The relationship between Corporate Governance and Firm Financial Performance: An Empirical Investigation of an emerging market

Abstract

We investigate whether the distinct nature of Multinational firms (MNC) differently influence the governance-performance relationship compared to the local firms in Pakistan. We used a dynamic system GMM estimator that produces consistent and efficient estimation after controlling for dynamic endogeneity and simultaneity. Our results demonstrate that corporate governance (CG) has a significant positive impact on firm financial performance whilst CG practice of MNC firms is more effective than local firms in Pakistan. We observed two distinct financing behaviours i.e. 'pro-active investment behaviour' of MNC firms and 'conservative investment behaviour' of local firms. We conclude that a well-established corporate culture, significant financial worth and firms' higher growth rate are key determinants of better CG practice.

Keywords- Pakistan, Corporate governance, Firm performance, Endogeneity, System GMM
Paper type- Research paper

1.Introduction

Corporate governance (CG) is a highly researched area which is widely discussed by the researchers and policymakers over the last two decades. The term CG refers to the principles and practice by which the corporate board ensure accountability, fairness, and transparency in the firms' relationship with stakeholders. Corporate governance is thus seen as the system in which firm objectives are determined and performance is monitored. An effective CG system enhances investors' confidence and improves firm performance. Moreover, to achieve the firm long-term objectives, CG ensures effective monitoring and focus on compliance to protect minority interest. In addition, CG investor confidence-building and improve the mechanism for management accountability which in turn, help to reduce agency cost and enhance the strategic orientation of the firm (Garcia-Meca et al., 2015).

To date, a large strand of studies have reported mixed results in terms of the corporate governance (CG) and firm financial performance nexus (see for example, Anderson & Gupta 2009; Awan, S. H. 2012; Al-Malkawi & Pillai 2013; El Mehdi, 2007; Ehikioya, 2009; Guest

2009; Haniffa & Hudaib 2006; Jackling & Johl, 2009; Klapper & Love, 2004; Munisi & Randoy, 2013; Nguyen et al., 2014; Qasim, Z. 2017; Sheikh et al. 2013). The debate on CG-firm financial performance relationship is ongoing. Most of the prior studies have not accounted for endogeneity problems and develop their hypothesis based on static models, hence the problem of endogeneity has largely been ignored.

We contribute to the literature by investigating the impact of CG on firm financial performance by considering the governance behaviour of two discrete samples i.e. MNC firms and local firms in Pakistan. The rationale for the comparative analysis of MNC and local firms is evident as the distinct nature of MNC firms could differently influence the CG-firm performance relationship compared to local firms. We observed numerous distinct characteristics across corporate sectors of Pakistan through in-depth analysis of firms' annual reports of MNC and local firms. We observe that MNC firms are more financially stable compared to local firms. In addition, the MNC firms have a strong corporate culture and managed by developed economies which may lead to effective CG approaches and distinct governance behaviour. This intuition is motivated as MNC firms are influenced by the governance mechanisms of their country of origin and at the same time follow the requirements of Pakistan CG code (2012). On the other hand, local firms are dominated by family-control and associated ownership and their product market is highly competitive. Drawing on these differences we postulate a diverse governance behaviour of local firms compared to MNC which impact governance-performance relationship.

Our focus on Pakistan is motivated for several reasons. A large strand of studies emphasises issues related to developed and emerging economies, hence, there are none to the authors' knowledge where Pakistan is the focus. Although, Pakistan is considered a common law country and follows the Anglo-American code of CG, hence, display the attributes of a code law country. The Common law countries are characterised by a well-developed capital market, sound institutional mechanisms and strong investors' protection which in turn, support a stable stock market (La porta, 2000). Moreover, the code law countries may face the lack of investors' protection and characterised by the weak institutional and legal framework and their capital market heavily relies on debt.

