

THE EFFECTS OF CORPORATE GOVERNANCE AND RELATED PARTY TRANSACTIONS ON FIRM PERFORMANCE AMONG PAKISTANI FAMILY-OWNED FIRMS

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Abstract

This study empirically examined the impact of corporate governance (CG) variables, namely, independent non-executive directors (INEDs), family directorship (FD), and family ownership (FO) and related party transactions (RPTs) on firm performance that prevail in Pakistani family-owned firms. This study analyzed the panel data of 150 family-owned firms listed on the Karachi Stock Exchange (KSE) from 2004 to 2014. Different Panel least squares Models i.e. Model 1, Model 2 and Model 3 are employed to examine the effect of related party transactions and corporate governance variables on firm performance. It has developed index of independent non-executive director (IDI) of family-owned firms comprising three dimensions for measurement of independency of Independent director i.e. composition, financial expertise and tenure. Results of IDI showed that more than 90% of family-owned firms fall in lowest category of IDI. This study found empirically that corporate governance variables, particularly independent director index (IDI) have positive relationship with firm performance. This shows that Pakistani family owned firms have low ratio of independent director on board. This weaker corporate governance in family-owned firms create opportunity for Major shareholders who expropriate resources through RPTs. Similarly, this study also found empirically that RPTs in Model 1, Model 2 and Model 3 has significant relationship with Firm Performance. This is consistent with agency theory and conflict of interest transaction which is potentially harmful to interest of minority shareholder. While, it has also found that RPTs has positive significant relationship with firm performance. It has also provided empirical evidence to show that both family directors and family ownership are negatively related to firm performance.

Keywords: Related party transactions, Independent Non-executive Director, Family Directorship, Family concentration, Major shareholder and Minority shareholder.

Introduction

Abusive Related Party Transactions (RPTs) are methods used by insider¹ shareholders to exploit outsider shareholders, (Ryngaert & Thomas, 2012). Investigations have shown that abusive RPTs lead to several scandals, such as WorldCom, Parmalat, Adelphia Communications, Coloroll, Maxwell Group, Nortel, Polly Peck, Royal Ahold, and Satyam, (Zalewska, 2014). This fraudulent activity through RPTs is of great concern for regulators and investors, as RPTs carries advantages as they save transaction costs and improve operating efficiency of the companies (Ge, Drury,

¹ Insiders are referred to as major or controlling shareholders, family, financial institutions, or government. Outsider shareholders are often referred to as minority shareholders (La Porta et al., 1998).

Fortin, Liu, & Tsang, 2010). Hence, corporate governance is concerned with ways that the interest of owners is reflected and implemented in the organizational system, (Sarbah & Xiao, 2015). Almost all countries have developed their own set of codes for corporate governance, which could also function as guidelines. Thus, corporate governance codes have started in late 20th century, such as the Cadbury (1992), Greenbury (1995), and The Sarbanes-Oxley Act of 2002 by Sarbanes (2002).

Conflict of interest may arise between major shareholder and minority shareholders. This situation prevails mostly in East Asia and in the West, where large shareholders control firms (Claessens, Djankov, Fan, & Lang, 2002). The controlling shareholder may have both the enticement and the capability to expropriate the interest of minority shareholders (Claessens, Djankov, & Lang, 2000; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1999) and “Tunneling” or “Expropriation of Resources” may be an obvious source of expropriation (Johnson, La Porta, de Silanes, & Shleifer, 2000). Therefore, major shareholders have the opportunity to expropriate funds from bottom to up through the pyramidal structure due to differences between cash flow and control rights, and this situation will make them wealthier at the expense of minority shareholders, (Riyanto & Toolsema, 2008). This Tunneling process negatively impacts on interest of minority shareholders, who generally gain less from their shareholding. Such resource transfer may be costly for minority shareholders, it also decreases transparency of the whole economy, shows biased accounting figures, and makes the examination of a company’s true performance difficult. Similarly, Bertrand, Mehta, and Mullainathan (2002) found a significant amount of Tunneling in India in transfer pricing contracts and asset sales or even outright cash appropriation.

This Conflict of Interest is consistent with the Model of Berle and Means (1932), who developed the relationship between the ownership structure and performance of firms with scattered ownership (where every owner holds a small percentage of total ownership). This notion is supported by Agency theory of Jensen and Meckling (1976), where corporate governance separates company ownership from management. Corporate governance emerged because of two issues: (i) agency issue and (ii) trade cost. Agency issues arise when the interests of owners and management are in conflict. Thus, owner (principal) and management (agent) try to look for their common interests. Trade cost arises when the agreement between owners and management fail to consider all future uncertain events. This situation could likely lead to opportunistic behavior by management, (Shleifer & Vishny, 1997).

Problem statement

The Concentration of ownership is a major issue in Pakistani family-owned firms (Azim, Mustapha, & Zainir, 2018; Hussain & Shah, 2015; Yasser, Entebang, & Mansor, 2015). The percentage of concentrated ownership is almost half of the corporate ownership held by large or concentrated owners (Javid & Iqbal, 2008; Khan et al., 2017). This ownership concentration has high negative impact on company performance Afgan, Gugler, and Kunst (2016), and decreases corporate efficiency and economic development. This situation may result in the expropriation of resources and exploitation of Minority Shareholder interests by large Shareholders (Abbas, Naqvi, & Mirza, 2013). Corporate governance has no effect on dividend pay-out and firm value, although dividend pay-out and firm value are significantly related (Tahir & Sabir, 2015). The controlling shareholders in family-owned firms expropriate funds from lower to upper level firms through pyramidal structure. The interests of minority shareholders are exploited due to this fund expropriation (Khan & Nouman, 2017; Sheikh, Shah, & Akbar, 2018; Ullah, Ali, & Mehmood, 2017). This resource transfer supports Agency theory, Jensen and Meckling (1976) and conflict of interest, (Gordon, Henry, & Palia, 2004). Despite corporate governance codes, the performance of groups decreases, (Afza & Nazir, 2015). The role of Controlling Shareholders in Pakistan varies due to the preference of firm owners, (Ramadani & Gërguri-Rashiti, 2017; Tahir & Sabir, 2015).

The International Finance Corporation (IFC, 2007)² highlighted weaknesses of Corporate Governance in Pakistan. IFC (2007) emphasized that the corporate board has low percentage of experienced personnel and low or no protection for minority shareholders. Lack of law enforcement with respect to investor right is rampant, as courts are laden with cases and prosecution of such cases is costly and time-consuming in deciding on the settlement. While listed companies perform adequate and timely disclosure, several groups in the manufacturing sector and state-owned firms do not follow rules and regulations. As penalty is low for not providing full disclosure, the company is not motivated to follow rules and regulations. IFC (2007) further cited the disclosure issue of conflict of interests and related party transactions. Similarly, few family-owned firms influence and control resources. These family-owned firms are usually involved in the expropriation of resources at the expense of minority shareholders, (Ibrahim, 2006). A developing country like

² A Survey of Corporate Governance Practices by International Finance Corporation in Pakistan 2007

Pakistan shows a complex situation in relation to examining these issues because capital markets are under developed with low stock market capitalization and foreign direct investment, (Gohar & Karacaer, 2009). Hence, speculation and corruption activities are heightened. Empirical evidence shows that affiliated firms have poorer performance than unaffiliated firms. Furthermore, the average values of the Tobin's Q, ROA, and OPROA of affiliated firms are significantly lower than unaffiliated firms. These values suggest monitoring group activities of family-owned firms through outsiders. This factor reduces agency problems and diminishes performances of family-owned firms than unaffiliated firms. Faccio, Lang, and Young (2001) argued the existence of agency problems in Asian firms employing corporate governance and engaging in a political environment. A study on the expropriation of resources in Pakistan was conducted before implementation of corporate governance codes in 2002, (SECP codes, 2002). Ikram and Naqvi (2005) showed the expropriation of assets of 86 firms belonging to family-owned firms for 10 years (1993–2003). The authors concluded the existence of tunneling in family-owned firms. Other issues include governing board, independence of board, no balance of power in the board, non-executive directors in firm succession, trust and confidence of the investors, and disclosure of Family-Owned Firms, (Ameer, 2013). All these issues may create problem for minority shareholders and other stake holders (Mehboob, Tahir, & Hussain, 2015).

