemented in the letter and spirit and that is what one (regulators) needs to investigate (participant -II)”*

A focus group participant informed that:

*“it means that there are limited like they [regulators] have limited resources, limited media regulatory system, like they can't make anything according to them, they [regulators] are limited by their rules and regulations (Participant -I)”*

It is evident that regulators are unable to perform better due to limited resources and political and other pressures. Effective regulations demand adequate authority and power to exercise and compel compliance and enforcement of regulations. Moreover, the financial conditions

could also persuade regulators to be involved in dodgy CG activities. Another issue is related to the power of regulators to abdicate their responsibilities. This lack of authority and power is erratic with assumptions of public interest theory (Den Hertog, 2010), that requires ample executive power and information to endorse public interest. Therefore, in developing countries like Pakistan, regulators not only suffer from lack of the required executive power but also have limited access to the information constrained by weak social and political institutions. Consequently, it restricts their ability to make informed decisions and quality is compromised.

## **5.5 Board**

CG research that investigates the effect of board composition on critical decisions has primarily adopted an agency theory rationale. As per the SECP CCG 2012, BoDs are responsible for ensuring effective CG practices among PSX listed firms. An effective board not only develops and promotes a collective vision of a company's purpose but also the values, behavior and culture to conduct business (Council, 2009). Thus, BoDs are responsible for adoption of control mechanisms (like selection, evaluation, monitoring) that align with the interests of managers and owners. BoDs are described as the apex of the internal control system (Jensen, 1993) and their monitoring has become pivotal in corporate governance research. According to SECP CCG, BoDs are required to take training to improve their effectiveness (SECP CCG, 2012). Researchers also documented that BoDs help organizations in establishing the nexus with the external environment. As per resource dependent theory, organizations are dependent upon resources in the external environment for their survival (Pfeffer, 1972) and BoDs act as the instrument to deal with external dependencies (Hillman & Dalziel, 2003). In addition, BoDs help to secure valuable resources and information and offer access to crucial constituents (Hillman, Cannella, & Paetzold, 2000). Similarly, Patel and Xavier (2005) debated that in developing countries, it is essential to have an effective system of checks and balances on managerial and board behavior in order to achieve a good corporate governance system. The analysis of the focus group reveals that BoDs should be independent to protect minority shareholders and make independent decisions. However, the analysis also reveals that BoDs lack independence among listed firms of Pakistan. Moreover, there is a lack of board heterogeneity and nepotism/kinship exists due to high ownership concentration. The family members are appointed as BoDs and in some cases, the entire board is composed of family members that ultimately leads towards expropriation of minority shareholders. The following sections expound evidence on three categories (1) board independence, (2) board heterogeneity and (3) nepotism/kinship that are classified together as board.

### 5.5.1 Board independence

The board's independence is supported in agency theory which adopts inadequacies that arise from separation of ownership and control (Fama & Jensen, 1983; Jensen & Meckling, 1976). According to agency theory, BoDs are responsible for monitoring, rectifying and evaluating managers' performance on behalf of shareholders (Lynall, Golden, & Hillman, 2003). Moreover, BoDs also assign rewards and penalties to management on the basis of criteria that emulate shareholders' interests. The independent BoDs provide effective oversight of the firm's executive directors and CEO. Researchers documented that independent directors are usually assumed to be more effective in protecting shareholders' interests (Baysinger & Butler, 1985), resulting in higher firm performance (Baysinger & Hoskisson, 1990). A focus group participant also highlighted that:

*“Definitely board independence not only helps ensure management of conflict of interest but also ensures that the minority shareholders are also protected in terms of their rights and their assets and their investment so the agenda that are taken by the board are mainly focused towards the minority shareholders... the protection of minority shareholders (Participant - IV)”*

An extensive literature has investigated the nexus between the composition of the BoDs and diverse proxies for corporate performance. Researchers pointed out that independent BoDs are very often executive directors in other firms (Fama & Jensen, 1983; Kaplan & Reishus, 1990). In addition, managers preferred independent directors because they better monitor the managerial discretion. Rhoades, Rechner, and Sundaramurthy (2000) found a positive impact of board independence on firm performance. Researchers documented that board independence has a positive effect on the corporate governance rating (del Carmen Briano-Turrent & Rodríguez-Ariza, 2016). In a similar vein, Ortas, Álvarez, and Zubeltzu (2017) found that the independence of a company's board positively influences corporate social performance. Ensuring board independence empowers BoDs to contribute substantially to the decision-making processes. However, the focus group pointed out that selection and appointments of board members are extensively based on personal relations and political gains. Such situations may undermine the boards' independence and their ability to question or challenge the authority of the managing director or CEO. A focus group participant pointed that:



*“A board should be independent.... independence of the board is very important, if the board is not independent, they will not make independent decisions. They will, they will not do anything which is right for the company (participant -I)*

Another focus group participant mentioned that:

*“There is no level of complete independence from each other so when somebody comes on to your board the high likelihood is even if they are an independent director there is a high likelihood that there is some connection to degrees of separation with other board members or management or somebody (Participant – II)*

A focus group participant also stressed on having an independent board to increase effectiveness of corporate boards:

*“I think one thing that has really made corporate boards more effective in listed companies is the idea of having board independence and board independent directors (Participant -III)”*

Anderson, Mansi, and Reeb (2003) debated that independent directors can arbitrate to protect the interests of all shareholders in case of disagreement of interests among controlling and outsider shareholders (Anderson et al., 2003). Nonetheless, it is divergent in PSX listed firms and firms lack independent directors in the true sense<sup>22</sup>. Due to lack of independence, the interests and rights of minority shareholders are not protected.

### **5.5.2 Board Heterogeneity**

Board heterogeneity is referred to as variation among board members in terms of gender, age, education, experience, managerial background, learning styles, cultural diversity and values (Coffey & Wang, 1998). Researchers argued that larger tenure of BoDs is linked with increased commitment to established procedures and practices (Pfeffer, 1972), better stringency (Boeker, 1992) and increased insulation towards new ideas (Hambrick, 1996). In a similar vein, Filatotchev, Jackson, Gospel, and Allcock (2007) argued that good CG is linked with high degrees of board diversity including social and human capital. Boards that are comprised of more diverse personals such as public affairs specialists, top management, financial representatives and lawyers, may be more effective in terms of bringing imperative experience,

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<sup>22</sup> In most firms, family members are appointed as independent non-executive directors (see Khan, 2014).

skills and expertise to provide advice and counsel. Board diversity, thus, benefits corporations for the following reasons: it allows a better understanding of the market, especially in a diverse market place; diversity is also linked with innovation and creativity; it enhances the effectiveness of corporate leadership; promotes more effective global networking and relationships; and enables more effective problem-solving (Nguyen & Faff, 2007). In addition, Odle (2007) argued that better governance structures can be achieved through encouraging greater board diversity. A focus group participant also informed that:

*“I am a big advocate for diversity at the board level, I have always spoken about age diversity I think gender diversity is also important.....When you have a greater diversity you bring in people from different socio economic backgrounds from different genders from different age structures you bring in people into a group who don't necessarily have that same level of comfort with each other and that is important for them to start voicing their differences of opinion because when there is difference of opinion there is a greater chance of a better discussion taking place and better decision making taking place (participant – II)”*

The analysis of the focus group reveals that diversity is very important in improving the CG practices in Pakistan because it helps in the creation of some voicing and difference of opinions. Moreover, different types of diversity also help in improving the CG practices, however, the level of board diversity is unknown among the listed firms of Pakistan<sup>23</sup>.

### **5.5.3 Nepotism/Kinship**

Pakistan remains dominated by a value system based on family, kinship, lineage group, and occupational group. Kinship connections are fundamental in reinforcing and negotiating bureaucratic hurdles and play an imperative part in political, social and administrative organizations (Jalal, 1995). The analysis of the focus group reveals that most businesses are family owned in Pakistan and ownership concentration is high. Moreover, the entire board is composed of family members due to high ownership concentration. This kinship creates a big problem in family owned businesses in Pakistan and family members believe that directorship of the firm is their inherited right. One focus group participant informed that:

*“I think predominantly there is a lot of family ownership as you know it is dominated by large families, but this has historically been the trend (Participant-II)”*

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<sup>23</sup> Diversity can be related to age, gender, experience, nationality and education etc.

Similarly, another focus group participant mentioned high ownership concentration:

*“So I think the level of ownership concentration is something that’s a challenge dealing with it, making sure that despite having a majority eighty ninety sometimes more or ninety-five, ninety percent shareholder owner (participant – III)*

He also highlighted that:

*“In Pakistan you have one big share owner who also has board representation, almost the entire board is composed of his family members and then they are also managing the business.....In Pakistan we have this high ownership concentration which means that I mean even among listed companies we have majority shareholders a family owner who owns sometimes as high as eighty or ninety percent of shareholding (Participant – III)”*

In some firms, family members are hired at board and management level, consequently, this kinship is a major problem in evaluating the board performance. In contrast, some firms hire individuals due to their competency, hence, the CG disclosure differs across firms. A focus group participant highlighted that:

*“some companies which have a very independent internal auditor function which reports directly to the chairman of the board, others it’s really a mouthpiece for the management and it’s very easy to gauge that sitting at the board from the level and comprehensive audit reports that come to the board, whether these audit reports are just mere formalities or there is actually something of substance in those internal reports or not. So again it tends to vary but where the board and the management are professional and the internal auditor function is independent, there are greater chances of better effectiveness and compliance with corporate governance (Participant-II)”*

It is evident that family businesses are perceived as creating barriers to good CG practices in Pakistan. This argument is also supported by literature. Morck and Yeung (2003) argued that family business may not alleviate agency conflicts, particularly, when family control the firms. They further documented that it can increase the agency problems because managers will work for controlling family and ignore the shareholders in general. Similarly, Bartholomeusz and Tanewski (2006) found that family control creates agency costs rather than negating them.

## 5.6 Shareholders' Awareness

Shareholder awareness is evolving, and it has been considered as one of the principles that affect CG practices. Researchers around the globe have agreed that CG is a benchmark of success for firms both in developed and developing economies. Nevertheless, effective implementation of CG is more needed in developing countries as compared to their developed counterparts. The awareness about CG in Pakistan is not very old and the initial CG code was implemented in 2002 and later revised in 2012 by the Securities and Exchange Commission of Pakistan with the collaboration of the Institute of Chartered Accountants of Pakistan (ICAP) and is a mandatory requirement for PSX listed firms. However, CG practices are in the developing phase due to the immature capital markets of the country (Afza & Nazir, 2012). The focus group analysis also reveals that there is lack of awareness about CG practices in Pakistan. One focus group respondent highlighted that:

*“as far as awareness is concerned it could be that our annual reports require a much higher level of disclosure now than they used to a decade and a half ago so maybe the kind of information that the shareholders are looking for is already provided to them via the many disclosures that the companies now are obliged to make so the awareness might already be there but it's not translating into their active voting (Participant – II)”*

Some of family owned companies considered it costly to implement CG practice and repel CG compliance due to wrong or negative or wrong perceptions towards CG. Hence, they argued that the lack of awareness and knowledge amongst different stakeholder are responsible for non-compliance of CG practices (Samza, 2016). Another focus group participant informed that:

*“If you were to work in Pakistan as to raise more awareness on the business case so if you make it clear to those family owners, majority shareholders that corporate governance is something that adds value to the bottom line of a company and it's not something that's there to dilute their control etc. (participant -III)”*

The analysis of the focus group reveals a lack of awareness and knowledge among different stakeholders especially shareholders among listed firms of Pakistan. For this reason, the CG compliance is lagging behind. Firms are not well aware of the benefits of implementing CG practices, hence, they are reluctant to adopt it in true spirit. The shareholders' rights are protected in the books of law but not in reality. There is a need to introduce educational and training reforms to increase levels of awareness among stakeholders. The following sections

expound evidence on two categories (1) shareholders' rights protection and (2) education and training that are classified together as shareholders' awareness.

### **5.6.1 Shareholders' Rights Protection**

Shareholders' rights reveal the balance of power between managers and shareholders and provides ability for voting stockholders to exercise control over firm assets, affect ownership changes to increase shareholder value and remove opportunistic or ineffective managers. As per the perspective of traditional theory, lower shareholder rights (weak external governance) create information asymmetry among managers and shareholders that provides opportunity and excessive incentives to the managers to reduce transparency and manage earnings to increase their bonuses. According to traditional theory, lower shareholder rights generate information asymmetry between managers and shareholders that leads to reduce transparency and increases managerial incentives in one hand (Jiang & Anandarajan, 2009). Greater shareholder rights, on the other hand, empowers shareholders to implement CG mechanisms to monitor managers more fastidiously. Researchers found that greater shareholder rights are linked with reduced agency risks and improves firm performance (Gompers, Ishii, & Metrick, 2003). Hence, shareholders' rights and protection are pivotal to increase transparency and firm value. However, shareholders especially minority shareholders are not aware of their rights in Pakistan. Due to lack of awareness and knowledge, their rights are diminished by majority shareholders. The focus group analysis reveals that the minority shareholders' rights are protected in books of law but not in practice. Similarly, Javid and Iqbal (2010) documented that family dominated boards are less able to protect minority shareholders' rights in Pakistan. One focus group participant also informed that:

*"...the implementation lacks behind again and there it is more to do with the minority shareholders perhaps not having the wherewithal to understand all their rights and be able to understand how they can process getting their due share too, but I mean as you know most of the companies are family owned and as such the majority shareholders' interests are sometimes paramount but the role of the independent directors is really to ensure that the decisions are made in line with the interests of all stakeholders but there is not much minority shareholder representation on the boards and hence their interests tend to suffer (Participant -II)"*

According to the Companies Ordinance, 1984<sup>24</sup>, the minimum threshold for seeking a remedy from the Court against oppression and mismanagement requires that 20% of the shareholders initiate a complaint. In addition, shareholders have the opportunity to employ an independent inspector through SECP to inspect firm's affairs opportunity if they hold at least 10% but less than 20% of shares<sup>25</sup>. This threshold effectively is in the favor of companies with high ownership concentration. One focus group participant also informed that:

*"I refer to the company's ordinance 1984 which was before the companies act of 2017, we had some provisions around minority shareholders and abuse of minority... protection against abuse of minority shareholders but one of the consistent issues has been that to invoke those redressal mechanisms first it required having at least twenty percent ownership or shareholding to actually go to a court and seek redress there. There is an allegation of abuse by the majority so that was a big hurdle and that actually meant that you effectively disenfranchise the minority shareholders because if you look at the ownership structure, I mean 20 percent was a long shot for I mean there was no way minority shareholders whether total minority shareholders are five percent or ten percent actually have that majority to go. So that was the first hurdle but then the process itself it was a court sanctioned process, so you had to petition to the high court of the province (Participant-III)"*

Moreover, no analogous provision exists for minority shareholders who represent less than 10% who do not have the standing to file a petition to the court or SECP for mismanagement and minority oppression<sup>26</sup>. Minority shareholders can enforce their claims in civil cases by suing for tortious loss in accordance with general laws, however, those cases take a long time and hinder a company's business<sup>27</sup>.