The legal and intuitional mechanisms of Pakistan is developed from a combination of the British legal system and Islamic legal principles whilst these Islamic principles are different from other Islamic countries who are under the influence of Kingship, Tribal affiliations and

Royal charter of firms and restriction on the direct foreign equity holdings. Therefore, Pakistan economic, legal and institutional system is unique across fellow emerging markets. Given the above factors, Pakistan provides an interesting context to examine CG firm performance relationship.

We make three important contributions to the literature. First, we introduce a novel approach of assessing governance-performance relationship by a comparative analysis of MNC and local firms. This unique approach provides grounds for future researchers to explore distinct features of MNC firms and compare it with local firms in relation to governance-performance relationship. To our knowledge, we are the first to examine the comparative analysis of MNC and local firms. Second, the theoretical and empirical literature has discussed four main types of ownership structure i.e. directors/managerial ownership, institutional ownership, pyramid ownership and family ownership. We freshly add to the existing literature by considering 'associated ownership' as another form of ownership structure. No prior study in the Pakistani context has examined the impact of associated ownership on firm performance. Third, we extend CG literature by suggesting that a well-established corporate culture, significant financial worth and firms' higher growth rate are the key determinants of better CG practice. The paper proceeds as follows. Section two discusses the literature review of CG and firm performance association. Section three explains the variables use in model estimation. Section four discusses the details of the model specification. The research methodology and the results present in section five followed by conclusion and limitations of the study.

2. Literature Review

Parum Eva (2005) documents that among researchers, there is no agreed theoretical framework to study CG, but an extensive review of previous literature shows that the main theories pertaining to CG are agency and resource dependence theory. Agency theory is the dominated theory in CG literature and most of the studies relating to CG has been conducted by the application of agency theory (Filatotchev et. al., 2009). Agency theory considers external audit as an effective control procedure to eliminate the conflicts of interest between the principal (shareholders) and agent (senior managers) to minimise agency costs. Agency theory focuses on the effectiveness of the board of directors who help to protect shareholders interest and minimised agency cost (McIlkennya et.al.,2015). In contrast, Charkham (1994) highlighted the shortcoming of agency theory by explaining that it does not include various expenditures and factors of investment which are pre-requisite for the long-term sustainability of an organization.

Likewise, Johanson & Ostergen (2010) reveal that apart from the major contribution of agency theory for CG mechanisms and agency cost, it is applicable only to those developed and emerging markets where the Anglo-Saxon model of governance is being followed. In addition, prior studies such as Hilman & Dalziel (2003) and Nicholson & Kiel (2007) document that agency theory should be complemented by resource dependence theory in CG studies. Therefore, we develop our hypothesis by combining the agency and resource dependence theory in the Pakistan context. Our empirical model consists of extensive governance variables such as board size, independent non-executive directors (NEDs), the frequency of board meeting, audit committee size, director ownership, associated ownership and ownership concentration.

Board size. The resource dependence theory argues that effective board help firms to enhance their performance by minimising the dependence on the external environment which reduce transaction cost. The director monitoring function requires a watchful eye on the management role to align the performance goals of professional managers with shareholders interest, to ensure that managers are performing for the best interest of shareholders. Mallin (2007) document that the board of directors play a significant role in control mechanisms as they ensure that the problem associated with the relationship between principal and agent are controlled. The effective board assures corporate, legal and ethical compliance in addition to monitoring management actions. The empirical literature related to board size and firm financial performance shows mixed results. For instance, Bozec (2005) and Kiel & Nicholson (2003) document a positive relationship between board size and firm performance. In contrast, other researchers such as (Garg, 2007; Guest 2009; Rose, 2007; Yermack 1996) report a negative association. Alternatively, Ho & Williams (2003) found no substantial impact of board size on firm performance. Further, agency theory anticipates a negative association of board size and firm performance while resource dependence theory presumes a positive association (Dalton et al., 1999; Jensen, 1993). The corporate sector of Pakistan is dominated by family ownership and deem to be influenced by resource dependence theory which suggests that large board provide a firm with greater expertise and accessibility to scarce resources. Furthermore, previous study of Sheikh et al. (2013) in the Pakistan context find a positive relationship between board size and firm performance. Therefore, based on the foregoing discussion, we develop the following hypothesis for both samples:

H_1: Board size is positive and significantly associated with firm performance.