Objectives of study

The three objectives of this study are as follows. First, this study has developed independent non-executive director index. Second, it has determined the effect of corporate governance mechanism i.e. Independent non-executive director index, Family Directorship and Family Concentration on Firm Performance. Third, it has determined the effect of RPTs on Firm Performance.

Contributions of study

The contributions of this study are as follows. First, it contributes to existing literature by showing how to minimize the exploitation of the Minority shareholder interests by Major Shareholders in Pakistani family-owned firms through their high ownership concentration, i.e., Agency Theory (Type II), conflict of interest between Major shareholders and Minority Shareholders (Jensen & Meckling, 1976), and Conflict of Interest Views (Gordon et al., 2004). Second, it contributes to corporate governance literature in the context of developing world like Pakistan empirically by developing index of Independent Directors (IDI). Most literature have seen attributes of independent director in term of composition of independent director and financial expertise. However, this study has added one more dimension of independent director i.e. tenure of independent directors. Final index includes three attributes of independent directors i.e. Composition, Financial Expertise and Tenure of independent directors. Independent director has great role in mitigating the transfer of resources made by Major Shareholder in family owned firms.

This is very critical issues with role of INEDs to examine independency of INEDs in three dimensions because most of family owned firms in Pakistan fall in lowest level of IDI in Table 03 and Figure 01(Azim et al., 2018). Independent director is main responsibility to mitigate abusive RPTs. This study has examined empirically effect of IDI with other variables i.e. family director ship and family concentration on firm performance. Third, it contributes to Corporate Governance literature in the context of developing countries, such as Pakistan, by empirically examining the impact of independent non-executive directors that prevent abusive related party transactions. Fourth, it contributes empirically by testing the impacts of INEDs, family directorship, and family ownership and RPTs on firm performance prevailing in Pakistani family-owned firms where major shareholders expropriate the resources through abusive RPTs (Agrawal & Knoeber, 2012; Azeez, 2015; Azim et al., 2018; Baysinger & Butler, 1985; Kang & Shivdasani, 1995).

Literature review and hypotheses

According to US GAAP, RPTs is defined as “transactions between a company and its subsidiaries, affiliates, principal owners, officers or their families, directors or their families, or entities owned or controlled by its officers or their families.”³ According to the International Accounting Standards (IAS), RPTs is “a related party can be a person, an entity, or an unincorporated business.”⁴ This definition has two sections. The first section recognizes “in a person, or a close member of that person's family, being a related party from the perspective of the reporting entity.” The second section ascertains “in an entity being related to the reporting entity.” Similarly, Gordon et al. (2004) explored two alternative perspective of RPTs. The first views conflict of interest transactions and the second views efficient transactions. First, conflict of interest transactions can be termed as abusive, which is consistent with agency theory of

³ US GAAP Statement of Financial Accounting Standards 57

⁴ As stated in paragraph 29.2, IAS 24 (revised) (PricewaterhouseCoopers, 2010)

Jensen and Meckling (1976) and Model of Berle and Means (1932). This conflict is potentially harmful to shareholder interests (Aharony, Wang, & Yuan, 2010; Cheung, Rau, & Stouraitis, 2006; Gordon et al., 2004; Jiang, Lee, & Yue, 2010). Second, efficient transaction view extends the transaction cost concept developed by Coase (1937) and Williamson (1975) and shows that related party transactions benefit and not harm shareholders (Chang & Hong, 2000; Jian & Wong, 2010; Khanna & Palepu, 2000; Stein, 1997).

Corporate governance practices and structures have witnessed enormous changes during the last two decades. Most firms in developing and developed countries have concentrated ownerships (La Porta, Lopez-de-Silanes, & Shleifer, 1998). These controlling shareholders normally use their stakes of ownership concentration, exercise control rights that surpass their cash flow rise, and provide more opportunities to insiders to expropriate outside shareholders through various firm operations and financing decisions (Bertrand et al., 2002; Claessens et al., 2002; Faccio et al., 2001; Gopalan & Jayaraman, 2012; Johnson et al., 2000; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000; La Porta, Lopez-de-Silanes, & Zamarripa, 2003). This situation exploits the wealth of minority shareholders through tunneling (Bae, Kang, & Kim, 2002; Buysschaert, Deloof, & Jegers, 2004).

Corporate governance becomes more significant in family-owned firms specifically in developing countries where most firms are dominated by families (Claessens et al., 2000; La Porta et al., 1999). The ownership structure of these family-owned firms may have cross shareholding or pyramidal structures in which members of the board of directors belong to the same family (Del Giudice, 2017; Hong, Kalcheva, Kim, & Yi, 2017; Javid & Iqbal, 2010). The controlling family is the major owner and controller, whereas the immediate and distant family-members help operate various firms within family-owned firms (Ghani, Haroon, & Ashraf, 2010). When family-owned firms grow, conflict of interest arises among the owners, managers, and employees (Bennedsen & Wolfenzon, 1998; La Porta et al., 1999). A good corporate governance system brings right policies to manage such conflict of interest (Sarbah & Xiao, 2015).

Corporate governance is a new phenomenon in Pakistan. Better understanding and awareness for the said phenomenon are implemented such that organizations become comfortable with the concept of corporate governance. To attract foreign investors, the markets should be properly governed. In Pakistan, foreign investment can be attracted by implementing true mechanisms of corporate governance. The stock exchanges of any country are the main avenues for attracting foreign direct investment. In Pakistan, stock exchanges must achieve better corporate governance standards, which are integral in measuring the performance of the said organization (Gulzar & Wang, 2010). This situation in a developing country, such as Pakistan, merits a thorough examination of these issues because capital markets are under developed, as indicated by their low level of stock market capitalization and foreign direct investment. Law enforcement is weak in the country, and speculation activities and corruption are high (Gohar & Karacaer, 2009). The few family-owned firms are powerful and dominate the economic landscape (Gul, Obaid, & Ali, 2017). Controlling shareholders in Pakistani family-owned firms expropriate funds from bottom- to upper-type firms through pyramidal ownership. The expropriation of resources occurs due to high percentage of concentrated ownership that almost half of the corporate ownership is held by large or concentrated owners. This high ownership concentration has highly negative effect on company performance. This situation decreases corporate efficiency and economic development, and it results in expropriation of resources and exploitation of minority shareholders by large shareholders (Abbas et al., 2013).

Therefore, corporate governance codes are developed to safeguard the right of shareholders in an emerging economy. The controlling shareholder in family firm groups transfers resources through pyramidal structure. This expropriation of resources by controlling shareholder can have adverse consequence for the minority shareholders and for the economy as it reduces transparency. This situation exhibits manipulated accounting figures and difficulty in evaluating the actual performance of the firms. Related party transactions are one of the factors used by controlling shareholders to exploit minority shareholder interests (Bhutta, Knif, & Sheikh, 2016; Ullah & Shah, 2015). This research highlights the exploitation issues of minority shareholders through related party transactions in Pakistan family-owned firms.

Research hypotheses

This study examines the impact of corporate governance variables, namely, independent non-executive director, family directorship, and family ownership and types of RPTs on firm performance.