### **5.6.2 Education and Training**

Educational background can be a pivotal determinant of corporate governance practices because better educated managers are likely to accept ambiguity and adopt innovative activities (Hambrick & Mason, 1984). Similarly, Nevertheless, Gray (1988) acknowledged education as an institutional consequence affecting disclosure practices and accounting values while Grace,

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<sup>24</sup> Companies Ordinance, 1984 (XLVII of 1984)

<sup>25</sup> Section 290, Companies Ordinance, 1984 (XLVII of 1984)

<sup>26</sup> In addition, section 290 of the Companies Ordinance, 1984, maintains that minority shareholders who represent less than ten percent do not have the standing to file a petition to the court for mismanagement and minority oppression.

<sup>27</sup> Cases are ordinarily adjudicated in four to six years at the Court of First Instance. Interlocutory appeals may take longer.

Ireland, and Dunstan (1995) argued that education level should be examined as a measure for professional status. Researchers also argued that a high level of education may increase the demand for corporate accountability and political awareness (Wallace & Cooke, 1990). In Pakistan, the education and training are considered as important determinants of CG practices. One focus group participant highlighted that:

*“I think the most positive influence is professionalism at the board and professionalism at the management and along with that of course is the director’s training so that people are aware of their role as directors and what they are supposed to be doing at the board level....the main thing director education and awareness is very important as I mentioned the case before I mean the directors didn’t even know that they were being made directors of a company I mean there is a sea change since those days but there is a greater need to make directors aware that they are there as professionals and not as a badge of honor (Participant-II)”*

Since the responsibility for preparing annual reports rests mostly with the principal officer of the company, the educational background of the financial controller is as important as that of other directors (Ahmed & Nicholls, 1994). In addition, if BoDs have accounting and business educational backgrounds, they may disclose more information to show accountability, increase the creditability of the team and improve the corporate image. Moreover, the high education of regulators also helps in increasing the compliance of CG. However, in Pakistan, most of the regulators lack knowledge and expertise. One focus group participant informed that:

*“There has been a challenge in Pakistan under the 2012 code and before that the first line regulator was stock exchanges and stock exchanges have had I would say a weak capacity in terms of enforcing corporate governance first because of not having staff who have expertise and knowledge in that area but then also sometimes there were other considerations where I mean people also raised questions about having the stock exchanges being independent enough or the department within them being assertive enough to actually hold companies accountable because one of the sanctions that could have been invoked under the 2002 and 2012 code against a company that was not complying with the CG code had been delisting, but then given that there are I mean stock exchanges wanted always to have more listing (Participant-III)”*

It is perceived that foreign qualified individuals receive more robust exposure and professional training compared to their locally qualified counterparts and might be expected to disclose more information (Ahmed and Nicholls, 1994). The focus group participant also informed that:

*“In terms of societal factors... social factors I would maybe point out as I said earlier for family firms you are seeing the second and the third generation they are more open minded for the simple reason that these owners have a been a bit more exposed to these ideas because of sometimes having more opportunities to get themselves educated in different countries and different areas. I think they have been a positive influence so things a founder would not have imagined I think the second and the third generation, they are more courageous to actually try to implement those in their companies.....Of course, as I said, there’s a lot to be done but I have even met and known some family firms where you see the second and the third generation thinking more in terms of... simply because of their education their exposure to the world so that is probably one example I can give of how from one generation to another generation the attitudes towards accountability, towards corporate performance, and corporate governance have changed (Participant -III)”*

It is argued that qualifications and training alone are not solutions to the problems faced in developing countries (Abayo & Roberts, 1993) and firms are unlikely to provide high-quality information in the absence of demand and enforcement function. This is particularly the case in Pakistani firms with substantial family shareholdings

### **5.7 Voting**

Shareholder voting lies on the basis of a broad range of corporate governance protections. The shareholders’ rights to choose BoDs give them fundamental power over essential corporate decisions. In contrast, if management holds more voting power, it tends to negate the discipline of CG and the market for corporate control, especially in the case of pyramidal business groups and multiple classes of common stock. Morck, Shleifer, and Vishny (1988) found evidence that firm value declines as the voting control of insiders rises. Moreover, they found that firm value increases if controlled by an independent person. Similarly, Gompers, Ishii, and Metrick (2009) found that firm value increases as cash flow rights of insiders increase while firm value decreases if voting rights of insiders increase. In addition, researchers argued that if CEOs are involved in the nomination process of BoDs, lower quality nominees emerge and CEOs tends to hire less independent outsiders and more gray outsiders with conflicts of interest (Shivdasani & Yermack, 1999). Other research has studied the general effects of voting restrictions on firm value and performance, often finding that firms perform worse in the presence of voting restrictions (Gompers et al., 2003), staggered boards (Bebchuk & Cohen, 2005; Faleye, 2007) and dual class voting structures (Gompers et al., 2009).



The analysis of the focus group reveals that mostly shareholders do not have voting rights among the listed firms of Pakistan especially family ownership firms. The rights are assigned to majority shareholders and minority shareholders do not have the right to vote. Moreover, there is a lack of shareholders' participation at AGMs that leads towards power quality reporting. The following section expounds evidence on one category (1) AGM participation that is classified as voting.

### 5.7.1 AGM Participation

AGMs are considered as an instrument of corporate governance that provides shareholders, especially minority shareholders, access to the board, puts pressure on managers and limits the possibility of their wealth expropriation (Strätling, 2003). Similarly, Cutajar (2015) argued that the AGM is a pivotal element of CG practices and it can be enhanced by shareholders' participation and proper education about laws and regulations. In addition, AGM proceedings should be carried out in more effective, managed, interactive and engaged ways (Cutajar, 2015). However, his study reveals that most shareholders lack relevant education and shareholder activism (Cutajar, 2015). Proxy voting is often seen as an opportunity for directors to strengthen their hold over the general meeting (Monks & Minow, 2001) and also influence the agenda, timetable and conduct of AGMs (Turnbull, 2000) at the company's expense. A similar situation exists among the listed firms of Pakistan. Most of the shareholders especially minority shareholders do not participate in AGMs and those who participate do not have any relevant knowledge and education. One focus group participant highlighted that:

*“See there are two ways one can gauge that one is of course voting by their phase which is buying or selling shares regarding... in line with their level of comfort or discomfort with how the companies manage and the second is how vocal they are at the annual general meetings. Now the little bit of experience I have attending AGMs of various companies... listed companies there is not much number one attendance and if the attendance is there really, the freebies that are distributed at the AGMs nobody is really interested in questioning the presentations or perhaps they don't know enough to question the presentations that are made by the management so there is not much vocal presence of shareholders at the AGMs. Regarding the buying and selling of shares again what I have seen with the way the prices have fared or the Pakistan Stock Exchange prior to that to the various Karachi Lahore stock exchanges is that the price changes don't seem to be based too much on fundamentals of course when the company is doing well I mean the price increases there but it seems to have increased*

*over a period of time despite the variations... the slight variations in the company performance. So as I said I often say that the price variations of the stock exchange have little to do with the fundamentals of the company. So if we gauge shareholder awareness by these two measures i.e. whether they are actually going in and out of shares actively no they are not and two whether they are playing a vocal part at the AGMs from my experience no they are not so there is not much shareholder participation which can act as a gauge for their awareness” (Participant -II)”*

Iwatani and Taki (2009) argued that the opening of AGMs to regular shareholders increases attendance, participation and questions specifically from individual investors, and annual meetings are now longer. Similarly, Dimitrov and Jain (2011) argued that these meetings provide an opportunity for shareholders to show their apprehensions with corporate performance, pressurizing managers to exhibit good results. One focus group participant also informed that:

*“...they must conduct AGMs and everything must be described in the report what you have done in corporate governance, who is the director, who is the financial director for CFO, who is an audit committee member, who is your auditor they need to say everything, they must get certified they must have the awareness section they must acknowledge and they must sign regarding the board of governors (Participant -V)”*

Moreover, managers respond positively to questions and concerns of shareholders and try to influence them by positive news before AGMs. These meetings are very important for shareholders especially minority shareholders to exercise their rights and increase value to the firm.

## **5.8 Culture**

Douglass (1990) documented that institutions are formed by formal constraints and informal constraints. As per his theory, formal rules are created by polity whereas informal norms refer to heritage or culture. A researcher documented that cultural factors are related to the corporate governance system (Semenov, 2000) and companies need to understand it. Similarly, Evans (n.d) documented organizational culture as a significant determinant of companies' governance structures. Pakistan is considered a short-term culture country which focuses on the present rather than the future. Short-term cultures value diligence, ordering relationships by status, shame and thrift. Similarly, it is uncommon to plan for the distant future and people often come

late for meetings and appointments<sup>28</sup>. In addition, meetings may be cancelled on the spur of the moment. Like many other developing countries, Pakistani culture can be categorized as collectivist (Kochanek, 1983), high power distance (Newberg, 2002), high uncertainty avoidance and moderately high masculinity. However, most of the Anglo-Saxon and Scandinavian countries are located toward the lower end of the power distance. Therefore, the implication of corporate governance may be different in Pakistan from Anglo-Saxon countries. It is important for researchers to continue to investigate the development of CG practices from the cultural perspective (Chan & Cheung, 2012). The analysis of the focus group reveals that culture has a great influence in the corporate sector of Pakistan and daily life of people. Hence, it has an effect on CG practices and behaviors of people. Firms are still in a private ownership mindset and they are not willing to come out of this. Moreover, people are afraid to speak about any wrong doing due to personal contacts or lack of protection. The following sections expound evidence on two categories (1) culture and (2) whistleblowers that are classified together as institutional culture.

### 5.8.1 Institutional Culture

In the extended literature, researchers found that CG disclosure has been influenced by the dominant culture (Haniffa & Cooke, 2002) especially in developing countries (Licht, Goldschmidt, & Schwartz, 2005). Similarly, Ogbojafor, George, and Owoyemi (2012) conducted a study in Nigeria and found that national culture plays a pivotal part in the effectiveness of CG system. The focus group analysis also reveals that culture has an impact on corporate governance practices in Pakistan. One focus group participant informed that:

*“Number three is cultural aspects, some of the companies are still in a private mindset, ownership mindset, they are not willing to come out of it so some cultural issues... (participant -IV)”*

Similarly, researchers argued that culture has substantial significance on CG practices especially in developing countries (Amaeshi, Ogbechie, Adi, & Amao, 2006). In addition, Licht et al. (2005) documented that culture has varied impact on CG practice across countries and is dependent upon different factors. Another focus group participant also commented that:

*“There are some social factors which can have an impact on corporate governance compliance like maybe culture, religion or maybe the lack of experience or relevant education or these*

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<sup>28</sup> Centre for Intercultural Training, Working with a Pakistani Partner (Ottawa/Islamabad: CIDA, 1995), p. 12.

*types of things can have some impact on the corporate governance compliance (participant-I)”*

Similarly, Pakistan has a national culture due to the historical relations and spiritual attachment (Mughal, 2008) that has impacted on the institutional culture and obstructed the adoption of CG.

### **5.8.2 Organizational Whistle-blowers**

Whistleblowing is seen as the process where employees are able to report any unethical incident or practice (Lewis, 2001). However, whistleblowing does not exist in most of the organizations and employees may experience retaliation in the form of a job loss and department demotion for doing so (Martin, 1999). In contrast, Dehn and Borrie (2001) documented that organizations should protect whistle-blowers. Sternberg (1996) also documented that whistleblowing policies were a proactive way to detect problems at an early stage and helps organizations in maximizing long term values for owners from an ethical perspective. The focus group participant informed that:

*“if I can just cite you an example of when I was working at [SECP] fifteen years ago the first show cause notice I issued to a company the directors who came in turned out to be the peons and the chauffeurs of the company whose names had been affixed to the names of the directors and their signatures taken without them even knowing that they were liable for the actions of the company. Of course the real shareholders had absconded but these poor directors who had done nothing but affixed their names had been left behind to face the consequences (Participant -II)”*

Recently, the Public Interest Disclosures Act (2017) was passed in Pakistan to protect whistleblowers and encourage employees to raise their voices about corruption and wrongdoing within departments and organizations. The BoDs should ensure procedures to track down any whistleblowing and take necessary actions to protect whistleblowers.

### **5.9 Values**

Corporate values comprise an internal institutional force which monitors corporate behavior and a robust determinant of its CG and leadership. Wieland (2005) argued that practical implementation of corporate governance codes of conduct cannot be realized alone without moral values of the company culture. In a similar vein, Hart and Holmstrom (2002) argued that corporate values may be part of a vision of the company's future that includes future ownership

and stakeholders. In addition, good governance comprises other different values including responsibility, integrity, fairness, honesty, accountability and transparency. In sum, the corporate governance problem is a moral challenge and can be resolved with ethical behavior of all corporate actors including managers, directors, auditors and regulators.

The analysis of the focus group reveals that social values are high in Pakistan and people give preference to social norms and personal relationships. Family members are appointed as BoDs and to managerial positions due to the existence of family systems. Moreover, the BoDs serve on each other's firms due to interpersonal connections. Consequently, the quality of reporting is compromised. The analysis also reveals that education and training are helping in changing the mindsets of people and improving CG practice. The following sections expound evidence on two categories (1) family systems and (2) interpersonal connections that are classified together as values.

### **5.9.1 Family Systems**

In most developing countries, family systems provide a set of interrelationships and social arrangements that allow people to live in harmony and pursue a social life (Klomegah, 1997). Pakistan has an extended family system in which the family is responsible for the care and nurture of all children. Moreover, the family is considered as a strong bond and primary source of identity, responsibility and loyalty. Similarly, Kimani (2010) debated that the family defines moral and social norms and safeguards spiritual and material traditions and customs. Researchers documented that family core values influence the family business (Hendrick, 2000) and determine the behavior of family enterprises (Klein, Astrachan, & Smyrnios, 2005). The analysis of the focus group reveals that family values are high in Pakistan and the whole family owns and controls the business. One focus group participant highlighted that:

*“but I think it's something that really needs a change of mindset on the part of majority shareholders and I think the more that I have seen over the years is that most of these family firms they go into second and third generations (Participant-III)”*

Family systems form the core values and fundamental principles which help in setting vision, missions and goals of family enterprises. Researchers found that family businesses differ in terms of family involvement in management (Sharma, 2004) and ownership (Astrachan, Klein, & Smyrnios, 2002). The focus group analysis also presented similar findings. One focus group participant informed that:

*“Family owners often perceive corporate governance as equivalent to losing control, as something that’s essentially to do with complying with certain regulations and sometimes they don’t perceive it as something that’s really contributing to their overall decision making (Participant – III)”*

Another focus group participant highlighted that:

*“I am not going to say that just because companies are more family owned there is less corporate governance, there are some family owned businesses which are actually very conscious about compliance and good corporate governance practices. It just depends on how well educated they are (Participant -II)”*

In addition, it is argued that family ownership can lead towards competitive advantage by reducing agency conflicts and maximizing the value of a firm because family wealth is directly related to the company. Therefore, it offers robust spurs to monitor managers and reduce the intrinsic problem of free-ride shareholder dispersion. Similarly, Anderson et al. (2003) argued that strong control mechanisms can increase the level of communication among stakeholders including family members and creditors that ultimately increases the quality of financial reporting and reduces the cost of debt. It is also imperative to cite that the family and the business are so entwined that sentiments are inevitable in a family business. Consequently, family firms are often counselled to hire outside board members for family businesses (Brockhaus, 2004) and to reduce resistance (Handler & Kram, 1988). One focus group participant informed that:

*“I have had the chance in my professional life to actually interview some of the family owners and in some cases I think I remember this family from a big family business in Karachi and the founder told me that he was skeptical at the start about having an independent director because it was a very closely held company with a family only board but now that person has been on board for one year they see value that that person brings, so that I think is most influential (Participant-III)”*

The sustainability and adoption of good corporate governance practices are as important as the public company. Besides this, personal relationships toward the family agents may compromise the principal ‘s ability to persuasively evaluate and monitor their performance.