Presence of independent Non-executive directors (NEDs). In accordance with the Cadbury report (1992), independent non-executive directors (NEDs) protect shareholders' interest by playing their role as independent and impartial members of the board. These NEDs act as referees especially in a situation where a conflict arises between managers and shareholders. Higgs Report (2003) reveals that the presence of NEDs improves the standard of financial reporting as the NEDs have no private interest and are free from board influence, thus provide efficient monitoring. The extant literature report mixed results regarding NEDs and firm performance relationship. For example, Gabriels-son (2007) report that the presence of NEDs positively influences on firm value by supporting board strategic decision-making. Likewise, Fama and Jensen (1983) document that the presence of NEDs improved the monitoring function of the board. In a similar vein, Gupta et al., (2009) and Mashayekhi & Bazaz (2008) reveal a positive relationship between NEDs and firm performance. In contrast, a few studies such as (Bozec 2005; Yermack, 1996) reveal a negative impact of NEDs on firm performance. Moreover, Treadwell (2006) argues that it is difficult to find experienced and professional NEDs with the expertise to monitor firm activities. Furthermore, Pakistan CG code (2012) recommends that one-third of the total board members should be independent NEDs. We, therefore, expect a positive impact of NEDs on firm performance. We, therefore, develop our second hypothesis:

H_2: Independent Non-executive director has a positive impact on firm performance.

Frequency of board meeting. In general, a high frequency of board meetings improves the overall performance through continuous monitoring and help to resolve corporate issues. Prior studies such as Carcello et al., (2002) and Mangena & Tauringana (2008) document a positive relationship and suggest that the frequency of board meeting help to resolve corporate issues more quickly. On the other hand, El Mehdi (2007) shows an insignificant relationship between the frequency of board meetings and ROA. Vafeas (1999) reports a negative relationship and argue that a greater number of meetings can result in a high cost of management such as managerial time, travel cost, directors' meeting fees and refreshment expenses. It is a general perception in Pakistan that firms prefer to hold a greater number of meetings to review firm performance in the competitors' perspective (Pakistan CG survey 2007). Therefore, we develop the following hypothesis:

H_3: Frequency of Board meeting has a positive relationship with firm performance.

Audit committee size. Board committees consider a primary mechanism which protects shareholders' interests by providing independent oversight about the firm activities. Agency theory argues that external audit help to maintained transparent procedures by mitigating the conflicts of interest between the board of directors and shareholders which help to minimise agency costs (Harrison, 1987). Aly Salama and Toms (2017) assert that an audit committee served as a tool for an effective monitoring process. Mallin, (2004) and Al-twaijry et al., (2002) studies investigate the audit committee-performance relationship and reveal that the audit committee served as a tool for effective monitoring process. These studies further report that the audit committee serve as a useful bridge between the directors and external auditors. April Klein (2002) study reported that the audit committee is the most impart element of effective cooperate governance. In addition, Alzeban & Sawan (2015) highlight the importance of audit committee and report that it is a monitoring mechanism which increases the quality of information among shareholders, managers and stakeholders. It improves disclosure practice, especially in a financial reporting environment. The presence of audit committee itself an assurance of less errors, illegal activities, irregularities on firm activities owing to the implementation of control procedures. Therefore, the audit committee is linked with more reliable financial reporting (Karamanou & Vafeas, 2005). In contrast, Keong (2002) point out that the audit, remuneration and nomination committees have no worth and seems like a window dressing unless they are independent and have full access to monitor firms' activities. Further, Main & Johnston, (1993) document that audit committee impact negatively on firm performance, while Baxter (2009) found no association. Pakistan CG code (2012) suggests that at least one-third of audit committee members should consist of NEDs to monitor the activities of management and make accountable for their conduct. We, thus develop the following hypothesis:

H_4: Audit committee size has a positive association with firm performance.