Independent Director index (Composition, Financial expertise and firm performance)

The RPTs have been identified as the most frequent technique used by controlling shareholders to extract corporate resources from non-controlling shareholders. Consequently, the concept of “board independence” was introduced and

become a priority of many corporate governance reforms. The appointment of Independent Non-Executive directors (INEDs), who are independent from management, is seen as a powerful tool to restrict resource diversion by controlling shareholders. Increasing the independence of corporate directors is one of the main focuses on corporate governance reforms. INEDs composition, financial expertise and tenure are among the attributes of INEDs that may influence their independence and oversight role

Financial Expertise of Independent Non-Executive Directors

Many studies suggest that financial expertise among INEDs is associated with effective functioning of board monitoring. Being members of the audit committee, it is vital for INEDs to be equipped with an accounting background. DeFond, Hann, and Hu (2005) argued that accounting-specific expertise may be important for the members of the audit committee due to their numerous responsibilities that require a relatively high degree of accounting sophistication. A study by DeFond et al. (2005) provided an evidence that market reacts positively to the appointment of accounting financial experts to the audit committee, suggesting that INEDs with accounting knowledge, improve the audit committee's ability to ensure high quality of financial information.

Prior studies suggested that the presence of INEDs with financial expertise may enhance the quality of financial reporting process. For example, financial expertise on boards reduces the likelihood of fraud and earnings restatements (Agrawal & Chadha, 2005), more effective in mitigating earnings management (Carcello, Hollingsworth, Klein, & Neal, 2006) and less likely to be associated with the occurrence of internal control problems (Krishnan, 2005). A study by (McMullen & Raghunandan, 1996) documented that firms with financial reporting problems are unlikely to have financial experts on their audit committees. Other studies directly investigated whether board's financial expertise has a positive impact on a firm's financial reporting quality. Felo, Krishnamurthy, and Solieri (2003) found that the fraction of audit committee members having expertise in accounting or financial management is positively related to financial reporting quality. Pucek and Richards (2013) indicated that the complexity and risks associated with recognition and disclosure of RPTs are significant. Many RPTs have "substance over form" problems and some of them are embedded in documentation that is less clear or thorough than the documentation that ordinarily exists between unrelated parties.

In Pakistani family owned context, due to the complicated nature of RPTs, This study has taken financial expertise attributes while making Index of INEDs. However, the (SECP 2002 codes) requires the appointment of only one INED obligatory for companies and prefer one third of the corporate board to have INEDs, which is very less. So this study expect that INEDs with financial expertise are more likely to constrain disadvantages RPTs. Therefore, this study proposes that a higher proportion of INEDs with financial expertise may have a positive impact in mitigating potentially abusive RPTs in Pakistani owned firms.

Tenure of Independent Directors

The U.S. Senate report on Enron (U.S. Senate, 2002) revealed that the board tenure is another shortcoming in corporate governance practices. The report documented that some of the Enron's directors had served on the board for at least 10 years. More recent trends shows a growing number of companies have adopted tenure-related guidelines for INEDs. For example, Hong Kong, Malaysia, Singapore, South Africa, and United Kingdom (UK) recommend a maximum tenure of 9 years for INEDs. In Malaysia and the UK, directors with more than 9 years tenures are deemed non-independent unless the company can explain otherwise.

Vafeas (2003) provided evidence that senior directors are more likely to make decisions favoring the management. Vafeas (2003) also discovered that CEOs tend to receive higher levels of compensation when compensation committees are made up of senior directors. This perspective is also supported by Rickling (2014) who found out that audit committee director tenure is positively associated with the likelihood of a firm repeatedly hold meeting or just beating analysts forecasts, and thus, support calls to limit the tenure of directors. Similarly, other researchers like Chen and Jaggi (2000), Cheng and Courtenay (2006), Morris, Susilowati, and Gray (2009) and Morris, Susilowati, and Gray (2012) also found a positive association between the ratio of independent directors and corporate disclosures.

In contrast, Liu and Sun (2010) demonstrated the negative relationship between the proportion of long-tenured directors and earnings management and thus, supporting the expertise hypothesis. Since there are two conflicting arguments on long-tenured directors, this paper proposes that INEDs tenure may have an impact on the potentially abusive RPTs. Researchers like Eng and Mak (2003), Barako, Hancock, and Izan (2006) and Nelson, Gallery, and Percy (2010) found negative relationship between the ratio of outside directors and firms' voluntary disclosures.

While, the some researchers give mix results, Gallery, Gallery, and Supranowicz (2008) found a negative relationship between independence of board and related party payment, showing the monitoring role of independent directors in checking payments to related parties. Lo and Wong (2011) exhibited that firms would disclose voluntarily the method of transfer pricing of their RPTs having large percentage of independent directors. They found that firms with high ratio of independent directors would disclose mandatory information of related party transactions disciplined by stock market regulatory bodies than those with a low ratio of independent directors, proposing that the more independent boards would support better monitoring of firm disclosures.

In context of Pakistan, Abdullah, Shah, Gohar, and Iqbal (2011) found that concentrated ownership companies with independent directors have positive impact on firm performance. Similarly, Khan and Awan (2012) found independent directors on board composition have positive effect on firm performance. This is also supported by Javaid and Saboor (2015) that independent directors have positive effect on firm performance. Based on above discussion, it is argued in this study that independent director has positive effect on firm performance. This leads to following hypothesis for independent director which improves performance of the company.

H1: Independent director index have positive effect on Firm performance in family-owned firms in Pakistan.

Family directorship and firm performance

According to Agency theory of Jensen and Meckling (1976), agency issues arise if family member are appointed as director. This main issue increases chances of the misappropriation of controlling shareholder. Furthermore, this family directorship can also affect interests of the minority shareholders because family owned firms tries to protect a firm from the probability of a hostile take-over (Gomez-Mejia, Larraza-Kintana, & Makri, 2003). There are limited studies on performance of family directorship in developing countries including Pakistan where board is more influential in family owned firms and most of the listed companies are family owned. Nicholls and Ahmed (1995) found high tendencies for appointment of director from family owned firms. La Porta et al. (1999) noticed that national institutions fail to protect right of investors due to family owned firms. Claessens et al. (2000) analyzed that family owned firms have different level of controlling rights as well as cash flow rights through their pyramidal ownership.

However, Barontini and Caprio (2006) explored the relationship between ownership structure and firm performance and found that director appointed from family owned firms is positively related to firm value and operating performance. Similarly, Chang (2003), Joh (2003) and Carney and Gedajlovic (2002) found empirically that directorship of family owned firms is significantly related with better performance. While, Morck, Shleifer, and Vishny (1988) found the negative association between effects of directorship of family owned firms and firm performance. However, Filatotchev, Lien, and Piesse (2005) found that directorship of family owned firms is not related with firm performance. Based on above discussion, it is argued in this study that family directorship has significant monitoring role on relationship between RPTs and firm performance. This leads to following hypothesis for family directorship which improves performance of the company.

H2: Family directorship have negative effect on Firm performance in family-owned firms in Pakistan.

Family ownership and firm performance

Jensen and Meckling (1976) concluded that managerial ownership are negatively associated with agency cost and are positively associated with firm's performance. This also supports by conflict of interest hypothesis (Gordon et al., 2004). Researcher like Shleifer and Vishny (1986) proposed hypothesis that high concentration ownership indicates better monitoring and performance especially when ownership is concentrated in institutional investors rather than individual investors. Therefore, institutional ownership could increase a firm's performance. Researchers like McConaughy, Walker, Henderson, and Mishra (1998) and Anderson and Reeb (2003) suggest that family owned firms improve the value of firms.