### 5.9.2 Interpersonal Connections

The interpersonal connections are very common in the corporate sector of developing countries especially Pakistan. In addition, directors (regardless of executive or non-executive) may sit on more than one board, called cross directorships. This practice is also common in both developed and developing countries (Roudaki & Bhuiyan, 2015). Some researchers argued that cross directorships are good for firms as directors can make comparisons based on knowledge of other organizations (Dahya, Lonie, & Power, 1996) while some researchers argued that cross directorship leads towards less independence and directors can make sympathetic decisions (Davis, 1993). Researchers also found a negative effect of interlocking on firm performance (Roudaki & Bhuiyan, 2015). These arguments are based on resource dependence theory. Similarly, people know each other especially in the business environment of Pakistan and the independence of directors is compromised. One focus group participant highlighted that:

*“but I think we tend to take much more for granted in Pakistan given that even within the corporate sector you find everybody knows everybody right, there is a certain comradery within the financial sector, within the banking sector, within the corporate sector because there is a certain class of participants who have been in the market for a long time and they are known to each other and hence there is no level of complete independence from each other. So when somebody comes on to your board the high likelihood is even if they are an independent director there is a high likelihood that there is some connection to degrees of separation with other board members or management or somebody. So that level of complete independence is not there I think more because of the social environment in which we operate compared to maybe some other countries where there is a certain level of... there is more distance between people serving in the same companies or serving on the same boards so I think that level does influence how people relate to each other, how the decision making function works in practice there is more give and take because it's the norm I mean more cross directorships. I mean somebody asks you to serve on their board there is a high likelihood that you will be asking them to serve on your board so there is a little bit of give and take in these situations. So what I am saying is that social norms perhaps bring a level of informality into our board structures which influences the implementation of corporate governance at some levels. (Participant - II)”*

Lorsch and Young (1990) emphasized that interlocking of CEOs is desirable because of their credibility and experience as peers. Additionally, it provides an opportunity to see how someone is doing the same thing you are doing. CEOs join other boards and thus form

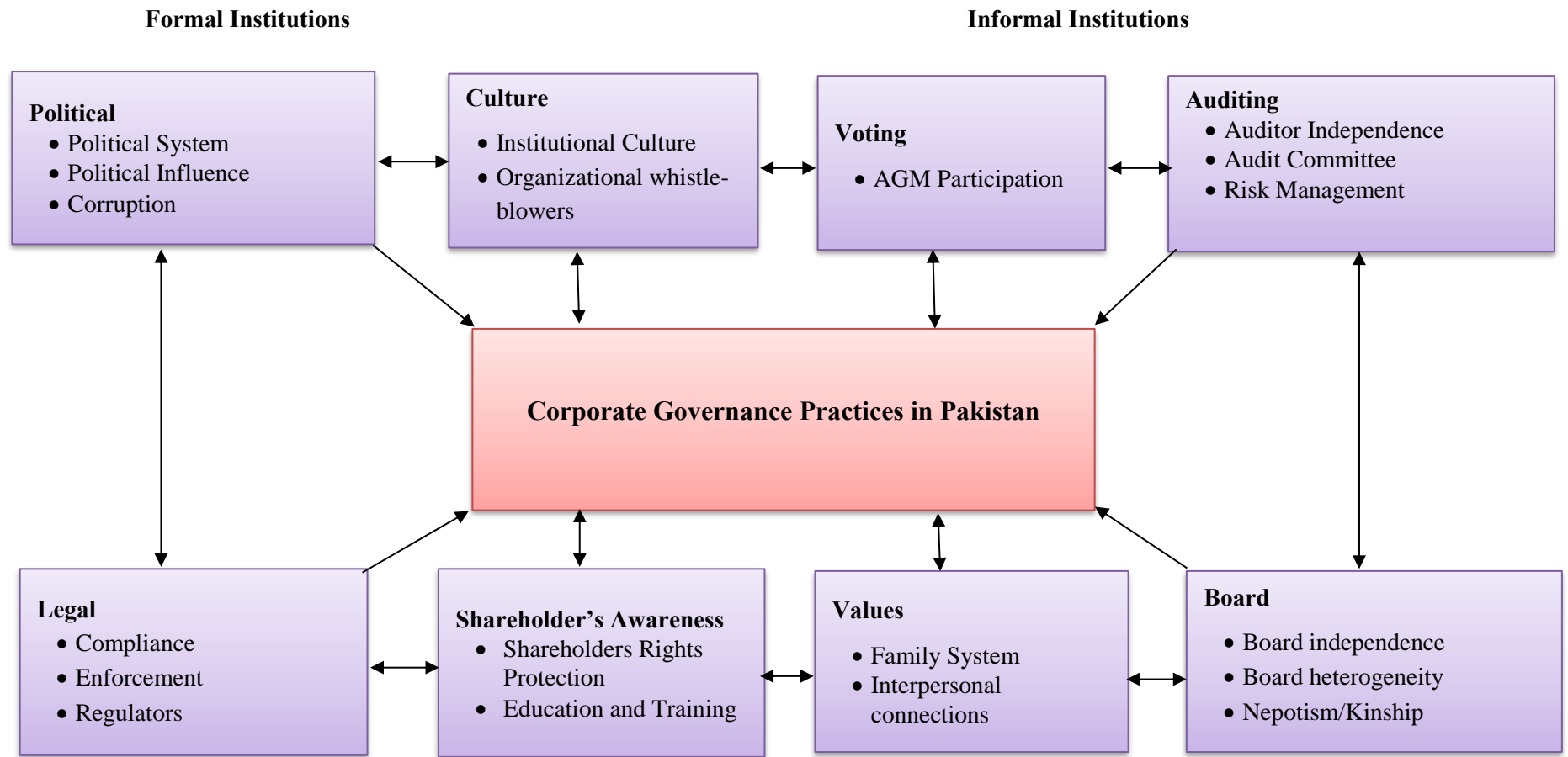
interlocking relationships specially to ‘embed’ what they are doing (Davis, 1996). The focus group participant also informed that:

*“As we discussed earlier in the conversation one of the socio-economic factors at play in Pakistan is the fewer degrees of separation between board members. What ends up happening is that they start operating as small country club boards where everybody knows everybody, they all pat each other on the back, and nobody really wants to take a stand against each other because they meet each other socially at the clubs or elsewhere (Participant-II)”*

Several studies have documented that interlocking relationships and control structures are related to independence of directors and have pivotal implications of governance function. While some researchers argued that interlocking directors can offer insights based on personal experience and practical knowledge of other organizations, hence, this experience and knowledge can serve as raw material for other organizations (Dahya et al., 1996). In sum, cross-directorships held by BoDs have significant insinuations for CG disclosure practice. In Pakistan, the cross directorship is common practice among BoDs, and they do not want to take strict action against each other, hence, transparency and fairness are comprised. In addition, this gives opportunity to wrong doing and ill practices. The following Figure 5 presents the institutional determinants of good governance practices in Pakistan.



**Figure 5 Institutional Determinants of Good CG Practices in Pakistan**



Developed by the researcher

### 5.10 Chapter Summary

This chapter presents the analysis of the focus group. Eight themes are explored; (1) Auditing, (2) Political, (3) Legal, (4) Board, (5) Shareholders' awareness, (6) Voting, (7) Culture and (8) Values. Auditing has three sub themes; (1) Auditor independence, (2) Audit committee and (3) Risk management. Analysis reveals that the auditing process is not effective and there is a need to improve auditing practices in Pakistan to improve CG practice in the country. The auditors are not independent, and their performance is questioned. Moreover, audit committees are not composed of independent directors, consequently, the quality of audits is poor. Due to lack of independent directors, internal control and risk management functions are not effective. Political has three sub themes; (1) political systems, (2) political influence and (3) corruption. Analysis reveals that corruption is high in Pakistan and political interference is badly affecting CG practices in Pakistan. Merit is compromised due to political influence that ultimately leads towards lower quality reporting. The appointments are made on political connections and firms' operations are influenced by the political system of the country.

Legal has three sub themes; (1) compliance, (2) enforcement, and (3) regulators. The analysis reveals that legal and regulatory systems fail to implement and enforce CG practice in the country. Moreover, regulators lack power and skills to enforce and ensure implementation of CG practices. Rules are in books but not in practice. Board has three sub themes; (1) board independence, (2) board heterogeneity and (3) nepotism/kinship. BoDs are not independent to protect shareholders' rights especially minority shareholders. Moreover, boards lack heterogeneity and nepotism/kinship exist among PSX listed firms. Hence, the effectiveness of the board is compromised. Due to lack of board heterogeneity, voicing mechanisms are absent. Shareholders' awareness has two sub themes; (1) shareholders' rights protection and (2) education and training.

The analysis of the semi-structured focused group revealed that shareholders are not fully aware of the benefits associated with good CG practices. In addition, shareholders lack adequate education and training. Hence, it is pivotal to increase the awareness among different stakeholders including shareholders. Voting has one sub theme i.e. AGM participation. Minority shareholders lack basic voting rights especially in highly concentrated family firms. Moreover, there is not much participation and vocal presence at AGMs. The freebies are attending the AGMs and do not have awareness. The social and cultural values are high and affect CG practices in the country. Culture has two sub themes; (1) institutional culture and (2) organizational whistle-blowers. Due to lack of protection for whistle-blowers, no one raises a

voice. Finally, values have two sub themes; (1) family systems and (2) interpersonal connections. Due to cultural and social values, people know each other and lack independence and voicing to protect all stakeholders' interests.

## CHAPTER SIX

### FINDINGS OF THE QUANTITATIVE PHASE

#### 6.1 Introduction

This chapter presents the results of the quantitative data analysis of the study and aims to achieve three objectives of this study i.e. (1) to explore the most influential barriers to good corporate governance practices in Pakistan, (2) to explore the most important drivers of good corporate governance practices in Pakistan, and (3) to investigate the nexus between CG compliance and financial performance of PSX listed firms. Results are presented in seven sections as, section 6.2 presents the results of demographic information of respondents. This includes age, position, qualifications, specialization and experience of respondents. Section 6.3 presents the results of descriptive statistics and correlation analysis of variables of the study. This section includes the variables such as Corporate Governance Index (CGI) score and firm performance indicators i.e. ROA and ROE. The results of exploratory factor analysis (EFA) of barriers and drivers of good corporate governance practices in Pakistan are presented in sections 6.4 and 6.5, respectively. The results of hierarchical multiple regression analysis are presented in section 6.6. Section 6.7 presents the discussion while section 6.8 integrates the qualitative and quantitative findings. Finally, the chapter summary is presented at the end of this chapter.

#### 6.2 Demographic Results

The results of the demographic information of respondents are presented in Table 6. There was a total of 105 respondents. The result reveals that most respondents (39%) were aged between 31 and 40 years while only 3.8% respondents were above 60 years of age. Table 6 reveals that 12.4% respondents were 30 years or less while 11.4 % respondents were aged 51 to 60 years of age. There were 33.3% respondents aged from 41 to 50 years. The respondents were predominantly middle-aged ( $39+33.3+11.4 = 83.7$ ) which is considered a reliable source of providing information for this study.

Regarding position, the results reveal that most of the respondents (42.9%) held the position of manager while 33.3% were in senior manager positions. There were only 8.6% respondents in the position of auditor while 15.2% of respondents were in the position of accountant. Coupling the demographic information on age and position is a way of providing reliable data for steady analysis.

The results of the demographic information also reveal that 48.6% of respondents have a Master's degree or equivalent qualification, while only 2.9% of respondents have other qualifications. It is highlighted that only 9.5% of respondents have PhDs or equivalent qualifications while Bachelors' and Diploma holders were 31.4 % and 7.6% respectively.

**Table 6 Results of the Demographic Information**

Demographic Information of Respondents			
		Frequency	Percent
Age	30 years or less	13	12.4
	31 to 40 years	41	39
	41 to 50 years	35	33.3
	51 to 60 years	12	11.4
	Above 60 years	4	3.8
Position	Senior Manager	35	33.3
	Manager	45	42.9
	Accountant	16	15.2
	Auditor	9	8.6
Qualification	PhD or equivalent	10	9.5
	Masters or equivalent	51	48.6
	Bachelors or equivalent	33	31.4
	Diploma or Professional	8	7.6
	Other	3	2.9
Specialization	Finance	28	26.7
	Accounting	36	34.3
	Economics	28	26.7
	Management	11	10.5
	Other	2	1.9
Experience	1 to 5 years	19	18.1
	6 to 10 years	42	40
	11 to 15 years	43	41
	16 to 20 years	1	1

N= 105

The results also reveal that most of the respondents (34.3%) have specialization in accounting while only 1.9% respondents have other specializations. There were 10.5 % respondents who have specialization in management while both finance and economic specialization holders are each 26.7%.

Regarding experience, results reveal that most of the respondents (41%) have 11 to 15 years of experience while 40% respondents have 6 to 10 years of experience. The 18.1% respondents

who were in their early career have 1 to 5 years of experience, while only one respondent has 16 to 20 years of experience. All in all, the respondents are mature experienced managers.

### 6.3 Results of Descriptive Statistics and Correlation Analysis

The results of the descriptive statistics and correlation analysis are presented in Table 7. The results show the correlation between explanatory variables such as CGI score and dependent variables i.e. ROA and ROE while controlling for the effect of age, position, qualification, specialization and experience of respondents. Table 7 also presents the descriptive statistics of the CGI score, ROA and ROE. The CGI score has a mean value of 162.5619 with a standard deviation of 15.101531. The ROA has a mean value of 0.06426 with a standard deviation of 0.067981, while the ROE has a mean value of 0.11491 with a standard deviation of 0.179549. The results of the correlation analysis reveal that the CGI score has a significant positive ( $p < 0.01$ ) association with both ROA and ROE at the 0.01 level of significance.

**Table 7 Results of the Descriptive Statistics and Correlation Analysis**

Control Variables		Mean	Std. Deviation	CGI score	ROA	ROE
Age & Position & Qualification & Specialization & Experience	CGI score	162.5619	15.101531	1		
	ROA	0.06426	0.067981	0.610***	1	
	ROE	0.11491	0.179549	0.431***	0.839***	1

\*\*\*Correlation is significant at the 0.01 level (2-tailed). Where the Total CGI score is the total score of CG compliance obtained from the survey questionnaire. ROA is return on assets while ROE is return on equity.

Table 7 shows that there is a significant positive relationship ( $r = 0.610$ ) between CGI score and return on assets at the 0.01 level of significance. Similarly, Table 7 reveals a significant positive correlation ( $r = 0.431$ ) between CGI and return on equity at the 0.01 level of significance. The results of the correlation analyses are supported by prior studies (Javid & Iqbal, 2008b; Maranho & Leal, 2018; Ntim et al., 2014; Tariq & Abbas, 2013) that found significant positive relationships between the CGI score, ROA and ROE.