Director ownership. The empirical literature suggests that when director ownership increases, it helps to minimise the opportunist behaviour of managers, thus lowering agency costs and enhancing firm performance (Mangena &Tauringana, 2008). When the managerial ownership increases, the managers become the directors and shareholders of the firm which more likely to lead a higher firm performance as the managers and interests are deemed to be aligned. Moreover, when the director ownership increases, the opportunist behaviour of managers is minimised which help to reduce agency cost. On the other hand, prior studies such as Bjuggren

et al., (2007) and Ho & Williams (2003) find an inverse relationship between director ownership and firm performance. This negative association supports the argument that due to the high volume of shareholding the directors may acquire a dominant position in the board and pursue private benefits based on their high voting power. In Pakistan, a large proportion of firms are dominating by family ownership who prefer to recruit their family members and relatives as directors/ managers to influence the board decision making. We, therefore, develop the following hypothesis for both samples:

H_5: Director ownership has a negative association with firm performance.

Associated Ownership. The associated ownership is a type of Pyramid form of ownership in Pakistan. The associated ownership means that the business group hold the shares of a given firm and play a major role in its governance. The essential feature of associated ownership is that associated directors actively participate in the firm operation and board decision making. For example, DGKC, Nishat mills and Jubilee insurance companies are in the associated ownership of Mansha group in Pakistan. Therefore, the associated directors of Mansha group actively involved in operation and board decision making of DGKC, Nishat mills and Jubilee insurance. Associated ownership different from the chaebol form of South Korean ownership. The chaebol is the largest South Korean family-controlled group of firms which is managed and controlled by the ultimate owner or CEO of the family group. The distinct characteristics of associated ownership make it unique among different ownership formats in others developed and emerging markets. We, therefore, develop the following hypothesis:

H_6: Associated ownership is positively associated with firm performance.

Ownership concentration. It is well documented that ownership concentration has the potential to mitigate the agency conflict, thus positively impact on firm performance (Jensen and Meckling, 1976; Hu and Izumida,2008). Ownership concentration is associated with effective monitoring to increase shareholders' value which helps to mitigate agency costs. The empirical evidence on the advantages of ownership concentration document that large blockholders have an incentive to monitor professional managers more effectively to protect shareholders' interest (Shleifer & Vishny, 1986). Cho & Kim (2007) document that board effectiveness is associated with diversity in firm shareholdings. Sanchez-Ballesta & Garcia-Meca (2007) document that large blockholders are relatively active monitors which may enhance firm profitability. In contrast, the ownership concentration negatively impacts on firm performance, as it relates to

the expropriation of resources, capital misallocation and lower economic growth (Morck et al., 2005). In addition, controlling shareholders may use the funds for personal incentive owing to the less monitoring by the outside directors (Paligorova & Xu, 2012). Moreover, prior literature related to ownership concentration-performance relationship report mixed results. For example, prior studies (e.g., Ehikioya, 2009; Gugler, 2003; Wiwattanakantang, 2001) found a positive relationship while other studies (e.g., Bjuggren, et al., 2007; Haniffa & Hudaib, 2006) document an inverse association between ownership concentration and firm performance. Pakistan corporate sector is dominated by a large business group and family ownership who prefer to consolidate power in the few hands which leads to weak CG. We, therefore, expect a negative impact of ownership concentration on firm performance. We propose the following hypothesis:

H_7: Ownership concentration negatively impacts on firm performance.

Following literature, we include important control variables such as firm size, leverage, dividend to total assets payment, investment ratio, sales growth and cash flow for the model estimation. Several prior studies (such as Bozec 2005; Nguyen et al., 2010; Mohd & Ghazali, 2010) found mixed results of these control variables in relation to governance-performance relationship.