Demsetz and Lehn (1985) found that family owned firms appoint persons is closely related to value of firm who closely monitor management efficiently and decrease problem associated with firms. Maury (2006) found that family owned firms improves firm profitability whereas legal environment protects interest of minority shareholders. Ben-Amar and André (2006) found that a family owned firms that often exerts control over voting rights having small ratio of cash flow rights. Klein, Shapiro, and Young (2005) attested that relation of performance also varies due to the variation of family concentration across countries. Villalonga and Amit (2006) posited that the highly concentrated family owned firms with CEO from family makes value for firms when management is under family control. The

previous researches have provided mixed result about the relationship between the family ownership concentration and performance. Demsetz and Lehn (1985) provided the evidence that family concentrated firms reduce managerial cost. Study of Fama and Jensen (1985) provided evidence that managerial costs are not decreased with concentration of family owned firm.

Various researchers like Hill and Snell (1988), Hill and Snell (1989), Agrawal and Mandelker (1990), Xu and Wang (1997) and (Wu & Cui, 2002) found positive and significant relation between concentration of family ownership and accounting profits and firm performance. However, some researchers like Leech and Leahy (1991), Mudambi and Nicosia (1998), Lehmann and Weigand (2000) and Chen and Cheung (2000) found negative and significant effect of ownership concentration on firm value. However, Prowse (1992) found no relationship between family concentration and profitability.

There are some studies aimed at exploring for nonlinear relationship between ownership concentration and firm performance. Thomsen and Pedersen (2000) found that as family concentration increases, it first improves firm performance that eventually declines. It shows that the value of concentrated ownership is offset by the negative effects when family concentration is high. Porta, Lopez-de-Silanes, and Shleifer (1999) found that the main problem of expropriation of resources because controlling shareholders have control rights significantly high than cash flow rights. Claessens et al. (2002), Joh (2003) and Baek, Kang, and Park (2004) found that firm value becomes high with cash flow rights of controlling shareholder but it declines when control rights of controlling shareholders exceed their cash-flow right. Lins (2003) found that low firm values are related when control right is higher than cash flow right, but this control is not enough to offset the benefits of concentrated ownership.

However, Sánchez-Ballesta and García-Meca (2007) found that this relationship of cash flow right and control right is moderated and stronger which would support the argument that ownership is positively associated with firm performance in countries having low investor protection. In context of Pakistan, Javid and Iqbal (2008) have found positive effect of ownership concentration on firm performance and negative association between family concentration and corporate governance practices and disclosures and transparency. Similarly, this is also supported by Ali, Tahir, and Nazir (2015) that there is positive effect of ownership concentration on firm value. While, Abdullah et al. (2011) found that firms with concentrated ownership structure have negative relationship with firm performance. This is also supported by Irshad et al., (2015) firms with concentrated ownership structure have negative relationship with firm performance. Based on above discussion, it is argued in this study that family concentration has significant monitoring role on relationship between RPTs and firm performance. This leads to following hypothesis for concentration of family structure which moderates the relationship between related party transaction performances of the company.

H3: The presence of higher concentration of family ownership structure have negative effect on firm performance among Pakistani family-owned firms.

Related party transactions and Firm Performance

Abusive RPTs are possible methods that are used by insider shareholders to exploit outsider shareholders, (Gordon et al., 2004; Ryngaert & Thomas, 2012). These RPTs are precisely associated with various cases of financial scam and deteriorated value of earnings (Ge et al., 2010). Specifically, these RPTs give chances to managers, directors and related parties to expropriate funds at expense of minority shareholders (Djankov, La Porta, Lopez-de-Silanes, & Shleifer, 2008; Johnson et al., 2000). All the RPTs are not exerted for expropriation of resources (Ryngaert & Thomas, 2012). Although certain types of RPTs might help controlling families to transfer the wealth of firms for them and expropriate minority shareholders, (Cheung et al., 2006; Jian & Wong, 2010; Kohlbeck & Mayhew, 2004). This idea is sustained by the tunnelling concept of Johnson et al. (2000) and agency theory of Jensen and Meckling (1976) which mostly implies that major shareholder may engage in transactions with their firms that expropriate resources and profit and exploit the minority shareholder.

Various researchers like Gordon et al. (2004); Cheung et al. (2006); Lei and Song (2008) Cheung, Jing, Lu, Rau, and Stouraitis (2009); Berkman, Cole, and Fu (2009); Chen, Chen, and Chen (2009); Kohlbeck and Mayhew (2010); Ge et al. (2010); Jian and Wong (2010) Chalevas (2011) and Lei and Song (2011) have categorized RPTs in different ways and all show a substantial association between the existence of RPTs and overstated returns, decrease in wealth of minority shareholder and decrease in value of firm.

While, some researchers like Gordon et al. (2004), Cheung et al. (2006), Lei & Song (2008), Gallery et al., (2008), Chen et al. (2009), Cheung, Qi, Rau, and Stouraitis (2009), Aharony et al. (2010), Munir (2010), Ge et al. (2010), Munir

and Gul (2010), Kohlbeck and Mayhew (2010), Aswadi Abdul Wahab, Haron, Lee Lok, and Yahya (2011), Yeh, Shu, and Su (2012) and Ryngaert and Thomas (2012) have found negative association between RPTs and firm performance.

Likewise, Various researchers like Arshad, Darus, and Othman (2009), Lo and Wong (2011) and Utama and Utama (2014) found a positive relationship between the RPTs and company performance, company size, professional affiliations and corporate governance index. However some study gives mix results. With respect to effect of corporate governance on the RPTs and firm performance, Chien and Hsu (2010) found a negative relationship between RPTs and firm performance and a positive relationship between corporate governance and firm performance. Similarly Yoong, Alfian, and Devi (2015) have examined the relationship between RPTs and firm value and with moderating effect of ownership concentration. They found that RPTs reduce firm value. Further they found that moderating role of ownership is positive on the association between RPTs and value of firm. They further found that there is no significant evidence between RPTs and decrease in value of firm and positive moderating effect for non-family firms. They have shown empirically that expropriation of resources via RPTs is high in family firms as compared to non-family firms.

Similarly, Pozzoli and Venuti (2014) have examined the relationship between RPTs and firm performance. They found no empirical correlation between related party transactions and firm performance and that there is no evidence of a cause-effect relation. Based on above discussion, it is argued in this study that related party transactions have negative effect on firm performance. This leads to following hypothesis for testing association between RPTs and firm performance.

H4: The related party transactions have negative effect on firm performance among Pakistani family-owned firms.

Methodology

Construction of Independent Director Index (IDI) of family owned firms

This study developed index for independent director (IDI) of family-owned firms which includes three dimensions for the measurement of the autonomy of independent directors. The overall IDI is computed as a weighted sum of three sub-dimensions, the composition of independent directors (IDC), the financial expertise of independent directors (IDFC), and the tenure of the independent directors (IDT). The first step in the calculations involve constructing all sub-indices separately by assigning a specific weight to each dimension using the principal component method (Filmer & Pritchett, 2001; Harttgen & Klasen, 2012; Sahn & Stifel, 2003; Sahn & Stifel, 2000), Javid and Iqbal (2010) of the CG index development and Khan and Yusof (2017) of the terrorist economic impact evaluation model (TEIE Model) development. To calculate the sub-dimensions, the max-min approach of the United Nations Development Program is adopted. The second step is to take the mean of the calculated dimensions to obtain the overall IDI for a particular year as follows.

Dimensions of the ID index are as follow.

Composition of independent director

It shows the value of independent director which is calculated by following formula.

$$IDC_g = \frac{IDC_{ac} - IDC_{min}}{IDC_{max} - IDC_{min}} \quad (1)$$

where

IDC_g stands for composition of independent director's growth rate

IDC_{ac} stands for composition of independent director actual value in particular period.

IDC_{min} stands for composition of independent director minimum value for sample period and sample family owned firms.