### 6.4 Barriers to Good CG Practices in Pakistan

This section presents the results of exploratory factor analysis (EFA) regarding barriers to good corporate governance practices in Pakistan. The survey includes 17 items that were measured on the five-point Likert scale (*see section 4.15*). The results of Kaiser-Meyer-Olkin (KMO)

and Bartlett's tests are presented in Table 8. KMO measure the sampling adequacy and should be greater than 0.5 for performing a satisfactory factor analysis. Kaiser (1974) and Tabachnick and Fidell (2007) provided guidelines for interpreting these values<sup>29</sup>. Table 8 reveals that the KMO has a value of 0.702 which shows the adequacy of the sample for EFA.

**Table 8 KMO and Bartlett's Test for Barriers to good CG Practices**

KMO and Bartlett's Test		
<hr/>		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0.702
Bartlett's Test of Sphericity	Approx. Chi-Square	1561.297
	df	136
	Sig.	0.000
<hr/>		

In addition to KMO, the Bartlett's test of sphericity that estimates which inter-correlation matrix produced is an identity matrix. Generally, the value of  $P < 0.05$  on Bartlett's test indicates that the inter-correlation matrix is not an identity matrix and factor analysis can be performed. In Table 8, Bartlett's test is highly significant ( $P < 0.05$ ) that shows that EFA can be run for the extraction of factors by including all the items.

In EFA, the next step is the extraction of factors. Researchers have argued that factors are extracted till the value of variance is maximized (Mvududu & Sink, 2013) and different methods can be employed to extract factors. This study employed the principal axis factoring (PAF) method to extract the factors. This method is a preferred approach in the presence of a multivariate normality problem and when the researcher aims to find latent factors in the study. In addition, the PAF extraction method generates reliable results despite the high or low values of communalities (Kahn, 2006).

It is important for researchers to examine which evolving constructs could be retained for additional interpretation or analysis. The factor retention decision has important implications. First, it should have more effect on overall EFA results (Zwick & Velicer, 1986). Secondly, it is necessary to balance the need for frugality while effectively demonstrating fundamental correlations (Fabrigar, Wegener, MacCallum, & Strahan, 1999). Third, researchers argued that

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<sup>29</sup> The value of KMO test is considered good if it is more than 0.60 (see Kaiser, 1974; Tabachnick & Fidell, 2007).

under-extraction and over-extraction can alter the overall EFA and its interpretation (Ledesma & Valero-Mora, 2007).

It is also noted that the number of factors retained varies across studies and different criteria have been used to make a decision. The following criteria (i.e. eigenvalue, scree test and variance explained) have been used in this study to make a decision about factor retention.

Kaiser (1960) suggested that only those factors are retained for interpretation that have eigenvalues greater than 1.0. Eigenvalues represents the explained variable by a given factor. The benchmark of establishing eigenvalue 1.0 seems arbitrary, however, researchers documented that factors that have eigenvalues greater than one should be retained because these represent those factors which contribute to a higher percentage of communal variance than average (Nunnally & Bernstein, 1994).

In addition to eigenvalue, there is an alternative approach called the scree test to determine factors' retention and involves developing a scree plot of extracted factors against the magnitude of their eigenvalues (Cattell, 1966; DeVellis, 2016). In this approach, the researcher needs to identify an elbow or break where larger eigenvalues end in steep slope rambling off of smaller eigenvalues begins. Cattell (1966) suggested that only left side factors of the elbow are retained while right side factors are dropped.

Another common method about making a decision regarding factor retention is examining the cumulative variance accounted for by retained factors. Various sources recommended numerous levels from 50% onwards and there is no exact percentage of total variance explained. However, most statisticians and scholars recommended factors that are required to obtain a variance of 75% to 90% (see Hair, Black, Babin, Anderson, & Tatham, 2006; Peterson, 2000; Pett, Lackey, & Sullivan, 2003).

Based on the above criteria (i.e. Eigenvalue, Scree test and Total variance), this study only retained five factors that have eigenvalues of greater than one as shown in Table 9. The Scree test also reveals the elbow after five factors. In addition, Table 9 also reveals that these five factors explain the cumulative variance of 80.29% which is recommend by other researchers<sup>30</sup>.

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<sup>30</sup> (see Hair et al., 2006; Pett et al., 2003)



**Table 9 Total Variance Explained for Barriers to Good CG Practices in Pakistan**

Factor	Total Variance Explained								
	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.861	34.476	34.476	5.661	33.299	33.299	3.671	21.595	21.595
2	2.922	17.187	51.663	2.629	15.467	48.766	2.736	16.092	37.687
3	2.279	13.408	65.072	2.05	12.06	60.826	2.541	14.947	52.635
4	1.406	8.273	73.344	1.096	6.446	67.272	1.849	10.876	63.511
5	1.182	6.954	80.298	0.928	5.457	72.728	1.567	9.217	72.728
6	0.867	5.097	85.396						
7	0.563	3.314	88.71						
8	0.455	2.677	91.387						
9	0.388	2.285	93.672						
10	0.285	1.675	95.346						
11	0.197	1.156	96.503						
12	0.183	1.074	97.576						
13	0.152	0.895	98.471						
14	0.096	0.565	99.036						
15	0.084	0.496	99.532						
16	0.042	0.249	99.781						
17	0.037	0.219	100						

Extraction Method: Principal Axis Factoring (PAF).

In Table 9, there are three main components, i.e. initial eigenvalues, extraction sums of squared loadings and rotation sums of squared loadings. The first factor has eigenvalues of 5.861 and these explain 34.476% of variance explained. Similarly, the second factor has an eigenvalue of 2.922 and explains 17.187% of variance, making a cumulative variance of 51.663%. The third factor has an eigenvalue of 2.279 and explains 13.408% of variance, making a cumulative variance of 65.072%. The fourth factor has an eigenvalue of 1.406 and explains 8.273% of variance and cumulative variances reach to 73.344%. Finally, the fifth factor has an eigenvalue of 1.182 and explains 6.954% of variance and cumulative variance reaches to 80.298% which is within the recommended range by the researchers<sup>31</sup>.

**Figure 6 Scree Plot of EFA for Barriers to Good CG Practices in Pakistan**

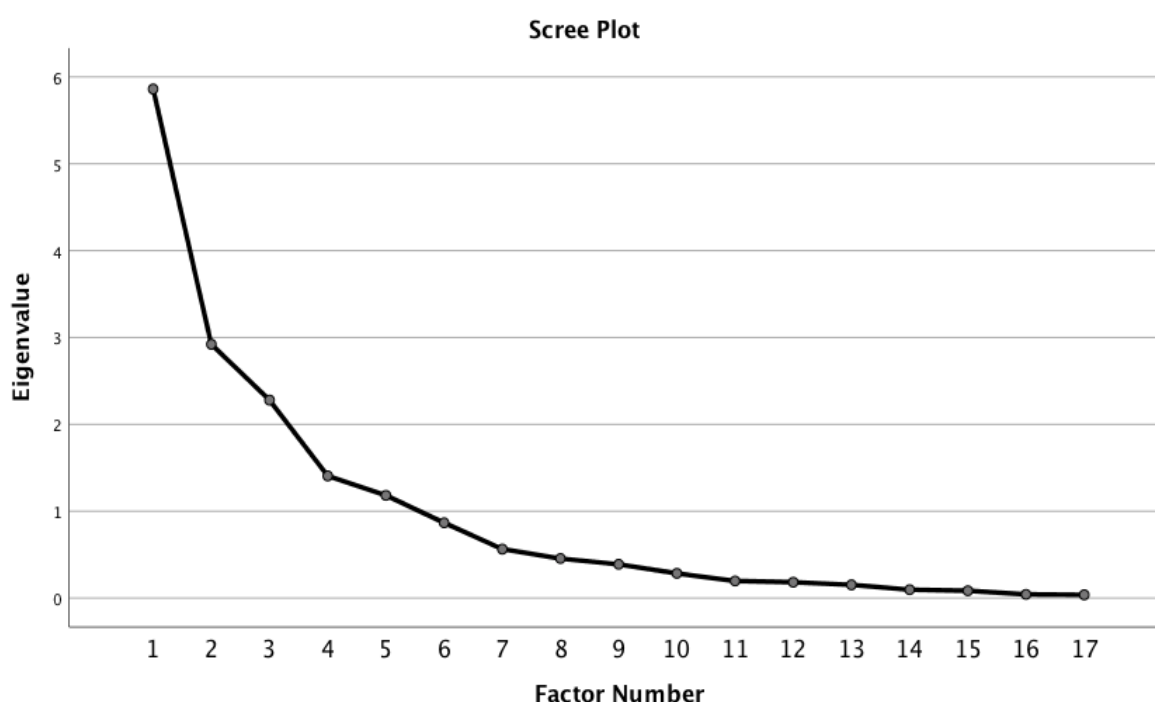


Figure 6 reveals the scree plot of EFA for barriers to good corporate governance practices in Pakistan. The scree plot graphically presents the eigenvalues in descending order. It can be seen that the first factor has an eigenvalue of 5.861 while second factor has an eigenvalue of 2.922. Similarly, the third, fourth and fifth factors have eigenvalues of 2.279, 1.406 and 1.182 respectively. In addition, an elbow can be seen after factor five. As suggested by Cattell (1966), only these five factors are retained in this study that were on left side of the elbow and the right side factors were dropped.

<sup>31</sup> (see Hair et al., 2006; Peterson, 2000; Pett et al., 2003)

It is often difficult to interpret factors that are initially extracted and retained. Consequently, Dimitrov (2014) recommended that researchers need to rotate these factors to more suitable positions to create the simplest possible factor structure, maximize high loading and minimize low loadings. The idea of rotating factors stems from the work of researchers such as Thurstone (1947) and Cattell (1966) who saw it as a way of simplifying factor structures so they could be more reliably interpreted. In SPSS, researchers have to choose either orthogonal or oblique rotation strategies which have quite different fundamental assumptions but have same goal (i.e. seeking simple structure) (Hair et al., 2006; Pett et al., 2003). In orthogonal rotation, it is assumed that factors are independent of one another, consequently, they are kept in a fixed position and it is expected that newly rotated factors are uncorrelated. Varimax, quartimax and equamax are three common orthogonal rotation algorithms and varimax is the most widely used and easy to interpret (Dimitrov, 2014). This study selected varimax from the rotation menu and chose to suppress factors, having a coefficient score of less than 0.50 due to small sample size<sup>32</sup>. Table 10 presents the rotated results of principal axial factoring for barriers to good corporate governance practices in Pakistan.

Factor loadings were considered in evaluating the factors retention that represent drivers of good corporate governance practices in Pakistan and only those factors were retained which had a minimum factor loading of 0.7 that is considered excellent (see Tabachnick & Fidell, 2007). Table 10 reveals that 17 items that were included into EFA were extracted and loaded into 5 factors. The factor 1 (three items) comprised lack of auditors' independence, board ineffectiveness and lack of shareholders' awareness. The factor 2 (three items) comprised political and governmental interference in business activities, weak legal control and enforcement and high levels of corruption. The factor 3 (two items) comprised strong social ties among different stakeholders and interpersonal connection among BoDs. The factor 4 (one item) comprised lack of professional education and training among stakeholders. At the end, factor 5 (one item) comprised fewer voting rights.

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<sup>32</sup> Due to the small sample, this study suppressed the small coefficient of absolute value of 0.5 (see Andy, 2000, p. 440).

**Table 10 Rotated Factor Matrix for Barriers to Good CG Practices in Pakistan**

<b>Rotated Factor Matrix<sup>a</sup></b>					
	<b>Factor</b>				
	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Lack of Auditors' independence	0.748				
Board ineffectiveness	0.866				
Lack of Shareholders' awareness	0.822				
Political and Governmental interference in business activities		0.762			
Weak legal control and enforcement		0.752			
High levels of corruption		0.759			
Strong social ties among different stakeholders			0.722		
Interpersonal connections among BoDs			0.786		
Lack of professional education and training among stakeholders				0.845	
Fewer voting rights					0.718

Extraction Method: Principal Axis Factoring.

Rotation Method: Varimax with Kaiser Normalization.

A Rotation converged in 12 iterations.

Based on item loading and shared characteristics on each factor, the researcher assigned factor labels. The factor 1 is labeled as **firm level barriers**, factor 2 is labelled as **external barriers**, factor 3 is labelled as **social barriers**, and factor 4 is labelled as **education and training barriers** while factor 5 is labelled as **legal barriers**.

### **6.5 Drivers of Good CG practice in Pakistan**

This section presents the results of exploratory factor analysis (EFA) regarding drivers of good corporate governance practices in Pakistan. The survey includes 12 items that were measured on a five-point Likert scale (*see section 4.15*). The results of Kaiser-Meyer-Olkin (KMO) and Bartlett's tests are presented in Table 11. KMO measures the sampling adequacy and should

be greater than 0.5 for performing a satisfactory factor analysis. Kaiser (1974) and Tabachnick and Fidell (2007) provided guidelines for interpreting these values<sup>33</sup>. Table 11 reveals that KMO has a value of 0.735 which shows the adequacy of the sample for EFA. In addition to KMO, the Bartlett's test of sphericity that estimates which inter-correlation matrix produced is an identity matrix. Generally, the value of  $P < 0.05$  on Bartlett's test indicates that the inter-correlation matrix is not an identity matrix and factor analysis can be performed. In Table 11, Bartlett's test is highly significant ( $P < 0.05$ ) that shows that EFA can be run for extraction of factors by including all the items.

**Table 11 KMO and Bartlett's Test for Drivers of Good CG Practices in Pakistan**

KMO and Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0.735
Bartlett's Test of Sphericity	Approx. Chi-Square	868.428
df		66
Sig.		0.000

Based on the criteria (i.e. Eigenvalue, Scree test and Total variance), this study only retained four factors that have eigenvalues of greater than one as shown in Table 12. The Scree test also reveals the elbow shape after the fourth factor. In addition, Table 12 also reveals that these four factors explain the cumulative variance of 77.728% which is recommend by other researchers (see Pett et al., 2003). In Table 12, there are three main components, i.e. initial eigenvalues, extraction sums of squared loadings and rotation sums of squared loadings. The first factor has eigenvalues of 5.504 and these explain 45.866% of variance explained. Similarly, the second factor has an eigenvalue of 1.545 and explains 12.872% of variance, making a cumulative variance of 58.738%. The third factor has an eigenvalue of 1.252 and explains 10.437% of variance, making a cumulative variance of 69.174%. At the end, the fourth factor has an eigenvalue of 1.026 and explains 8.554% of the variance and cumulative variances reach 77.728% which is within the range recommended by Pett et al. (2003) and Hair et al. (2006).

<sup>33</sup> The value of KMO test is considered good if it is more than 0.60 (see Kaiser, 1974; Tabachnick & Fidell, 2007).

**Table 12 Total Variance Explained for Drivers of Good CG Practices in Pakistan**

Total Variance Explained									
Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.504	45.866	45.866	5.504	45.866	45.866	4.228	35.236	35.236
2	1.545	12.872	58.738	1.545	12.872	58.738	2.404	20.037	55.273
3	1.252	10.437	69.174	1.252	10.437	69.174	1.354	11.285	66.558
4	1.026	8.554	77.728	1.026	8.554	77.728	1.34	11.17	77.728
5	0.701	5.842	83.571						
6	0.667	5.554	89.125						
7	0.459	3.824	92.949						
8	0.307	2.556	95.505						
9	0.224	1.869	97.375						
10	0.155	1.289	98.663						
11	0.091	0.761	99.424						
12	0.069	0.576	100						

Extraction Method: Principal Component Analysis.