3. Research methodology

3.1 Data and Sample

Our preliminary sample consists of all 559 listed firms of the Pakistan stock exchange (PSX). We exclude Financial industries (SIC codes, 6000–6999) and Utilities (SIC codes, 4900–4999), subject to differences in listing and regulatory requirements. We also dropped those firms which are either declared as newly listed, delisted, or merged/demerged. Final sample contains an unbalanced panel data set of 259 firms and 2184 observations covering the period 2005-2014. The sample includes 63 MNC firms and 196 local firms of Pakistan. The MNC sample consists of US, UK, France, Germany, Netherland, Switzerland, Finland, South Korea and Japanese firms listed in Pakistan stock exchange. The data are extracted from the State Bank of Pakistan audited financial statements, annual reports and firms' individual websites. Table 1 present the definition of the variables used in this study.

TABLE 1 ABOUT HERE

4. Generalized Method of Moments (GMM)

We apply the dynamic system GMM estimator which control the potential source of endogeneity by estimating the following equation:

$$FP_{i,t} = \alpha + k_1 FP_{it-1} + \beta CG_{it} + \gamma_X Controls_{it} + \mu_i + \varepsilon_{it} \quad (1)$$

where FP represents firm performance (ROA) while CG represents corporate governance variables and the respective control represent as control variables. We estimate the model with GMM estimation and compare it with static models.

5. Results and discussion

5.1. Summary statistics

Table 2 presents the summary statistics of the variables used in the study. The mean value of ROA for MNC firms (0.089) is significantly higher than the mean of the local firm (0.065), indicating that MNC firms are more financially stable compared to local firms in Pakistan. The mean of MNC firms board size (8.1) is greater than local firms board size of (7.4). The average board size of Pakistani firms is significantly smaller than the board size of other emerging markets such as Mauritius firms (9.6) and Nigerian firms (9.7) report by Mahadeo at el., (2012) and Akpan & Amran (2014) respectively, while greater than Kuwaiti firms (6.16) document by Al-Matari EM et al., (2012). The mean of NEDs of MNC firms (0.43) is significantly greater than the mean of local firms (0.37). This NEDs ratio is greater than Mauritius firms (0.26), while significantly lower than the Kuwaiti firms (0.74) and Nigerian firms (0.45). The mean of audit committee size of local and MNC firms are (3.13) and (3.52), respectively which are greater than mean value of audit committee size of Kuwaiti firms (2.75). The mean of dividend payments and investment ratio of MNC firms are (0.03) and (0.067), respectively which are greater than the mean value of dividend payments and investment ratio of the local firms. In addition, the mean value of sales growth of MNC firms (0.05) is greater than local firms (0.01) reflecting that MNC firms are high growth firms compared to local firms of Pakistan.

TABLE 2 ABOUT HERE

Table 3 present the results of the pairwise correlation of the variables used in the study. The results show that explanatory and control variables are both positively and negatively correlated with ROA. Moreover, most of the cross-correlation of explanatory variables are small, thus at the first stage, it does not show the problem of multicollinearity across the variables. For example, the highest correlation is between director ownership and associated ownership (0.42) which indicates that Pakistani firms are dominant by associated and director ownership. The second highest correlation is between NED and ROA (0.39) reflecting that presence of NEDs positively impact on firm performance. The other higher correlations are between ROA and leverage (-0.31), and between ROA and sales growth (0.29). None of the variables is above 50% correlation which indicates that the likelihood of multicollinearity in OLS regression is low. In addition, we also perform another formal test of multicollinearity such as VIF (Verification inflation factor test) which shows that mean value as 1.53 which is far below the threshold of 10, indicating that multicollinearity is not an issue with our data set.