IDC_{max} stands for composition of independent director maximum value for sample period and sample family owned firms

Financial Expertise of independent directors

Financial expertise is measured by first coding to independent director with respect to financial education i.e. degree and financial experience. Code 1 is used when independent director have no financial education and financial experience. Code 2 is used for financial education. code 3 is used only for financial experience. Code 4 is used when

independent directors have both financial education and financial experience. After coding of financial education and financial experience of independent director, the next step is calculate the growth rate of financial expertise by following formula.

$$IDFE_g = \frac{IDFE_{ac} - IDFE_{min}}{IDFE_{max} - IDFE_{min}} \quad (2)$$

where

$IDFE_g$ stands for financial expertise of independent director's growth rate

$IDFE_{ac}$ stands for financial expertise of independent director actual value in particular period.

$IDFE_{min}$ stands for financial expertise of independent director minimum value for sample period and sample family owned firms.

$IDFE_{max}$ stands for financial expertise of independent director maximum value for sample period and sample family owned firms.

Tenure of independent director

Tenure of independent director is measured by first coding to independent director with respect to tenure period which independent director is appointed till completion of his/her tenure period. Code 1 is used when independent director have tenure of 5 years or more than 5 years period. Code 2 is used when independent director have tenure of 3 years to 5 years period. Code 3 is used when independent director have tenure of less than 3 years period. Code 4 is used when independent director have tenure of 3 years. After coding of tenure of independent director, the next step is to calculate the growth rate of tenure by following formula.

$$IDT_g = \frac{IDT_{ac} - IDT_{min}}{IDT_{max} - IDT_{min}} \quad (3)$$

where

IDT_g stands for tenure of independent director's growth rate

IDT_{ac} stands for tenure of independent director actual value in particular period.

IDT_{min} stands for tenure of independent director minimum value for sample period and sample family owned firms.

IDT_{max} stands for tenure of independent director maximum value for sample period and sample family owned firms.

Independent Director Index

Independent director's index can be calculated as.

$$IDI_t = \frac{IDC + IDFE + IDT}{3} \quad (3.4)$$

where

IDI_t stands for index of independent director

IDC stands for independent director composition growth rate.

$IDFE$ stands for independent director financial expertise growth rate

IDT stands for independent director tenure growth rate

The range of ID index value lies between 0 and 100 where 0 explains least independency of independent director while 100 shows highest independency of independent directors.

Models specification

This study has drawn three empirical Models based on literature review and development of hypotheses.

Model 1

Analytically, Model 1 with the nonlinear relation is employed to examine the relationship between Response Variable (accounting based measure i.e. ROA) and explanatory variables (related party transactions and corporate governance i.e. independent director index, family directorship and family ownership and interaction variable i.e. RPTs with IDI, FD and FO).

$$ROA_{it} = \beta_0 + \beta_1 IDI_{it} + \beta_2 FD_{it} + \beta_3 FO_{it} + \beta_4 rpt_{it} + \beta_5 PM_{it} + \beta_6 FS_{it} + \beta_7 YEAR_{yit} + \varepsilon_{it}$$

Model 2

Analytically, Model 2 with the nonlinear relation is employed to examine the relationship between Response Variable (accounting based measure i.e. ROE) and explanatory variables (related party transactions and corporate governance i.e. independent director index, family directorship and family ownership and interaction variable i.e. RPTs with IDI, FD and FO).

$$ROE_{it} = \beta_0 + \beta_1 IDI_{it} + \beta_2 FD_{it} + \beta_3 FO_{it} + \beta_4 rpt_{it} + \beta_5 PM_{it} + \beta_6 FS_{it} + \beta_7 YEAR_{yit} + \varepsilon_{it}$$

Model 3

Analytically, Model 3 with the nonlinear relation is employed to examine the relationship between Response Variable (Market based measure i.e. Tobin's Q) and explanatory variables (related party transactions and corporate governance i.e. independent director index, family directorship and family ownership and interaction variable i.e. RPTs with IDI, FD and FO).

$$Q_{it} = \beta_0 + \beta_1 IDI_{it} + \beta_2 FD_{it} + \beta_3 FO_{it} + \beta_4 rpt_{it} + \beta_5 PM_{it} + \beta_6 FS_{it} + \beta_7 YEAR_{yit} + \varepsilon_{it}$$

The details of variables employed in Models 1, 2, and Model 3 are as follows.

The dependent variables are:

ROA_{it}: return on asset of firm at year t

ROE_{it}: return on equity of firm at year t

Q_{it}: Tobin's Q of firm at year t

The independent variables are:

IDI_{it}: independent non-executive director index in family-owned firms

FD_{it}: natural log of the shareholding amount by a family member as a director in the Board of Director (BoD) in i firm at year t

FO_{it}: family concentration of major shareholder in the firm at year t (%).

RPT_{it}: amount of related party transactions that is likely to result in expropriation at year t

Control Variables:

PM_{it}: profitability of firm i at year t.

FS_{it}: firm size of firm i at year t

YEAR_{yit}: Year Dummies

ε: standard error

Dependent variables

The dependent variables are firm performance. Firm performance are measured in two ways i.e. accounting based performance and Market based performance (Tobin's Q) to obtain the empirical findings on Firm Performance.

Accounting based measurement

Accounting based measurement has further two parts i.e. ROA and ROE. The first measurement is return on assets (ROA), which concerns the management of the company who are responsible to check the short and long term value of firm. Second measurement is return on equity (ROE) which concerns the investor's perception who anticipate return on their investment. This study has used both instruments because these two methods use profit of company. These two measurement instruments are very important to management and owners of family-owned firms (Ibrahim, 2009). Return on asset is calculated as ratio of net income to total assets (Anderson & Reeb, 2003; Holderness & Sheehan, 1988). Return on equity is calculated as ratio of net income to total stockholder equity (Holderness & Sheehan, 1988; Rechner & Dalton, 1991).

Market based Performance

The Market based Firm Performance is calculated by “the ratio of (Total Market Value of Equity + Total Book Value of Liabilities)/ (Total Book Value of Equity + Total Book Value of Liabilities)”. The larger the value of Tobin’s Q shows the better sign of company performance. This ultimately shows that mechanisms of corporate governance are efficient in the company (Anderson & Reeb, 2003).

Independent variables

The independent variables of the study are related party transactions and corporate governance variables i.e. IDI, Family directorship and concentration of family ownership. Corporate governance variables such as IDI, family directorship and family ownership. Independent director Index has included three dimensions for measurement of independency of Independent director. Those dimensions has included number of independent director, financial expertise of independent director and tenure of independent director (Al Daoud, Ismail, & Lode, 2014; Anderson, Mansi, & Reeb, 2003; Lin, Piotroski, Tan, & Yang, 2011; Yunos, Smith, Ismail, & Ahmad, 2011). This measurement of independent director index reveals that Major shareholder might possibly influence independent directors, (Abdelsalam & El-Masry, 2008; Vafeas, 2003). Family directorship is computed as the percentage of shares held by family members on the board. Family ownership is measured in terms of the percentage of total equity held by each controlling shareholder (Demsetz & Lehn, 1985; Gul, Kim, & Qiu, 2010; Maury, 2006; Wruck, 1989). The related party transactions are measured using the total amount of bonus shares, convertibles shares, rights shares, organizational, insurance, royalty expenses, ordinary shares, dividends, donations, interests, investments, purchases of assets, sales of asset, employee benefits, leases and loans, and advances to related party as a measure of RPTs.

Control Variables

Control variables are firm size or total assets of the firm and profit margin.

Firm size or total assets

Firm size refers to the value of the total assets of a firm. Considering firm level variables, the size of firm is kept as control variable and inverse relationship between ownership concentration and firm size, which is expected for risk averting and risk neutral effects. In larger firms, the stake of ownership is greater, and higher price of shares would reduce degrees of concentration. These factors are important determinants in assessing firm performance, and propagated by many theorists in business literature.