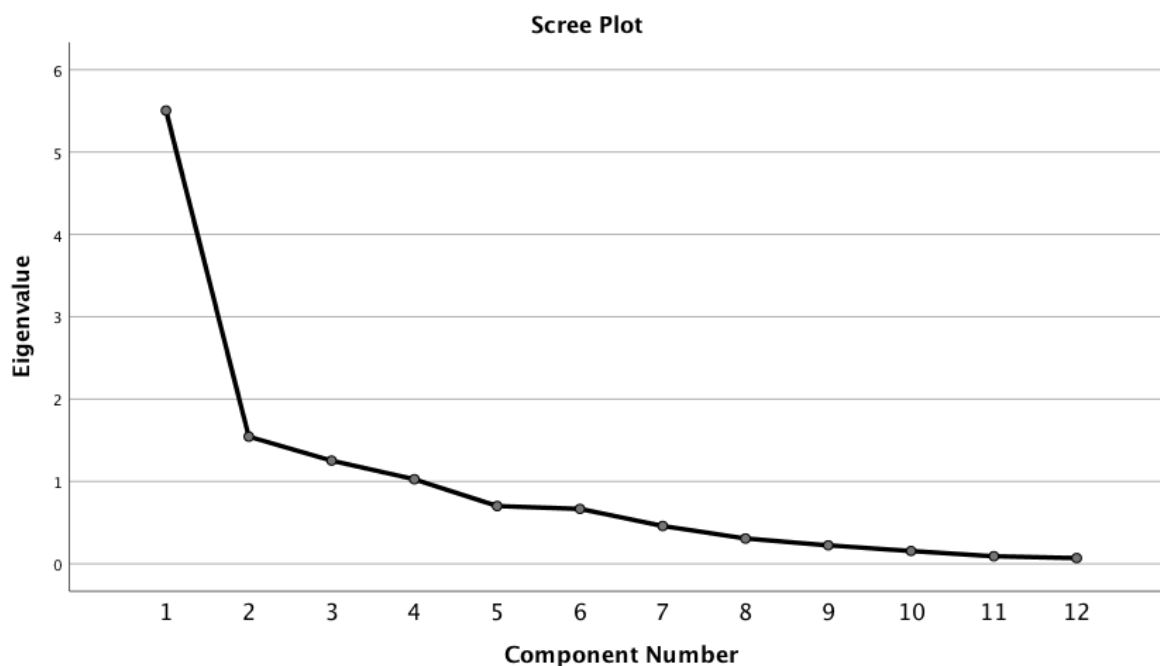
**Figure 7 Scree Plot of EFA for Drivers of Good CG Practices in Pakistan**

Figure 7 reveals the scree plot of EFA for drivers of good corporate governance practices in Pakistan. The scree plot graphically presents the eigenvalues in descending order. It can be seen that the first factor has an eigenvalue of 5.504 while second factor has an eigenvalue of 1.545. Similarly, the third and fourth factors have eigenvalues of 1.252 and 1.026 respectively. In addition, an elbow shape can be seen after the fourth factor. As suggested by Cattell (1966), only these four factors that were on left side of the elbow are retained in this study and the right side factors were dropped. Table 13 presents the rotated results of principal component analysis for drivers of good corporate governance practices in Pakistan. Factor loadings are considered in evaluating the factors retention that represent drivers of good corporate governance practices in Pakistan and only those factor were retained which had a minimum factor loading of 0.7 that is considered excellent (see Tabachnick & Fidell, 2007). Table 13 reveals that 12 items that were included into EFA are extracted and loaded into 4 factors. The factor 1 (four items) comprised auditors' independence, board heterogeneity, board independence and initiate training programs for directors, raise awareness and education for CEOs, directors, shareholders and board members. The factor 2 (one item) comprised enhancing and empowering professional regulatory bodies. The factor 3 (one item) comprised encouraging participation in events and conferences related to corporate governance). Finally, factor 4 (one item) comprised enhance partnership with international regulatory bodies i.e. OECD, IFC to promote CG in Pakistan.

**Table 13 Rotated Factor Matrix for Drivers of Good CG Practices in Pakistan**

	<b>Rotated Component Matrix<sup>a</sup></b>			
	<b>Component 1</b>	<b>2</b>	<b>3</b>	<b>4</b>
Auditors' independence	0.867			
Board heterogeneity	0.792			
Board independence	0.804			
Initiate training programs for directors, raise awareness and education for CEOs, directors, shareholders and board members	0.915			
Enhancing and empowering professional regulatory bodies		0.88		
Encouraging participation in events and conferences related to corporate governance			0.869	
Enhance partnership with international regulatory bodies i.e. OECD, IFC to promote CG in Pakistan				0.824
Extraction Method: Principal Component Analysis.				
Rotation Method: Varimax with Kaiser Normalization.				
a Rotation converged in 6 iterations.				

Looking at the item loading on each factor, the researcher identified factor labels based on the shared characteristics of each item. The factor 1 is labelled as **internal drivers**, factor 2 is labelled as **regulatory drivers**, and factor 3 is labelled as **motivational drivers** while factor 4 is labelled as **collaborative drivers**.

## **6.6 Nexus between CG compliance and Firm Performance**

This section presents the nexus between corporate governance index score and firm performance among PSX listed firms. The corporate governance compliance score is developed from the five-point Likert scale survey questionnaire. There was a total of 48 CG provisions that were divided into seven elements (Appendix D). The firm performance is measured through ROA and ROE, taken from annual reports of sampled firms. Only those firms are selected who filled the survey questionnaire.

### **6.6.1 Hierarchical Multiple Regression Analysis of ROA**

A multiple regression analysis is a type of test that analyses the amount of variance explained in a dependent variable by one or more independent variables, while hierarchical multiple regression adds another piece to it and allows researchers to determine the  $R^2$  change and change in F statistics.



The results of hierarchical multiple regression analysis are presented in Table 14. There is a total of two models. In model 1, only the effect of demographic factors such as age, position, qualification, specialization and experience are measured on ROA. In addition to multiple hierarchical regression, the collinearity tests are also conducted. In model 1, it can be seen that all the demographic factors have a variance inflation factor (VIF) of greater than 1, it means there is no multi-collinearity among variables. The model 1 shows the  $R^2$  value of 0.092, it means 9.2% variance in dependent variable (ROA) is explained by these demographic variables.

In model 2, the CGI score is also added to investigate its impact on ROA. The model 2 reveals that CGI score has a significant positive impact on ROA. It means those firms increase their financial performance which comply with the CG practices in true spirit. In model 2, the VIF also reveals the absence of multi-collinearity among variables. The VIF of CGI score is 1.161 which rejects the existence of multi-collinearity. In addition, the  $R^2$  has increased to 0.43, it means 43% variation in ROA is explained by these explanatory variables. The p and t -statistics of the CGI score also show that CGI score has a significant positive relationship with ROA.

**Table 14 Results of Hierarchical Multiple Regression and Collinearity Stats for CGI Score and ROA**

Variables	Model 1					Collinearity Stats		Model 2					Collinearity Stats	
	B	Std. Error	Beta	t		Tolerance	VIF	B	Std. Error	Beta	t		Tolerance	VIF
Constant	0.041	0.036		1.127				-0.440	0.069		-6.338			
Age	0.015	0.011	0.223	1.404		0.364	2.751	0.005	0.009	0.074	0.575		0.355	2.817
Position	-0.004	0.007	-0.054	-0.534		0.903	1.108	0.004	0.006	0.057	0.700		0.874	1.144
Qualification	0.005	0.008	0.068	0.660		0.857	1.166	0.004	0.006	0.047	0.567		0.856	1.168
Specialization	0.014**	0.007	0.217	2.062		0.831	1.203	0.007	0.006	0.113	1.331		0.810	1.235
Experience	-0.024*	0.014	-0.266	-1.707		0.378	2.648	-0.001	0.012	-0.010	-0.080		0.352	2.842
CGI Score								0.003***	0.000	0.627	7.631		0.861	1.161
R	0.303							0.6560						
R <sup>2</sup>	0.092							0.4300						
Adjusted R <sup>2</sup>	0.046							0.3960						
std. error of the estimate	0.066392							0.052852						
F	2.008							12.3440						
Sum of square total	0.481							0.4810						
Df	(5, 99)							(6, 98)						

Dependent Variable: ROA

\*, \*\*, \*\*\* Correlation is significant at the 0.10 level (2-tailed), 0.05 level (2-tailed) and 0.01 level (2-tailed), respectively.

### 6.6.2 Hierarchical Multiple Regression Analysis of ROE

The results of hierarchical multiple regression analysis are presented in Table 15. There is a total of two models. In model 1, only the effect of demographic factors such as age, position, qualification, specialization and experience are measured on ROE. In addition to multiple hierarchical regression, the collinearity tests are also conducted. In model 1, it can be seen that all the demographic factors have a variance inflation factor (VIF) of greater than 1 and means there is no multi-collinearity among variables. The model 1 shows the  $R^2$  value of 0.065, it means 6.5% variance in the dependent variable (ROE) is explained by these demographic variables.

In model 2, the CGI score is also added to investigate its impact on ROE. The model 2 reveals that the CGI score has a significant positive impact on ROE. It means those firms perform better which comply with the CG practices in a true spirit. In model 2, the VIF also reveals the absence of multi-collinearity among variables. The VIF of CGI score is 1.161 which rejects the existence of multi-collinearity. In addition, the  $R^2$  has increased to 0.225 which means a 22.5% variation in ROE is explained by these explanatory variables. The p and t -statistics of the CGI score also reveal a significant positive relationship between the CGI score and ROE.

**Table 15 Results of Hierarchical Multiple Regression and Collinearity Statistics for CGI score and ROE**

Variables	Model 1					Collinearity Stats		Model 2					Collinearity Stats	
	B	Std. Error	Beta	t		Tolerance	VIF	B	Std. Error	Beta	t		Tolerance	VIF
Constant	0.069	0.098		0.702				-0.803	0.214		-3.760			
Age	0.038	0.030	0.209	1.298		0.364	2.751	0.020	0.027	0.107	0.714		0.355	2.817
Position	-0.003	0.020	-0.017	-0.171		0.903	1.108	0.012	0.019	0.059	0.617		0.874	1.144
Qualification	0.026	0.021	0.125	1.193		0.857	1.166	0.023	0.020	0.110	1.148		0.856	1.168
Specialization	0.021	0.019	0.121	1.135		0.831	1.203	0.009	0.017	0.050	0.502		0.810	1.235
Experience	-0.069	0.038	-0.291	-1.842		0.378	2.648	-0.027	0.036	-0.116	-0.771		0.352	2.842
CGI Score								0.005***	0.001	0.431	4.493		0.861	1.161
R	0.256							0.474						
R <sup>2</sup>	0.065							0.225						
Adjusted R <sup>2</sup>	0.018							0.178000						
std. error of the estimate	0.177906							0.162824						
F	1.386							4.744						
Sum of square total	3.353							3.535						
Df	(5, 99)							(6, 98)						

Dependent Variable: ROE

\*Correlation is significant at the 0.10 level (2-tailed)

\*\*Correlation is significant at the 0.05 level (2-tailed)

\*\*\*Correlation is significant at the 0.01 level (2-tailed)

## 6.7 Discussion

This chapter aims to achieve remaining three research objectives of this study. First, the study identifies the more influential barriers to good CG practices in Pakistan. To achieve this, the study used EFA on all 17 barriers and identified five major barriers i.e. **firm level barriers** (lack of auditor independence, board ineffectiveness, lack of shareholders' awareness), **external barriers** (political and governmental interference in business activities, weak legal control and enforcement, high level of corruption), **social barriers** (strong social ties among different stakeholders, interpersonal connections among BoDs), **education and training barriers** (lack of professional education and training among stakeholders) and **legal barriers** (fewer voting rights). These five barriers are the most important barriers which are affecting the implementation of good CG practices in Pakistan. The results are well supported from the previous studies (Kaur & Mishra, 2010; Wanyama, Burton, & Helliard, 2009).

Regarding the first factor (**firm level barriers**), the study finds that from the CG implementation view point, auditors' independence is compromised in Pakistan. In addition, the BoDs have failed to be effective and shareholders' awareness acts as a barrier to implementation of good corporate governance practices in Pakistan. These findings are well supported by Capaul (2003) who argued that auditing is a major area of weakness in corporate governance enforcement in most transition and developing countries which have also failed to enforce their laws, rules and regulation consistently. Auditors' independence is compromised, and they have been giving unqualified opinions, certifying that the accounts audited provide a true and fair picture despite the many defects noted.

Regarding the second factor (**external barriers**), the study finds political and governmental influence in firms and weak legal control and enforcement of regulatory bodies. In addition, the study also finds that the level of corruption is another major factor that hinders good corporate governance practices in Pakistan. Doidge et al. (2007) argued that the political system of a country can have implications for corporate governance. The findings of the study reveal that weak legal control and enforcement are barriers to implement good CG practices in Pakistan, while researchers documented that enforcement is vital for providing good CG system and an effective business environment in developing countries like Pakistan (Berglöf & Claessens, 2006). Similarly, Wilson (2007) and (Lin & Liu, 2009) documented that firms can be estranged from the corruption that prevails in the society if they are operating in a weakened corporate governance environment like Pakistan. Regarding the third factor (**social barriers**), the study finds that strong social ties and also interpersonal connections among

BoDs, also hinder good corporate governance practices in Pakistan. Similarly, Haniffa and Cooke (2002) found that social factors such as culture affect the CG practices in emerging countries. Regarding the fourth factor (**education and training barrier**), the study finds that stakeholders lack professional education and training. In a similar vein, Okpara (2011) documented that lack of required education and training is a barrier which hampers the development and implementation of corporate governance practices in Pakistan. Regarding the fifth factor (**legal barriers**), this study finds that shareholders have fewer voting rights, consequently, this acts as a barrier in the implementation of CG practices in Pakistan. Due to limited voting rights, the protection of shareholders' rights is also absent in Pakistan. In a similar vein, Okpara (2011) documented that shareholders' rights are very crucial and vary from country to country. In addition, Jiraporn and Davidson (2009) argued that shareholders' rights are an important part of corporate governance and play a pivotal role in controlling the behavior of BoDs. Kirkbride, Letza, and Smallman (2009) argued that there is a need to provide effective protection in law to disgruntled minority shareholders.

To fulfill the second objective, the study identifies the most influential drivers of good corporate governance practices in Pakistan. To achieve this, the study used EFA on all 12 drivers and identified four major drivers i.e. **internal drivers** (auditors' independence, board heterogeneity, board independence, initiation of training and educational programs to raise awareness), **regulatory drivers** (enhancing and empowering professional regulatory bodies), **motivational drivers** (encouraging participation in events and conferences related to corporate governance) and **collaborative drivers** (enhancing partnership with international bodies). These four drivers are the most important drivers to promote good corporate governance practices in Pakistan.