TABLE 3 ABOUT HERE

Table 4 presents the impact of CG on firm financial performance across MNC and local firms. We employ two-step system GMM estimation techniques by Arellano & Bond (1991) and Arellano & Bover (1995) and compare its results with static OLS and fixed effects model. The main advantage of GMM estimation is that it mitigates the potential source of endogeneity. The results show that the coefficient on the board size is negatively significant at 1% level of significance for the MNC firms indicating that larger board size negatively impacts on firm performance due to lack of communication among board members. The larger board size has fewer chances to coordinate between shareholders and board members effectively. This outcome supports the agency theory which predicts that a smaller board can perform better control function compared to the larger board (Jensen, 1993). This outcome is congruent with prior studies (see, for example, Guest, 2009; Haniffa and Hudaib, 2006; Mashayekhi and Bazaz, 2008). Interestingly, the static fixed effects model shows an insignificant relationship but after controlling dynamic endogeneity through system GMM, the coefficient sign of board size flips from insignificant to significant. In contrast, GMM estimator of local firms shows an insignificant relationship which is consistent with the prior study of Mohd and Ghazali, (2010). These results reject hypothesis *H1*.

The coefficient on independent NEDs is positively significant at 5% level in the case of MNC firms reflecting that NEDs increase firm value and perform better than firms with a lower

percentage of NEDs. Based on this result we accept the hypothesis *H2*. This outcome is consistent with the prior studies (e.g., Jackling and Johl, 2009; Liu et al., 2015; Ritchie, 2007; Volonte, 2015). In addition, this result supports agency theory which predicts that a greater proportion of NEDs is more effective in board monitoring (Jensen, 1993). The potential explanation of this result is that NEDs act as a referee especially in a situation of conflict between professional managers and shareholders. On the contrary, the presence of NEDs is insignificant for ROA in the case of local firms. We thus reject hypothesis *H2* in the case of local firms. The potential explanation of this result is that information asymmetry, lack of professional expertise and a higher level of ownership concentration prevent the NEDs to perform their monitoring function effectively. Moreover, several emerging market studies document an insignificant impact of NEDs on firm performance such as Korean context (Choi & Hasan, 2005), Mauritius firms (Mahadeo et al., 2012), Nigerian context (Akpan & Amran, 2014) and Asian emerging economies (Al-Matari et al., 2012; Vas Essen et al., 2012). The coefficient on the frequency of board meeting is insignificance for both samples indicating that firm financial performance depends upon day to day effective management, rather the frequency of board meeting. This result is consistent with the study results of El Mehdi (2007). Further, our results show that the audit committee has no significant impact on firm performance. This result is congruent with the prior study of Wang et al., (2016) who document that audit, remuneration and nomination committees have no worth and seem like a tool of window dressing unless they are independent and have full access to monitor firm activities. In contrast, the results of static OLS and fixed effects show a significant positive impact of audit committee on firm performance. Based on the findings of GMM estimation results we reject both the hypothesis i.e. *H3 and H4*.

TABLE 4 ABOUT HERE

The coefficient on the director ownership is negative and statistically significant at 10% level for both the samples. The possible explanation of this result is that due to a high volume of shareholding, directors may dominate in board decision-making and protect themselves against any disciplinary action by the other members of the board. This situation encourages managers to adopt opportunistic behaviour which affects negatively on firm financial performance. This result validates hypothesis *H5* and congruent with the prior study of Sheikh et al., (2013). Associated ownership is positive and statistically significant at 5% level in the case of local firms but insignificant for MNC firms. The associate directors play a vital role in corporate

decision making by directly engaging with the shareholders. Therefore, hypothesis *H6* is accepted for local firms but rejected for MNC firms. Further, ownership concentration is negative and statistically significant at 10% and 5% level in the case of MNC and local firms, respectively. This outcome is in line with the hypothesis *H7* for both samples and consistent with the previous studies (e.g. Bjuggren, et al., 2007; Haniffa & Hudaib, 2006).

Firm size is insignificant for both samples i.e. MNC and local firms, indicating that firm performance is not affected by the firm size. This outcome is congruent with the study results of Tuan Nguyen et al., (2014). Moreover, leverage is negative and statistically significant at 5% level for MNC firms which demonstrate that a large amount of debt tends to decrease the firm performance. This result is congruent with the prior study of Sheikh et al., (2013). On the other hand, leverage is positively significant at 10% level for local firms, indicating that due to the low rate of interest, the cost of operation and the amount of debt decrease which resulted in a low rate of interest payment. This result is consistent with the prior study of Nguyen et al., (2010). Dividend ratio is positive and statically significant at 1% level of significance for MNC firms but insignificant for local firms indicating that frequent dividend payments of MNC firms positively influence firm performance.