Net Profit Margin

In the research of Kajola (2008), variable net profit margin is used to represent the performance variable concerned with firm operations. This ratio is especially important because it links core business operations with the profit the business generates. At the end of a fiscal year, the net profit margin ratio indicates how well a firm transformed its business activities into retained earnings. The net profit margin is ideally calculated by dividing the net profit of the firm by its sales revenue for the year. Therefore, this ratio describes the profit sales relationship, an important notion for measuring firm performance.

Data and Sample

The sample size for the current study consists of 150 family-owned firms related to the top 47 family-owned firms listed firms on the KSE (Azim et al., 2018; Javid & Iqbal, 2008). The details of family business are showed in appendix. Every business group contained numerous firms. These family-owned firms are included in the study with respect to high market capitalization. The study used quantitative approach secondary published data, and utilized 1,650 observations for the sample period of 2004 to 2014 after the implementation of corporate governance codes in 2002. Data are collected from documents, surveys, annual reports, analyst reports, and various research reports about family-owned firms in Pakistan.

Estimation techniques

The study used panel data analysis through statistical software, namely, Stata version 14. Generalized Method of Moments (GMM) estimator is employed to empirically test the developed hypotheses in this study. GMM estimators

are used for robustness testing and control of heteroscedasticity problems in the data. The Model for this study is similar to the Models used by Arellano and Bond (1991), Xu and Wang (1999), Claessens et al. (2002) and Anderson et al. (2003) which ignored non-linearity to keep Model parsimony and to prevent significant multicollinearity and autocorrelation issues (Gujarati & Porter, 2009). Data examination is conducted on raw data to produce descriptive statistics.

Results and discussions

Table 01: Descriptive statistics

Variable	Mean	Std. Dev.	Min	Max
Related party transaction (RPTs)	48.69	2.28	42.72	55.70
Independent non-executive director (IDI)	29.28	9.71	0.00	100.00
family director (FD)	16.76	2.22	11.37	23.42
family ownership (FO)	22.20	16.35	5.10	50.99
Profit Margin (PM)	12.73	13.66	1.00	58.43
Firm Size (FS)	14.92	1.82	7.85	19.48
Return on Asset (ROA)	13.57	8.07	3.30	34.80
Return on Equity (ROE)	13.54	8.15	2.04	39.99
Tobin's Q (Q)	13.77	8.35	3.30	45.00

Table 01 shows descriptive statistics of RPTs, corporate governance variables, namely, INEDs, family directorship, and family ownership and control variables are profit margin and firm size. The mean of the variables determines the overall value of the variables across all family-owned firms in the KSE-listed sample. The mean rpt determines the number of RPTs of family-owned firms listed on the KSE. The percentage of IDI in the board is 29.28%. Family directorship determines that on average, every firm has around 16.76%. Family ownership indicated that on average concentration owned by family firms is 22.20%. The average log of assets, i.e., firm size is 14.92 in the sample. The average ratio of profit margin is 12.73% in the sample. Standard deviation compares the overall deviation or divergence prevalent in the data of the sample. This variation determines the diversity and different patterns of family-owned firms included in the sample. The least amount of deviation is observed in the return on assets, whereas the most deviation is noted in the board size. The confidence level is taken at 95%.

Table 02: Correlation Matrix

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) Related party transactions (RPTs)	1								
(2) Independent non-executive director (IDI)	0.01	1							
(3) family director (FD)	0.33	-0.04	1						
(4) family ownership (FO)	0.04	0.03	0.03	1					
(5) Profit Margin (PM)	0.01	0.14	0.12	0.08	1				
(6) Firm Size (FS)	0.17	0.09	0.18	0.17	0.18	1			
(7) Return on Asset (ROA)	0.00	0.01	0.12	-0.04	0.00	-0.17	1		
(8) Return on Equity (ROE)	0.01	-0.18	-0.01	0.05	-0.03	-0.04	0.05	1	
(9) Tobin's Q (Q)	0.01	-0.03	-0.06	0.05	0.11	-0.04	0.04	0.21	1

Table 02 presents the correlation among the variables. The Pearson correlation of the variables was used in this research. The purpose of Pearson correlation is to measure extent of multicollinearity among the variables. In this table, the variables are compared to determine the correlation among them. The variables are compared horizontally and vertically. The relationship between RPTs and corporate governance variables, which are independent non-executive directors, family directorship, and family ownership, is indicated. The RPTs is positively correlated with independent non-executive director, family directorship, and family ownership. Similarly, RPTs is positively correlated with profit margin and firm size. Meanwhile, FD is negatively correlated to IDI roe and Q. while FD is positively correlated with FO and ROA. Although significant correlation is indicated among the variables, for multicollinearity to diminish, the

significance should be more than 0.8; however, the issue of multicollinearity can be ignored in this scenario (Gujarati & Porter, 1999, 2009).

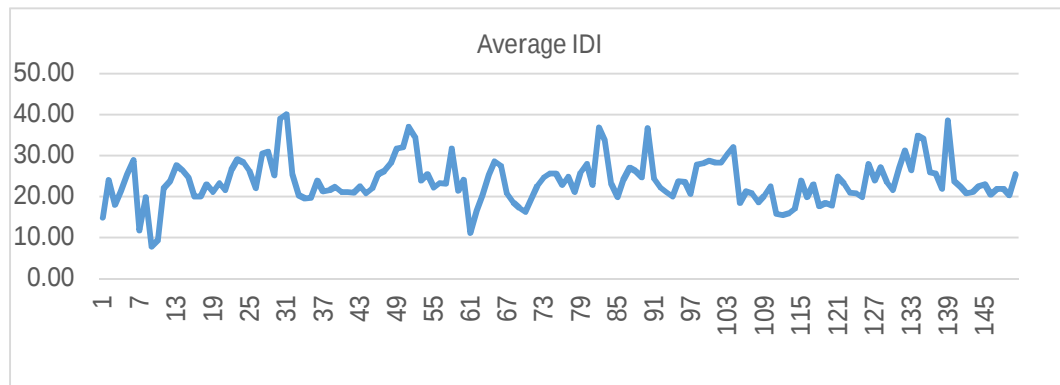


Figure 01: Independent Director Index (IDI) of Family Owned Firms

Table 03 shows the results independent director index (IDI). Results shows averages values of IDI of each family owned firm for particular period i.e. 11 years. The lowest average IDI values is 7.79 and highest average value of IDI of family-owned firms in Pakistan for particular period is 40.08. Similarly, categorization of IDI into three levels i.e. lowest level, moderate level and highest level. This is also shown graphically in figure 01 supported by Azim et al. (2018). The ranges of these three levels are level 1, 2 and 3. Level 1 is the range from 0 to 33. Level 2 is from 34 to 66. Level 3 is from 67 to 100. The results of this study show that among of 150 family owned firms, 140 family owned firms fall into lowest category. While only 10 family owned firms fall into moderate level. This results further elaborates that more than 90% in lowest category. While less than 10% fall into moderate level. The results of IDI concludes that independency of independent director in family owned firms is low which is very important issues for attention of SECP regarding importance of Independency of independent director (see Table 03) supported by Azim et al. (2018).