Regarding the first factor (**internal drivers**), the study finds that auditor independence, board heterogeneity and independence and initiation of training and educational programs can promote good corporate governance practices in Pakistan. These findings are consistent with previous studies (Al-Mudhaki & Joshi, 2004). Similarly, Turley and Zaman (2004) documented that auditor independence has the potential to alleviate weaknesses in existing corporate governance structures especially in emerging countries. In addition, the researchers also argued that board heterogeneity promotes relationships and networking (Cox & Blake, 1991), enhances corporate leadership and increases firm performance (Carter, Simkins, & Simpson, 2003; Nguyen & Faff, 2007). Odle (2007) also argued that better corporate governance begins from board diversity. Researchers also documented that board

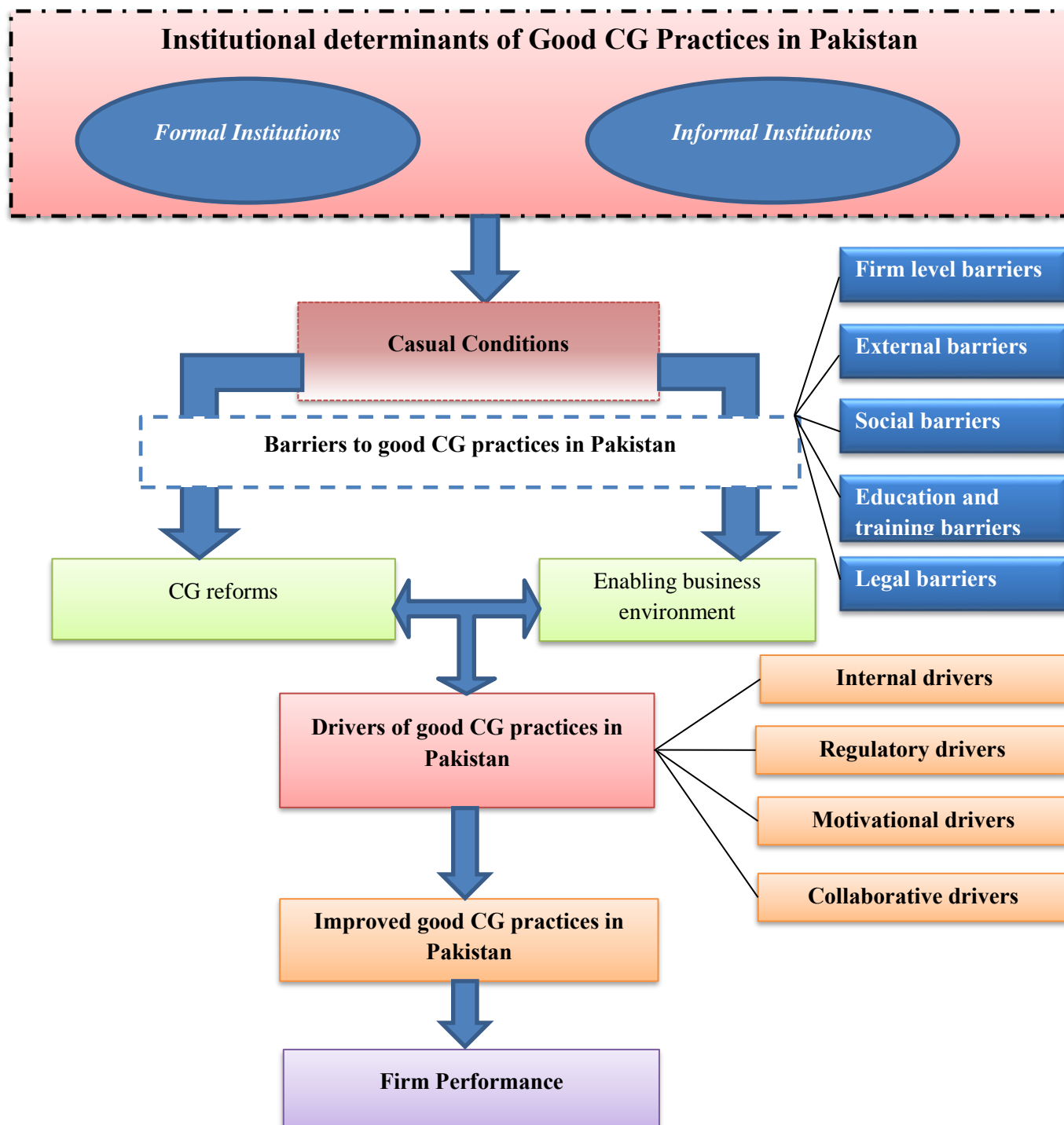
independence promotes corporate governance practices in firms (MacAvoy & Millstein, 2003). Regarding factor 2 (**regulatory drivers**), the study finds that empowering the regulatory and professional bodies can promote good corporate governance practices in Pakistan. Kajola (2008) argued that the corporate governance system will continue to experience challenges due to the absence of empowerment of regulators. Hence, it is pivotal to empower regulators to promote good corporate governance practices in Pakistan. Regarding factor 3 (**motivational drivers**), the study finds that there is a need to motivate stakeholders to participate in events related to corporate governance to raise awareness of and willingness to adopt practices in the true sense. In Pakistan, corporate governance compliance is not in a true sense (Khan, 2014) and it is necessary to conduct CG related events in order to promote CG practices (Samza, 2016). Regarding factor 4 (**collaborative drivers**), the study finds that there is need to collaborate with international bodies such as IFC, OECD to promote CG practices in Pakistan. Khan (2014) and Samza (2016) also recommended collaboration with international bodies to promote CG practices in Pakistan. Third and the last, the study examines the nexus between CG practices (measure from CGI score) and firm performance (measure from ROA and ROE). To achieve this objective, the study used a five-point Likert scale questionnaire to measure the CGI score and employed multiple hierarchical regression analysis. The findings of multiple hierarchical regression analysis reveal that the CGI score has a significant positive relationship with both ROA and ROE. Hence, CG practices can increase the firm's performance among listed firms of Pakistan. These findings are supported from existing empirical studies (Afza & Nazir, 2012; Javid & Iqbal, 2008b; Tariq & Abbas, 2013).

### 6.8 Integration of Qualitative and Quantitative Findings

This section integrates the qualitative and quantitative findings and presents the proposed model of good CG practices in Pakistan (Figure 8). Drawing on qualitative analysis, the study first explored the eight key institutional determinants of good CG practices in Pakistan such as auditing, political, legal, the board, shareholders' awareness, voting, institutional culture and values and these were divided into formal and informal institutions. These are the key institutional determinants of good CG practices in Pakistan. Researchers have argued that certain prerequisite casual conditions need to be established and clarified for effective implementation and functioning of CG practices such as the role of government in the introduction of CG reforms and providing an enabling business environment (Goergen, 2012). In addition, it is fundamental to ascertain a suitable legal and institutional foundation to ensure an efficient corporate governance system (OECD, 2004). Based on these identified institutional

determinants, this study developed a survey questionnaire and found five most influential barriers to good CG practices in Pakistan. These barriers were firm level barriers (lack of auditor independence, board ineffectiveness, lack of shareholders' awareness),

**Figure 8 Proposed Model for Good CG Practices in Pakistan**



Developed by the researcher



external barriers (political and governmental interference in business activities, weak legal control and enforcement, high levels of corruption), social barriers (strong social ties among different stakeholders, interpersonal connections among BoDs), education and training barriers (lack of professional education and training among stakeholders) and legal barriers (fewer voting rights). These barriers hinder good CG practices in Pakistan and influence the effectiveness of CG reforms and disturb the enabling business environment. Existing literature also provides evidence that ineffective BoDs (Okpara, 2011), a weak regulatory system and enforcement (Okeahalam & Akinboade, 2003), corruption (Adegbite, 2012, 2015), political influence (Adegbite, Amaeshi, & Amao, 2012; Okpara, 2011) weak monitoring (Adegbite, 2015), ineffective auditing practices (Kachelmeier, Rasmussen, & Schmidt, 2016), and interlocking relationships (McGee & Bose, 2009; Mensah, Aboagye, Addo, & Buatsi, 2003) are major challenges hindering effective implementation of CG practices in developing countries such as Pakistan. However, researchers' marked the role of government in CG development through providing an enabling business environment and introducing CG reforms (Adelman, 2003; Goergen, 2012).

Drawing on qualitative findings, the study also finds four major drivers of good CG practices in Pakistan through the survey questionnaire such as, i.e. internal drivers (auditors' independence, board heterogeneity, board independence, initiation of training and educational programs to raise awareness), regulatory drivers (enhancing and empowering professional regulatory bodies), motivational drivers (encouraging participation in events and conferences related to corporate governance) and collaborative drivers (enhancing partnership with international bodies). These drivers can improve good CG practices in Pakistan. Enriques and Volpin (2007) also argued that some drivers can propel the CG practices in the presence of some fundamentals, to attain desired expectations such as shareholder activism (Appel, Gormley, & Keim, 2016; Bourveau & Schoenfeld, 2017; Stathopoulos & Voulgaris, 2016), board independence (Adegbite et al., 2013; Terjesen, Couto, & Francisco, 2016), investor protection (La Porta et al., 2002), information disclosure (Hermalin & Weisbach, 2012), auditor independence (Francis, 2004), shareholders' engagement (Filatotchev et al., 2007) and collaboration with international regulatory bodies (OECD, 2004).

Finally, the study examines the nexus between CG compliance and firm performance on a sample of PSX listed firms and found a significant positive relationship between CG practices, measured by a five-point Likert scale CG compliance index, and performance, measured by

ROA and ROE. These findings are also consistent with studies of (Afza & Nazir, 2012; Javid & Iqbal, 2008b; Tariq & Abbas, 2013).

### **6.8.1 Proposed Model of Good CG Practices in Pakistan**

This study proposed a model for good CG practices in Pakistan (see Figure 8) which aims to promote the good CG practices in Pakistan. The study highlights and identifies the formal and informal key institutional determinants which shape the CG practices in Pakistan. This study also emphasized on the role of government to do CG reforms and provide enabling business environment. However, there are different barriers such as firm level barriers (lack of auditor independence, board ineffectiveness, lack of shareholders awareness), external barriers (political and governmental interference in business activities, weak legal control and enforcement, high level of corruption), social barriers (strong social ties among different stakeholders, interpersonal connections among BoDs), education and training barriers (lack of professional education and training among stakeholders) and legal barriers (fewer voting rights) that restrain the effectiveness of CG reforms and compliance in Pakistan. GOP and regulatory bodies (SECP, PICG) need to take appropriate measures to control these barriers in upcoming CG reforms and codes. The findings of study reveal that auditing process is not effective in Pakistan, hence, government needs to make strict criterion regarding appointment of internal and external auditors. In Pakistan, CCG 2012 required at least one independent director while it is increased to two independent directors in new CCG 2017. The problem is not about numbers, it is about true and fair compliance of CG code. It is proposed that SECP and PICG need to set a strict criterion regarding appointment of independent directors and it should be mandatory for firms to take approval from SECP before appointment of independent directors. It is proposed that SECP and PICG should launch awareness programs and highlight potential benefits of CG compliance. Political interference is quite common among business organizations in Pakistan; hence, politics should be separated from business and this can only be done through enforcement. Corruption is another severe problem that exist in Pakistan. Government needs to take reforms to tackle corruption in the country and strict action is proposed against those who involved in it. Social barriers are another big challenge in corporate sector of Pakistan. Appointments are made on the basis of social ties and personal relationships. Hence, it is proposed that regulatory bodies need to set strict criteria for key appointment within firms. Shareholders also have fewer voting rights that limit their power to control the firm. GOP needs to develop a policy regarding protection of voting rights of shareholders especially in family owned business.

The study also identified some drivers such as internal drivers (auditors' independence, board heterogeneity, board independence, initiation of training and educational programs to raise awareness), regulatory drivers (enhancing and empowering professional regulatory bodies), motivational drivers (encouraging participation in events and conferences related to corporate governance) and collaborative drivers (enhancing partnership with international bodies) that can promote implement and compliance of CG practices in Pakistan. It is proposed that GOP should make a separate independent regulatory body that ensure the independence of auditors and BoDs. GOP can also provide subsidies for those firms that comply the CG practices in true spirit and punish the others. In addition, it is necessary to enhance the power of existing regulatory bodies (i.e. SECP, PICG, PSX etc.) to ensure true CG compliance. It is also proposed that there is need to take initiatives to motivate shareholders to take part in CG related events. For this, SECP and PICG can organize events in major cities of Pakistan and encourage shareholders to participate either physical or online thorough video conference. It is also observed that SECP and PICG have launched directors training program (DTP) to train the directors which is became mandatory in CCG 2017. The cost of DTP is too much which may hinder directors of small companies to get training certificates. Therefore, it is proposed that cost should be reduced and subsidized for such programs. In addition, GOP may motivate firms for CG compliance by giving them some tax rebate. The study also proposed that there is need to increase the collaboration with international regulator bodies such as OECD, IFC etc. to implement effective CG system in Pakistan. GOP may fund and send some candidates to get training from these international regulatory bodies and these candidates can offer their services to firms at low cost.

## **6.9 Chapter Summary**

The findings of the quantitative analysis are presented in this chapter. The study achieved three research objectives in this chapter. (1) What are the barriers of good corporate governance practice in Pakistan? (2) What are the drivers to promote good corporate governance practices in Pakistan? (3) What is the nexus between CG compliance and firm performance?

The primary data was collected from 105 respondents through survey questionnaires while secondary data was gathered from annual reports of sampled firms. The results of demographic information reveal that most respondents (39%) were aged between 31 and 40 years. In addition, most of the respondents (42.9%) were holding a manager's position in their organization. The results of correlation analysis revealed the significant positive relationship between explanatory variable (CGI score) and dependent variables (ROA & ROE). The results

of EFA revealed that firm level barriers (lack of auditor independence, board ineffectiveness, lack of shareholders awareness), external barriers (political and governmental interference in business activities, weak legal control and enforcement, high level of corruption), social barriers (strong social ties among different stakeholders, interpersonal connections among BoDs), education and training barriers (lack of professional education and training among stakeholders) and legal barriers (fewer voting rights) can hinder good corporate governance practices in Pakistan while internal drivers (auditors independence, board heterogeneity, board independence, initiation of training and educational programs to raise awareness), regulatory drivers (enhancing and empowering professional regulatory bodies), motivational drivers (encouraging participation in events and conferences related to corporate governance) and collaborative drivers (enhancing partnership with international bodies) can promote good governance practices in Pakistan. The chapter also presented that CGI score has significant positive relationship with both ROA and ROE. At the end, study proposed a model of good CG practices in Pakistan.

## **CHAPTER SEVEN**

### **CONCLUSION, RECOMMENDATIONS AND SIGNIFICANCE OF THE STUDY**

#### **7.1 Introduction**

This chapter concludes the study. The section two summarizes the main thrust of the study while section three highlights the main contributions of the study. The section four presents the recommendations to improve the CG practices in Pakistan. The limitations and area for future research are presented at the end of this chapter.

#### **7.2 Conclusion of the Study**

The study highlights the pros of robust CG systems in Pakistan; however, the attainment of these pros can be compromised by various institutional determinants. Drawing on institutional and agency theory, this study pursues comprehending how CG can be regulated and reformed to improve good CG practices in Pakistan? Therefore, it was necessary to explore the institutional determinants of good CG practices in Pakistan. This study also identified the barriers and classified the drivers to promote good CG practices and examines, in addition to examine the nexus between CG compliance index and firm performance through a sample of PSX listed firms.