Sales growth is positive and statistically significant at 1% level for MNC firms confirming that on average, MNCs in Pakistan have high growth firms. In contrast, sales growth is insignificant in the case of local firms. The coefficient on investment opportunities shows a positive impact on firm performance at 5% level of significance for MNC firms. This result indicates that MNC firms invest in diversified sectors which in turn, positively impact on firm performance. In contrast, investment ratio is insignificant for local firms indicating that local firms are less pronounce for external investment. The coefficient on investment ratio across MNC and local firms reflect two distinct financing behaviours i.e. 'pro-active investment behaviour' of MNC firms and 'conservative investment behaviour' of local firms. The cash flow to total assets is positive and statistically significant at 5% level for MNC firms indicating that firms hold more cash to finance short-term investment opportunities. On the other hand, the cash flow to total assets is insignificant for local firms.

5.2 Robustness Test

We examine the robustness of our results by replacing the proxy of two variables such as audit committee size and ownership concentration and presents the results in Table 5. The audit

committee size is replaced by the independence of the audit committee and ownership concentration replaced by top 20 largest shareholders to check the sensitivity of the results. The results show that in the case of MNC firms, the role of audit committee either as a size or independence (alternate proxy) remain insignificant. Similarly, the coefficient on ownership concentration remains negative and significant even after replacing its proxy of top 5 blockholders by top 20 blockholders. The results also show that p-values of other explanatory and control variables are slightly changed but the coefficients sign and level of significance remains the same. Overall, the results remained very similar to the ones we obtained from our main estimation. On the other hand, the robustness test of local firms indicates same results even after changing the proxy of the audit committee and ownership concentration except for leverage which coefficient sign change from significant to insignificance but still shows a positive association. In addition, the significance level of director ownership is increased from 5% to 1%. Overall, our results are robust to the alternative proxies for CG and firm performance relationship.

TABLE 5 ABOUT HERE

6. Conclusion

We make three important contributions to the literature. First, we present a first-time investigation of governance-performance relationship across MNC and local firms in Pakistan. To the best of our knowledge, no previous study has conducted a comparative analysis of MNC and local firms in terms of governance-performance relationship. Second, our investigation extends CG literature by adding 'associated ownership' as a fresh indicator to the existing literature by considering this as another form of ownership structure which is positively linked with firm financial performance. Our findings document that MNC firms belong to the developed countries with a strong internal corporate culture and financial stability which strengthen better CG Practice compared to local firms. Third, we extend CG literature by suggesting that a well-established corporate culture, significant financial worth and firms' higher growth rate are the key determinants of better CG practice. We observed two distinct financing behaviours i.e. 'pro-active investment behaviour' of MNC firms and 'conservative investment behaviour' of local firms.

We estimate the governance-performance relationship in the dynamic framework and compared our results with static models i.e. OLS and fixed effects. Our hypothesis results for the MNC firms validate that board size, independent NEDs, director ownership, and leverage significantly affect the firm performance. In contrast, the board size, director ownership, associated ownership and ownership concentration have a significant impact on firm performance in the case of local firms. Our results have economic significance as there is similarity among emerging markets in terms of political, economic and social set-ups. Pakistan being an emerging market have the same corporate level issues, thus the findings of this study can be applied to other emerging markets. Moreover, investigation of MNC firms represent the international dimension of CG and enabled these findings to compare with developed countries. The comparative analysis of MNC and local firms is a unique approach which provides obstinate grounds for future researchers to explore distinct feature of MNC firms and compare it with local firms of developed and developing economies. We acknowledge a few limitations of this study. There are a few governance variables such as female board members, nomination committee and remuneration committee, research and development expenditure which are not part of this study due to the non-availability of data.

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