Table 03: Independent Director Index (IDI) of family-owned firms

Company Code	Average IDI	Company Code	Average IDI	Company Code	Average IDI	Company Code	Average IDI	Company Code	Average IDI
1	14.763	31	40.085	61	11.061	91	24.375	121	24.896
2	24.032	32	25.470	62	16.591	92	22.194	122	23.178
3	17.917	33	20.240	63	20.342	93	21.051	123	20.885
4	21.196	34	19.578	64	25.384	94	20.046	124	20.786
5	25.507	35	19.755	65	28.564	95	23.706	125	19.763
6	28.980	36	23.964	66	27.452	96	23.552	126	27.887
7	11.776	37	21.176	67	20.727	97	20.619	127	23.829
8	19.911	38	21.514	68	18.550	98	27.847	128	27.180
9	7.798	39	22.277	69	17.204	99	28.059	129	23.415
10	9.365	40	21.029	70	16.185	100	28.792	130	21.485
11	21.974	41	21.051	71	19.719	101	28.262	131	26.988
12	23.752	42	20.978	72	22.650	102	28.243	132	31.275
13	27.632	43	22.541	73	24.658	103	30.536	133	26.332
14	26.335	44	20.755	74	25.556	104	31.967	134	34.830
15	24.456	45	22.018	75	25.550	105	18.493	135	34.039
16	19.949	46	25.516	76	22.751	106	21.234	136	25.936
17	20.001	47	26.194	77	24.813	107	20.714	137	25.601
18	22.945	48	28.092	78	21.019	108	18.632	138	21.909
19	21.118	49	31.758	79	25.822	109	20.146	139	38.636
20	23.350	50	31.972	80	28.012	110	22.453	140	23.731
21	21.627	51	37.063	81	22.835	111	15.739	141	22.341
22	26.489	52	34.531	82	36.928	112	15.482	142	20.815
23	29.047	53	23.854	83	33.806	113	15.956	143	21.112

24	28.345	54	25.430	84	23.139	114	17.058	144	22.428
25	26.212	55	22.112	85	19.774	115	23.839	145	22.916
26	21.951	56	23.294	86	24.007	116	19.790	146	20.512
27	30.484	57	23.176	87	26.981	117	22.970	147	21.841
28	30.911	58	31.777	88	26.295	118	17.662	148	21.920
29	25.166	59	21.333	89	24.672	119	18.396	149	20.259
30	39.072	60	24.107	90	36.665	120	17.851	150	25.464

Table 04 shows the regression result by using Generalised Method of Moments (GMM). Table 4.4 further shows the Model 1, Model 2 and Model 3 with independent variables i.e. related party transactions, independent director index, family directorship and family ownership. The dependent variable in Model1, Model 2 and Model 3 are ROA, ROE and Q respectively. Model 1 shows relationship between ROA and independent variables, which are RPTs and governance variables i.e. independent director index, family directorship and Family ownership. The control variables are profitability and firm size employed in Model 1. The RPTs of Model 1 is significant having coefficient -0.016. This shows Firm Performance has significant negatively relationship with related party transactions i.e. RPTs at less than 1%. Similarly, Firm performance of Model 1 has significant relationship with IDI, FD and FO having coefficient 0.009,-0.045 and -0.000 respectively.

This further shows that Firm performance has significant positive relationship with IDI at less than 1%. Similarly, Firm performance has negative relationship with Family Directorship (FD) and Family Ownership (FO) less than 1% and 10% respectively. However, all dummy years of the Model 1 are significantly decreased except year 2006. This shows that there is significant decreased in trend in firm performance calculated through ROA. This decreased in trend of ROA are significant at less than 1% in all years starting 2005 to year 2014. While, ROA is significantly decreased in year 2007 at less than 10%. Finally, Model 1 of Table 4.4 shows that shows the significant values of AR (1) and the rejection of the null hypothesis of autocorrelation among error terms in the first difference. AR (2) is significant and shows that error terms in level regressions are not correlated. The results of AR (1) and AR (2) indicate that GMM is correctly specified and no identifications issues emerged.

Similarly, Model 2 shows relationship between ROE and independent variables, which are related party transactions and governance variables i.e. independent director index, family directorship and family ownership. The control variables are profitability and firm size employed in Model 2. The related party transactions of Model 2 is significant having coefficient -0.121. This shows Firm Performance has significant negatively relationship with related party transactions i.e. rpt at less than 5%. Similarly, Firm performance of Model 1 has significant relationship with IDI, FD and FO having coefficient 0.001, -0.194 and -0.013. This further shows that Firm performance has significant positive relationship with IDI at less than 10%. Similarly, Firm performance has negative relationship with Family Directorship (FD) and Family Ownership (FO) less than 1%.

However, all dummy years of the Model 2 are significantly decreased. This shows that there is significantly decreased in firm performance calculated through ROE. This decreased in ROE are significant at less than 1% in years 2011, year 2012, year 2013 and year 2014. However, all dummy years of the Model 2 are increased with respect to ROE except year 2014. The trend in ROE are more significantly increased in year 2008, 2009 and 2010. This increased in trend of ROE are significant at less than 10% in year 2005. While, they are more positively significant at year 2009 to 2014. Finally, Model 2 of Table 4.4 shows the significant values of AR (1) and the rejection of the null hypothesis of autocorrelation among error terms in the first difference. AR (2) is significant and shows that error terms in level regressions are not correlated. The results of AR (1) and AR (2) indicate that GMM is correctly specified and no identifications issues emerged.

Model 3 shows relationship between Tobin's Q and independent variables, which are RPTS and governance variables i.e. independent director index, family directorship and family ownership. The control variables are profitability and firm size employed in Model 3. The RPTs of Model 3 is significant having coefficient -0.075. This shows Firm Performance has significant negatively relationship with related party transactions i.e. RPTs at less than 10%. Similarly, Firm performance of Model 1 has significant relationship with IDI, FD and FO having coefficient 0.058, -0.577 and -0.041. This further shows that Firm performance has significant positive relationship with IDI at less than 10%. Similarly, Firm performance has negative relationship with Family Directorship (FD) and Family Ownership (FO) less than 1% and 5% respectively. However, all dummy years of the Model 3 are significantly increased with respect to Tobin's Q. This shows that there is significantly increased in trend in firm performance calculated through Tobin's Q. This increased in Tobin's Q are significant at less than 10% in years 2009. However, they are more significant at less

than 1 % in year 2010 and 5% in year 2012. Finally, Model 3 of Table 4.4 shows the significant values of AR (1) and the rejection of the null hypothesis of autocorrelation among error terms in the first difference. AR (2) is insignificant and shows that error terms in level regressions are not correlated. The results of AR (1) and AR (2) indicate that GMM is correctly specified and no identifications issues emerged.

Table 04: Related Party Transactions, Corporate Governance and firm performance

	Model 1 (ROA)	Model 2(ROE)	Model 3 (Q)
L.ROA/ L.ROE /L. Tobin's Q	0.977*** (0.001)	0.846*** (0.008)	0.089*** (0.020)
Related party transaction(RPTs)	-0.016*** (0.001)	-0.121** (0.054)	0.075* (0.202)
Independent director Index (IDI)	0.009*** (0.000)	0.001* (0.008)	0.058* (0.032)
Family Directorship (FD)	-0.045*** (0.004)	-0.194*** (0.060)	-0.577*** (0.217)
Family Ownership (FO)	-0.000* (0.000)	-0.013*** (0.004)	-0.041** (0.018)
Profit Margin (PM)	0.002*** (0.000)	0.018*** (0.005)	0.096*** (0.022)
Firm Size (FS)	0.014*** (0.002)	0.006*** (0.047)	0.061*** (0.197)
Year (2005)	-0.219*** (0.008)	0.520* (0.271)	0.593 (0.625)
Year (2006)	-0.025*** (0.005)	0.602*** (0.212)	-0.630 (0.564)
Year (2007)	-0.021*** (0.005)	0.717*** (0.175)	0.186 (0.667)
Year (2008)	-0.068*** (0.004)	1.109*** (0.150)	0.953 (0.653)
Year (2009)	-0.036*** (0.004)	1.065*** (0.146)	1.250* (0.648)
Year (2010)	-0.263*** (0.005)	1.259*** (0.127)	2.648*** (0.644)
Year (2011)	-0.083*** (0.004)	0.900*** (0.140)	0.440 (0.522)
Year (2012)	-0.074*** (0.003)	0.778*** (0.134)	1.350** (0.657)
Year (2013)	-0.100*** (0.003)	0.594*** (0.147)	0.334 (0.628)
Year (2014)	-0.010*** (0.001)	0.428*** (0.328)	0.328 (0.412)
AR(1)	0.0000	0.0001	0.0000
AR(2)	0.3888	0.8786	0.2804
Number of Groups	150	150	150
Observations	1,650	1,650	1,650