Drawing on the lenses of institutional and agency theories, the study explores key institutional (formal and informal) determinants of corporate governance practices in Pakistan using the methodological framework recommend by Creswell and Clark (2007) that are essential to comprehend in order to promote good corporate governance practices. The study finds eight aggregate institutional determinants of good corporate governance practices i.e. political, legal, culture, values, shareholders' awareness, voting, auditing and board in Pakistan. The study finds that the political invulnerability and political influence are affecting the true practices of corporate governance in Pakistan. In addition, the study highlights that good CG practices are also affected due to high levels of corruption within the country It is noteworthy that political invulnerability advances the latitude of existing knowledge, however, it has not attracted much attention particularly in emerging countries. The study finds that PSX listed firms lack true spirit CG compliance. Most firms are unaware of the benefits of CG practices and do not have enough resources. Due to political influence and corruption, the enforcement is not there. The regulatory measures pointed at concentrating on Pakistan's corporate governance problems must be institutionally based. In addition, the regulators do not have required skills, expertise and power to enforce CG provision in a true spirit which causes ineffectiveness of CG reforms. Similarly, it is necessary to gear the efforts of enforcing compliance in developing countries,

especially Pakistan, with reforms and introducing new regulations (Okike, 2007). In developing countries, corporate governance regulatory strategies must systematically employ globally, regionally and locally accepted principles of good corporate governance in order to produce more efficient and easily implementable regulatory and administrative governance mechanisms.

The study finds that the institutional culture has a critical effect on corporate governance practices in Pakistan. Discussions have revealed that the culture of Pakistani society has negatively influenced the quality, direction and practice of corporate governance. In addition, there is no protection for organizational whistle-blowers, hence, CG related problems are not detected at an early stage. The study also finds that family systems and interpersonal connections have great importance and affect the corporate governance practices in Pakistan. In addition, the appointments are made on personal and family connections rather than merit, consequently, firms lack transparency. The study also finds that shareholders lack awareness of the potential benefits of corporate governance practices. In addition, the rights of minority shareholders are only protected in law, not in reality. The active participant in AGMs is not there. Consequently, the voicing is not there. In addition, the voicing mechanism does not affect the corporate governance practices in Pakistan. The study also finds that BoDs are not independent and diverse, and interlocking exists between BoDs. Mostly, the family members are appointed as independent non-executive directors. At the end, the study finds that the audit function is not effective. The auditors lack independence and audit committees are not composed of independent directors. Hence, the authenticity and creditability of auditing are questionable. The institutional determinants acknowledged in this study have been significantly neglected in CG codes in Pakistan, therefore, it can be argued that the CG codes in Pakistan is unfamiliar to the obligatory business demands. Researchers documented that sometimes political and social forces surpass economics forces in shaping corporate destiny (Warren, 2003) and CG practices (Aguilera & Jackson, 2003; Judge et al., 2008). The findings also reveal that the legal infrastructure and regulatory instruments are present in Pakistan to successfully promote good corporate governance, but that compliance and enforcement related issues remain the key impediment.

In addition to qualitative analysis, the study also employed quantitative analysis to identify the most influential barriers to and drivers of good corporate governance practice in Pakistan and examined the nexus between CG compliance and firm performance among PSX listed firms. The study identified five major barriers i.e. firm level barriers (lack of auditor independence,

board ineffectiveness, lack of shareholders' awareness), external barriers (political and governmental interference in business activities, weak legal control and enforcement, high levels of corruption), social barriers (strong social ties among different stakeholders, interpersonal connections among BoDs), education and training barriers (lack of professional education and training among stakeholders) and legal barriers (fewer voting rights). These five barriers are the most important barriers which are affecting the implementation of good corporate governance practices in Pakistan. Patel (2006) argued that there should be an effective system of checks and balances on boards and managerial behavior to promote a good CG system in emerging countries. Regarding drivers of good CG practices in Pakistan, the study identified four key drivers i.e. internal drivers (auditors' independence, board heterogeneity, board independence, initiation of training and educational to raise awareness), regulatory drivers (enhancing and empowering professional regulatory bodies), motivational drivers (encouraging participation in events and conferences related to corporate governance) and collaborative drivers (enhancing partnership with international bodies). Similarly, Causey (2008) argued that there must be awareness and clarity regarding board independence, strong internal control mechanism and audit functions in order to achieve good corporate governance system. Judge et al. (2008) also argued that the greater the extent of law and order in a country and the more the culture emphasizes global competitiveness, the higher the corporate governance legitimacy. The Government of Pakistan should delegate more power to regulatory bodies to ensure true compliance and promote CG practices. The findings of the study reveal that CG practices can be increased by motivating the stakeholders to participate in CG related events. In addition, CG practices can be promoted through effective collaboration with international regulatory bodies. Whilst these drivers are by no means absolute, they may direct the path of improvement for CG in the developing world, especially in Pakistan. The findings of multiple hierarchical regression analysis reveal that CGI score has a significant positive relationship with both ROA and ROE. Hence, CG practices can increase the firm's performance among the listed firms of Pakistan. At the end, this study proposed a model for good CG practices in Pakistan that identifies institutional determinants and the most influential barriers of CG practices which restrain the effectiveness of CG reforms and hinder the enabling of the business environment in Pakistan. The model also identifies the most important drivers of good CG practices in Pakistan which can increase CG compliance and ultimately increase firm performance.

We argued that corporate governance practices are governed by institutions and do not appear out of nothing. In modern organizations across different countries, the expression and format of governance are reflections of their institutional environment. Two classes of institutions (formal and informal) and their associations with CG in the context of Pakistan have been analyzed. Most prominently, these institutions are inter-reliant, interact with and affect each other. Consequently, in theorizing on CG in emerging countries, especially Pakistan, it is imperative to mention that the overall nature of the country's institutional environments is not harmonized with good CG principles, both at the firm and national levels. Institutions matter in reshaping corporate governance in Pakistan; however, Pakistan has not achieved required level of CG compliance despite enormous efforts. It can be due to lack of interests from firms or lack of enforcement in real sense. Evidence reveals that institutional environment still matter and persuade firms despite globalization. Therefore, CG models cannot be treated and comprehended in isolation from institutional reinforcements (Guillen, 1999). Actually, CG cannot be formulated in seclusion but exposes the fundamental institutions which influence the firm structures, responsibilities and rights of directors and managers and structure these are systematized in distinct nations.

### **7.3 Contributions and Implications of the Study**

Given these key findings, this research contributed new knowledge and insights by going beyond what was obtained in earlier studies in terms of theory and literature, and practice and policy.

#### **7.3.1 Theory and Literature**

The study contributes to and encompasses the extent of institutional theory. The institutional theory has already identified the capacity of institutions to control behavior of economic agents (Douglass, 1990; Scott, 2013) and has received increasing interest among scholars regarding its role in the evaluation of CG issues (Aguilera, 2005; Roe, 2003). In addition, an emerging literature affirmed that CG is persuaded by the vigor of institutional factors (Adegbite et al., 2013; Nakpodia, Shrivs, et al., 2018) in the business environment (Adegbite & Nakajima, 2011; Judge et al., 2008). Consequently, various categorizations such as legal, political and economic institutions (Adegbite & Nakajima, 2011; Okike et al., 2015) and sociological, historical and political institutionalism (Leicht & Jenkins, 2009), have been widely espoused in discussing the institutional environment and theory of CG (Adegbite & Nakajima, 2011, 2012).



Notwithstanding these developments, this study was inspired to explore the capacity and robustness of the key institutional determinants and categorizations in order to expound CG practices in an emerging country such as Pakistan. In addition, this interest was inspired by the positions of some scholars (Fukuyama, 2006; Glaeser, La Porta, Lopez-de-Silanes, & Shleifer, 2004; Przeworski, 2004) who question the applicability of institutions and institutional determinants. Scholars further postulated that it is the conditions that reinforce institutions, more than institutions affecting the CG practices and direction. The findings of this study (see chapter five) are in agreement with the views and support the applicability of institutions (Nakpodia, 2017; Owoye & Bissessar, 2012; Sorour & Howell, 2012), confirming their significance in adding to existing knowledge concerning the institutional theory of CG.

It is noted that CG literature is limited in developing countries (Armitage, Hou, Sarkar, & Talaulicar, 2017; Berglöf & Claessens, 2006; De Nicolò, Laeven, & Ueda, 2008; Mangena & Taurigana, 2007), hence, this study adds to the existing CG literature. Majority of CG studies, in emerging countries particularly in Pakistan, are exaggerated on the empirical and limited to secondary data. Additionally, this study contributes to CG literature by employing both qualitative and quantitative methods. Due to the scarcity of CG studies in developing countries, it is challenging for multiple national corporations to comprehend the challenges of CG in these countries. Thus, a key motivation of this study is to address these challenges among developing countries and contribute to existing knowledge.

### **7.3.2 Practice and Policy**

The study also has major contributions towards practice and policy. In Pakistan, the foremost corporate governance regulation was introduced in 2002 by SECP, a principal based regulatory approach, and was recently reformed in 2012, in which SECP made provisions mandatory for listed firms. However, many scholars and practitioners have identified concerns and challenges regarding CG practices in Pakistan (Fatima et al., 2018; Khan, 2014; Samza, 2016). This antecedent assessment was supported by participants of the current study, consequently, need arises to introduce a regulatory approach that could promote good CG system in Pakistan. The chapter five highlighted the CG challenges which are faced in the country. In Pakistan, the corporate governance code was introduced with a principles-based approach (comply or explain), however, SECP has made it mandatory in the recent reform in 2012. Indeed, it was apparent that most companies are not complying with corporate governance practices in a true spirit and are performing tick box practice. It indicates that a rule-based approach is also not helpful in the context of Pakistan while a principles-driven approach is effective in presence of

robust institutional elements and free information flow (Arjoon, 2005; Tariq & Abbas, 2013). Therefore, it proposes the need for integration of the elements of rules based and principles-based approaches in Pakistan. Both approaches can adequately strengthen each other to spawn optimum outcomes of CG system (Arjoon, 2005; Sama & Shoaf, 2005). The combination of both will help in boosting the CG system in Pakistan.

### **7.3.3 Implications of the Study**

The study has some important implications for policy and practice. The findings of study highlight that existing CG literature is dominated by agency theory perspective in emerging economies including Pakistan which is not sufficient. Hence, need arises to conduct CG studies from alternative perspectives in emerging economies including Pakistan because these emerging economies have different institutional context as compared to developed countries. SECP and other regulatory bodies such as PICG and PSX can play their role by providing funding and initiating such research in Pakistan at national level. However, a rigorous policy is needed for such initiative. The study finds some macro-level challenges such as political, legal and cultural etc. all of which make the institutional environment uncertain. The study also finds that core difficulty in Pakistan is principal-principal agency problem due to high ownership concentration. The effective judicial system can help in reducing such conflicts. At present, the judicial system of Pakistan is not effective and provides opportunities to majority shareholders to expropriate the minority shareholders. GOP needs to reform the judicial system to punish such expropriation. A firm level governance solution would help in reducing conflicts and attracting more investment in emerging economies especially Pakistan. GOP and regulatory bodies (SECP, PICG) need to work together with firms to reduce the CG issues.

In Pakistan, CCG 2012 required at least one independent director while it is increased to two independent directors in new CCG 2017. The problem is not about numbers, it is about true and fair compliance of CG code. It is proposed that SECP and PICG need to set a strict criterion regarding appointment of independent directors and it should be mandatory for firms to take approval from SECP before appointment of independent directors. There should be an autonomous body to determine the suitability of independent directors to the board. Recently, SECP and PICG have launched directors training program (DTP) to train the directors which is became mandatory in CCG 2017. However, it is observed that the cost of DTP is too much which may hinder directors of small companies to get training certificates. Therefore, it is suggested that such costs should be reduced, and government should subsidize for such programs. SECP may collaborate with international training organizations for such initiatives.

The professional and highly trained board can have important implications for the firm through attracting investments and ultimately for economic growth of the country. In addition, GOP may motivate firms for CG compliance by giving them some tax rebate for high CG compliance. The study finds that auditing process is not effective in Pakistan, hence, government needs to make strict criterion regarding appointment of internal and external auditors. It is pivotal to launch awareness programs regarding CG practices. The policy makers may include CG subjects at university level. This will help in promoting CG agendas and motivating the students who will be future leaders at different firms. Political involvement is quite high among PSX listed firms and appointments are made on political connections which comprise the merit. A policy should be introduced to limit the political influence. The SECP and PICG can play an important role in this matter. Corruption is another contributing factor towards poor CG practice in Pakistan. Law enforcement agencies should take strict action against corruption. Policy makers should protect minority shareholders through policy reforms and provide them voting rights especially in family owned business. Regulators and firms need to work together to address these CG issues in Pakistan.

#### **7.4 Recommendations of the Study**

Based on qualitative and quantitative analyses, the study has proposed the following four recommendations in the areas of business environment, government, regulation and institutional reinforcement. It is recommended that there is need to create an enabling business environment. Regarding the enabling environment, both government and firms need to play their part and there is need for interventions in areas of infrastructure, the legal system and human development, among others. Key stakeholders such as shareholders, auditors and directors must be trained and educated to appreciate awareness and development in corporate governance. In addition, the power and capacity of various regulatory bodies such as SECP, PSX and PICG need to be enhanced to discharge their role effectively. It is also recommended that politics should be separate from business. Due to the overwhelming influence of the Pakistani government, it should be committed to promote a good corporate governance system (Goergen, 2012). It is also essential to delineate the boundary between business and government. In addition, it is the responsibility of government to establish robust governance systems through creation of rigorous corporate governance practices in government organizations. It is also recommended to use independent regulatory agencies, preferably foreign agencies, to increase the enforcement and CG compliance. It is assumed that these independent agencies may be more effective compared to local regulatory agencies due to their

independence. It is also recommended that the government provide some subsidy or resources regarding CG compliance to cope with huge CG compliance costs<sup>34</sup>. The code of corporate governance should be amended and adjusted according to the socio-economic factors and institutional environment of Pakistan. The CG code must reflect key institutional elements and many of them are presented in this study and inform CG practices in the Pakistani business environment. It is recommended that existing institutions be reinforced, and advances must be made regarding formal and informal institutional domains. Corruption is underlying these institutional challenges. In Pakistan, there is an anti-corruption agency, called the National Accountability Bureau (NAB), however, its accountability process is also questionable. Institutional forces shape corporate governance practices; hence, it is recommended to make necessary adjustments based on these institutional forces.

### **7.5 Limitations of the Study and Agenda for Future Research**

Although the research has important implications for developing countries, especially Pakistan adequate caution must be exercised in making generalizations. This is a Pakistani case study. Due to the sensitivity of CG issues, participants were not drawn from all sectors of the Pakistan economy. Some participants were afraid to talk on this sensitive issue and have not given their consent to record their interview. Although, the principles of corporate governance are applicable to all listed firms of Pakistan, however, is challenging to obtain data from the whole population. Nevertheless, whilst the findings of this study are not easily generalizable, given its contextual dimension, it nevertheless offers significant analytic generalizability (Creswell & Clark, 2011; Yin, 2009). In this study, the research has also employed a qualitative mixed-method approach to data collection and analysis. Future studies may employ alternative methodologies to further validate or challenge its findings. The study has drawn the sample from PSX listed firms through a survey questionnaire and future research may be conducted on listed vs non-listed<sup>35</sup> firms of PSX. In addition, there is also opportunity to draw a sample from SMEs. In Pakistan, the studies related to CG are somewhat scant and have neglected the SEOs, hence, it provides an opportunity to conduct further studies to evaluate the dynamics of CG in SOEs. Finally, as suggested by Steger and Hartz (2005), it is imperative to make some further efforts to explore corporate governance from economic and sociological theories which may add to existing knowledge.