Discussion

This study has developed index of independent non-executive director of family-owned firms which includes different dimensions for measurement of independency of Independent director. Those dimensions include composition, financial expertise and tenure of independent director. Results of index shows that among of 150 family- owned firms, 140 family owned firms fall into lowest category. While only 10 family owned firms fall into moderate level. This

results further showed that more than 90% in lowest category. While less than 10% fall into moderate level. The results of IDI has concluded that Major shareholders expropriate resources through RPTs in Pakistani family owned firm where there is low independent of independent director. This low value of independency of independent directors is very important issues for attention of SECP regarding importance of Independency of independent director (see Table 03). It has also found empirically that Independent Director Index (IDI) in Model 1, Model 2 and Model 3 has positive significant relationship with Firm Performance, Javaid and Saboor (2015). This relationship is very significant but as most of family-owned firms have low independence, as most decisions are taken by Major shareholders and the interest of Minority shareholder is exploited due to this related party transactions Abdullah et al. (2011) and Khan and Awan (2012). This results are also consistent with researchers like Chen and Jaggi (2000), Cheng and Courtenay (2006), Morris et al. (2009) and (Morris et al., 2012) who have identified a positive association between the ratio of independent directors and corporate disclosures.

Similarly, it has also found empirically that related party transactions in Model 1, Model 2 has negative significant relationship with Firm Performance. This is consistent with previous researchers like Gordon et al. (2004), Cheung et al. (2006), Lei and Song (2008), Gallery et al. (2008), Cheung, Jing, et al. (2009), Chen et al. (2009), Aharony et al. (2010), Kohlbeck and Mayhew (2010), Ge et al. (2010), Munir (2010), Munir and Gul (2010), Aswadi Abdul Wahab et al. (2011), Yeh et al. (2012) and Ryngaert and Thomas (2012) have found negative association between RPTs and firm performance. While in Model 3 of Table 04, related party transactions has positive significant relationship with firm performance. It is consistent with researchers like Arshad et al. (2009), Lo and Wong (2011) and Utama and Utama (2014) found a positive relationship between the RPTs and company performance, company size, professional affiliations and corporate governance index.

While, it has found empirically that family directorship in Model 1, Model 2 and Model 3 has negative significant relationship with Firm Performance. This is consistent with researcher like Morck et al. (1988) who has found negative association between effects of directorship of family owned firms and firm performance. However, this is not consistent with researchers like Nicholls and Ahmed (1995), Barontini and Caprio (2006), Chang (2003), Joh (2003) and Carney and Gedajlovic (2002) who have found positive relationship of family directorship with firm performance. However, this study also found empirically that family ownership in Model 1, Model 2 and Model 3 has negative significant relationship with Firm Performance. This is consistent with researchers like Leech and Leahy (1991), Mudambi and Nicosia (1998), Lehmann and Weigand (2000) and Chen and Cheung (2000) who have found negative and significant effect of ownership concentration on firm value.

Conclusions

This study empirically examined the impact of corporate governance (CG) variables, namely, independent non-executive directors (INEDs), family directorship, and family ownership and related party transactions (RPTs) on firm performance that prevail in Pakistani family-owned firms. It has developed index of independent non-executive director of family-owned firms comprising three dimensions for measurement of independency of Independent director i.e. composition, financial expertise and tenure of independent director. Results showed that more than 90% of family-owned firms fall in lowest category of IDI. It has analyzed the panel data of 150 family-owned firms belonging to 47 family business group listed on the KSE from 2004 to 2014. Different Panel least squares Models i.e. Model 1, Model 2 and Model 3 are employed to examine the effect of related party transactions and corporate governance variables i.e. IDI, Family Directorship, Family Ownership on Firm Performance. This study found empirically that corporate governance variables, particularly independent director (IDI) have positive relationship with firm performance. This shows that Pakistani family owned firms have low ratio of independent director on board. This weaker corporate governance in family-owned firms create opportunity for Major shareholders who expropriate resources through related party transactions (RPTs). These major shareholders exploit interest of Minority shareholder through this transfer of resources.

This finding is supported by IFC (2007). Corporate governance in Pakistan indicates the low or poor protection of minority shareholders. Similarly, this study also found empirically that RPTs in Model 1, Model 2 and Model 3 has significant relationship with Firm Performance. This is consistent with agency theory of Jensen and Meckling (1976) and Model of Berle and Means (1932) which is potentially harmful to interest of minority shareholder. This also consistent to conflict of interest transaction of Gordon et al. (2004) who have found negative association between RPTs and firm performance. While, it has found RPTs has positive significant relationship with firm performance. It is consistent with researchers like Utama and Utama (2014) found a positive relationship between the RPTs and company performance, company size, professional affiliations and corporate governance index. It has also provided empirical

evidence to show that family directors are negatively related to firm performance. This shows that board of family owned firms have high proportion of family directorships. It has also found empirically that the family ownership of family-owned firms have negatively significant relation with firm performance. Major shareholder of family owned firms has negative tendency for exploitation of interest of minority shareholder through RPTs. These results are consistent with Ikram and Naqvi (2005), Ibrahim (2006) and Mehboob et al. (2015) who have indicated that corporate governance and ownership concentration have negative effect on firm performance and exploitation of the interest of minority shareholders due to expropriation of resources through certain related party transactions (RPTs).

Implications

The findings of this study focus regulatory authority attention to the importance of disclosure requirements to bring more transparency despite the code of corporate governance. This study was conducted after implementation of corporate governance code of SECP (Securities and Exchange Commission of Pakistan). Furthermore, the findings of this study direct the attention of the regulatory authority (SECP) to the importance of having independent non-executive directors on boards. Board size of family owned firms show low proportion of independent non-executive director. This low ratio of independent non-executive director on board is very important issues to SECP to bring more independency in board by selecting director from outside. These independent directors should have financial expertise to mitigate transfer pricing policy and related party transactions that are not at arm's length prices of major shareholders. This situation could enhance transparency and increase confidence of Minority shareholders. Finally, this study educates minority shareholders and investors by suggesting that measures are necessary to restrict the expropriation by major shareholders.

Appendix

No.	Family Owned Firms	No.	Family Owned Firms
1	The Nishat Group	25	The Hashoo Group
2	The Saigols Group	26	The Packages Group
3	The Atlas Group	27	The House of Habib
4	The Lakson Group	28	Nawa-E-Waqt Group
5	The Dawood Group	29	The Saif Group
6	Chenab Group	30	Alabas Group
7	The Dewan Group	31	Fatima Group
8	Ghani Group	32	The Crescent Group
9	Gul Ahmad/Al-Karam Group	33	The Monnoo Group
10	Nagina Group	34	The Sapphire Group
11	Sharif Group	35	The Haroon Family
12	Arif Habib Group	36	The Bawany Group
13	THE Din Group	37	The Servis Group
14	Abid Group	38	The Tata Family
15	The Best Way Group	39	The Alam Group
16	Yuns Brother	40	The Guard Group
17	The Ejaz Group	41	The Tabani Family
18	The Dadabhoy Group	42	The Tapal Group
19	Sitara Group	43	Jahangir Siddiqui & Co.
20	Chakwal Group	44	The Adil Group
21	Ummer Group	45	Sitara Group
22	Elahi Group	46	The Colony Group
23	Mahmood Group	47	Kassim Dada
24	The Jang Group		

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