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<sup>34</sup> The majority of businesses are not complying with the CG provisions due to lack of required resources and costs.

<sup>35</sup> SECP has introduced a voluntary Code of Corporate Governance (CCG) for Non-listed firms.



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**APPENDICES**  
**Appendix A: Ethical Approval Letter**

**Research Management Office**

T 64 3 423 0817

PO Box 85084, Lincoln University

Lincoln 7647, Christchurch

New Zealand

[www.lincoln.ac.nz](http://www.lincoln.ac.nz)

**4 April 2017**

**Application No: 2017-18**

**Title:** Corporate Governance, Compliance and Performance Nexus

**Applicant:** M Arslan

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*The Lincoln University Human Ethics Committee has reviewed the above noted application.*

Thank you for your response to the questions which were forwarded to you on the Committee's behalf.

I am satisfied on the Committee's behalf that the issues of concern have been satisfactorily addressed.  
I am pleased to give final approval to your project.

Please note that this approval is valid for three years from today's date at which time you will need to reapply for renewal.

Once your field work has finished can you please advise the Human Ethics Secretary, Alison Hind, and confirm that you have complied with the terms of the ethical approval.

May I, on behalf of the Committee, wish you success in your research.

Yours sincerely



Grant Tavinor

Chair, Human Ethics Committee

**PLEASE NOTE:** The Human Ethics Committee has an audit process in place for applications. Please see 7.3 of the Human Ethics Committee Operating Procedures (ACHE) in the Lincoln University Policies and Procedures Manual for more information.

## **Appendix B: Questionnaire – Semi-Structured Focused Group**

### **Board Structure and Sub-committees**

1. What is your view about the influence of Board Structure and Sub-committees (Audit Committee, Remuneration Committee) on Corporate Governance (CG)?
  - Board Composition
  - Sub committees
  - Board Independence
2. What is your view about level of ownership concentration in Pakistan Stock Exchange (PSX) listed firms and its effect on CG?
3. How do you appraise shareholders' awareness of the board's performance and governance practices?

### **Transparency and Disclosure (T& D)**

1. What is your opinion about T & D of CG in the PSX listed firms of Pakistan?
  - Suitability of Security and Exchange Commission of Pakistan (SECP) Code of Corporate Governance
  - Effectiveness of Internal Control
  - Level of T & D

### **Shareholders' Rights**

1. What is your view about Shareholders' Rights especially minority shareholders'?
  - Protection of shareholders' rights by the PSX listed firms
  - Protection of shareholders' rights by Legislation (Companies Ordinance 1984).

### **Legal and Regulatory System**

1. What is your view about the Legal and Regulatory System of Pakistan?
  - Assessment about Corporate Governance Reform 2012
  - Assessment about stakeholders' level of CG awareness
  - Assessment about the level of co-ordination and interaction between regulatory bodies
  - Assessment about support of reforms by the contemporary legal system

### **Socio Economic Factors and CG**

1. How do you evaluate the effect of socio-economic factors in the adaptation of corporate governance?
  - Religion
  - Values
  - Norms
  - Culture
  - Politics

### **Level of CG Compliance and Financial Performance**

1. What is your view about Compliance and Financial Performance (FP)?
  - Level of compliance in the PSX listed firm
  - Nexus between Corporate Governance Code Compliance and Financial Performance

### **Determinants of CG**

1. In your opinion, what are most influential determinants in good corporate governance practices in the PSX listed firms of Pakistan?
  - Economy of Pakistan
  - Weak infrastructure
  - Culture
  - Religion
  - Weak legal controls and enforcement
  - Less experience and relevant education
  - Poor T & D

### **Improvement in Corporate Governance**

1. In your opinion, what can improve corporate governance practice in Pakistan?

## **Appendix C: Interview Card**

### **Introductory explanation**



First welcome the participant and icebreaking. Introduce the research project starting with introduction, outline aims and objectives of the research project. Address any potential questions and assure anonymity and confidentiality of information. Seek permission for audio/video recording of interviews. With the permission of the interviewee the questions are presented as below.

### **Board Structure, Shareholders' Awareness**



- What is your view about the influence of Board Structure and Sub-committees (Audit Committee, Remuneration Committee) on Corporate Governance (CG)?
- What is your view about level of ownership concentration in the Pakistan Stock Exchange (PSX) listed firms and its effect on CG??
- How do you appraise shareholders' awareness of the board's performance and governance practice?

### **Transparency and Disclosure (T& D)**



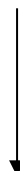
- What is your opinion about T & D of CG in the PSX listed firms of Pakistan?

### **Shareholders' Rights**



- What is your view about Shareholders' Rights especially minority shareholders'?

### **Legal and Regulatory System**



- What is your view about the Legal and Regulatory System of Pakistan?

**Socio Economic Factors and CG**

- How do you evaluate the effect of socio-economic factors in the adaptation of corporate governance?

**CG Compliance and Financial Performance**

- What is your view about Compliance and Financial Performance (FP)?

**Determinants of CG**

- In your opinion, what are most influential determinants in good corporate governance practices in the PSX listed firms of Pakistan?

**Improvement in Corporate Governance**

- In your opinion, what can improve corporate governance practice in Pakistan?

**Closure**

Thanks and assurance of confidentiality; and email transcription of interview.



## Appendix D: Survey Questionnaire

### Corporate Governance, Compliance and Performance Nexus

#### Part One: Level of Corporate Governance Compliance

Please indicate the level of your agreement on the compliance of each of the provisions of the Code of Corporate Governance 2012 (CCG) within your organization. Please circle or tick your answer.

**1 = strongly disagree, 2 = Disagree, 3 = Uncertain, 4 = Agree, 5 = strongly agree**

#### A. Audit

- |    |   |   |   |   |   |   |
|----|---|---|---|---|---|---|
| 1. | The Audit Committee should consist solely of independent non-executive outside directors.   | 1 | 2 | 3 | 4 | 5 |
| 2. | The Audit Committee of a listed company shall meet at least once every quarter of the financial year.   | 1 | 2 | 3 | 4 | 5 |
| 3. | The company should have a formal policy on external auditor rotation.   | 1 | 2 | 3 | 4 | 5 |
| 4. | The Chairman of the Audit Committee shall be an independent director, who shall not be the chairman of the board.   | 1 | 2 | 3 | 4 | 5 |
| 5. | The secretary of the Audit Committee shall either be the Company Secretary or Head of Internal Audit.   | 1 | 2 | 3 | 4 | 5 |
| 6. | A Human Resources and Remuneration committee should be introduced.  | 1 | 2 | 3 | 4 | 5 |
| 7. | The internal audit function may be outsourced by a listed company to a professional services firm or be performed by the internal audit staff of the holding company. | 1 | 2 | 3 | 4 | 5 |

#### B. Board of Directors (BoDs)

<b>8.</b>	No former CEO should serve on the board.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>9.</b>	BoDs should meet at least once every quarter of the year.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>10.</b>	The board of directors of each listed company shall have at least one and preferably one third of the total members of the board as independent directors.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>11.</b>	Executive directors, i.e. working or whole-time directors, should not be more than 75% of the elected directors including the Chief Executive	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>12.</b>	All directors should attend board meetings or have a valid excuse for non-attendance.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>13.</b>	As per CCG 2012, a director can serve on the board of seven listed companies at the most at any one time.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>14.</b>	Board members should be elected annually.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>15.</b>	Shareholder approval should be compulsory to change board size.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>16.</b>	Any casual vacancy on the board of directors of a listed company shall be filled up by the directors at the earliest but not later than 90 days.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>17.</b>	All written notices shall be circulated at least seven days prior to the meetings, except in the case of emergency.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>18.</b>	The Board of Directors shall clearly define the respective roles and responsibilities of the Chairman.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>19.</b>	The Board of Directors shall clearly define the respective roles and responsibilities of the CEO.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>20.</b>	The Chairman shall ensure that the minutes of meetings of the board of directors are appropriately recorded.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>21.</b>	The Chairman and CEO shall not be the same person.	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>

22.	The Chairman shall be elected from amongst the non-executive directors of the listed company.	1	2	3	4	5
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23.	There should a mechanism for undertaking annual evaluations of the performance of the Board.	1	2	3	4	5
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### **C. Charter /Bylaws**

24.	Shareholders should act by a non-unanimous written consent.	1	2	3	4	5
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25.	Shareholders should be allowed to call special meetings.	1	2	3	4	5
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26.	A simple majority but not a supermajority vote should be required to amend charter/bylaws.	1	2	3	4	5
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27.	A simple majority but not a supermajority vote should be enough to approve a merger.	1	2	3	4	5
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28.	The company should not be authorized to issue blank check preferred stock.	1	2	3	4	5
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29.	The Board should not have right to amend bylaws without shareholder approval except under limited circumstances.	1	2	3	4	5
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30.	Shareholders should have the right to vote on directors' appointments to fill vacancies.	1	2	3	4	5
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31.	Shareholders should have cumulative voting rights to elect directors.	1	2	3	4	5
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### **D. Directors' Education**

32.	The CFO should have a post graduate qualification in accounting and finance.	1	2	3	4	5
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33.	The CFO should have five years of experience of handling the financial or corporate affairs of a listed company or a bank or a financial institution.	1	2	3	4	5
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34.	The company should encourage board members to attend professional training programs.	1	2	3	4	5
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35.	It will be mandatory for directors of listed companies to attain certification under any SECP approved director training program (DTP).	1	2	3	4	5
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#### **E. Executive and Directors' Compensation**

36.	Directors' remuneration packages shall encourage value creation within the company and be subject to prior approval of shareholders/board as required by the company's Articles of Association.	1	2	3	4	5
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37.	The appointment, removal, remuneration and terms and conditions of employment of the CFO of listed companies shall be determined by the Board.	1	2	3	4	5
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38.	The appointment, removal, remuneration and terms and conditions of employment of the CS listed companies shall be determined by the Board.	1	2	3	4	5
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39.	The appointment, remuneration and terms and conditions of employment of the Head of Internal Audit (IA) of listed companies shall be determined by the Board.	1	2	3	4	5
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40.	There shall be a formal and transparent procedure for fixing the remuneration packages of individual directors.	1	2	3	4	5
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41.	No director shall be involved in deciding his/her own remuneration.	1	2	3	4	5
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42.	The company's Annual Report shall contain details of the aggregate remuneration separately of executive and non-executive directors, including salary/fee, benefits and performance-linked incentives etc.	1	2	3	4	5
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#### **F. Ownership**

43.	If any director, CEO or executive of a listed company or their spouses sell, buy or transact, whether directly or indirectly, in shares of the listed company of which he is a director, CEO or	1	2	3	4	5
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executive, as the case may be, he shall immediately notify in writing to the Company Secretary of such transaction.

- |     |  |   |   |   |   |   |
|-----|--|---|---|---|---|---|
| 44. | Each listed company shall determine a closed period prior to the announcement of interim/ final result and no director, CEO or executive shall, directly or indirectly, deal in the shares of the listed company in any manner during the closed period. | 1 | 2 | 3 | 4 | 5 |
|-----|--|---|---|---|---|---|

#### **G. Progressive Practices**

- |     |  |   |   |   |   |   |
|-----|--|---|---|---|---|---|
| 45. | A board-approved CEO succession plan should be in place. | 1 | 2 | 3 | 4 | 5 |
| 46. | The Board should have independent outside advisors.      | 1 | 2 | 3 | 4 | 5 |
| 47. | The Board should include independent directors.          | 1 | 2 | 3 | 4 | 5 |
| 48. | Director term limits should exist.                       | 1 | 2 | 3 | 4 | 5 |

### **Part Two: Barriers to good governance practices in Pakistan Stock Exchange (PSX) listed firms**

Please indicate the extent of your agreement as to whether each of the possible barriers below negatively impact the CG practices in Pakistan. Please circle or tick your answer.

**1 = strongly disagree, 2 = Disagree, 3 = Uncertain, 4 = Agree, 5 = strongly agree**

- |    |  |   |   |   |   |   |
|----|--|---|---|---|---|---|
| 1. | Lack of Auditors' independence                                 | 1 | 2 | 3 | 4 | 5 |
| 2. | Board ineffectiveness  | 1 | 2 | 3 | 4 | 5 |
| 3. | Institutional Culture of Pakistan                              | 1 | 2 | 3 | 4 | 5 |
| 4. | Political and Governmental interference in business activities | 1 | 2 | 3 | 4 | 5 |
| 5. | Weak legal control and enforcement                             | 1 | 2 | 3 | 4 | 5 |
| 6. | Lack of Shareholders' awareness                                | 1 | 2 | 3 | 4 | 5 |
| 7. | Lack of resources for CG compliance                            | 1 | 2 | 3 | 4 | 5 |

8.	Lack of Shareholders' rights protection especially minority shareholders	1	2	3	4	5
9.	Lack of protection for Whistle blowers	1	2	3	4	5
10.	Lack of professional education and training among stakeholders	1	2	3	4	5
11.	Fewer voting rights	1	2	3	4	5
12.	Low AGM participation	1	2	3	4	5
13.	High level of corruption	1	2	3	4	5
14.	Nepotism or Kinship culture	1	2	3	4	5
15.	Wobbly/unstable economy of Pakistan	1	2	3	4	5
16.	Strong social ties among different stakeholders	1	2	3	4	5
17.	Interpersonal connections among BoDs	1	2	3	4	5

### Part Three: Drivers of good corporate governance practices in PSX listed firms

Please indicate the extent of your agreement as to whether each of the possible drivers below positively impacts the CG practices in Pakistan. Please circle or tick your answer.

**1 = strongly disagree, 2 = Disagree, 3 = Uncertain, 4 = Agree, 5 = strongly agree**

1.	Auditors' independence	1	2	3	4	5
2.	Internal control and Risk Management	1	2	3	4	5
3.	Provide protection to whistle blowers	1	2	3	4	5
4.	Enhancing and empowering professional regulatory bodies	1	2	3	4	5
5.	Board heterogeneity	1	2	3	4	5
6.	Board independence	1	2	3	4	5
7.	Encouraging participation in events and conferences related to corporate governance)	1	2	3	4	5
8.	Enhancing partnership with international regulatory bodies i.e. OECD, IFC to promote CG in Pakistan	1	2	3	4	5

9. Provide accounting and auditing education to internal stakeholders	1	2	3	4	5
10. Initiation of training programs for directors, raise awareness and education for CEOs, directors, shareholders and board members	1	2	3	4	5
11. Establish corporate governance education programs at universities	1	2	3	4	5
12. Promote CG research in Pakistan	1	2	3	4	5

#### Part Four: Demographic information

Please place a tick in the appropriate box in each of these questions

##### 1. Age group

- a) 30 years or less
- b) 31 to 40 years
- c) 41 to 50 years
- d) 51 to 60 years
- e) Above 60 years


##### 2. Position within Organization

- a) Senior Manager
- b) Manager
- c) Accountant
- d) Auditor
- e) Other


##### 3. Qualifications

- a) PhD or Equivalent
- b) Masters or equivalent
- c) Bachelors or equivalent


d) Diploma or professional

e) Others

**4. Specialization of your latest education**

a) Finance

b) Accounting

c) Economics

d) Management

e) Others

**5. Experience within job**

a) 5 years or less

b) 6 to 10 years

c) 11 to 15 years

d) 16 to 20 years

e) Above 20 years

Thank you once again for your time and efforts in completing this questionnaire. If you have any comments, please mention them below:

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**Thank You**